How are leading companies managing today's political risks?

2022 SURVEY AND REPORT

A report produced for WTW

Oxford Analytica
PART OF FiscalNote

wtw

About this report

Oxford Analytica is providing this survey report for WTW.

Oxford Analytica is an independent geopolitical analysis and advisory firm that draws on a worldwide network of experts to advise its clients on their strategies, operations, policies and investments. Oxford Analytica's trusted insights and seasoned judgements on global issues enable its clients to navigate complex markets where the nexus of politics and economics, business and society is critical to success.

Founded in 1975, Oxford Analytica is the pioneer of geopolitical risk analysis, and today works with the world's most influential businesses, governments and international organisations.

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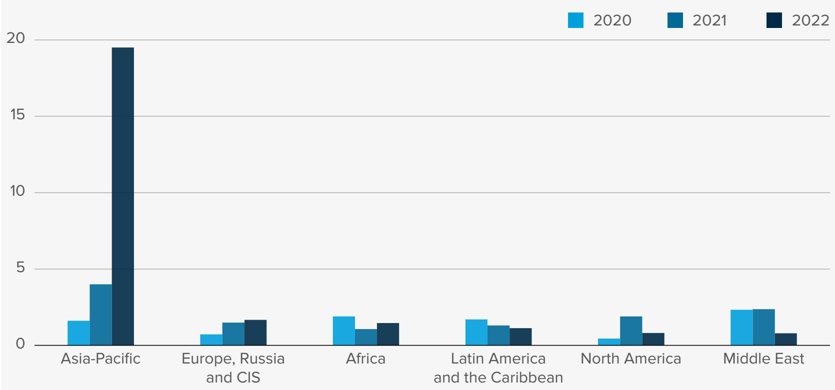
EXECUTIVE SUMMARY

If we had to sum up the findings from this year's survey in a single phrase it would be: "bifurcated world." While tensions between China and its Western trading partners are nothing new, this year, alarm about the political risk consequences of the deteriorating relationship between China and the West has moved from a concern expressed by a minority of executives we surveyed to a global, cross-industry consensus.

This new consensus was reflected in many of our survey findings, but perhaps no single result expressed the shift more dramatically than our question about world regions of political risk concern. In our 2020 survey, the ratio of respondents who declared themselves "concerned" about political risk in the Asia-Pacific region to those who expressed no concern was well below 2:1. In this year's survey, that ratio nearly reached 20:1.

REGIONS OF POLITICAL RISK CONCERN

(ratio of those saying 'concerned' to those saying 'not concerned')



Note: respondents with no exposure excluded

Source: Oxford Analytica

Perhaps surprisingly, this shift exceeds the rise in concern regarding political risk in Europe and Russia, even though the survey was conducted as Russia gathered its military forces on the Ukrainian border. As of this writing, with a violent conflict in Ukraine underway, it is hard to conceive of a more momentous turn of geopolitical events. And yet, Russia accounts for only 0.2% of total foreign direct investment (FDI) abroad by US companies (for European companies, the figure is 2.9%). By contrast, China, Hong Kong and Taiwan account for 4% of US FDI – a figure nearly 20 times greater (and for European companies, 5% of FDI). Russia's share of world trade is about 2%; the equivalent figure for China is more than seven times greater. In human terms, the impact of the conflict in Ukraine is profound. That said, an equivalent deterioration in relations between the West and China would likely have an impact on global businesses, global economic growth and global financial markets that would be an order of magnitude more severe.

Amongst respondents who specifically reported having financial exposure in Asia-Pacific, the proportion who said they were "concerned" about political risk in the region rose from 62% in 2020, to 80% in 2021, to an almost-unanimous 95% in 2022. Meanwhile, the proportion of those with exposure who said they were "concerned" about political risk in Europe and Russia rose from an average of 41% in 2020 to 57% in 2022.

These risk issues were, of course, foreshadowed in past years of this survey. In 2017, the first year of this study, "Disruptions from a rising China" ranked 7th on our risk radar (and concerns about "US sanctions on Russia" topped the risk radar). A few years later, in 2021, our survey indicated that Asia was already the top region of political risk concern.

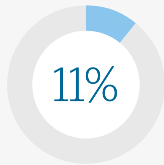
What has changed is not the identification of the threat from geostrategic competition, but rather, the corporate consensus that this issue is likely to have serious financial repercussions for global businesses. Results from other areas of the survey underlined the new consensus. Overwhelming majorities of respondents believed that trends towards geostrategic competition and economic decoupling between China and the West would intensify in the future. A majority of respondents expressed concern that private companies would be targeted in international diplomatic disputes. Indeed, already, more than one in five respondents reported having experienced a political risk loss in either the US or China, presumably due to retaliatory trade policies or sanctions.

Overall, the survey results this year painted a picture of globalized companies surprised to be caught between geopolitical competitors. "The worsening of relations between USA and China has led to a rethinking of the way we think about supply chains in the bioscience business," a life sciences executive noted. "There is a growing concern that companies will be forced to choose between 'blocks,'" as an oil executive explained.

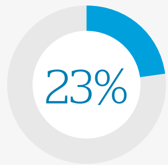
We hope you enjoy this 5th annual edition of our political risk survey and find the contributions of these expert analysts to be as valuable and thought-provoking as we have.

AT A GLANCE
(%)

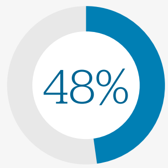
Proportion of respondents reporting a political risk loss in Venezuela



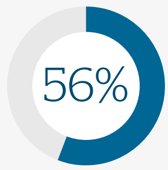
Proportion reporting a political risk loss in the US or China



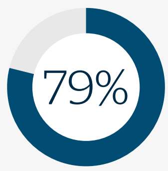
Proportion of reported political risk losses that exceeded $250 million



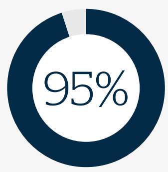
Proportion expressing concern about "governments retaliating against private companies in international diplomatic disputes"



Proportion believing economic decoupling between China and the West would "strengthen" or "greatly strengthen" in the future



Proportion of respondents with Asia-Pacific exposures saying they are "concerned" about political risk in the region



