

INSURANCE FUTURES

Global politics: Alternative futures

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The political risk landscape is being rapidly transformed. Among the factors driving this are a new era of geopolitical competition; increased migration flows; the rise of national populism; rapid and destabilising technology change; a new and apparently more easily manipulated media environment; climate change; and new and more disruptive forms of conflict. Many of these feed off each other, creating a more volatile and unpredictable environment than at any time since perhaps the 1940s.

The challenges to leadership teams at all levels are pervasive, complex, interdependent and permeated by uncertainty.

Ultimately, they may be met. The US and China might yet find an accommodation. Multilateral trade, finance and security regimes and institutions may enjoy a renaissance. New and effective instruments of arms control and disarmament may be found to deal with autonomous, bio-, cyber- and nano-weapons. Effective international action on climate change has the potential to create a shared sense of purpose, limiting migration pressures and associated geo-political stress.

Innovation on a mass scale, facilitated and aided by permissive forms of anticipatory regulation may help to solve many of humanity's greatest problems. New technology may create more jobs than it destroys, ushering in a period of rising living standards for the masses, and less economic insecurity. Improvements in health and productive lifespan may also ease burdens on the public purse. More effective measures to secure nuclear and biological materials that could be used by terrorists or 'weirdos with expertise', could be put in place.

It is far from certain, however, that this will be the outcome. At the other extreme the relationship between the US and China may slide from cold to hot war, triggering a collapse of wider multilateral financial, trade and security regimes in the process. Existing nuclear and conventional arms control regimes may be destroyed by proliferation and new weapons systems that are impossible to control, destabilising wider conflict prevention measures and making inter-state war once again more commonplace. Runaway climate change may generate new and massive waves of migration, adding to geopolitical pressures and increasing the risks of policy errors.

Within states, the fuel for a re-nationalisation of politics might be driven by a growing backlash against migration, the dominance of a new politics of national identity and by the popular desire to wrest control from what are increasingly seen as remote and unaccountable global and regional institutions. Islands of innovation may be hemmed in by over-cautious political and regulatory environments, meaning many structural problems remain unaddressed. Concerns over rising inequality, as wealth is accrued by a few while technology drives job losses on a massive scale could create an ugly and volatile mood, one easily manipulated by fake news and disinformation campaigns on social media.

This essay sets out two possible extreme scenarios that may emerge between now and 2035 before going on to consider the implications for the insurance industry. Our experience is that by exploring extreme possible, distinct from probable scenarios is that they create a framework within which policy options, hedging and business strategies can be developed. They reduce the risk of surprises and create 'memories of the future' that make recognising emerging risks more likely.

Worst case scenario: The possible path to war

The growing US-China rivalry is at the core of this worst-case scenario which many current trends point to. Previous US presidents had always assumed that China could be integrated into a US-dominated international system. Starting with the Trump presidency, more and more Americans now believe—especially the foreign policy elite—that US and Chinese interests are fundamentally opposed on any number of grounds from governance to economics.¹

The same has been occurring in China but from a different angle.² For most Chinese, the US remains the most powerful country, but is in decline. The Chinese believe they are owed respect by others, including Americans. After all, China saved the West after the 2008 financial crisis—and Beijing has just been doing in the South China Sea and elsewhere what the US has long done, namely dominating its neighbourhood. The Chinese bristle at the thought of the US holding China back, putting a ceiling beyond which it could not rise unless it constantly defers to Washington.

A key question for the Trump and successor US administrations is whether the United States should make China into an outright enemy. By 2035, both the US and China will have hedged for years, building up military capabilities in case the bilateral relationship turns sour. Both sides know there would be economic costs in such a case. Most US multinationals rely on global supply chains involving a strong Chinese role. Chinese leaders aim to make their economy more domestically driven, but so far it remains vulnerable to a trade war with the United States.³

Given these serious downsides, a bipolar world has not appeared likely until recently. But, with falling middle class living standards fuelling populist fears and Trump's electoral base believing that they were globalisation's sacrificial lambs, China has become a natural target. Increasingly, the foreign policy elite thinks as well that Washington needs to stand up to China if the US is to remain the world's most powerful country. Any US President would find it hard to balance the risks of conflict against China's increasing business, technological, and military challenges to US primacy. For Trump, particularly so, with his re-election chances hanging in the balance on another big turnout by his base. That said, Trump must worry about precipitating an economic recession as a result of a crisis—trade or otherwise—with China.

