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Borders vs. Barriers

Navigating uncertainty
in the US business
environment



Atlantic Council

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Building a better
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Foreword



Despite today's volatile world of jittery stock markets and geopolitical fears, CFOs are still bullish on the US economy. That's one of our findings from a survey of 500 CFOs from around the world. This news may be surprising to some, given the daily headlines about tariffs, immigration, trade agreements and shifting global dynamics.

So why are we optimistic? Unemployment levels are near record lows, the US Federal Reserve is raising interest rates, and tax

reform is expected to drive growth and fuel the economic engine.

"Borders vs. Barriers: Navigating uncertainty in the US business environment" not only explores the reasons driving optimism today, but also what the future might bring.

This report examines three scenarios for the future of the US business environment. All of these scenarios have historic precedents with modern iterations throughout. The report assesses four risks facing businesses — public policy, supply chain, investment behavior and reputation — and how those risks evolve in each scenario. The current optimism with the US economy could lead to companies underestimating the potential negative impact of geopolitical risks, in particular those highlighted in this report.

Zurich Insurance is in the business of managing risk and in helping others understand and protect themselves from risk. We collaborated on this report with Ernst & Young LLP (EY), the Atlantic Council, and the Organization for International Investment. We are grateful for their insightful contributions. And a special thank you to all the CFOs who shared their knowledge and perspectives. This report would not have been possible without you.

As CFOs, numbers will always be the foundation of what we do. But we have to know and understand the marketplace in which we operate, especially in a time of volatile economic conditions and geopolitical dynamics. Preparation and scenario planning are critical in order to guide our businesses. In that regard, this report comes at a very important time.

We need to look not just at the here and now, but at the future. The lessons learned from this report demonstrate there are ways to inspire confidence in a world that continues to rapidly evolve and transform.

I hope you will find this report as thought-provoking as I did and that it will help you prepare your business to reach its full potential.

Best regards,

Dalynn Hoch
CFO
Zurich North America

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Executive summary

For the first time since the global financial crisis, every major economy in the world is projected to grow, and President Trump says the US is “open for business.” As of early 2018, business leaders have been generally buoyant. The Global CFO Survey conducted for this report found CFOs to be optimistic about the economic outlook for the US; 61% of respondents indicated they are confident or extremely confident about investing in the US, and 71% expect continued improvement in the US business environment in the next one to three years. Business leaders are bullish on the near-term US outlook, according to the survey; deregulation and the passage of landmark US tax reform has boosted business confidence, with 68% of CFOs reporting that they expect the passage of the US tax reform to have a positive impact on their company’s financial performance in the next one to three years.

Get beyond those exclamation points, though, and you start to see the question marks and concerns — about global shifts in power, a potential wave of protectionism, and warnings that business leaders and policymakers should be “on guard” for the next recession and that global growth may be masking systemic financial, social and geographical risks. Economic volatility and policy uncertainty in the first quarter of 2018 have only increased those concerns.

In this age of transformation and transition, the US has questioned long-standing trade agreements, transformed the tax and regulatory system, and challenged traditional defense treaties. In 2017, the US Congress passed the most significant changes to its tax code in 30 years and the Trump administration opened renegotiations on the 25-year-old North America Free Trade Agreement (NAFTA). The impact of these changing policy choices has yet to be fully realized, and our research suggests the impact on business may differ significantly over the short and long term. The alterations to the tax code present reasons to be optimistic in the near term, but longer-term effects have yet to be seen.

Conversely, although NAFTA renegotiations raise concerns and risk disruption to existing operations, they also present an opportunity to modernize the agreement. According to the Global CFO Survey, business leaders are most concerned about policies that would restrict the flow of goods, capital and people; 68% of CFOs surveyed expect growth of US protectionism in the next one to three years, and 46% fear this growth will negatively impact investment.

Geopolitical trends and shock events can disrupt, but they can also create opportunity. Given the potential impact, businesses must act to dissipate a potential storm and create

upsides, for their customers, shareholders and employees. Leading organizations must increasingly consider geopolitics in their business strategy; explore contingent scenarios; make preparations; engage with stakeholders and policymakers on local and national levels; and potentially shift operations to seize opportunity and mitigate risks, whether financial, locational, political or social.

