

 **Teneo®**

Vision

Edition 5 | 2018



**Where Is The World Going?
How Do We Get There First?**

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View From The Top: The Big Three Economies in Flux

Globalization Is Not Going Away

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If 2016 was the year of the surprise and 2017 the year of the surreal, what then is in the offing for 2018? Following the historic and unprecedented vote in the United Kingdom to exit the European Union and the presidential election in the United States, the tone of 2017 was set in mid-January... and all in one week. President Donald Trump, in his inaugural address, delivered a dystopian speech describing American "carnage" and championing an "America First" world view. Prime Minister Theresa May outlined the UK's plan for Brexit. And Xi Jinping, the first sitting Chinese president to attend the World Economic Forum, spoke to the assembled elite in Davos as the champion of free trade and the liberal economic order. This seeming reversal of traditional global roles provided an umbrella context for the uncertainties that prevailed through much of 2017: Would the nationalist and populist forces that characterized the previous year carry through to the European election cycle and whither the U.S. role in the world? And what would the impact be on the prevailing global trading system? As it happens, these questions remain unanswered, but 2018 looms as the year in which the fallout from these dynamics is felt.

Much of 2016 for policymakers, analysts, investors, the media and corporate leaders was dominated by two unexpected events: the Brexit vote and the election of Donald Trump. There was a natural tendency for the pendulum to swing and greater probability being applied by analysts to other unlikely events in 2017. But the Dutch and French elections were not won by right-wing nationalist or populist parties (and the German election is likely to yield a fourth term for Chancellor Angela Merkel). Meanwhile, Brexit has continued to be more noise than action as the sides jockey for position before negotiations begin in earnest. And importantly, China has endeavored to maintain growth and status quo – and protect against geopolitical and economic volatility ahead of the People's Congress in October, where Xi Jinping will want to stack the leadership with his appointees and potentially tee up a third term for himself. The biggest variable therefore, the biggest generator of political risk, is the U.S. Due to its economic and strategic heft, the United States has perennially been the key swing player, tipping the playing field that it designed and perpetuated, but now there is a greater than usual element of policy uncertainty, given the non-ideological basis of the new administration and its rhetoric to policy preference to actual legislation ratio being unknown to an unprecedented degree. In 2018, Brexit negotiations will be fully engaged and the contours of what to expect during the interim period between 'divorce' and a new, permanent, trading regime between the EU and the UK will become apparent. Xi Jinping will have greater latitude to pursue his domestic, regional and global agenda after securing the leadership hierarchy during the People's Congress and the Trump administration will push its unorthodox agenda with an eye on the late 2018 mid-term elections. The transition of the three largest economies in the world in 2018 will provide the backdrop and context against which other political developments will have to be considered.

Europe

At the outset of 2017, there was much media hype that the continent was about to fall victim to takeovers by far-right populist parties and leaders. This despite the proportional electoral systems and the need to form coalitions generally conspiring to prevent such outcomes. In the event, these fears did not materialize. In the Netherlands, the right-wing Freedom Party of Geert Wilders wound up the second largest party in parliament, but will be excluded from the governing coalition that will be headed, once again, by PM Mark Rutte of the center-right VVD.

In France, Emmanuel Macron won, commanding mandate over the divisive Marine Le Pen of the National Front in the presidential election, and his newly-formed LREM party secured a landslide victory in legislative elections, rendering any significant opposition highly unlikely during the first half of his presidency.

Meanwhile, as expected, Angela Merkel of Germany recovered from her poll dip resulting from the migrant crisis, and has won re-election – the only question being coalition composition. However, political and policy continuity from Europe's most powerful state is expected.

However, there is a false sense of security in all of this. Populist forces have demonstrated that they do not need to 'win' elections to continue shaping the political debate via their influence on center-right parties. Consider the Brexit vote, where the UK Independence Party (UKIP) was able to realize its sole agenda item while holding a single parliamentary seat. In the Netherlands, Wilders and the far right were prevented from doing even better by the centrist parties veering right on populist issues like immigration and the future of Europe. The phenomenon has also manifest itself in Germany, where the far-right Alternative for Germany (AfD), which has remained steady in the polls at just below 10 percent, nevertheless was able to force a dramatic *volte face* on migration by Merkel and her CDU/CSU. Meanwhile, there are greater concerns in central Europe, particularly Poland and Hungary, which are pushing back against democratic and liberal norms from within the ruling administrations. At the same time, the EU is proving impotent to a degree in challenging these governments and forcing them back into union standards.

