The Scenario Approach to Risk Management as Applied to Geopolitical Risks

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Foreword

I have been asked to write about managing geopolitical risks. However, I am an expert in scenario planning, not geopolitical risks or risk control. So I would like to take this opportunity to do a thought experiment, in which I will use the scenario method to reconstruct some part of *Top Risks 2016*, the annual outlook on geopolitical risks by Eurasia Group, a consulting firm highly regarded by the Japan Economic Foundation. The outline of *Top Risks 2016* must have been written in 2015; it says that "we don't think Trump can be the nominee." Why did Eurasia Group reach that conclusion? I will investigate this from my field of expertise. To put it another way, I will explore the potential for the scenario planning method in identifying and analyzing geopolitical risks.

This essay will proceed in the following manner. First, an overview of scenario planning will be given. Second, the views of Professor Taketoshi Taniguchi of the University of Tokyo on how risk is manifested in the world today will be introduced. Third, the scenario method will be used to reconstruct part of *Top Risks 2016* from Eurasia Group with a focus on the Trump question. Finally, the thought experiment will be reviewed to consider how the scenario method could be used in managing geopolitical risks.

What Is Scenario Planning?

1. What is a scenario?

A scenario is a story about the future. It is used, for example, in scripting plays. There, the players and the setting on the stage are depicted along the flow of time.

A scenario is not a forecast. Generally speaking, a forecast is a look into the future as an extension of the past. For example, a forecast is based on the assumption that current business conditions will continue. Alternatively, the future may be estimated by using statistically derived trend lines. Either way, it is difficult to subsume vague, weak trends and signals of fundamental structural changes that may occur, or our imaginations and instinct about the things that could happen. The scenario method is a mechanism that frees us from these psychological and methodological constraints.

A scenario contains some potentially important things that may happen, who and what could cause them to happen, what the ripple effects will be, and how the world of the future will be altered from the present as a consequence.
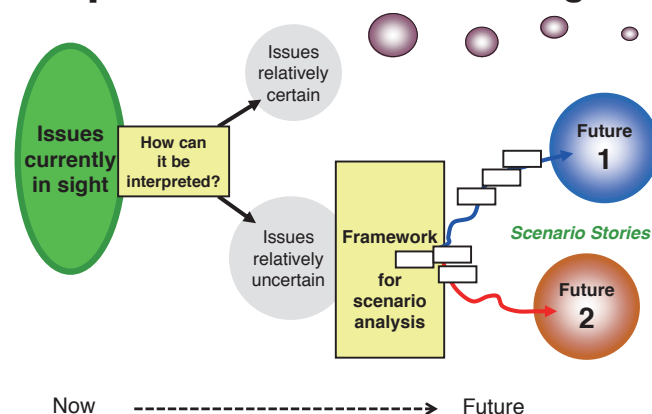
2. What is scenario planning?

There is, of course, no way to know with certainty what will happen in the future. Hence we will mull over many possible futures through research, analysis, and interpretation of the issues currently in sight. But, in the scenario method, the infinitely varied possible futures are culled through the following process.

Plenty of data and insights are available at any moment to consider the future. It is desirable to divide them, boldly and tentatively, into two categories, i.e. one category that indicates an outlook with a certain level of certainty, and another category that indicates high uncertainty. In other words, there are issues and themes that fail to yield a sense of direction when you try to look into the future. They will be explored in more depth to figure out the reasons why it is so hard to see how they play out going forward. Pushing our thoughts further along these lines, we begin to move forward on the interpretation of the various issues and themes as an integrated system. A framework for scenario analysis will be revealed from this systematic interpretation. This framework has to be holistic and robust enough to accommodate multiple different views and opinions, manifested in the data and insights collected. Based on the framework, the issues and themes are arranged along the time line into scenario stories in accordance with the causal relationships. The multiple different stories combined with the analytical framework become the scenario product *(Chart 1)*.