Note: For details of respondents and sample size, see main report

Source: Oxford Analytica

02

ABOUT THE RESEARCH

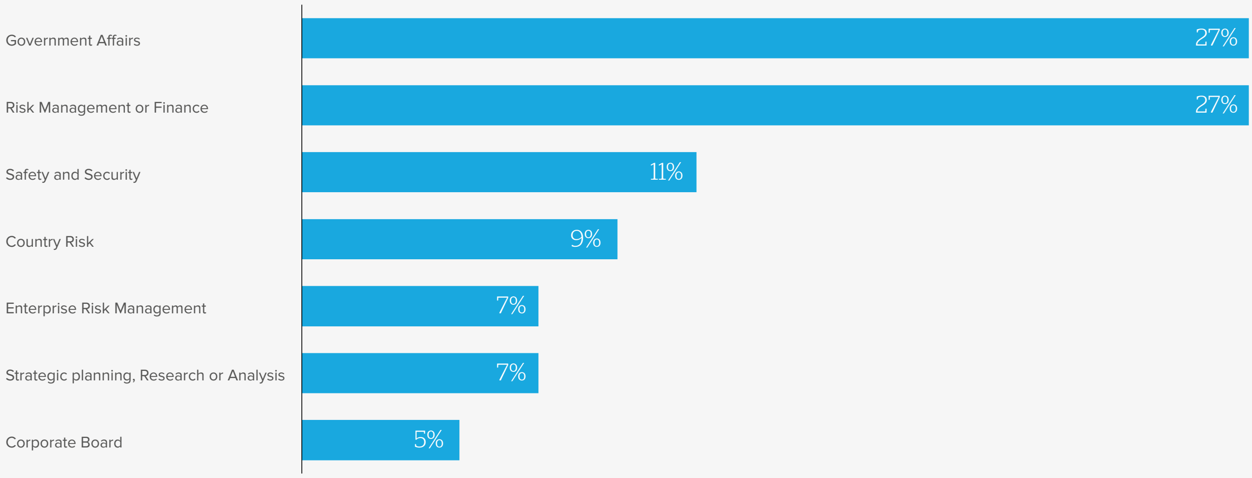
As with last year's study, this year's research combined in-depth interviews with a broader survey of a larger sample of companies. There were 15 participants in the interview panel; there were 44 respondents to the survey.

Because the companies that joined the panel and survey were primarily clients of WTW and Oxford Analytica, they are not necessarily representative of typical firms worldwide. Rather, our study participants tended to represent companies that have extensive international operations and invest heavily in the management of political risk.

Perhaps partly as a result, our sample was, as usual, heavily biased towards the world's largest firms. Nearly 70% of respondents worked for companies with revenues of $10 billion or more. In terms of job functions, the largest set of respondents worked in risk management or external affairs (at 27% each). The survey sample was widely distributed across industries, with the manufacturing and technology sectors most heavily represented.

We thank the survey participants and panelists for their time and insights.

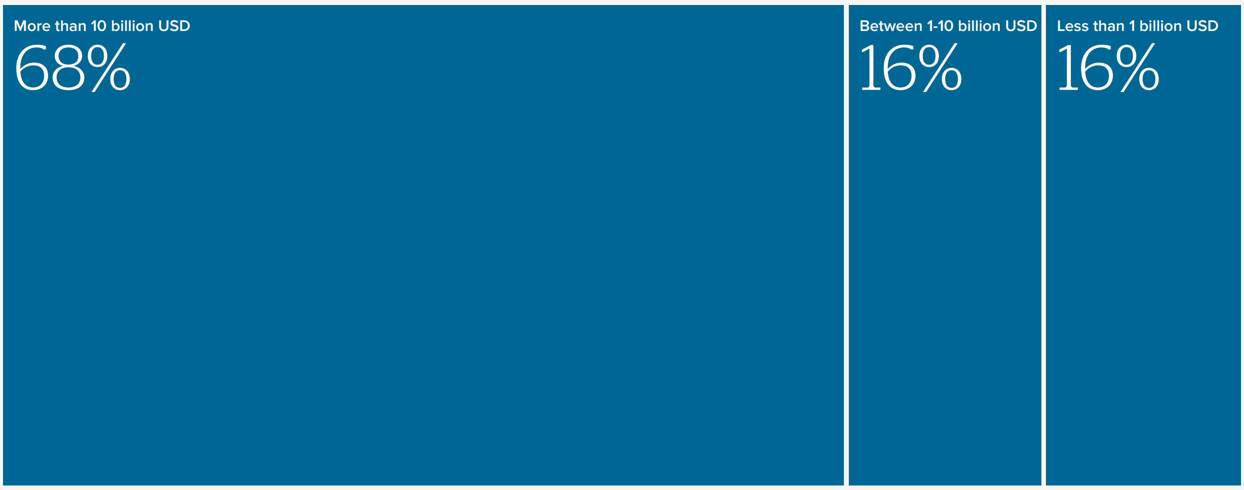
JOB FUNCTION OF RESPONDENTS



Note: all respondents; n=44; 'other' not shown

Source: Oxford Analytica

ANNUAL REVENUE OF COMPANY



Note: all respondents; n=44

Source: Oxford Analytica

INDUSTRY OF COMPANY

Note: all respondents; n=44

Source: Oxford Analytica

03

HOW HAS THE PANDEMIC RESHAPED POLITICAL RISK?

In last year's survey, we focused on the immediate political risk impacts of the pandemic. In 2020, there had been at least five sovereign defaults (more defaults than had occurred in the immediate aftermath of the global financial crisis). More than 70 countries had imposed limits on the export of medical products – a beggar-thy-neighbor response to the scarcity of vital goods that fortunately was quickly reversed. That same year, more than 70 countries had postponed or cancelled elections, partly to control the spread of the pandemic, but in some cases with apparent anti-democratic intent.

In this year's survey we asked our respondents to look to the long term, and consider the ways in which the pandemic could reshape key geopolitical trends in the future. We asked about seven trends in total; alarmingly, for five out of the seven trends, the majority of respondents expected a worsening direction of travel even as the pandemic (hopefully) recedes.

In keeping with the overall theme of this year's survey results, the greatest consensus was around the trend of rising great power competition. 90% of respondents expected political contestation among Russia, China, the US and Europe to increase in intensity; 79% expected this intensified political conflict to be accompanied by a trend towards greater economic decoupling, specifically between China and the West.

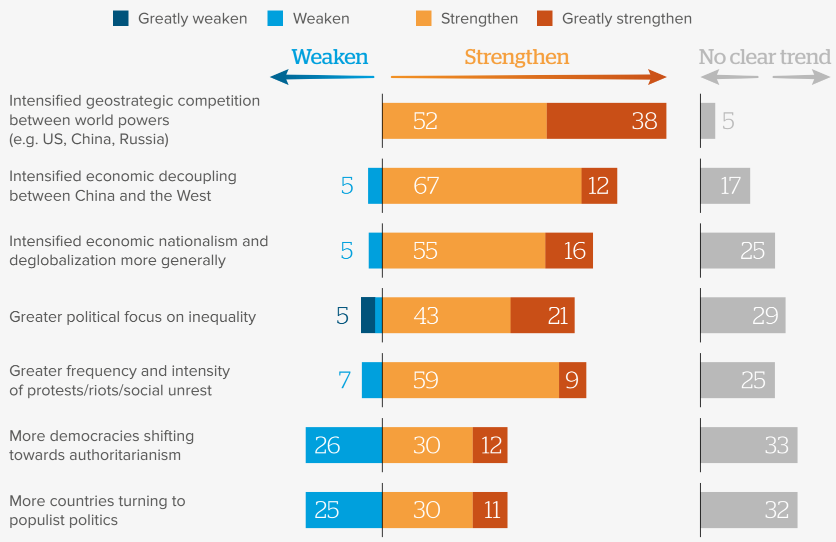
The news was only slightly better for the trend towards economic deglobalization more generally, with 55% expecting economic nationalism to "strengthen" and 16% expecting the trend to "strengthen greatly." Even if the world has pulled back from the initial export restrictions that started in medicine and spread to food, the supply chain disruptions of 2021 continued to provide an impetus to political leaders seeking to bring production chains closer to home. As a panelist in the life sciences sector put it, "especially off the back of COVID-19, countries are worried about serving themselves so they are putting up local [production] requirements."