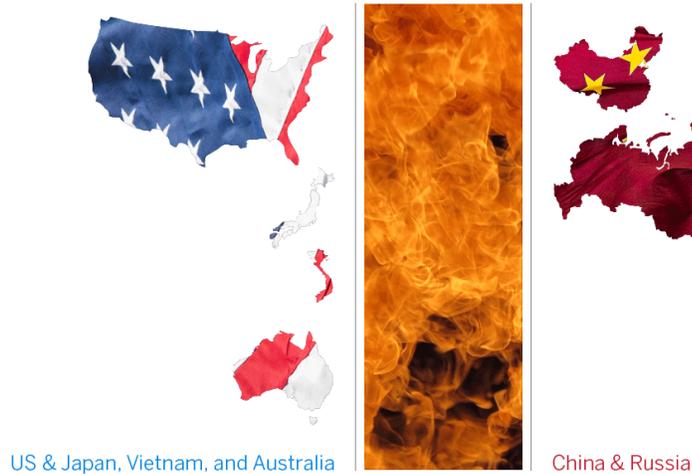
Equally on the Chinese side, could Xi or his successors take the risk of seeming to be weak even if economic growth begins to weaken? The Chinese economy is anyway becoming less dependent on US trade and investment, and China's leaders are more confident of the country's technological prowess. Party leaders know that the public would be as outraged as they are about US attempts to keep China down. The stage seems set for a possible conflict.

How a conflict could happen

Just as in the lead up to the First World War, many people today say they are against getting into a war—but that did not stop the conflagration from breaking out in 1914.⁴ A bipolar world that is on the road to conflict may not be as unlikely as it appears at first glance. Japan, Australia, Vietnam, and India share US concerns about a dominant China and have been pushing Washington to maintain, if not increase its military presence in Asia. They think that a stronger US presence will force China to respect them even as they seek to avoid a Sino-US conflict which could cripple their economies.

With more US assets patrolling near Chinese-claimed territorial waters, the risks of a naval clash are increasing. No doubt, if a clash happened, a truce would be called but could break down as the rhetoric—each condemning the actions of the other—escalates. Some Asians—Japan, Vietnam, and Australia—would take the US side, others would straddle the fence. In this scenario, the US could create a collective Pacific Treaty Organization with the three as signatories with Washington. Other Asians—South Korea, the Philippines, Malaysia, India, and Indonesia—may seek observer status hoping that they can benefit from the US security umbrella even though officially non-members.

Threatened by this development, China and Moscow could publicly sign a Reinsurance Treaty that provides that each party would support the other if it were attacked by the US or NATO.⁵ This would stun Western observers who believe that the Russians are wary of their dependence on Beijing. Nevertheless, the Russian economy has profited from massive Chinese investments into the energy and infrastructure sectors in recent years. Moscow could use the opportunity to expand aggressively its sphere of influence, provoking several proxy conflicts in Ukraine, Georgia, and Kosovo.



NATO could be expected to react forcefully, providing local governments with weapons and military equipment and by deploying further forces into Kosovo to stabilize the region. Pro-Russian protests in Latvia could break out and turn violent, leading NATO to immediately deploy troops into the Baltic nation, to which Russia could be expected to react by mobilizing its western military district. Although this standoff may not ultimately lead to war, it would raise the stakes for both sides.

Europe has had the experience of a Cold War and does not want a repeat performance. Following French proposals, the EU could create a common defence fund and swiftly deployable common defence forces. The EU sanctions regime against Moscow would likely be widened. Brussels would start competing with Russia for influence in the Balkans, Ukraine, and parts of the Middle East, using its superior economic power to coerce leaders and people. Russia would respond with cyberattacks, misinformation, and surrogate forces.