CHART 1

Components of scenario building

Source: Compiled by the author

3. How is scenario planning used?

Scenario planning is a tool for organizations (governments, private businesses, etc.) to help them to test their plans and strategies. The leader of an organization establishes a vision and a strategy, seeks consent from its members, and attempts to influence its environment. However, the environment — the business environment in the case of a business, the policy environment in the case of the government — is always in flux. There may be discontinuity between the present and the future. This is where scenario planning comes in. A scenario product is set up as a tool that enables the organization to test whether the vision and the strategy currently adopted by the organization will be able to withstand significant changes that may occur in the future. Thus, it is critical to make sure that the two or three completely different futures depicted in the scenario product have the appearance of having the same plausibility. Care must be taken to choose the material and rhetoric so that the richness of the information and the persuasiveness of the different futures are on the same level from the perspective of the leader.

The leader cannot help but see multiple developments in the environment. Paths can be seen branching off. Some of them will look auspicious, while others loom ominously; but there is no way to pick a single one. "We have a problem," the leader realizes. And that is the point.

How Risk Is Manifested in the World Today

Now let's move on to risk control. The following is a summary of the views of Prof. Taniguchi on the nature of risks as they are manifested in the world today.

The world we live in is a complex adaptive system in the form of a dynamic network connecting countless numbers of diverse agents (the "players" in the scenario method). It contains many feedback loops, and its overall behavior is manifested as the consequence of the perpetual interaction and massive number of decisions on the part of the multiple individual agents. Thus, it should come as no surprise that many things, anything, can happen. It order to handle these circumstances, we should switch our mindset from the conventional focus on the agents that comprise the system to a focus on the networks and mutual interactions.

Risks are always shifting, and hidden. There are issues in our world that are unknown to us. The real world is a complex system, so it is impossible to predict emergent phenomena. We must shed the notion that "risks are controllable" and switch to an approach that adapts to risks while securing the resilience of our society.

Prof. Taniguchi's views are close in some ways to the approach that the scenario method takes, but different in others. Prof. Taniguchi and the scenario expert both believe that a forecasting method that considers the future as an extension of the present is inappropriate in dealing with the risks of our world today. At this point, the scenario expert proposes to conduct a thought experiment in which he/she observes the current state of the world, comes to a systematic understanding of it, then takes an issue or theme whose future development is seemingly most difficult to foresee as the starting point, and starts to craft several possible futures. On the other hand, Prof. Taniguchi will say there may be individual issues or agents whose behaviors are foreseeable, but the behavior of the social system as a whole is manifested as the outcome of the interaction among the individual agents. From his perspective, it is impossible to foresee phenomena that have yet to emerge in a complex system like our world today.

How does *Top Risks 2016*, Eurasia Group's annual outlook for geopolitical risk, deal with the challenge of foreseeability versus un-foreseeability? That is, in the world of scenario planning, how to recognize degrees of uncertainty of issues and themes which could develop and formulate a gross geopolitical risk in the future?

Reading *Top Risks 2016*

First, my own conclusion. Eurasia Group specializes in political risk. It focuses its analysis on nation states, those who hold the power of the state and their opponents, and other agents. It analyzes the current state of affairs, comes to a systematic understanding of it, and then writes one single story of the near future. It surely must have considered the possibility of multiple possible futures, but it places its reputation on the line by putting forward the most likely future in development.

I will now provide a summary of the *Top Risks 2016* announced at the beginning of the year 2016. Following this, I will use the scenario method in order to look into the logical process by which the report came to the conclusion: "We don't think Trump can be the nominee. Even if he is the nominee, he can't beat Hilary Clinton."

1. *Top Risks 2016*

Top Risks 2016 lists the following as the 10 most important risk themes.

① The hollow alliance: The transatlantic partnership between the United States and Europe is the most important international framework for maintaining global order. But it is now weaker than it has ever been.

② Closed Europe: "Open Europe", the principle on which the European Union was founded, is being threatened by a combination of inequality, refugees, terrorism, and the rise of populism and nationalism.

