

ICI VIEWPOINTS

MAY 31, 2017

Geopolitics and Global Business: What the Future Holds

By Jeanne Arnold

The challenges of navigating geopolitical developments while operating a global business took center stage during two key sessions at ICI's 59th General Membership Meeting (GMM), held in Washington, DC, from May 3 to 5.

"Geopolitics are becoming much more important, because politics are driving so many economic ups and downs—and will continue to do so over the next few years," said Ian Bremmer, founder and president of Eurasia Group. In a session titled "Managing Risk in an Unstable World," Bremmer first talked about how global politics are affecting businesses worldwide and then engaged in a discussion with GMM Chairman Jim McNamara, president and CEO of Goldman Sachs Mutual Funds.

The End of the US-Led World Order

"I believe we have just entered into a 'geopolitical recession.' That is not actually a term. But it should be," said Bremmer, "because the bust cycle is the end of the US-led order." In his remarks, Bremmer explained that people in other countries are increasingly uninterested in living in a world where the United States continues to be the architect of global trade and the driver of global values and standards. Americans are less interested as well, he added. "A solid majority of Americans feel that global free trade hasn't helped them, and they are no longer as dedicated to America's tradition of promoting liberal democracy and free markets abroad," he explained.

Bremmer was quick to add that this unwinding of the current geopolitical system did not happen because the United States elected President Donald Trump. "The unwinding was coming regardless of whether he was elected," he said. "His inauguration simply accelerated it."

If the United States isn't going to be the leader of the free world, who will? The answer, said Bremmer, is no one. Instead, he explained, we will end up living in a world where countries such as Russia and China act as regional policemen, exercising their power and influence in their own backyards.

A Tale of Two Wikipedias

China is the only large country today with a global economic strategy, stated Bremmer. The Chinese government, he said, is writing big checks to support infrastructure projects around the world and to create a new economic architecture in the region—"but the checks they're writing and the architecture they're creating is not about supporting liberal democracy or a free market. They're about quid pro quos to support China's economic, diplomatic, and strategic aims." Those aims include supporting and strengthening such institutions as the Asian Infrastructure Investment Bank and the Chinese Development Bank, or helping create and participate in the One Belt, One Road initiative—a modern-day Silk Road that would connect China to Europe via Central Asia, Southeast Asia, South Asia, and the Middle East. All of these make up an alternative system to the US-led institutions and global economic architecture created after World War II, stated Bremmer. "Ultimately, China is not creating a new economic order," he added. "It's fragmenting the old one. For example, instead of having one global Internet, there will be a bunch of countries that are linking to the Chinese Internet—countries in which China has heavily invested. There won't be one Wikipedia, but two: a global/US Wikipedia and a Chinese Wikipedia."

Bremmer further warned that in an increasingly fragmented world where the United States is no longer the global leader, and where alliances and common interests may not always be apparent, it may be harder to build the consensus necessary to confront global

issues, such as climate change and nuclear proliferation. Using the Paris Agreement on climate change as an example, he explained that, ultimately, the solutions will increasingly come from regional sources—mayors, governors, and business leaders, for example.

“The Paris Agreement didn’t get done because of President Obama or President Jinping,” he explained. “After failed summits in Cancun, Durban, and Copenhagen, mayors from different cities around the world came together and said, ‘Our governments aren’t getting this done, so we need to.’” This will be how communities and states deal with issues such as poverty and inequality in the United States, Bremmer added. “We need to fix the social security net. We need to find a way for people to live and realize the American dream again. The US government isn’t going to do it. It will be CEOs, mayors, and governors who come up with the solutions.”

Brexit: The Most Significant Political Risk Since the Cuban Missile Crisis

In the immediate aftermath of the United Kingdom’s vote in June 2016 to leave the European Union, Bremmer tweeted, “Brexit is the most significant political risk the world has experienced since the Cuban Missile Crisis.” Pressed by McNamara on this point, Bremmer explained that Brexit was the tipping point for the US-led global order, signifying that it wasn’t working anymore.

“Looking forward, I think there is a risk that the European Union and United Kingdom do not reach a deal, and that the United Kingdom ends up trading under the World Trade Organization’s rules,” he said. “Yet we’re still two years away from either that or another outcome. Until Brexit actually comes closer, the markets won’t care. But make no mistake—when we do get to Brexit, it will be a big problem.”

Brexit was also a key topic of concern during GMM’s Global Asset Management panel, which was moderated by Ted Truscott, chairman of ICI and CEO of Columbia Threadneedle Investments. During the panel’s discussion about Brexit, Aberdeen Asset Management CEO Martin Gilbert was optimistic that asset managers would be less affected than other financial services, such as banks. “As far as large asset managers go, I think we will be okay, as most large asset managers have operations in Ireland or Luxembourg—two of Europe’s leading investment fund centers. Yet, small or midsize funds that do not have operations in either of those two countries will find it difficult to sell into the European Union.”

David Semaya, executive chair of Nikko Asset Management, echoed Gilbert’s concerns. “One of the issues for small or midsize funds is that the barriers to entry are going up. The cost of starting and growing a business in Europe are higher than they used to be. For example, it used to be that distributors required a UCITS fund to have €100 million net asset value before they would invest in it and sell its shares. Now they won’t consider a fund with less than €200 to €300 million.” Semaya also expressed concerns about the “knock-on effects” from Brexit, including whether rules surrounding delegation of portfolio management to third countries, such as Japan, will stay the same.

Weathering Challenges, Finding Opportunities

In addition to Brexit, Gilbert touched on other challenges his company has recently faced, including a decline in emerging markets. “It’s been a tough time for us,” said Gilbert. “We have been very reliant on emerging markets, and for the past four years, we have watched money go out of our funds. We finally saw those flows change this past quarter, which has helped us recover.”

With the recovery in emerging markets, Gilbert said he sees opportunities in a number of countries, including India. Semaya agreed, acknowledging the challenges India presents, but adding, “It’s important to be in a market where there is capital formation, income growth, and, most importantly, the right demographics—where people are saving rather than decumulating. India has the population growth and the economic growth. In addition, the English language is there, which is important for building up that ecosystem.”

Semaya also discussed the long-term investment potential in Indonesia, where “you have a country with a growing middle class and a leader who is leading. Though it is dependent on commodities, there is desire to broaden their economy, which is why I think Indonesia is a good opportunity.”

Truscott wrapped up the panel by asking both men what advice they would give a small firm today. Gilbert jokingly responded, “stay small, don’t try and get big.” Semaya ended on a more serious note, advising firms to “innovate, innovate, innovate.”

Jeanne Arnold is a senior writer and editor for ICI.