

# Rising Global Risks, Growing Concerns About the Future, Nations Facing Unprecedented Social Disruption — How Can We Break the Bottleneck?



Author Naoyuki Haraoka

By Naoyuki Haraoka

## Introduction

Mrs. Watanabe, the nickname given by the media in Europe and the United States to the archetypal Japanese individual investor thought to have a major influence on the foreign exchange market, is today very concerned about geopolitical developments in the world as well as the development of the global economy. This is because the former increasingly affects currency values today. Since the floating exchange rate system was officially adopted by the IMF in 1976, few have denied the geopolitical impact on currency values. In particular, the short-term fluctuations in currency values have been widely recognized to be affected by global geopolitical risks. However, rising global risks today seem to be continuing over a longer term than before.

For example, the North Korean nuclear missile crisis will continue for a long time, assuming that no regime change can be achieved shortly and that nuclear arms are vital means of ensuring national security. The risk of terrorism from Islamic State (IS) will also continue for a while, as potential IS terrorists, frustrated by expanding income gaps between the rich and the poor, could crop up all over the world even if IS itself in the Middle East were destroyed by the Western nations. The overflow of immigrants from the Middle East and Africa into Europe cannot be stopped immediately, since poverty in those regions, a principal cause of immigration, will not be easily mitigated. Thus political risks in Europe will not be eliminated immediately.

Unlike in the past, global geopolitical risks now look set to remain over the long term. Mrs. Watanabe, permanently concerned about all kinds of risks as an investor, today worries about the possible impact of these rising and continuing risks on exchange rates. Excessive worries over any tiny risk could lead to many risk-hedging investments and they would cause even more fluctuations in currencies, destabilizing the global economy. Many professional economists are saying today the economy is steadily picking up, but whether this growth is sustainable or not may depend on particular geopolitical risks. Economics has thus become a study of the political economy today. Econometric models that have been used for economic forecasts for a long time do not work well anymore, as they cannot take account of any political developments.

Mrs. Watanabe, suffering from so much concern and anxiety over rising global risks but eager to gain money, will need to know how she can deal with those risks appropriately. Knowledge would empower her and enable her to survive this crisis.

## What Kind of Global Risks Surround Us Today?

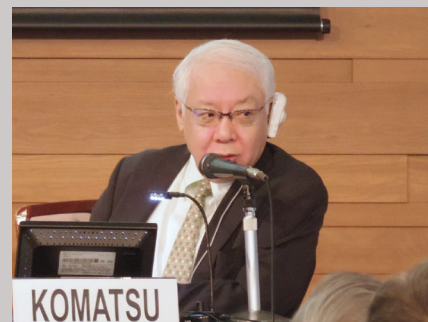
It is true that we are surrounded by many risks which cannot be easily mitigated. Terrorism, North Korea's nuclear missile development, and immigration into Europe are not the only risks observed today. The political stability of China is occasionally questioned. Whereas its economy is in transition to free capitalism, its political system remains a form of old communism leading to



Opening remarks, Kazumasa Kusaka



Closing remarks, Yoriko Kawaguchi



Dr. Keiichiro Komatsu

dictatorship. This discrepancy between the economic system and the political system could destabilize not only the Chinese economy and politics but also the economy and peace across Asia. And the risks from China are not limited to its domestic political instability: its aggressive military and foreign policy in the South China Sea and some other areas will pose a serious geopolitical risk in Asia.

Russia could be another source of rising global risk. Its worsening foreign relations with the pro-European Ukrainian government holds the risk of continuing confrontation between Russia and the EU. The Middle East remains a source of risks not only in terms of being the bastion of IS terrorists but also as a potential flashpoint for nuclear war.

The Fourth Industrial Revolution, including IT-oriented innovation such as AI or Big Data, is expected to lead global growth. But these new technologies could also bring new risks. Cybersecurity is one of them. As we learn from Dr. Constantine A. Pagedas' article on "The Apprentice: Donald Trump & His Russia Problem" in our July/August 2017 issue, Russian intelligence meddling through computer networks in the 2016 US presidential election is suspected. There are no rules or guidance established yet to achieve an international consensus, but abusive use of this new technology needs to be controlled as quickly as possible.