③ The China footprint: Never in history has a country at China's modest level of economic and political development had such an influence on the global economic market and geopolitics.

④ ISIS and "friends": The threat from the world's most powerful terrorist organization will grow in 2016.

⑤ Saudi Arabia: The Saudi kingdom will face growing and destabilizing discord within the royal family this year, and will be increasingly isolated internationally. This will lead Saudi rulers to act more aggressively.

⑥ The rise of technologists: Non-state actors from the world of

technology are entering the realm of politics. Their influence will undermine government policies, and citizens will begin to distrust these actors from the world of technology.

⑦ Unpredictable leaders: Some leaders, such as Russia's President Vladimir Putin, Turkey's President Recep Tayyip Erdogan, and Saudi Arabia's Deputy Crown Prince Muhammad bin Salman, are demonstrating erratic behavior.

⑧ Brazil: Brazil is in the midst of a deep, multi-year recession, and President Dilma Rousseff is fighting for her political survival.

⑨ Not enough elections: In 2016, there are relatively few national elections in the emerging economies. Political and social destabilization in these countries will be the result as there will be no outlet for their dissatisfaction.

⑩ Turkey: Erdogan will now work to replace the country's parliamentary system with a presidential one. The country's foreign policy will be infused with nationalism aimed at catering to Turks' increasingly conservative views.

2. Red herring

Eurasia Group also listed three themes that it did not see as being risks in 2016.

⑪ US elections: "We don't think Trump can be the nominee. Even if he is the nominee, he can't beat Hilary Clinton."

⑫ China: No hard landing. President Xi Jinping has the political capacity to prevent this.

⑬ Asia will evade geopolitical risk. Japan's Prime Minister Shinzo Abe, India's Prime Minister Narendra Modi, and China's Xi Jinping all seek geopolitical stability.

Reconstructing Eurasia Group's Geopolitical Risk Analysis/Forecast through the Scenario Method

Eurasia Group decided that Donald Trump would not win the US presidential election. Actually, material to consider the Trump question is embedded all over the analysis of the 10 top risks. And "① The hollow alliance", "⑥ The rise of technologists", "⑦ Unpredictable leaders", and "⑨ Not enough elections" are of particular interest.

I will now reconstruct the Eurasia Group's rich narrative for those four themes using the scenario method. The scenario method is distinguished by the systematic and integrated understanding of the theme in question. A scenario expert draws up an endless number of tentative system diagrams. So, let's go back to Eurasia Group's analysis of the current state of affairs and, without altering it, demonstrate the possibility of "alternative futures".

Breaking down each of the four themes into segments and reorganizing them into a system

diagram, we can see that causes for Trump's victory are embedded in Eurasia Group's analysis itself.

1. The rise of technologists

This system diagram breaks down the text of Eurasia Group's observation and analysis of the "rise of technologists" as a risk theme, and arranges them according to the causal relationships. Eurasia Group has the following to say:

A variety of highly influential non-state actors from the world of technology are entering the realm of politics — Google, Apple, Facebook, Amazon (GAFA) and hackers. Because these actors do not have party platforms or voter constituencies behind them, they will be difficult to understand and assess. At times, they will oppose incumbent administrations, generating policy and market volatility.

The political rise of these actors will generate pushback from governments and citizens. There is little doubt that the EU's scrutiny of American technology giants has been driven, in part at least, by a tacit mandate from European populations. Authorities may view local technology stars with growing suspicion, which may lead to their fall, as in the case where the Russian government took down the oligarch Mikhail Khodorkovsky. That said, governments will surely play along when they find the political actions of the actors from the world of technology advantageous.

I've laid out the alternative scenarios implied by the Eurasia Group analysis in italics in *Chart 2*. Against Eurasia Group's assumption that "the political rise of technologists will create conflicts between competing centers of power", I will propose the possibility that the two could collude. After all, there are cases all over the world where those in power made skillful use of information and media technology to impose political propaganda on its citizens.