The third trend we put before our survey participants was "greater political focus on inequality." This question provoked arguably the most divisive response of the entire survey: 21% expected the trend to greatly strengthen, but 5% expected it to greatly weaken – the only trend on which our survey respondents were so polarized. Our interview panel was similarly divided on the issue. A panelist in the mining sector claimed that "inequality makes our line of business difficult" in part because "community approval becomes more challenging." A technology executive disagreed entirely, saying: "professionally, this is not a concern."

Were there any geopolitical trends that could improve as the pandemic recedes? Possibly. A majority of our respondents thought the trend towards populism would either weaken or remain unchanged. As of this writing, at least some of this optimism appears justified. A 2022 report from the Center for the Future of Democracy at the University of Cambridge, based on opinion surveys in 27 countries, indicated that approval for populist leaders and support for populist parties had indeed declined during the pandemic thus far.

Our respondents were also relatively optimistic that the trend towards greater political authoritarianism would weaken. Here, the data so far do not paint a hopeful picture. There were at least six military coups or coup attempts in 2021; Freedom House noted the trend towards deterioration of political freedom during the pandemic was the most widespread it had been since 2006. Even in many advanced economies, the Cambridge study quoted above found a weakened preference for democracy in the wake of COVID-19. Perhaps, however, the future will be brighter?

IMPACTS OF THE PANDEMIC ON GEOPOLITICAL TRENDS
(%)



Note: 'don't know' excluded; n = 44

Source: Oxford Analytica

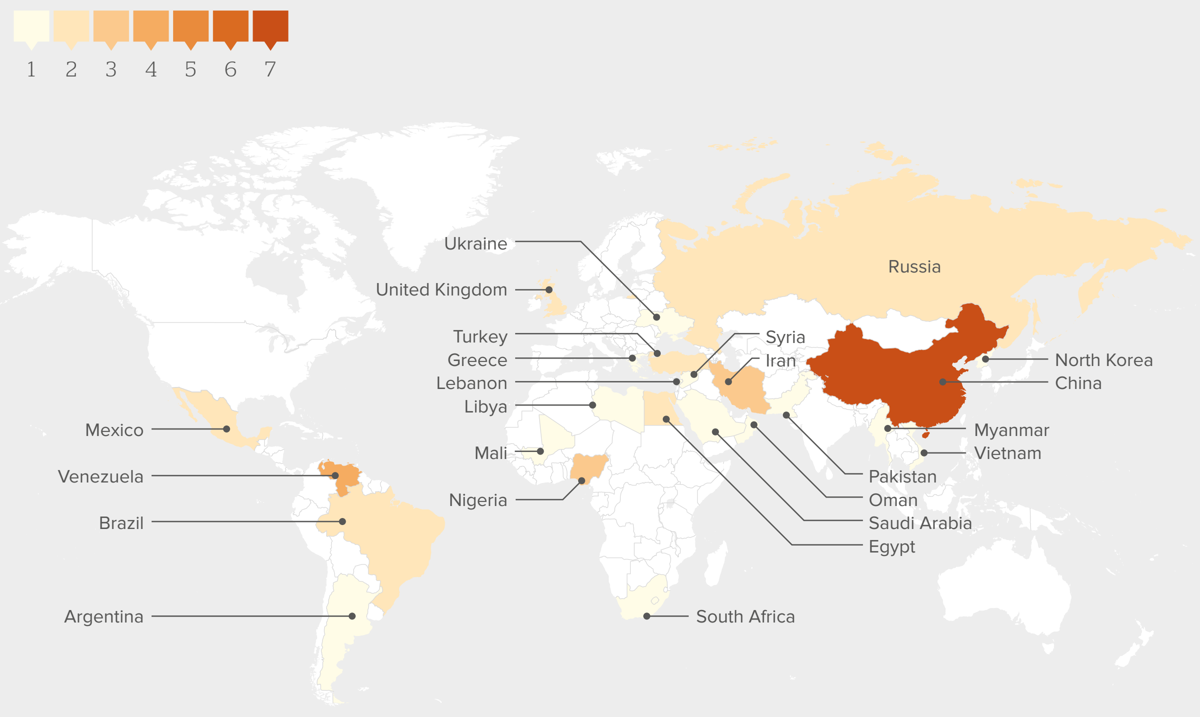
Each year, we have asked our respondents about the countries where they have avoided or reduced investment as a result of political risk concerns. The responses to this question highlighted the geopolitical shifts discussed above. In prior years of the survey, the top responses were always high-risk markets. In 2019 (not shown), the most frequently mentioned countries were Iran and Nigeria; in 2020, Iran and Libya; in 2021, the top choice was post-Arab-Spring Egypt.

This year, our respondents mentioned China most often – an extraordinary shift given that China has historically been one of the world's most attractive destinations for foreign direct investment. As one of our panelists put it: "great power conflict is becoming the dominant paradigm and it is unquestionably impacting losses and the cost of navigating their [US-China] relationship for international business."

In the next section, we turn to this question of political risk losses in detail.

COUNTRIES WHERE RESPONDENTS REDUCED OR AVOIDED INVESTMENT BECAUSE OF POLITICAL RISK CONCERNS

(number of mentions)



Note: all respondents

Source: Oxford Analytica

TOP COUNTRIES WHERE RESPONDENTS REDUCED OR AVOIDED INVESTMENT

(ranked by number of mentions)

Note: all respondents

Source: Oxford Analytica

The threat from 'gray zone aggression'

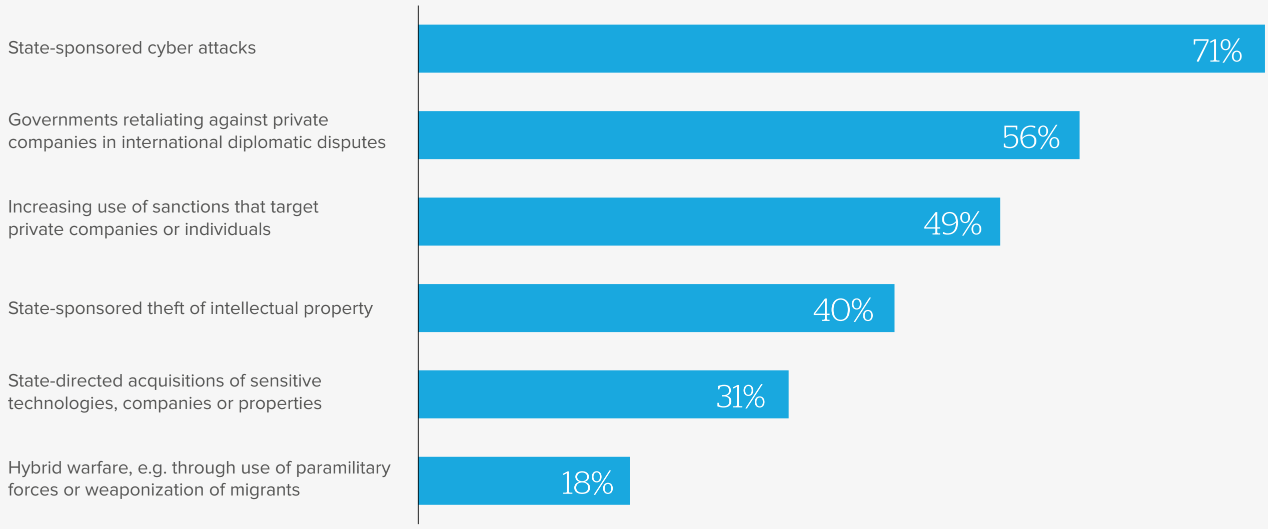
How does geostrategic competition translate into political risk losses for companies? One mechanism is what Elisabeth Braw, a senior fellow at the American Enterprise Institute in Washington, DC, has dubbed "gray-zone aggression." As Braw explains, "gray-zone aggression takes place in the gray zone between war and peace and is used to weaken another country using means short of war."