Europe's election calendar and the need for the UK to get its position in order, has meant that Brexit negotiations haven't really begun until the second half of 2017. 'Divorce' talks must conclude by the fourth quarter of 2018 to allow enough time for the European Parliament to adopt the deal and the national ratification processes to meet the 2019 Article 50-imposed deadline. So late 2017 and the first three quarters of 2018 will be a scramble. But, to be clear, the future trade agreement talks between the UK and the EU could take years to finalize, not least because the UK has not negotiated its own trade deals since 1973 and so there is a dearth of British trade negotiators in the civil service – versus 600 sitting in Brussels. The complexities of negotiating future economic relationship is difficult to overstate.

But the bottom line is that there ultimately remains no way to reconcile a desire for access to the single market to be preserved if immigration is to be limited. There is no 'soft' Brexit – the question is how 'hard' it will be.

Where Is The World Going? How Do We Get There First?

Against this backdrop in Europe, austerity is over, but it is important to note that what this really means is that the macro fiscal policy stance in the Eurozone has merely moved from negative to neutral and the stimulus levels being contemplated, argued and discussed in the U.S. and for the post-Brexit UK is not in the cards for Europe. On the monetary policy front, unconventional policies continue for the moment, but the debate on phasing out QE is in full gear. Despite these evolving policies, true Eurozone rebalancing, with the north loosening its fiscal stance and the south reforming, remains far off.

In Russia, president Vladimir Putin continues to play a weak hand masterfully and, now that he's achieved most of his objectives in both Ukraine and Syria, he is seeking a normalization of relations with the U.S. and the EU – which Russia hopes will lead to a gradual easing of sanctions, even without tangible progress on the implementation of the Minsk protocols.

Asia

While U.S. policy in the region remains one of the big questions, it is clear that China, with its wealth, resources and ability to offer market access, is the strongest contender to assume the leadership role if, as is increasingly expected within the region, U.S. engagement is in decline. This decline is most evident in the U.S.' withdrawal from TPP negotiations, which has had a negative effect on the credibility of U.S. efforts to counterbalance growing Chinese economic influence. From the perspective of Beijing, this is the latest example (Brexit being another – an existential decision made by a mere 37 percent of registered voters) of the dangers of popular democracy – proof, if more were needed, that a country should never leave questions of national interest in the hands of the underinformed masses. The Chinese leadership (indeed some American leaders as well) are baffled that a superpower would allow a minority of voters in declining industries and a rust-belt swing state to damage the overall national interest. The turn from TPP is indicative of a Trump administration that has yet to proffer an agenda comparable to the “pivot to Asia” of the previous administration.

In the context of (relatively) declining U.S. engagement, what does Xi's heralded Davos appearance mean? It is important to recall that while he championed the liberal global trading environment (in front of the proverbial choir that frequents the WEF), he is also the authoritarian head of the Communist Party, presiding over a regime that imposes capital controls, media censorship and keeps key sectors closed to foreign investors. And therein lies the rub: As China assumes a greater leadership role in the world, that is not to say that it wishes to play the erstwhile U.S. role. The Chinese vision, quite frankly, is for globalization without the liberalism. Put bluntly, China will defend the aspects of globalization it has benefitted from, e.g. free trade, but it is not committed to the aspect of globalization that is a liberal project for constructing a future (read: better) world. How influential will this be – the proof will be in the accomplishment of its goals. China's proposition is that it can change the developmental trajectory of countries by financing and building the infrastructure that they need – as opposed to focusing on “soft development.” The bet is that this will augment China's influence *and* create markets for Chinese products. This is the thinking behind the One Belt One Road (OBOR) initiative.

In pursuit of this agenda, China possesses considerable financial firepower. Its two largest policy banks, the China Development Bank and the Export-Import Bank of China, disburse more in loans each year than the world's six largest multi-lateral lending institutions put together. But these investments are overwhelmingly in the developing world, markets where it can reap economic and strategic rewards and remain insulated from western demands and influence. But this is a long game – assuming the role of regional hegemon is not easy and despite the progress thus far seen with the likes of the AIIB and the OBOR initiative, the actual disbursements remain limited.