CHART 2
The rise of technologists
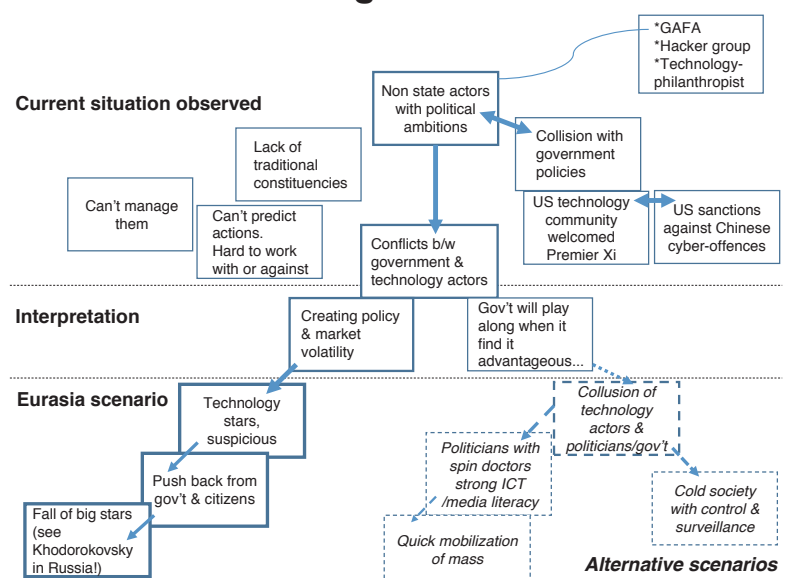
Source: Compiled by the author

2. Unpredictable leaders

Eurasia Group has the following to say about this:

There is an almost unprecedentedly wide constellation of leaders known for erratic behavior, such as Putin, Erdogan, and bin Salman. They have a proven tendency to pursue loose-cannon foreign policies. Why the unpredictable behavior? Several reasons. Some of these leaders have a craving to attract attention to themselves. Erdogan and Putin are notoriously big-headed. Erdogan wants an executive presidency, and bin Salman wants a throne. They put personal considerations above national interests. Furthermore, these leaders all benefit from a dearth of domestic institutional constraints on their freedom of maneuver. In 2016, unforeseeable geopolitical risks will rise from these personalities. Each of these three plays a role in the Syrian conflict. Their interventions will overlap and conflict, spelling volatility for the international system, and a lot more turmoil.

I believe that the personal qualities of these leaders also apply to Trump *(Chart 3)*.

3. Not enough elections

In 2016, there are relatively few elections in emerging economies. Slower growth and stagnating living standards will harness popular discontent. There is an absence of national-level electoral relief valves in Brazil, Turkey, Russia, and South Africa amongst others. This will lead to street protests and social unrest. There is also the risk that middle and working class voters disillusioned with incumbent regimes will support non-mainstream parties with more radical agendas. When the middle classes of the emerging economies see their economies taking a turn for the worse, they will be shaken by the fear of losing socio-political status and turn to more populist politicians.
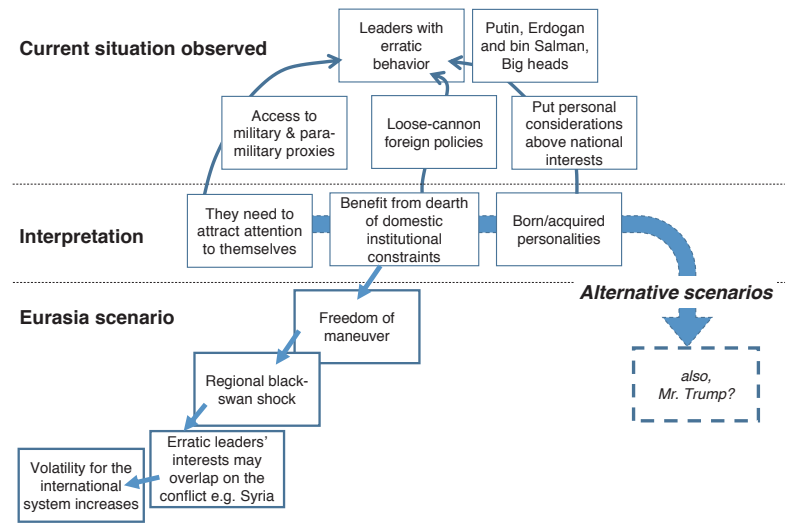
I believe that this risk analysis by Eurasia Group is also applicable to developed countries, and not just to emerging economies. It may have been reflected in 2016 in the US presidential election *(Chart 4)*.