In recent years we have seen increasing instances of state-directed actions that are aggressive but highly unorthodox, muddying the waters regarding responsibility and intent, and creating dilemmas for targeted countries in how they ought to respond. For instance, Belarus allegedly arranged flights and onward travel to deposit thousands of asylum-seeking migrants from the Middle East on the Polish, Latvian and Lithuanian borders. This bizarre act was presumably an effort to sow dissent within the European Union, but intent and accountability were far from clear.

In many cases, acts of gray-zone aggression target private companies, rather than armies or governments. Aggressor countries can take actions ranging from intellectual property theft to cyber-attacks to the coercive cancelling of sponsorship deals as a means of inflicting economic harm or exerting political pressure on the targeted country. Meanwhile, because gray-zone aggression is difficult to address militarily, Western countries often respond with sanctions – imposing further costs on private businesses.

We asked our survey respondents about the growing phenomenon of gray zone aggression and whether they were concerned. Two issues were indicated as a concern by a majority of respondents: state cyberattacks; and governments retaliating against private companies in international diplomatic disputes. Both of these issues are discussed further in the "What Next?" section, below.

Please indicate the types of 'gray zone aggression' of greatest concern to you
(% of respondents mentioning each issue)



Note: all respondents; multiple responses permitted; n = 44

Source: Oxford Analytica

04

MANAGING POLITICAL RISK LOSSES

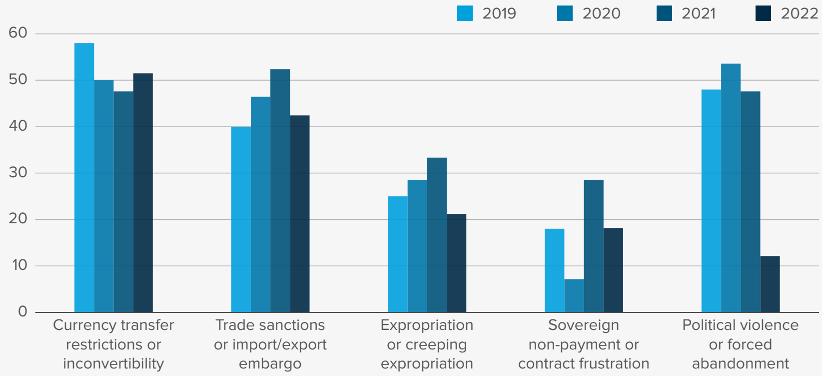
As in prior years, we were struck by the quantum of political risk loss uncovered by our survey, and the implied cost that political risk must impose on globalized businesses. 73% of respondents stated that they had experienced a political risk loss; nearly half of those losses exceeded $250 million; and nearly a quarter exceeded $499 million.

Are the returns from globalization so great that losses of such frequency are tolerable? Or has something changed, and have country-location decisions made in more stable times served to lock companies into a pattern of rising political risk loss in the face of unanticipated geopolitical shifts?

To back up the former view, we can draw on data regarding the type of loss. Despite the shifts in geopolitics during the pandemic – on top of shifts in the composition of our survey sample from year to year – the types of political risk loss our respondents have reported have remained remarkably stable over time. The one exception, political violence losses (which fell sharply this year), could reflect periods of lockdown during which social unrest declined, at least temporarily.

TYPES OF POLITICAL RISK LOSSES EXPERIENCED

(%)



Note: Companies experiencing political risk loss; for 2019, n = 14; for 2020, n = 28; for 2021, n = 21; for 2022, n = 32; "other" not shown

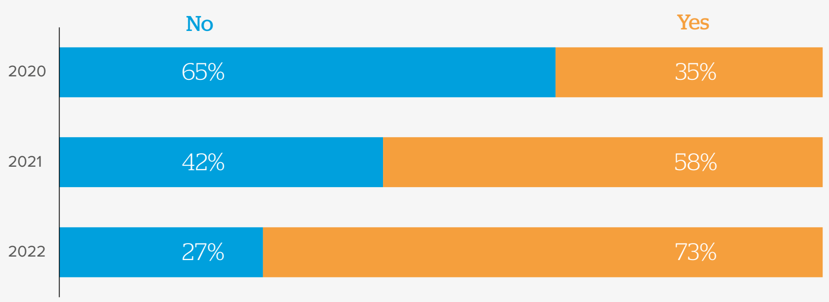
Source: Oxford Analytica

From other survey questions, however, there is stronger evidence of discontinuity. Responses to questions about loss frequency and location have changed sharply over the past few years (although, again, some of these changes could be attributable to changes in the sample). It is possible that, had recent geopolitical shifts been anticipated, some companies would not have established the global presence they have today; it may be the case that high levels of political risk loss could be an impetus towards greater deglobalization in the future.

Some evidence of such trends comes from our question on the occurrence of loss. The proportion of respondents reporting a political risk loss has increased dramatically over time, from 35% in 2020 to 73% in 2022. Further evidence comes from the list of countries where respondents had experienced a loss. Historically, that list was dominated by high-risk locations, including Argentina, Iran, Venezuela and Libya (like the list of countries where respondents had avoided or reduced investment, discussed in the previous section).

This year, for the first time, China and the US topped the list of countries where political risk losses have been incurred. Indeed, also for the first time, four of the seven countries most frequently mentioned were investment destinations usually seen as low risk, including the UK and EU. Presumably, most of the losses companies have suffered in these countries relate not to political turmoil but to trade sanctions and the use of trade policy to retaliate in diplomatic disputes (such as China's dramatic 2020 trade actions against Australia, and its 2021 embargo of Lithuanian products).