The global confrontation and economic pressures could draw India closer to the West. Although New Delhi may try to remain neutral, its dependence on energy imports from the Gulf and access to Western markets—combined with the increasing threat of an assertive China in the Indo-Pacific—would foster closer cooperation with the United States. For its part, Pakistan would ramp up its cooperation with China and Russia, further distancing Islamabad from Washington.

Iran, supported by Russia and China, would be more likely to develop nuclear weapons in this scenario, increasing its support for Hezbollah. The Saudis, mainly supported by Israel, could follow suit. The Shia-Sunni wars in Syria, Iraq, Jordan, Yemen, and Lebanon would be reignited and turn into proxy wars between NATO and Russia. Terrorism would become a weapon used by both sides.

The end of globalisation

With this East-West conflict breaking out, globalisation would fray enormously with everyone paying the price in serious losses in economic growth. From time to time, US and global business leaders might appeal for lowering tensions and going back to free trade, but neither group would want to seem unpatriotic, so they would not press their case too hard. With liberal and conservative media

united in blaming Russia and China, minimal political dissent would occur in the West. Governments everywhere—not just Beijing and Moscow—would use data and surveillance to identify, track, and isolate troublemakers in any event. With modern technology, George Orwell’s 1984 vision proves easy for governments to implement. The war atmosphere provides the justification.

More widely, Chinese firms would be restricted from investing in Western technology firms.⁶ All sides would slap export controls on sensitive technology. Chinese students would no longer attend Western universities for their STEM education. The US would also discourage students from countries friendly to Russia and China. East-West travel may fall to a low ebb as Chinese tourists find it difficult to get permission to travel to the West. Those who do travel would find a mixed reception in the West and vice versa.

Although Russia, China, and the United States are building up WMD arsenals, including tactical nuclear weapons and new and devastating agents, cyber will be the likely weapon of choice for all sides. Increasingly, other countries—not just Russia and China—would close off their national borders to all kinds of information, to better protect themselves from outside attacks. There would be separate internets, despite their once common ancestor. They would no longer connect. Periodically, Russia and China and US/NATO on the other side would test each other’s defences. No national leader would have any idea what the red lines were for the other. None of the major players might take down a power grid or any major infrastructure in another’s homeland, but they would be preparing by taking opposing sides in various proxy wars and sending each other warnings of what they could do in the event of a real war.



Fear would be the dominant emotion in this scenario. Everyone would just be waiting for the moment when a hot war erupts. As in August 1914, no one would believe that such a war could be stopped.

Best case scenario: Resurgent cooperation

Worrying as this scenario is, an opposite, brighter future— of *resurgent cooperation* is possible— though even if it happens, it is likely only after a period of growing disruption. The US may decide that containment of China is too costly and many people in the US may come to fear that such a strategy would only result in a war. Chinese President Xi’s gambit of forcing innovation while suppressing freedoms might finally hit a brick wall. In the US, the dream of recreating a unipolar world could finally be dropped by the US foreign policy elite. Chinese leaders could be forced to accept the fact that the so-called ‘Chinese model’ of a heavy state-led development can only get a country so far. The result on both sides may be to reach for an accommodation.

Middle classes opting for prosperity

Washington's instinct has been to stifle Chinese innovation during the Trump Administration. Restrictions on Chinese access to US markets and know-how has increasingly been hardened. Even in a more benign future scenario US markets are likely to become inaccessible to Chinese goods and investment while China can be expected to reciprocate, forcing US companies to depart. The Europeans will be divided. West European firms feel the same way as US companies about alleged Chinese intellectual property (IP) theft and replication and have pressured their governments to tighten up access for Chinese investments. In Eastern Europe, it is a different story. Still seeking to bring living standards up to Western levels, most East European countries welcome Chinese investments, particularly as those from elsewhere are declining.

Eventually the world may suffer a deep recession because of the standstill in trade. Trumpian populism in the US could become discredited partly as a result and populism elsewhere will take a similar hit. US debt will soar as tax revenues are hit. Policy makers will talk about cutting back entitlements, which will anger the middle class, especially seniors who are dependent on it for their welfare. Most European countries will face even stiffer fiscal challenges. The instinct to turn back to cooperation could grow. A new peace movement could take off, calling for an end of the arms race.