4. The hollow alliance

The transatlantic partnership has been the world's most durable and significant alliance, underpinning the global economic order and bolstering peace and stability. But it is now weaker, and less relevant. The reason for this is that China and other emerging markets are rising and European countries and the US no longer share a common interest. The UK tries to deepen its economic relationship with China, France looks to Russia for a solution to the situation around Syria, and Germany approaches Turkey to stem the tide of Syrian refugees. Swamped by one crisis after another, European leaders can no longer afford the luxury of taking the big picture into account. Europe
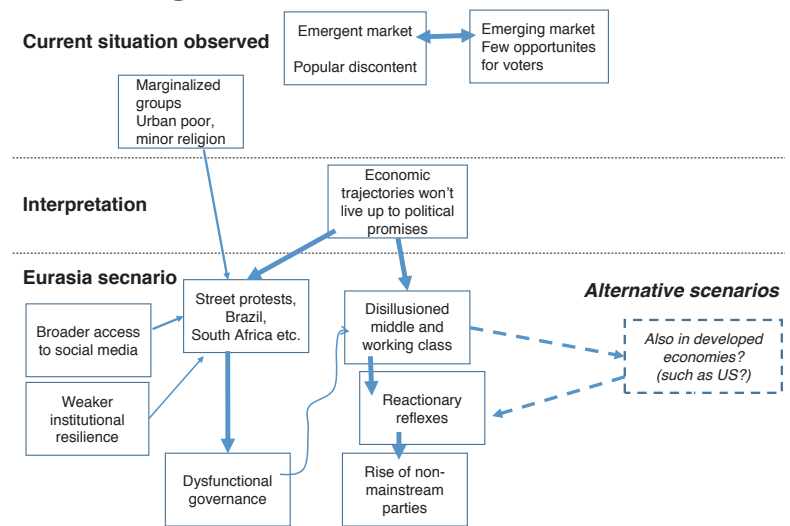
is divided, and weak.

The US has adopted unilateralism over the last decade or so; now, there is no global policeman to maintain order. The situation in Ukraine, Syria, and the Middle East will deteriorate. How will the US handle the transatlantic partnership with Europe under President Trump?

The Trump Question from Within *Top Risks 2016*

With all due respect to Eurasia Group, let's take the liberty of using the words and phrases of *Top Risks 2016* itself to create a set of scenarios.

CHART 3
Unpredictable leaders

Source: Compiled by the author

CHART 4
Not enough elections

Source: Compiled by the author

Trump is demonstrating inconsistent behavior, and there are several reasons for this. There is the craving to attract attention to himself. He also made skillful use of a media strategy and information technology to quickly build up voter support. His support came less from the Republican Party organization than from the populist movement that he created.

In other words, Trump acts to maximize the freedom of his decision-making activities. He wants to eliminate institutional constraints to the exercise of his power. This is what any CEO of a company wants to do. Positioning this understanding of Trump's characteristics as the key theme in the holistic system of the "Trump question" enables us to craft several scenarios.

Scenario 1: President Trump is not interested in international politics, which he cannot bend to his will. American unilateralism intensifies, and Trump will generate unforeseeable geopolitical risk.