EXPERIENCED A POLITICAL RISK LOSS



Note: All respondents; for 2020, n = 41; for 2021, n = 33; for 2022, n = 44

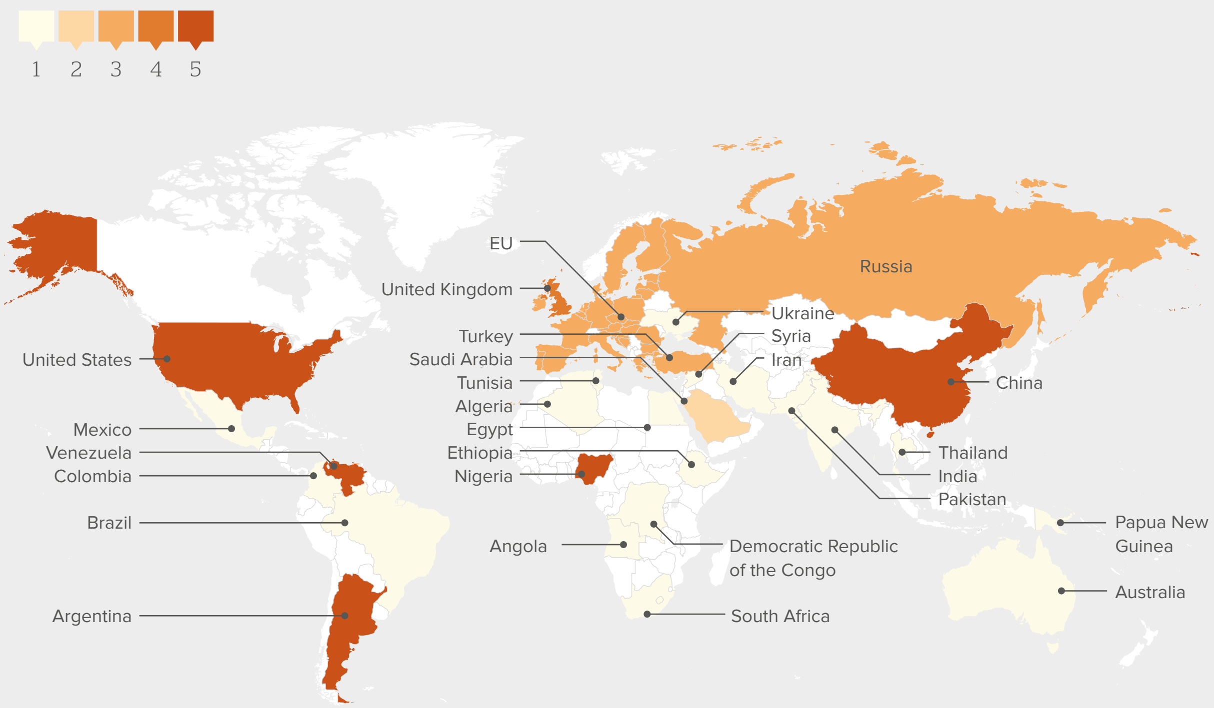
Source: Oxford Analytica

As the nature of political risk losses has shifted, have companies' strategies for managing political risk changed? There is some evidence to suggest they have, although the picture is muddied by alterations in our survey sample and questions over time. This year, the most popular risk management technique was proactive issue identification and monitoring, which is similar to previous years of the survey. A majority of respondents also indicated that geopolitical risk was formally included in their enterprise risk management framework – up from 45% last year, although this relatively small difference may be due to changes in the sample.

More striking is the growing popularity of scenario analysis and political risk insurance. In the early editions of the survey, financial assessments were popular as a technique to manage political risk (including using political risk insurance premiums as a proxy for risk levels, whether or not that insurance was purchased). Over the past four years, however, the popularity of scenario analysis has soared past such financial measures, with 58% of respondents now using scenarios in their political risk management efforts. In addition, political risk insurance appears to have grown in popularity, purchased by 25% of respondents in 2019 but 48% in 2022.

COUNTRIES WHERE RESPONDENTS EXPERIENCED A POLITICAL RISK LOSS

(number of mentions)



Note: all respondents

Source: Oxford Analytica

TOP COUNTRIES WHERE RESPONDENTS HAD EXPERIENCED A POLITICAL RISK LOSS

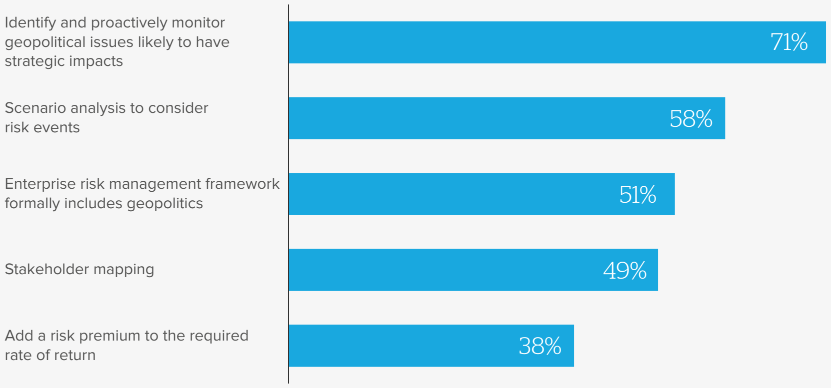
(ranked by number of mentions)

Note: all respondents

Source: Oxford Analytica

It is tempting to read into these results a reaction to the unpredictability of geopolitical events. Financial measures of political risk can be precise, but also, as the saying goes, precisely wrong. Scenarios may be a more useful technique when uncertainty is high, as scenario-based risk-analysis methods allow for multiple possible futures. Similarly, when losses are potentially large and cannot be forecast, risk transfer through insurance may also be a useful risk management approach.

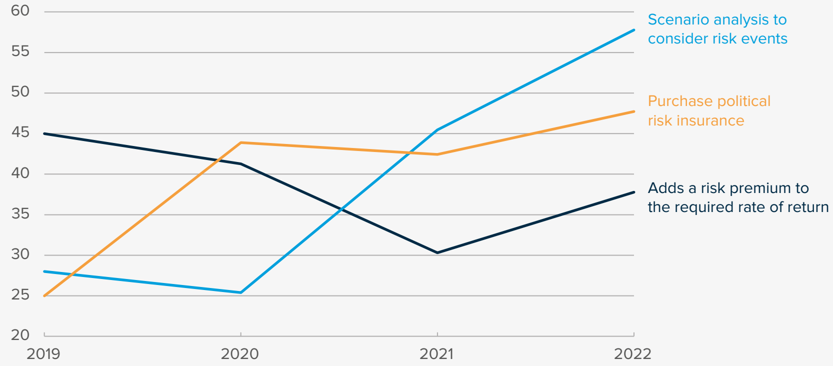
TECHNIQUES COMPANIES USE TO MANAGE POLITICAL RISK



Note: All respondents; n = 44; "other" not shown

Source: Oxford Analytica

SHIFTING POPULARITY OF POLITICAL RISK MANAGEMENT TECHNIQUES OVER TIME



Note: Percent of respondents using each listed technique; all respondents; for 2019, n = 40; for 2020, n = 41; for 2021, n = 33; for 2022, n = 44

Source: Oxford Analytica

The U-curve of political risk loss

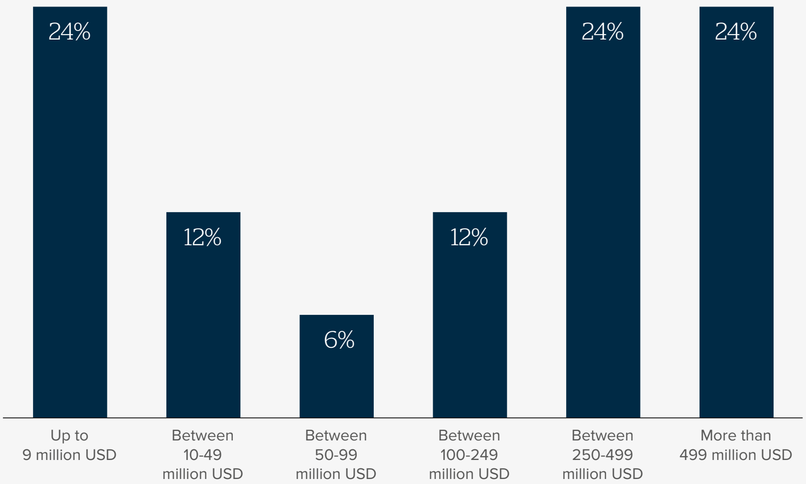
One of the more striking patterns from our survey is the U-shaped distribution of losses from political risk. We have uncovered this pattern in every year we have posed questions about respondents' political risk losses.