China's burgeoning middle class will be in the same situation as their Western counterparts. Aging and growing more risk-averse and tired of the social restrictions, Chinese citizens could begin making their displeasure known. Fearing that the Communist Party could be dethroned, the elites could ease out President Xi and resurrect the memory of former Chinese leader Deng Xiaoping, who had counselled caution in confronting the West.

With new leaders on all sides, the opportunity might arise for East-West relations to be reset. This would occur slowly, however. At times it will look like both sides are falling back into confrontation. While recommitting itself to multilateralism, the US would start by strengthening ties with its traditional allies in Europe and Asia. A new president could return to Obama's idea of negotiating an updated Trans-Pacific Partnership (TPP) and a Transatlantic Trade and Investment Partnership (TTIP) to bolster US leadership and turn a page on Trump's "America-First" stance.

Meanwhile, China would use its ties with the developing world to press for a new global trade round. It knows it might have to give on IP but it wants more access to Western markets, including relaxation of Committee on Foreign Investment in the United States (CFIUS) and other restrictions.⁷ Developing countries want better treatment of their young citizens educated and working in the US and Europe. Similarly, they want the advanced economies to incentivize their return to their home countries in order to ease the brain drain.

Western governments understand that inequality is a sore point with the middle and working classes, who feel they are losing too much ground to the rich, worry that their children's futures are endangered by it and could act to do something about it.⁸ Raising taxes on the wealthy would be hard absent an international agreement ensuring that the rich cannot simply relocate, thereby escaping taxation. Pressured by the US, Europe, and Japan, the G20 could therefore create a comprehensive agreement to combat international tax evasion.

Growth returning

A renewed commitment to global trade could then ensure a return of higher global growth rates. The continuous exchange among the global innovation hubs could prevent the balkanization of online and communication standards and create significant breakthroughs in fields such as AI, genetics, and robotics, which in turn could spur productivity growth in the developed world. Western governments could use an increased tax on tech companies to compensate workers hurt by automation and increased use of robotics in manufacturing.

In China, a new social contract could emerge, one that enhances welfare programs and creates more opportunities for the middle class. Although Xi might be history, his anticorruption campaign could gather new momentum as Chinese leaders seek to bolster inclusive growth.

The US under new leadership would re-join the international community in fighting climate change, though the efforts to lower emissions may still not make the hoped-for difference. Coal would remain king in the developing world, where economic growth is prized over environmental preservation. The US and the rest of the West would seek to increase assistance to the developing world so China is not its only patron. Much more assistance aimed at boosting renewable energy sources would be needed to incentivize clean growth in the developing world.



From nationalism to global cooperation

With climate change accelerating and becoming an obstacle to growth, the international agenda could begin to see significant shifts. Some countries could initially flirt with geoengineering to solve their climate challenges, but those efforts often lead to unintended negative consequences, both for themselves and their neighbours. Over time, just as countries had to band together to fight inequality, rapid climate change and its associated economic toll on all major powers could lead them to emphasize cooperation over competition on this issue too. All this new cooperation would form the basis for more extensive cooperation on peace-building. The leading military powers (US, Russia, and China) could agree on a global defence spending freeze and successfully negotiate new international conventions on the ban/limitation of the militarisation of space, biological and cyber weapons.

Conflict would not completely go away: the Middle East, Africa, and Central Asia would continue to experience civil wars, terrorism and insurgencies. The major powers would, however, seek to dampen those conflicts instead of turning them into proxy wars and would cooperate on fighting terrorism.

Implications for the insurance industry

As the two dramatically different scenarios just outlined demonstrate, geopolitics is a growing uncertainty and risk. Gone are the assumptions of a decade ago about the permanence of globalisation or a Western-led rules-based order. We live in an unstable world where geopolitics and globalisation are being transformed.