Key takeaways

- In our Global CFO Survey, which comprised 500 CFOs in 30 countries, we found that CFOs were bullish on doing business in the US, mainly due to a positive economic outlook and the passage of landmark tax reform.
- However, the survey results indicated that CFOs are concerned about US policies that would restrict the flow of goods, capital, and people, as these could negatively impact the current positive business environment.
- The improved outlook for the US economy is generating optimism about growth among CFOs, yet at the same time, there are high levels of concern with unconventional or inward policy shifts from the US. This raises the question of how companies are approaching the difficult task of integrating this uncertainty into their business planning and whether they can be prepared for any potential adverse and longer-term impact of geopolitical events.
- In our modeling of three potential geopolitical scenarios for the US, the Isolationist scenario was defined as the most inward-looking, characterized by protectionist trade policies. Our models reflected that over a five year period, Isolationism was associated with significantly lower US GDP — a cumulative loss of \$2 trillion — and higher unemployment — 1.7 million US job losses — as compared with an open-market Internationalist scenario.
- To minimize risk and take full advantage of opportunities, companies need to develop a more strategic approach to understanding geopolitical change. This involves defining a holistic “geostrategy”, including bold scenario planning, to successfully navigate through periods of geopolitical uncertainty. Organizations have a choice – manage geopolitical risks or be managed by them.

Scenario analysis

Given the level of uncertainty around the future of the US business environment, we have explored three geopolitical scenarios and their impact on strategy and operations. In addition, US policy decisions will have very real impacts on the US economy, and by extension the global economy. For example, modeling of these scenarios shows a potential difference of \$2 trillion in cumulative US GDP and 1.7 million US jobs for the period of 2017 to 2022 between the Internationalist and the Isolationist scenarios.



Internationalism

- Globalism
- Free and open trade
- Global cooperation

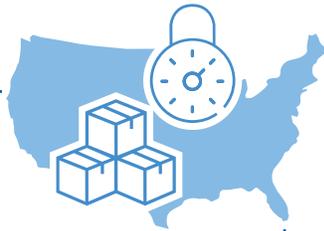
| GDP | Unemployment | Trade |
|-----|--------------|-------|
| | | +10% |

Supply Chain – Increase transparency, global standards, increase security, block chain opportunity, increased collaboration

Investment – Increased global competition, increased US investment, CFIUS scrutiny moderated

Reputation – Human rights, data privacy focus, international cooperation / consistent global regulation, increase in US aid reduces risk

Policy – Education investment, tax incentives in technology, advanced manufacturing, and engineering, ESG focus



Isolationism

- Protectionism
- Economic restrictions
- Domestic focus

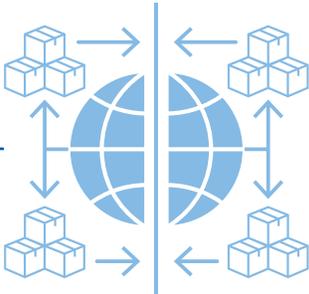
| GDP | Unemployment | Trade |
|-----|--------------|-------|
| | | -30% |

Supply Chain – Localize operations, domestic sourcing / local content, export focus

Investment – Focus on US productive capacity, increased CFIUS challenges and cross-border M&A scrutiny

Reputation – Focus on local investment / contribution, provide “American” credentials

Policy – Immigration restrictions, tax incentives, tariffs / border adjustment taxes



Atlanticism

- Elements of Isolationism / Internationalism
- Focus on European/Americas relationships

| GDP | Unemployment | Trade |
|-----|--------------|-------|
| | | -10% |

Supply Chain – Focus on the bloc, “picking sides”, restrictions on non-bloc locations

Investment – Intra-bloc production & activity incentivized, non-bloc activity scrutinized, including CFIUS challenges

Reputation – Cyber, government social risks in the operating cross-blocs; pressure to contribute to US economic development

Policy – Tariffs/taxes: bloc and non-bloc

Note – As constructed, the US trading relationship with the rest of the world contributes to defining each scenario. In the Isolationist and Atlanticist scenarios, increased tariffs and border adjustment taxes drive the value of US trade with the rest of the world lower (modeled at 30% and 10%, respectively). In the Internationalist scenario, the further opening of markets through new trade agreements increases the value of US trade (modeled at 10%).

Each scenario carries implications for overall US policy (including economic, regulatory, military and immigration), global supply chains, investment behavior and reputation. To assess these scenarios, business must consider the interconnectedness of the operating environment and the short- and long-term impacts of varying policy choices and geopolitical events.