The unusual distribution of political risk losses is arguably one factor that contributes to the difficulty of managing political risk. For most categories of risk, one might expect to see something close to a normal distribution: for most companies in most years, losses would be small, and then there would be a narrowing tail of larger loss events.

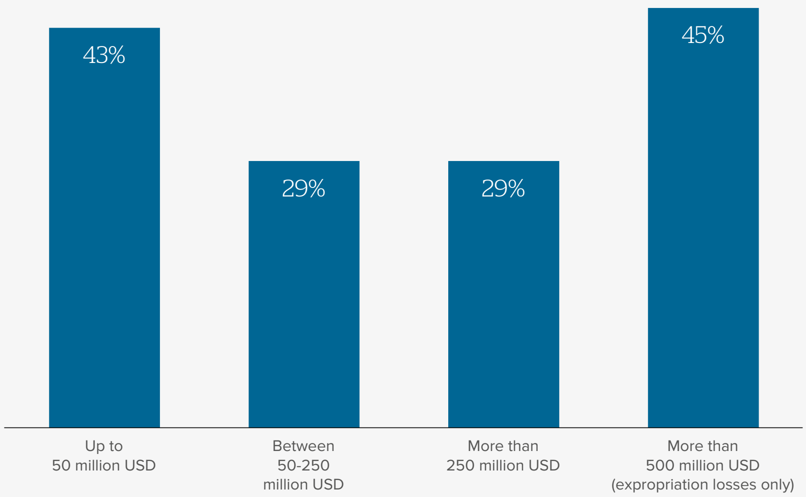
The U-distribution of political risk loss, however, could lead to a false sense of security. Small losses are frequent and losses in the middle of the scale are less frequent, perhaps leading to the impression that political risk losses are normally distributed. However, catastrophic losses are also, in fact, relatively frequent – indeed, according to this year's respondents, just as frequent as small losses. This unusual frequency distribution of political risk loss could lead to negative surprises for companies attempting to project their future financial performance.

CUMULATIVE FINANCIAL IMPACT OF POLITICAL RISK LOSSES

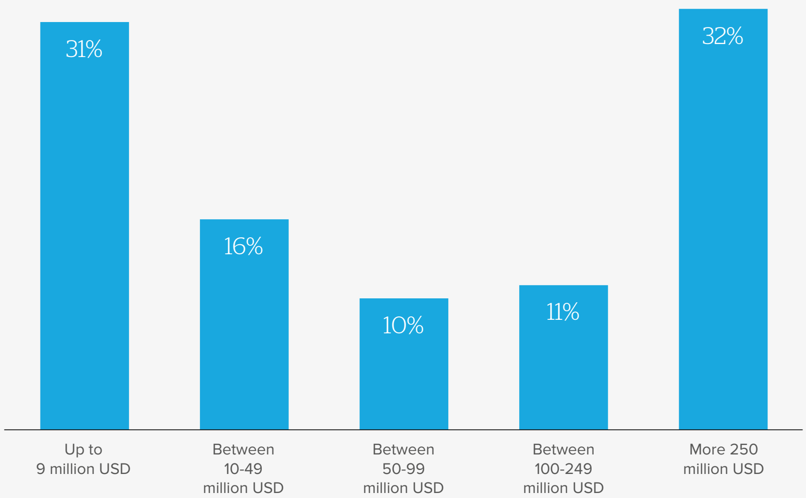
2022



2021



2020 (companies with revenues over 1 billion USD)



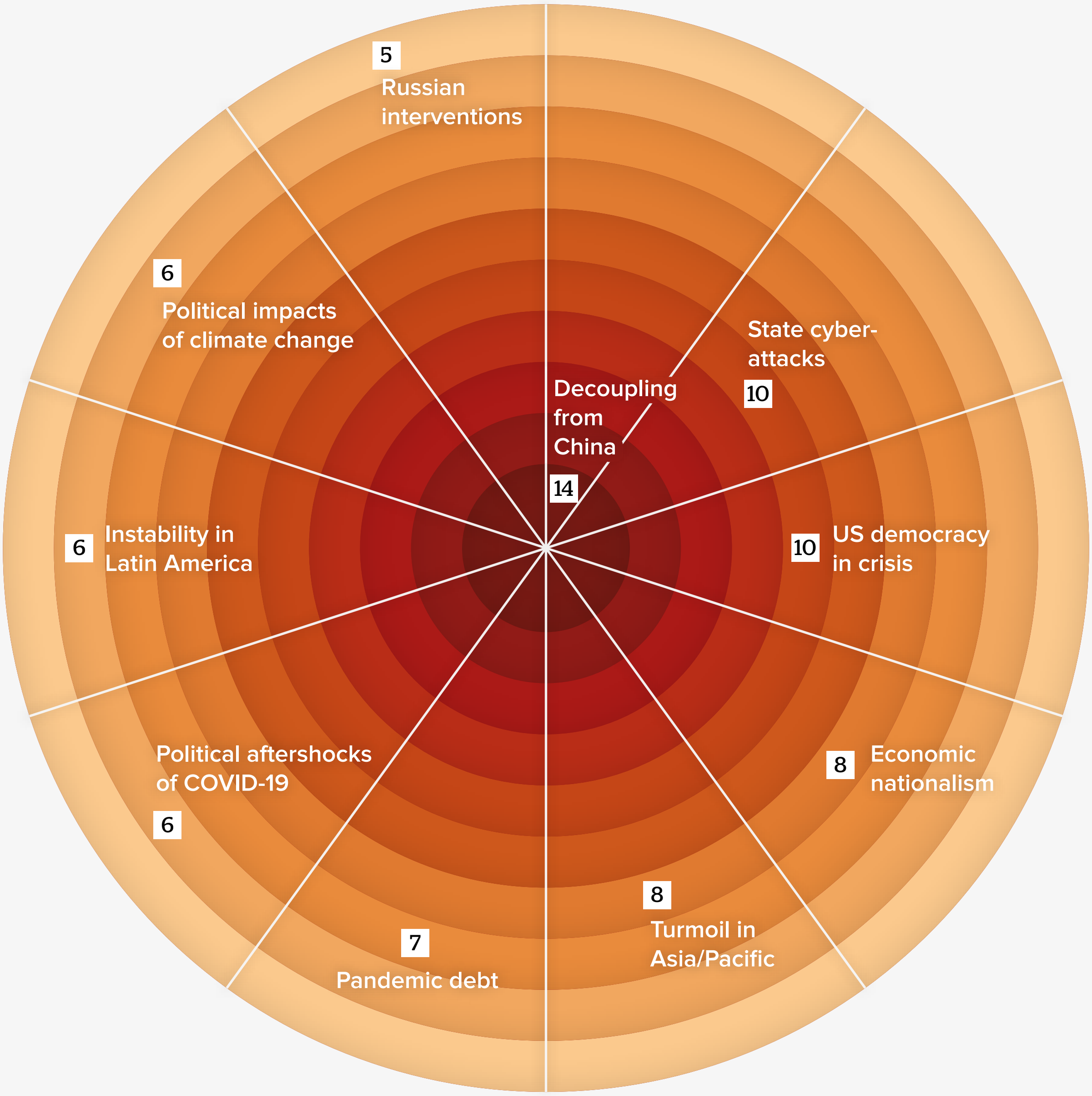
Note: respondents experiencing political risk losses only; 'don't know' excluded; for 2022, n = 32; for 2021, n = 21, for "expropriation losses only," n = 7; for 2020, companies with revenues less than $1bn excluded, n = 19

Source: Oxford Analytica

05

WHAT NEXT?