The Trump administration is also a cause of serious geopolitical risk. It is now pursuing what President Trump calls an "America First" policy, which has so far resulted in the United States withdrawing from the ambitious Trans-Pacific Partnership trade agreement as well as from the Paris Agreement on Global Climate Change for protection of the environment. Since both agreements can be considered symbols of successful multilateral governance in 2016, the US withdrawal has highlighted the crisis of leadership in global governance. If the US continues to be reluctant to take leadership in any international rule-making process, assuming that all such international deals need to be reexamined in the light of this "America First" policy, we will see a vacancy of leadership in global governance and the situation could lead to abusive use of political

power by the superpowers.

All these risks cannot be mitigated easily and thus they have a structural nature. The last risk concerning US government foreign policy may be less structural, since there could be a new administration born at the end of the current presidential term that will seek changes in policy. But even if this were the case, the current risks will continue for at least another three years.

We will call this situation in which we have to face this wide range of risks as the status quo "new normal", as highlighted in Dr. Keiichiro Komatsu's article on "Future Prospects of Geopolitical Risks: Adapting to the New Normal Era" in our March/April 2017 issue.

### Background to Rising Global Risks

In order to find relevant solutions to these rising global risks, we first need to understand the background to them. Let me introduce one such detailed explanation as given by Richard Baldwin, professor of International Economics at the Graduate Institute of International and Development Studies in Geneva, in his recently published book *The Great Convergence* (Harvard University Press, 2016).

According to his theory, "New Globalization" driven by information technology since 1990 has reversed the century of predominant wealth of rich nations like the G7 (US, Germany, Japan, France, United Kingdom, Canada and Italy) in just two decades. In more detail, the "Old Globalization" driven by steam power and international peace having lowered the costs of moving goods in the 1800s triggered a self-fueling cycle of trade, industrial agglomeration and growth which propelled today's rich nations to dominance. Asia and the Middle East, which had dominated the world economy for 4,000 years, were displaced by today's rich nations like the G7 that took full advantage of the merits of falling trade costs in less than two centuries. This is what historians call the "Great Divergence".



Prof. Matthew Goodwin



Prof. Ramiarison Herinjatovo Aimé



Dr. Yong Sueng Dong

But this trend of concentration of political and economic power in the hands of a few rich nations has flipped since 1990. The New Globalization initiated by Information and Communication Technology (ICT), having radically lowered the cost of moving ideas, has had dramatically different effects on the world's economic geography. ICT has made it more profitable for multinational firms to achieve “unbundling of the production process”, since each separated production process can be efficiently coordinated by ICT.

This has made it practical for them to move labor-intensive production processes such as assembling to developing nations where cheap labor is available. Firms have also shipped their marketing, managerial, and technical know-how abroad along with offshore jobs in order to maintain the whole production process in a synchronized way.

Thus the new possibility of combining high technology with low wages in developing nations has been created. That has encouraged the rapid industrialization of a handful of developing nations and on the other hand the simultaneous deindustrialization of developed nations. The result is that the rich nations' income share of the global economy is now back to what it was in 1914. This is what Prof. Baldwin calls the “Great Convergence”.

This seems to explain much of the origin of the new assertiveness of “emerging markets” like China and also the economic difficulties of developed nations such as the US. As sources of growth are transferred from developed nations to developing ones, the developed nations face unprecedented policy challenges in their efforts to maintain reliable growth and social cohesion. Growing concerns in Europe about increasing immigration from the Middle East and Africa make it difficult to achieve social cohesion, as political views on this issue become increasingly polarized.

In addition to Prof. Baldwin's observations, under low economic growth in those countries income inequality between the rich and the poor is increasing. This will make it even more difficult to achieve social cohesion. Political parties should have addressed the interests of working people who feel seriously pressed by their economic situation, but the principal political parties in developed nations have failed to do this, being more concerned about winning support from the professional intelligentsia who have been gaining in social influence. Working-class people in developed nations threatened by the increasing presence of emerging economies have felt ignored and abandoned by the mainstream political parties. We need to understand their sentiments in considering recent political developments, such as the election of President Trump in the US. Geopolitical risks brought about by so-called anti-globalization sentiment in rich nations can be understood against this background, but it is noteworthy that this is also a structural issue and as such this risk continues as part of the “new normal”.

### “New Normal” Global Risks

Risk is not to be understood as something negative, as a nuisance that others compel one to address. The concept of risk, whether seen etymologically or in the context of the spirit of the age, is something one chooses to tackle actively and positively. It embodies the spirit of adventure and of taking on challenges. Risks are to be scientifically examined and taken. If Mrs. Watanabe prefers more sentimental concepts like safety and peace of mind, simply expressing two values without any concept of probability rather than examining risks and taking them in accordance with scientific analysis, she could lose money that would have been obtained



Global Risk Symposium, Tuesday, July 11, 2017 at I-House, Tokyo





otherwise in the long run under a “new normal” situation. Safety and peace of mind cannot have evidence-based definitions and if she is faced with a choice between safety and danger or peace of mind and anxiety, the answer must be clear. But evidently, this is not science.

