Global Prospects for 2020

Management of Risks in Times of Accelerating Change

There has been an exceptionally high incidence of global historical events including the Shale Revolution, Arab Spring, the United States’ shift towards the Pacific, the arrival of new leaders in China, the emergence of post-BRICs countries and the European Union’s economic downturn. The world changes greatly according to changes in the balance of power. Under the circumstances, corporations should assess the risks posed by social networking, terrorism and cyber threats, and take a portfolio approach for investment to facilitate smooth business.

—Shale Revolution Impact

The emergence of shale oil and gas as an energy source will profoundly affect global geopolitics. First, it will cause the United States to be less connected and tethered to conventional energy sources from the Middle East. The rise of shale oil and gas as a source of energy coupled with alternative energy sources in the United States will accelerate the United States’ focus on Asia. This is because the geopolitical energy that the United States tends to put into the Middle East and the Persian Gulf will be diminished by a reduced dependency on those sources of hydrocarbons. As a result, perhaps as soon as 2020 but certainly within 10 years after that, the United States will become energy self-sufficient and in fact will be a net exporter of energy. That will allow the United States to continue its shift to the Pacific as a central operating feature of its foreign policy.

—Post-Arab Spring

It is too soon to determine the outcome of Arab Spring. Arab Spring will unfold in ways that are difficult to predict at present. But nevertheless there are two models we can examine: One is the American Revolution and the other is the French Revolution. Both had periods of turbulence that lasted decades.

Unfortunately, we are in for a period of real turbulence in the Arab world and within that world there will be nations that progress more rapidly toward positive outcomes. It is hard to say from this moment, but Libya could move relatively quickly toward a more stable situation because they have oil and a small population. They were very united as a people in overthrowing Qaddafi.

Syria, on the other hand, will take far longer to resolve. Because the inter-religious and inter-ethnic conflicts are so deep, so angry and so embedded that Syria will take the longest of any of the Arab states to resolve.

Iraq will be on the end of the spectrum near Syria. It will take Iraq a long time to resolve the internal conflict between Sunni, Shia, and Kurd.

Egypt has the longest civilization. It is an ancient civilization with deeply embedded elements of bureaucracy and a positive sense of cultural unity. Egypt will move to a better place relatively soon, 5 to 10 years in the future, whereas a place like Syria or Iraq
will take decades.

Overall, the region will be very volatile and very dangerous. We still have not seen the true effects of the Arab Spring in the monarchies in Bahrain, Saudi Arabia, and UAE. There are tensions between Sunni and Shia, and there are frequent protests.

What that means is that a significant part of the world’s population as well as a significant source of hydrocarbons and energy will be in a state of tension and conflict for several decades, if not complete turmoil. What that means is that consequently, alternate energy sources, such as shale oil and gas, nuclear, and renewable energy sources, will enjoy a continued upsurge. Here we get into technology as the effect of hydrocarbon resources being in a place of extreme turbulence will place a premium on technologies that can harness renewables. Batteries, use of rare earth elements, nanotechnology, and new materials will all benefit from the way geopolitics of the Arab Spring are unfolding.

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Post-Shale Revolution in Russia

Russia is concerning for a number of reasons. The first is they have a significant demographic problem. Their population is declining rapidly, perhaps as much as one million per year.

Secondly, Russia has a high incidence of drug addiction and alcoholism in their population, perhaps as many as two million heroin addicts. This is a number produced by the Russian drug enforcement agency. Russia still has about 8,000 nuclear weapons and they are also experiencing a great deal of turbulence and terrorism coming from the south.

Thirdly, their economy is a “one trick pony” in that it can only do one thing. This is a way of saying that the Russian economy is absolutely focused on gas and oil. As natural gas is produced in more areas around the world their market share will decline and the effect on Russia will not be good, adding to the stresses that they already feel.

Russia will desperately seek new markets for its gas and oil. The degree to which renewables and shale resources come online will put great pressure on Russia’s economy and cause their foreign policy to become one of more engagement and more focus to other markets. They will be challenged by the rise of share resources and renewables in very significant ways.

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Post-TPP US Military Influence in ASIA

The United States has interests all around the world. The traditional partnerships for the United States over the last 50 years had been across the Atlantic to NATO, across the Pacific to Japan and South Korea, as well as close relationships with Australia. Although the United States will remain very oriented globally, there will be increased emphasis on its relations in the Pacific going forward and that will manifest itself across the spectrum of government activities. We will see more business partnerships, more academic and educational engagements, and increased pure economic activity.