TOP RISKS 2022
(number of mentions)



Each year we have conducted this study, we have asked the panel members an open-ended question about emerging political risks in the coming year. The results have been prescient. Four years ago, panelists' top concerns related to an end to the globalization consensus of the past several decades (although they could hardly have anticipated the degree to which the pandemic would lead their worst fears to be realized). Three years ago, panelists worried about the growing use of trade sanctions – an issue that, as of this writing, is top of mind for companies doing business with and in Russia.

So, what are our panelists worried about for 2022 and beyond? Perhaps surprisingly, even though many of the interviews were conducted as Russia moved its forces to the Ukrainian border, concerns about "Russian intervention" did not top the list. In keeping with the "bifurcated world" consensus from our survey, China topped our panel's concerns. In our 2020 study, the issue was mentioned by about half the panelists; in 2021, by 10 panelists out of 14; and this year, by all except one.

Decoupling from China

That said, while the survey respondents were most focused on geostrategic competition between China and the West, the panelists focused on the logical next step: the costly and painful process of economic decoupling. The idea of dismantling the trading and investment relationships between China and the West seems almost inconceivable. Indeed, as of this writing, China is continuing to open its economy to foreign investment, at least in some areas, such as investment banking and asset management. In the second half of 2021, US financial companies were reported to be rapidly adding China staff as a result.

And yet, most on the panel were convinced that decoupling was inevitable, at least in some sectors. The process would begin with capital markets, several panelists contended. "Financing will be a leading indicator of how this unfolds, in the public and private markets," said a panelist in the defense sector. "As a starting point, Chinese companies will be 'encouraged' to list or relist in Hong Kong and Shanghai." As the relationship between China and the West becomes increasingly fraught, certain sectors will increasingly become targets. One panelist mentioned technology and consumer brands; another warned that "retail, at least visibly, could be hit hard."

Panelists in the life sciences and renewables sectors worried that decoupling would result in a major restructuring of their respective industries. China has a dominant position in the production of certain pharmaceutical ingredients and renewables technologies. "Our number one concern in this area is the [solar equipment] supply from China – we rely on a high-efficiency global supply chain," as one panelist put it. "That was something we took for granted, but it is now experiencing shifts."

State cyber-attacks

There is a tie for the next position on our risk radar – and both threats are new this year. The first is state cyber-attacks. While we traditionally have avoided covering cyber threats in this report, as cyber risks are not, strictly speaking, political risks, this year, our panelists were clear: the concern is government action. Most of the panelists were worried about catastrophic event risk. "One ... surprise could be highly disruptive cyber-attack on critical infrastructure that is orchestrated by state actors ... such an attack in Europe and North America seems highly likely," as a technology sector executive put it. "The question of energy security in Europe is cyber," another panelist claimed (even as headlines about Russian gas supplies to Europe filled the newspapers). "To what extent are systems vulnerable or able to protect against cyberattacks?"

The second tied threat is one that gave us significant pause. It must be said that many seemingly objective analyses of US politics in recent years have been produced with partisan intent. To pick one example, the bestselling book *How Democracies Die*, by two Harvard University political scientists, drew on an extensive research base to identify a checklist of factors that have been associated with reversions from democracy, and applied this checklist to then-US President Donald Trump. Much of the research on which the checklist was based was widely seen to be of the highest quality and the arguments that linked the checklist to President Trump appeared plausible. The problem lay in the fact that the cases on which the research was based were profoundly dissimilar to the modern-day US – involving impoverished countries with new and fragile democracies, such as Weimar Germany. Hence the applicability of the checklist to the US case was tenuous and the analysis appeared to be partisan in intent.

US democracy in crisis

It is with some hesitation then, that we list the next threat – the perceived crisis in US democracy – recognizing that the appearance of the issue on our list may reflect the partisan feeling of at least some of the panelists. Panel members appeared to understand our concern. "There are meaningful and valid concerns about the future of our democracy, with or without Trump," an executive from a US consumer products company contended. A European panelist attempted to spread the blame: "both [major US political] parties seek power by sowing division and questioning institutional approaches or decisions when the narrative doesn't suit their base, and both parties are pursuing voting reforms that are hugely politically motivated."

The panel's specific political risk concerns in regard to this perceived "crisis" were mostly related not to the prospect of political turmoil in the US, but the risk that US policymaking would be erratic or gridlocked. "The crisis of American democracy ... provides volatility and uncertainty both domestically and abroad due to lack of direct and indirect leadership," as one panelist put it. Several panelists drew links between US partisan politics and our first risk relating to geostrategic competition. "Issues [involving Russia and China] are exacerbated by the waning role of the US as the world's policeman," as a technology sector executive noted.

Economic nationalism

Appearing next on our list are another set of threats tied in the rankings: economic nationalism and turmoil in Asia, both of which appeared near the bottom of the radar last year. One might have hoped that as the pandemic has dragged on, knee-jerk reactions spurred by the absence of toilet paper on store shelves might have been replaced with more strategic thinking on how to encourage supply chain resilience. Arguably, such a shift has occurred: but the strategy, in many countries and sectors, is to bring supply chains home, and replace foreign products and services with domestic alternatives.

Panelists in the renewables sector pointed specifically to Mexico, where new regulations threaten to disadvantage foreign investors against domestic energy producers. In the life sciences sector, concern was more widespread. "To sell medicine in many countries, you must establish local production," one panelist complained. “From a supply chain perspective it is not cost-efficient – these facilities can’t produce with the economy of our large operations.”

Other panelists worried about nationalistic labor restrictions. “At the people level, collaboration and the movement of talent has provided spectacular results [in terms of innovation],” said one executive. “Parochial nationalism is blocking such movement.” In a similar vein, a panelist in the food retail sector noted that “low-skilled and unskilled migration gets the headlines, but shortages in high-skilled labor could ultimately be more crippling as borders close.”

Turmoil in Asia/Pacific

Turning to risks in Asia, many panelists were concerned by the sheer number of flash points. “Taiwan is a low-ish probability concern but hugely high impact; India and China tensions could escalate, while there’s also the possibility of escalation from some incidents in the South China Sea,” a defense sector executive noted. “It’s hard to call what will ‘hit’, but at least one significant regional conflict in Asia seems possible.” Several executives worried about the political stability of China (on top of concerns just mentioned regarding the stability of the US). One panelist drew a link between domestic and global politics, saying: “the breakdown of relations between China and the US and the division of the world as a result ... also threatens internal stability in the US and China.”

