

Overview on Understanding the Structure of Geopolitical Risks



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The Japan Economic Foundation (JEF) has been studying the impact of geopolitical risks on the economy since 2013, in the belief that global geopolitical risks such as North Korea or the Middle East could seriously affect the global economy, as well as economic developments such as the world financial crisis in 2008. In 2017, JEF hosted a symposium in Tokyo on risks linked to the global economic performance which could have a deep impact on business strategies. This first symposium was an attempt to draw the attention of Japanese business people to some geopolitical risks as factors that could influence their business decisions. The second symposium in 2018 highlighted the fact that each risk involves a wide range of players and needs to be analyzed in terms of their different perspectives and the relations among them. With such a holistic overview of the nature of the risks, firms could better work on their global business strategies.

Why Does the Global Economy Feel So Fragile?

At the beginning of 2019, a few months after our second global risk symposium, some new geopolitical risks emerged, such as the trade war between the United States and China, as prime sources of concern for economists in their predictions for the global economy. At the symposium, we discussed Russia's influence on politics in European nations, as well as views on Brexit, geopolitical stability possibly to be provided by cooperation in the Indo-Pacific Ocean region, and the likely direction of North Korea. As time goes by, however, geopolitical risks evolve like an animal: we see new ones emerging and old ones changing.

For business people, perhaps the key question in 2019 will be why the global economy feels so fragile. This concern about fragility could stem partly from a possible breakdown in the global political order, creating severe economic disruption probably through a collapse in trade resulting from US-China trade frictions and a rise in protectionism. Other geopolitical events could also be sources of fragility, as well as the possible unmanageability of accumulated public debt among leading OECD nations. Although political centrists may hope that anti-globalization movements led by the right will founder, as perhaps seen in the US mid-term elections where the Republicans led by President Donald Trump lost their majority in the House of Representatives, there are also such movements led by the left, as seen in the election of Andrés Manuel López Obrador as president of Mexico in 2018. Populist movements may continue to

be sources of geopolitical risk, so we could continue to see economic fragility, which could also be expanded by deeper fluctuations in exchange rates as well as stock market volatility that could cause serious turbulence.

Overview of the Structure of Geopolitical Risks

Geopolitical analyses should be free from any subjective and emotional views, such as “anti-American” or “anti-Russian”. Think-tanks must obviously take a neutral and objective approach to any actual event or issue to present the public with the evidence. While economic developments are mostly analyzed from this perspective, geopolitical developments are occasionally seen to be biased. This possibly originates from the Cold War period when nations were categorized into a group of either capitalist or socialist countries. Today, even after the end of the Cold War, we can see a “pro-Chinese” or “anti-Chinese” bias in some geopolitical views. These were not shared by our symposium's organizers and speakers. The symposium has a mission to provide factual analyses and a variety of views on geopolitical events. I think business leaders can best learn from such objective analyses to help them with their business strategies.

We are living today in what has been termed a VUCA world – meaning a world with volatility, uncertainty, complexity and ambiguity. In particular, it should be noted that under globalization the interlinkage between national economies is greatly enhanced, so that a policy or incident in any given country could affect the global economy overall. In addition, developed countries' economic performances have tended to converge today, as each one has come to a mature stage and even many developing nations have begun to reach that stage. Thus, the trend is for national economies to be synchronized, and in such a world the blurred relations between domestic economies and the international economy make issues more complex and ambiguous.

The increase in anti-globalization sentiment seen in many nations today stems largely from the excessive globalization of business activities, and this kickback itself has started to affect the international economy in the form of protectionism. With this trend, uncertainty is exacerbated by stock market or exchange rate volatility. In such circumstances, the need for a bird's-eye view of the global economy is increasing. For example, Japan's labor market reform will attract a non-Japanese labor force into Japan and thus

facilitate more FTAs involving Japan thanks to a greater flow of human labor. It may also encourage Japan to conclude an Asia-wide regional FTA, which could be instrumental in convincing the US or the other trading partners of the utility of free trade again.

Globalization itself should encourage geopolitical analyses to be holistic, given the deeper interlinkages among national interests and the world becoming more close-knit. Focusing only on any given geopolitical incident will not enable business leaders to create relevant strategies.

Sir Graham Fry, a former British ambassador to Japan, pointed out in the symposium in 2018 that although Brexit could gravely affect the future of the European Union, the geopolitical crisis in Europe should be seen more in terms of the rise in nationalism among European nations and the increase in Russian influence in this area. We should not forget that Russia would be the main beneficiary of any collapse in Western capitalistic and democratic values. The situation in Europe should be analyzed not only from the UK's perspective but also from that of other players, including Russia.

Deonanan (Raj) Makoond, chairman of Business Mauritius Regional Energy Working Group, mentioned the crucial role of the Indian Ocean for geopolitical stability in the world. The conclusion of the CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership) was a successful step in efforts to integrate Asia-Pacific economies. Broad economic cooperation among East Asia, India and South Asia, and Africa would help achieve peace and prosperity by mitigating geopolitical risks caused by China's aggressive foreign policy in this area and also encourage development in Africa and reduce the risk of terrorism by extremely poor Africans. Thus the Indian Ocean region is important not only for Japan but also for stable growth of all the nations in this region.

Dr. Yong Sueng Dong, a former member of the Council of Policy Advisors to the President of the Republic of Korea, and Dr. James E. Hoare, an associate fellow of Chatham House and consul general at the British Embassy in Pyongyang at the time of its establishment, told the symposium that when trying to analyze North Korea it is important to recognize how it is linked with other countries and to understand the viewpoint of North Korea itself. It is necessary to look at the key players – China and Russia – as well as the US, South Korea, Japan and even Europe and Africa. It is also important to see the interlinkages between geopolitical risks. For example, today it is said in the media that China may use its power over North Korea to achieve its denuclearization in the hope of persuading the US to



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accept a compromise in China's favor in their trade negotiations.

Three of the four speakers mentioned above have contributed articles to *Japan SPOTLIGHT* largely consistent with their presentations at the symposium in 2018. Readers will gather from them that looking only at risks could simply result in making business become cautious. It is more important to think about solutions. A view of geopolitical risks that takes account of different players' views and the interlinkages among them – an overview of the structure of geopolitical risk – could provide clues to such solutions in clarifying the meaning of each geopolitical issue.

This is particularly important for the interests of multinational enterprises since they are doing business all over the world. They will need a holistic overview of geopolitical risks in formulating their global business strategies. **JS**

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