In this “extremist” world where the alternatives are almost diametrically opposed to one another, we are likely to see growing demand for political risk insurance. The potential for contagion from one issue domain or geography of political risk to others will also make risk assessments challenging. The frequency and scale of losses is likely to increase in what will be a less stable environment. In addition to insisting on key preventive and protective measures as a condition

of cover, the industry therefore faces the challenge of keeping capitalisation requirements under constant review when few basic assumptions can be made. Financial planning is especially hard when the possible scenarios are so divergent.

This context does not necessitate hauling up the drawbridge—as there will be opportunities even in adversity—but being proactive in investing in a deeper understanding of the risks. A systematic effort is needed to understand the risk environment, develop scenarios on how they could affect key industries, and then determine the measures required to mitigate those risks, both to aid a sensible approach to underwriting and for effective management of the insurance industry’s own investment portfolios. This may involve partnerships and investments in open source intelligence and foresight platforms that can deliver next generation risk insights.

Too often, decision-makers wait until the crisis is upon them before acting, by which time it is too late. It takes judgment and courage to make decisions amidst uncertainty, when the storm clouds are not yet visible. Yet waiting often lessens the effectiveness of any actions aimed at averting the threat.

A first step in assessing risk for many multinational firms comes from understanding how global value chains could be impacted by such geopolitical forces as trade disputes, conflict, climate change and shifting tax or regulatory regimes. Anticipating what the implications would be for business operations from specific changes in the environment must come before figuring out ways to lessen them, including alternative options for how businesses are currently positioned.

Insurers working with large multinational clients can help by developing supply chain risk assessments, including use of innovative modelling techniques that use artificial intelligence to generate a wider array of scenarios and desirable mix of policies favouring positive outcomes.⁹ These new methodologies not only identify risk exposures but opportunities that could arise in the changing geopolitical context. Insurers can also be helpful in elevating the risks discussion to a higher level in firms by organizing regular briefings for the C-suite on geopolitical trends and events and their likely effects on businesses. This could open a two-way communication between senior management and insurers, resulting in an increased focus on geopolitics in the overall strategy and planning by firms.

1 <https://www.pewresearch.org/global/2019/08/13/u-s-views-of-china-turn-sharply-negative-amid-trade-tensions/>. “Today, 60% of Americans have an unfavourable opinion of China, up from 47% in 2018 and at the highest level since Pew Research Center began asking the question”.

2 <https://www.pewresearch.org/fact-tank/2016/03/30/6-facts-about-how-americans-and-chinese-see-each-other/> Chinese public – only 44% – give the U.S. a positive rating, in stark contrast with the global median of 69%.

3 <https://www.brookings.edu/blog/order-from-chaos/2018/04/04/why-a-trade-war-with-china-would-hurt-the-u-s-and-its-allies-too/>.

4 <https://centenarynews.com/index.php/article?id=1621>.

5 Russia and China have been growing closer. <https://worldview.stratfor.com/article/china-and-russia-common-interests-make-closer-security-ties-great-power-competition-us>.

6 Curbs on Chinese investments in US tech is already happening. <https://www.chinalawblog.com/2019/01/new-cfius-rules-shut-down-chinese-investment-in-u-s-technology.html>.

7 <https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius>.

8 <https://www.pewresearch.org/fact-tank/2018/09/06/the-american-middle-class-is-stable-in-size-but-losing-ground-financially-to-upper-income-families/>.

9 See the author’s *Global Risks 2035 Update: Decline or New Renaissance*, pp 76-77 on the Atlantic Council, Washington DC website at www.atlanticcouncil.org.

About the author

Mathew Burrows retired in 2013 from a 28-year career in the CIA and State Department, the last 10 spent at the National Intelligence Council, the premier analytic unit in the US Intelligence Community, where he authored the highly praised 'Global Trends 2030: Alternative Worlds.' He is now director of the Atlantic Council's Foresight, Strategy and Risks Initiative, working with an array of governments, businesses, multilateral institutions and NGOs on analysing trends and scenarios. His recent book is 'The Future Declassified: Megatrends That Will Undo the World Unless We Take Action.'

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