Pandemic debt

The next risk on our list is another that has climbed the list over the past few years: pandemic debt. Public debt levels were already elevated and growing rapidly in many emerging economies before the pandemic hit. Gross government sector debt in emerging markets averaged 54.1% of GDP in 2019, up significantly from 43.1% in 2015 and comparable to levels last seen in the debt crises of the mid-1980s and 1990s. In 2020, overall public debt ratios in emerging economies then jumped a further 9.2 percentage points to 63.3% of GDP, mainly as a result of COVID-19. In 2021, in many countries, these debt burdens continued to grow. In the US, Japan and a number of European countries, for instance, debt levels now exceed 100 percent of annual economic output.

These elevated levels of pandemic debt create many risks. One is outright sovereign default. “Argentina is a good example because of its repeated defaults on its debt,” one life sciences panelist noted. “And this risk is hard to hedge.” Several panelists reported that during the peak of pandemic economic stress, sovereign payments were delayed. An executive in the utilities sector noted that, in one Middle Eastern country, the government had unilaterally decided to pay only half its energy bills. For panelists in the healthcare sector, who tend to rely on well-funded public healthcare systems, and in renewable energy, who often depend on functioning energy markets, even the prospect of post-pandemic cuts in government spending creates significant business risks. There is also the threat that a sovereign debt crisis in one emerging market could lead to economic contagion. Turkey was mentioned as a particular bellwether in this regard.

Political aftershocks of COVID-19

Rounding out our risk list comes another tie, this time between three geopolitical threats. The first is another holdover from last year: political aftershocks of the pandemic. While concerns last year focused around social unrest, this year panelists – perhaps worn down by another year of intermittent lockdowns – wondered if the economic drag from the novel coronavirus might be with us for the long term. "Risks will rise if we don't solve the pandemic," one oil and gas panelist contended. A renewables executive commented: "COVID-19 isn't a political risk, but lots of political risks arise from the response to the pandemic." Examples mentioned included discriminatory tax hikes and debt and currency crises.

Instability in Latin America

The next two risks are new on our list this year. One is political instability in Latin America – which was a surprise, given that respondents to the main survey were relatively sanguine about risk in the region (only a minority of survey respondents, 41%, stated they were "concerned" about political risk in Latin America, compared to 89% for Asia). Perhaps the panel is aware of risks that have not yet become apparent to most businesses?

"During an election year, people are probably underestimating risks in Brazil," one panelist contended. Other executives were concerned that ongoing political and economic turmoil in Argentina or Venezuela would escalate. More broadly, in 2021, a year in which support for populist candidates abated in many countries worldwide, Latin America arguably saw two important "populist" victories, in Peru and Chile. Partly as a result, an executive in the consumer products sector claimed that the outlook had worsened dramatically in the second half of 2021: "We have concerns about Brazil, Chile and Mexico, plus the usual suspects ... the Latin America risk is real. If you had asked in June, I would have had a different answer."

Political impacts of climate change

The last peril in the three-way tie is also new on our top ten risk list: political impacts of climate change. As extreme weather events become more common, the political consequences of these events have increased – a dynamic intensified by the fact that many of the costs are falling disproportionately on the world's most politically-fragile states. "There is a huge issue of security and law and order in Nigeria," argued one panelist in the natural resource sector. "Climate change will make things a lot worse due to shrinkage of agricultural land." Another panelist linked recent turmoil in Haiti to climate change. Several executives expected such climate-related instability to increase.

Russian interventions

For our final risk we turn to Russian intervention. It is striking that the risk appears so low in the list, even though many of the panel interviews were conducted as the Russian military buildup was already underway. Those panelists who did mention the risk were deeply concerned about it. "There is a 150% signal that Russia will invade," said a mining sector panelist interviewed in early December 2021. An executive in the oil and gas sector commented: "Until [European energy] supplies can be diversified or altered to other energy sources, [Russian President Vladimir] Putin has Europe in an acutely difficult position."

No doubt part of the reason for the low placement of the risk is that some of our panelists assumed Russia would not invade, or that the objectives of a Russian invasion would be limited. As of this writing, that assumption appears incorrect, and many of the world's leading economies have responded by imposing harsh and coordinated sanctions on Russia. Senior Russian politicians have threatened to respond in kind: former Russian President Dmitry Medvedev urged the Russian government to consider the "nationalization of property belonging to entities registered in unfriendly jurisdictions."

With the conflict in Ukraine ongoing at the time of writing, it is impossible to write about this issue with perspective. These events appear likely to have profound geopolitical consequences as well as producing a humanitarian disaster. That said, another likely reason for the low placement of the risk is that relatively few of our interviewees had direct financial exposure to the conflict. Russia accounts for only 0.2% of total foreign direct investment (FDI) abroad by US companies (for European companies, the figure is 2.9%). Russia's share of world trade is about 2%, roughly equivalent to Belgium's. In human and geopolitical terms, the impact of the conflict in Ukraine is profound. That said, an equivalent deterioration in relations between the West and China would likely have an impact on global businesses, global economic growth and global financial markets that would be an order of magnitude more severe.

We should also mention one risk that dropped from the top ten, again surprisingly, after appearing at the top of the list last year: ESG (environmental, social and governance) shocks. Although only three panelists mentioned the issue this year, those who did evinced some new concerns. "The private sector must position itself carefully," one executive counseled. "It cannot be seen as an instrument of inequality." A panelist from the food and beverage retail sector pointed out: "ESG risks can arise from anywhere a company does business around the world, and the scale of the loss you could face is unrelated to the scale of your [international] operation." This latter point has been amply illustrated by the conflict in Ukraine, as many global multinationals have elected to exit their Russian investments, apparently for ESG reasons.

06 CONCLUSION

After another year marred by tragic events, we found ourselves looking for bright spots in our study results. One such was the European Union. Two years ago, “European de-integration” appeared on the top ten risk list. This year, despite ongoing friction with the European Union’s (EU’s) Eastern European members, some members of our panel had praise for the region. “It’s fashionable to pick on Europe, but the EU has a very good way of managing divisions,” a panelist in the oil and gas sector claimed. Thus far, the conflict in Ukraine appears to have bolstered European unity despite extreme stresses and differences over energy policy among other issues. Another panelist claimed that bleak forecasts of the impact of the pandemic on Africa had not been realized. “We likely overestimated the impact on COVID on the continent,” this mining sector executive stated.

Such upside surprises notwithstanding, our results painted an alarming picture of the world’s largest and most globalized companies struggling to manage geopolitical shifts that pose a fundamental challenge to their business models. Economic nationalism threatens to force the restructuring of industries such as renewables and pharmaceuticals. The growing unpredictability of political events, even in historically stable countries, poses a serious threat to traditional risk management techniques.

But more than anything, this year’s results have been notable for the corporate consensus that has materialized on the business impacts of geostrategic competition, particularly between Russia, China and the West. No longer an abstract issue for foreign policy journals, this competition is leading to costly economic decoupling and significant political risk losses. We hope that future editions of this survey will paint a brighter picture; but at this moment it is difficult to imagine how these alarming trends towards a bifurcated world can be reversed.

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