I would recommend the scenario approach to risk management to deal with “new normal” global geopolitical risks. You must examine issues currently in sight first and create a framework for scenario analysis. In accordance with this framework, you then create several possible scenarios of the developments of the specific risks and prioritize them by probability. You would have to work on your reactions to those risks dependent upon each scenario, but after analyzing each risk scenario, you must be complacent in taking risks. Masahiro Kakuwa, a visiting professor at the Graduate School of Public Policy, the University of Tokyo, contributed an article titled “The Scenario Approach to Risk Management as Applied to Geopolitical Risks” for our March/April 2017 issue, and this will help readers understand better what the science of risk analysis means.

To sum up, first you need to understand correctly the nature and background of each geopolitical risk and then try to create a scenario for each risk, and then take it after taking account of the probability of each scenario. In addition, it should be noted that this is a long-term issue, as the “new normal” situation continues. So you need a long-term goal for your business, to be achieved by a long-term strategy based on your scenario approach to geopolitical risks. With such a long-term goal, you can be encouraged to take a risk. This is a lesson for Mrs. Watanabe and other business people.

The Japan Economic Foundation (JEF) organized a Global Risk Symposium on July 11, 2017 at I-House in Roppongi, Tokyo. Its title was “Prospects of Increasing Geopolitical Risks & Their Solutions — How to Live in an Era of New Normal”. We organized this for the benefit of business people like Mrs. Watanabe who worry about possible risks surrounding

them and occasionally are at a loss. Discussions were initiated and excellently moderated by Dr. Keiichiro Komatsu who introduced his creative thoughts on geopolitical risk analysis ([Program](#), [photos](#)).

Three other distinguished experts on geopolitical risks joined this symposium as speakers and have kindly contributed articles here based upon their presentations. I hope you enjoy reading them. **JS**

#### PROGRAM

Global Risk Symposium	
Prospects of Increasing Geopolitical Risks & Their Solutions - How to Live in an Era of New Normal	
Tuesday, July 11, 2017 9:00am - 11:00pm at I-House, Tokyo	
Program	
Time	Details
9:00 - 9:10	<b>Opening remarks:</b> Mr. Kazumasa Kusaka, Chairman and CEO of the Japan Economic Foundation (JEF)
<b>9:10 - 10:40</b>	<b>Part 1 - Global Geopolitical Risks: Present and Prospects</b>
9:10 - 9:35	“Global Geopolitical Risks: Present and Prospects” Dr. Keiichiro Komatsu, Principal, Komatsu Research and Advisory (KRA), (Speaker/moderator)
9:35 - 10:00	“Brexit: Causes & Consequences” Professor Matthew Goodwin, University of Kent (UK) and Visiting Senior Fellow at Chatham House
10:00 - 10:25	“Geopolitical Risks in Africa and Asia from a Comparative Perspective: the Strategic Role of the Indian Ocean Zone” Professor Ramiarison Herinjatovo Aimé, University of Antananarivo (Madagascar)
10:25 - 10:40	Q&A
10:40 - 11:00	Coffee break
11:00 - 11:50	“Geopolitical Risks of the Korean Peninsula” (Korean-Japanese simultaneous interpretation) Dr. Yong Sueng Dong, Representative, Oriental Link
<b>11:50 - 12:50</b>	<b>Part 2 - How To Live in an Era of New Normal</b>
11:50 - 12:40	<b>Panel discussion and Q&amp;A</b> Dr. Yong Sueng Dong, Representative, Oriental Link Professor Matthew Goodwin, University of Kent (UK) and Visiting Senior Fellow at Chatham House Professor Ramiarison Herinjatovo Aimé, University of Antananarivo (Madagascar) Dr. Keiichiro Komatsu, Principal, Komatsu Research and Advisory
12:40 - 12:50	<b>Summary:</b> Dr. Keiichiro Komatsu, Principal, Komatsu Research and Advisory
12:50 - 13:00	<b>Closing remarks:</b> Ms. Yoriko Kawaguchi, ex-Japanese Minister for Foreign Affairs

Naoyuki Haraoka is editor-in-chief of *Japan SPOTLIGHT* & executive managing director of the Japan Economic Foundation (JEF).