While China's ambitions, ultimately, have far greater and long-lasting ramifications than Russia's, they have generated less frenzied concern in the West due to the elegance of their application. While Putin took all but overt military action in eastern Ukraine, Xi's aggression involves smaller, incremental steps which make it difficult for other powers to respond without appearing to overreact. Chinese activity in the South China Sea, for example, creates no hardship, really, for regional civilians and essentially no military casualties. And with the U.S. currently focused on the North Korea nuclear weapons crisis, China can continue essentially unchallenged – and even work cooperatively with the U.S.

Nevertheless, it should also be expected that these China-led initiatives will generate push back elsewhere in the region. Coupled with the responses to U.S. engagement decline, there will be region-wide recalibration of foreign and trade policy, and regional leadership at the sub Sino/U.S. level will be in flux. And, in a sense there is more room in Asia for another set of power to determine the political, economic and security agenda of the region, for better and for worse, between Japan, India, South Korea, Australia, Pakistan and, of course, North Korea. But, of course, each of these countries has domestic and international challenges of their own and, to varying degrees, they are economically interconnected with China and they certainly will not be able to supplant the U.S. in terms of military capability. As such, it will remain the U.S. and China's show in the region.

In that context, the tone of Sino-American relations, at the presidential level, got off to a decent start at the much fan-fared Mar-a-Lago summit in April 2017. More substantively, the U.S. has not designated China a currency manipulator (an absurd notion in the context of RMB levels, but a campaign promise nonetheless), trade action against China has thus far been trivial and the U.S. has reaffirmed the "One China" policy. All of this is important in the context of the imperative for Xi to avoid economic and strategic disruption ahead of the Party Congress. However, assuming Xi succeeds in stacking the Standing Committee and the feeder Politburo with his allies and potentially setting himself up for a third presidential term, he could essentially set the course for China for the next fifteen years. Once accomplished, Xi will be freer to pursue his agenda. But it is important to remember, that China has a number of advantages in any potential 'trade war': China could replace Boeing orders with Airbus, it could limit access to essential commodities such as rare earths metals, it could slow efforts to combat piracy of U.S. patents and copyrights....and the U.S. absorbs only 16 percent of Chinese exports. But even more important, outsourcing to China is no longer solely about a hunt for the lowest possible cost, for some products, iPhones for example, the premier plants in Shenzhen are quite simply the best in the world at any price. And herein lies the point: a 'trade war' precipitated by U.S. trade sanctions would ultimately do little to narrow the American trade deficit and they could easily cast China, rhetorically championing the

Where Is The World Going? How Do We Get There First?

cause of open rules-based trade, as the victim. In so doing, the U.S. would give a big push forward to China's alternative system – one in which it co-opts countries into the system of rules it wants to dictate rather than being co-opted further itself into existing institutions under the current rules.

The wildcard in Asia remains North Korea. While it has not conclusively demonstrated either ICBM re-entry capability or nuclear warhead miniaturization, North Korea's recent nuclear and missile tests have shown how tantalizingly close they are getting. And while the crisis provides an enormous opportunity for Sino-American cooperation, it is serving instead to put in stark relief their differing objectives. The United States, along with its allies Japan and South Korea, look at the crisis primarily through the lens of nuclear security. Indeed, one objective of North Korean ICBM capacity could very well be to drive a wedge between the allies as it wagers the U.S. will not trade a major U.S. city for Tokyo or Seoul. For its part, China acknowledges it already lives in a dangerous nuclear neighborhood – Russia, India, Pakistan, not to mention the U.S. nuclear triad – they're all there. Of great concern, as well are sanctions against North Korea so crippling that it precipitates regime collapse – at once destabilizing (a race for loose nukes, lack of clarity on any capable internal successor), and likely leading to a massive influx of refugees across the Chinese border and a de facto 'southern' victory with its concomitant positioning of U.S. troops on a physical Chinese frontier.

The North Koreans have not demonstrated during previous negotiations an appreciation of escalation theory, while President Trump, while eschewing the words themselves, is drawing rhetorical red-lines around potential northern provocations. And meanwhile, just how much leverage China has (following the killings of Kim Jong-un's uncle and half-brother) in the context of not toppling the regime remains an open question. It remains to be seen if China becomes more aggressive against the North following the Party Congress, but clearly North Korea remains the biggest near-term geopolitical fat tail risk. Ironically, once the North achieves what it (and preferably the U.S. and China) believes to be a survivable deterrent, they may then be incentivized to return to the negotiating table. The period between now and then remains critical to monitor closely.