Another part of that will be military activity. We will see increased training together and increased partnership. The United States and Japan have an extremely strong partnership together in the military dimension and that will broaden to include Australia, South Korea, New Zealand, potentially the Philippines, and other actors in the region.

None of this should be seen as a provocation to China. We believe the United States as a Pacific power will continue to be very engaged along with other nations that are Pacific powers, including Russia. Russia very much sees itself as engaged in the Pacific as well.

We will see an incremental increase in military activity, but only as part of a larger rise in engagement in business, finance, education, culture, demographics, and so forth.

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New Chinese Leaders Xi Jinping and Prime Li Keqiang

It is too soon to comment on the individual leadership of China’s new leaders. Rather than facing a wall, China faces a very bumpy road with big holes. Indeed, hundreds of billions of dollars will be needed annually to fix the environment.

Another challenge for China is demographics, particularly the imbalance between males and females. It is difficult to know how that will cause China’s society to change over time.

Thirdly, the major challenge for China is their transition of government. It is not a democracy because the individuals selected come from a small group of people who select each other, and there is no stated way for the will of the people to be expressed. They are not a democracy.

I am not an expert on Chinese society, but as I look around the world, at events like the Arab Spring and I see that consider how over time large societies have a very strong tendency to want to organize around democratic principles. That will be a challenge that China will have to resolve over time within its own society. China has many challenges and its other demographic challenge is not simply gender imbalance but an aging population.

There are many challenges ahead for Chinese leaders. I wish them well because it is in the interest of all of us that China succeed, continue to lift people out of poverty and become a significant global contributor to security. In a year or two, we will have a better sense of the new leadership team. They have initially done the right things for China but it is too early to tell. In the end, this is for the people of China to judge, not for the rest of us.

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Chinese Military Power’s Influence in Asia

China continues to increase its defense spending. To simply articulate the numbers, the United States today spends about $600 billion a year on defense. Europe spends $300 billion a year. Japan, South Korea, and Australia together spend about $100
billion a year. That is about $1 trillion of defense spending in democracies that are roughly aligned with each other. China spends about $150 billion. That amount is rising but it has a long way to go before China begins to represent a significant military concern.

Secondly, despite tensions and disagreements, Japan and China are having a discussion over disputed islands. The Philippines and China have bumped shoulders over the Spratly Islands and there are certainly territorial tensions throughout East Asia. Despite that, the likelihood of an outbreak of real state-on-state significant violence is not apparent. I do not discount the possibility of occasional incidents but it is highly unlikely that we would see an open conflict in the region.

The United States’ role is to operate in these waters, which are international waters. It operates together with partners like Japan, South Korea, Australia, and the Philippines. Where it makes sense the US can invite China to be part of exercises and operate together as well so that it can build confidence and avoid confrontation. The United States has an important role to play in these waters.

The world can change very suddenly in Asia, as we all know. But in the future, China will likely continue to interact responsibly with the other nations in the region and I count the United States as one of those nations.

—Emerging Countries

Over the next 10 years Brazil will be a very strong market and will experience growth. They are in a period of retrenchment at the moment, but they probably will have a successful Olympics and a successful World Cup, and there will be a positive effect resulting from that. Brazil will continue to grow also because it has the advantage of being a giant in the region.

Russia has significant structural issues and of all the BRICS nations Russia warrants the most concern in terms of having difficulties, obstacles, and challenges.

India has enormous potential. India is on a bumpy road now. Over time India’s road will become smoother, partly because they have a democracy. Their democracy may be imperfect but it is capable of transferring power with the will of the people. Secondly, they have laws and norms built-in in their colonial period that are relatively strong despite a great deal of current corruption in the system. The laws and the framework are there to move the society forward. Thirdly, it has a vibrant entrepreneurial people with strong demographics and rising population. Then fourthly, English is a powerful advantage for India. Thus India has a very strong upside.

China will continue to grow but not as quickly as it has in the past.

South Africa has enormous potential. South Africa has a strong position with natural resources, coastline, and an English-speaking population.

Turkey has significant upside potential.

Poland has a great deal of potential. It is also a nation with shale gas, and it has continued to grow despite the downturn in the European economy.

I would add Indonesia to this list as it has a very large population, is relatively stable, and is geopolitically well positioned.

Lastly, Colombia should also be included; it is a South American nation whose economy will continue to grow a strong entrepreneurial class as they are coming out of 50 years of insurgency that have held them back.

Those are probably some of the stronger potential nations. It is very important for nations to work collectively on their economies and have balanced labor movements around the world. If we can create more free trade agreements and work on the environment, we have a fairly good chance of the world moving in a positive direction.