Will the "Trump question" stabilize? A future can be seen developing in which opposition from intellectuals and parts of the establishment grows. What is hard to foresee is whether his populist methods of securing support that were so successful in 2016 will continue to be effective as the years go by. This leads to two more scenarios.

Scenario 2: The traditional media remain within the establishment. But technology-driven new media groups with political ambitions emerge and begin to support the Trump administration. That makes it possible to rapidly organize the support from 2016. A new, non-mainstream party ardently supporting the Trump administration is born.

Scenario 3: The Trump administration's strategy towards the technology-driven new media fails, and President Trump is unable to remain in office. The four-year term is no longer able to protect him *(Chart 5)*.

Conclusion

This has been a personal thought experiment in which I reconstructed some part of *Top Risks 2016* around the Trump question using the scenario method. I did not add any themes or insights other than to propose the possibility of "collusion of technology stars and politicians/government". Even so, the "Trump risk" emerged when I used the scenario method to create a tentative system diagram connecting the issues raised in *Top Risks 2016*, assuming that technology-driven new media groups with political ambitions emerge and begin to support the Trump administration.

The following is my conclusion as I look back on this thought

CHART 5
Trump risk?
Current situation observed
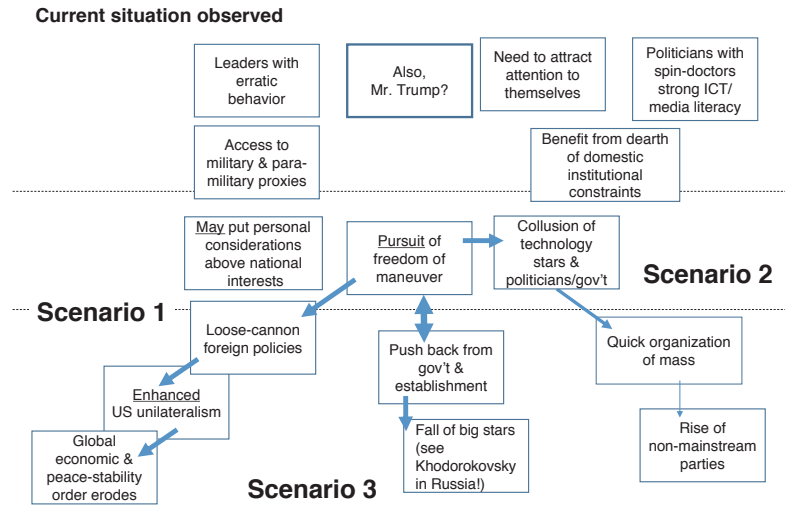
Source: Compiled by the author

experiment.

The geopolitical risk analysis by Eurasia Group in its *Top Risks 2016* is a highly regarded, fine piece of work. However, Eurasia Group, after considering all possible futures, presents only what it considers to be the most likely outcome. The argument is excellent, and persuasive. But the conclusions should not be read in isolation. Other possibilities may emerge when it is read while carefully examining the causal relationships between the issues and themes that lead to the conclusion.

This is where the scenario method comes in. The guiding principle of the scenario method is that multiple futures are always created. This method forces someone who has discovered one very much potent story of the future to go back to the system diagram and undertake the intellectual activity of thinking up other, unfamiliar stories. This experiment could be uncomfortable though, as the scenario product that is produced as a result (the analytical framework and the multiple, divergent stories) generates new discoveries and starts stimulating us to consider even more questions.

Prof. Taniguchi surely knows that the efforts of us human beings, who cannot stop engaging in the world around us, to come to a structural understanding of the present, and the intellectual activities to create the future will not cease. Yet Prof. Taniguchi is resigned to the idea that risk phenomena that may occur in the future in the real world cannot be predicted since it is a complex system, and proposes an approach that secures social resilience while abandoning the notion that risk can be controlled. And on this point, experts in the scenario planning have no disagreement with the professor. **JS**

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