United States

Traditionally, American presidents have maximum power at the beginning of their terms – fresh with mandates from the electorate. And while the Trump administration came to office with an ambitious and controversial agenda, it did so with almost no experience in actually operating the levers of power. The ordering of the legislative agenda, the extended delays in filling senior positions, the fraught relations between the president and the Republican congressional leadership, and Trump's propensity to "take his eye off the ball" have conspired to create a new kind of gridlock in Washington. Recent apparent 'deals' between the president and the leaders of the Democratic Party (continuing resolution/debt ceiling/hurricane relief and DACA) need to be viewed with clear-eyed skepticism – these issues were easy "low-hanging fruit" compared with the daunting prospects of tax reform and, certainly, repealing and replacing the Affordable Care Act. Furthermore, it has thus far proven a dangerous exercise to straight-line expectations from any positions taken by this White House.

It is this uncertainty in policy preference and policy implementation that bedevils planning – be it corporate investments or strategic geopolitical moves. President Trump has often been described as transactional – and this must be considered in the context of his presidency not being anchored by ideology; certainly not one that fits easily with traditional Republican platforms. In addition, the administration has made policy pronouncements and followed through on some (withdrawal from TPP, striking Syria following the regime's use of chemical weapons) but not on others (declaring China a currency manipulator). And there's a third category: policy limbo. The President announced an intention to withdraw from the Paris climate treaty and now feelers are being proffered about staying in a renegotiated agreement. The second half of 2018 will be dominated by the mid-term elections (traditionally a tough situation for the party that had won the previous presidential election – and the coattails of the current president are more questionable than usual) and so the time to get anything accomplished legislatively is getting woefully short, particularly on complex issues.

A wildcard in all of this is the ongoing investigation by Special Council (and former FBI Director) Robert Mueller into Russian interference in the 2016 election. In due course, the investigation may yet yield what the actual electoral objectives of the Russian actions were and whether they preferred Trump over Clinton. What does seem clear though is that the campaign of interference (via hacking, 'fake news', collusion etc.) was primarily designed to undermine the nobility of the democratic experiment in the United States. With the United States seen as culpable for the financial crisis and "Great Recession" and getting international opprobrium for the Iraq War and other foreign policy gambits, this serves to drive a further wedge between the United States and other countries and, indeed, between Americans themselves. And while Russia, or its proxies, may be behind the acts of 2016 and may reap the benefits in the form of greater freedom of action, the reality is Russia remains a diminished player. Russia does not itself present a viable alternative to the American system. China, on the other hand, presents a more compelling option. They are, or could very well be, the 'winner' here. America's myriad 'soft powers' have always been powerful selling points (in addition to 'harder' military and economic power) in coercing international behavior. Recent American 'sins and failings' allow China (and other growing countries) to present counter-narratives that, as they're adopted, further alter the global playing field.

Conclusion

There are myriad other major political issues global corporations face going into 2018 – from the transnational (climate change and international terrorism, for example) to the regional (Project 2030 and the succession in Saudi Arabia, the ongoing fallout of the Brazilian corruption scandals, the implications of ANC divisions on South Africa's leadership, the evolution of government/chaebol relations in South Korea, just to name a few). However, the context here is that the three largest economies in the world are in states of flux, internally and in their relations with one another. 2018 will be the year when many of the building issues play out. Globalization isn't going away, but it is evolving and the opportunities will be found in the context of the reordering of the operating environment. As ever, a clear-eyed appraisal of political actors' motivations and limitations will be key to the successful navigation. In 2017 there are 25 fewer democracies in the world than there were in 2000, the organizing principles of the largest economies are evolving,

Where Is The World Going? How Do We Get There First?

manufacturing is relatively de-globalizing, while services and data are hyper-globalizing, and globalization in the context of the liberal order will look different when caught up in the tension with a less liberal but co-powerful order as an alternative. Close monitoring of the issues playing out, coupled with a dispassionate analysis of what it means longer-term, are more critical than ever for the ongoing success of multi-national corporations and CEOs that run them.



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