—US, Mexico and Canada Relationship

Mexico is also on my list of countries that can do well. The key there is demographics. Today in the United States, 15% of the population speaks Spanish as a first language. By the middle of the century, that number will be 30% as the Latino population is rising rapidly. That will enhance US connections the US with Mexico and that world to the south very strongly.

Canada also should be added to that list above, as it has enormous natural resources despite its very small population. When we combine these countries with the US and consider the ability in the neighbourhood to work closely together with Canada and Mexico, there is an enormous comparative advantage for the United States; coupled with shale which enables energy self-sufficiency, it is a very positive development for the United States.

—US and EU Relationship

The United States will maintain very strong transatlantic connections. There are very historic reasons for this. A great deal of its culture and history and its democratic systems come out of the European tradition. Second, although the US has a rapidly rising Asian-American population and a very rapidly rising Latino population, still today 60% of Americans still today are of European descent.

Thirdly, the United States has about 25% of the world's gross domestic product and Europe has about 25% of the world's domestic product, so together they have a very powerful economic connection.

When I look at Asia and consider China's size and its mass, that will cause the United States and Europe to work even more closely together as we look at China not as an adversary or military threat but as a geopolitical counterbalance.

The US-EU relationship will continue to be quite strong. The problem for Europe is demographics; Europe's population is declining fairly rapidly. Immigration into Europe is coming from
Africa. It is largely Islamic and Europe has difficulty integrating its immigrant groups.

Europe continues to have difficulties in terms of conflicts between the northern tier of countries and the southern tier largely over economic issues. Ironically, the Euro was to be the currency which would have pulled them together, but as of this moment it has instead become a fairly divisive force in Europe.

Europe has challenges just as every part of the world has challenges. But the Europeans over time will gradually come to work together better because they have no other real option and they will seek partnership with the United States.

The United States is not walking away from Europe. It will focus more on the Pacific but will still maintain strong connections across the Atlantic as well.

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Global Risks

Let me address some of the global risks countries are facing. Let us start with the Arab Spring, which is political turbulence as large populations are unleashed as a result of social networking, social media, the ability to connect and create subgroups, and to challenge particularly repressive regimes. Therefore, risk of political turbulence is high.

Secondly, there is violent extremism or terrorism, although it is not simply political terrorism or terrorism that is generated in the Middle East. We see right wing nationalist groups that are conducting violent extreme acts. We see Talibanian groups as well as doing this. We see Al Qaeda and its affiliates doing this.

The third is the presence of rogue nations that seek to develop and potentially employ weapons of mass destruction. At the top of the list are North Korea, Iran and Syria.

The fourth would be cyber risk. Our nations' infrastructure is increasingly run by the so-called Internet of Machines and the possibility for that to come under significant attack, either by a state, by an insurgency, or by an anarchist, such as one of those "V for Vendetta" kind of groups, is of significant concern.

Fifth, there is the risk of competition for resources. While we are improving in areas such as energy, competition for resources like water, food in certain areas, and fisheries will all bring tension and concern to the global world.

The final risk concerns pandemics. We do not spend enough time thinking or worrying about what we are doing to the environment. The potential for pandemics or significant perturbances to the environment are in a sense the ultimate black swans, to use that expression.

There is a series of risks worth mentioning. Corporations should invest some of their money in very safe places and most of their money in places that are risky but not crazy. Then, they should put a small amount of money into investments that are very risky but have very high potential upside. Following are examples of each of those categories.

A place that is relatively safe to invest where one need not be concerned about their investment and with an economy that is growing in positive ways would be a country like Japan. Like the United States, it has a sort of blue chip environment. It would be really worth the effort for a corporation to do a significant amount of investing in these very safe environments.

However, in the middle, the company wants to make money and thus might want to look at some of the nations that are coming along in a positive way: Poland, Turkey, and South Korea, etcetera. That list of second-tier BRICS mentioned earlier as well as China and India could be placed in this middle basket.

Then at the very risky level but with potentially big upside are places like Israel, with a highly innovative culture, and other places like potentially Nigeria, Kenya, and Colombia. Places that focus on in this basket are countries that are coming out of extreme violent periods and Afghanistan could be put in that box. It might come as a surprise to some that Afghanistan sits on top of $1 trillion of rare earth metals: cobalt, copper, manganese, lithium. The two nations that are doing the most investing right now in Afghanistan are China and India and that is a pretty good sign.

So the best advice is to be very aware of the global risks, be willing to invest in people, consulting firms, information that help us understand global risk and specific markets. Then take a portfolio approach that puts some safe money in really stable areas. Put most of the investment in edgier, riskier, but probably very stable places, and then put some money in these high-end, potential markets.

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