Organizations have a choice — manage geopolitics or be managed by them

With so many potential and unknown factors, it may seem daunting to even attempt to manage geopolitical risk and uncertainty. The first step is relatively straightforward: assess your global footprint and consider your strategic goals within that context. Second, invest in knowledge and networks. Internal knowledge and practices can be supplemented by needed external expertise. In the age of constant news and information, dispassionate, experienced geopolitical perspective is critical, especially amid the increasing likelihood of misinformation campaigns around the world. Third, organizations must act. To thrive in a world being transformed by geopolitics, businesses need to be flexible and resilient, monitor risks proactively, and constantly challenge their corporate cultures. Advanced planning and business continuity assessments can build an organization's resiliency in times of crisis.



Adaptation in an age of transformation

As highlighted in the World Economic Forum's 2018 Global Risk Report, the world's increasing interconnectedness reminds us that geopolitics cannot be viewed in a silo. As political, economic, social and geographic issues shape our world, shifts of a similar magnitude are occurring in information technology, automation and robotics, demographics, and the future of work. While three discrete scenarios are presented, the future US business environment is likely to be more fluid, reflecting various characteristics of each scenario at different times, and taking into account reciprocal or retaliatory action by other nations. To the extent the environment tilts in one direction or another, playing out the implications developed as part of these scenarios can contribute to planning and adaptation.

After nearly a decade of slow growth, the improved economic outlook appears to be prompting CFOs to be overwhelmingly optimistic. However, they may be overlooking the implications that possible policy changes may have on the US economy and on their business strategy directly. This raises the question of whether companies are truly prepared for the impact of potentially negative geopolitical events, which could be further exacerbated by an economic downturn. In the words of IMF Managing Director Christine Lagarde, this is the "perfect opportunity ... to repair the roof." We believe now is the time for action — the time to consider the future and prepare your business to navigate and thrive through uncertainty in the US business environment.



Introduction

With nearly every developed market and most emerging ones projected to grow this year, business leaders' optimism in the US economy seems to outweigh concerns of any implications that political uncertainty may have on their investment strategy. Threats to globalization have the potential to create real barriers to the flow of people, goods, capital and ideas that companies have relied upon to generate growth. How real are the risks posed by protectionism — and to what extent can they be mitigated in a geopolitically uncertain environment?

This report explores these issues for companies that have or are considering a presence in the United States. While 2017 saw the US withdraw from multilateral agreements, such as the Paris Agreement and the Trans-Pacific Partnership (TPP), and the reopening of existing trade agreements, questions exploring the role of US leadership in the world and the changing characteristics of globalization have been pertinent since the rise of emerging markets and the global financial crisis.

Drawing from a global survey of CFOs, statistical modeling and professional insight, this report aims to help business leaders put their company's strategic objectives into perspective and to consider the need to develop a "geostrategy." Geopolitics and policy shifts have the potential to undermine long-held assumptions and reshape global economic connections. By understanding and integrating geopolitics into strategic planning, business leaders are less at the mercy of unfolding events and can become more proactive in a time of transition.

The current landscape

In January 2018, the World Bank revised its global growth forecast for 2018 to 3.9% following stronger-than-expected growth in 2017 and the passage of landmark US tax reform. US growth forecasts were also revised upward from 2.3% to 2.8% for 2018. In addition, unemployment levels are near record lows and the US Federal Reserve has begun to raise interest rates following a decade of historically low interest rates. Our Global CFO Survey captures the buoyant mood of companies: only 10% of those surveyed anticipate a decline in US growth over the next one to three years, and 68% of CFOs expect a boost from US tax reform.¹

US consumer confidence is also riding high — after a dip in January, the Organisation for Economic Co-operation and Development (OECD) Consumer Confidence Index (CCI) showed February 2018's confidence levels for the US reaching highs not seen since 2000.² Indeed, confidence across the OECD countries reached similar highs not seen since the beginning of 2001.

However, this positive economic outlook also comes with a return of volatility to the markets. US stock indexes ended 2017 with their strongest year since 2013 and set records nearly every week at the beginning of the year. Yet by the end of Q1, the CBOE Volatility Index (VIX, the so-called "fear index") had moved more than 20% in a single day seven times likely in response to increased disruption in the global trading environment. This level of volatility has not been seen since 2014, when there were seven 20% moves in the entire calendar year.

At the same time, political uncertainty globally is increasing, with the success in mainstream politics of non-establishment candidates and nationalist movements raising fears of protectionist policies, and prompting some countries to turn inward. Ten years on from the global financial crisis, inequality has only increased through the uneven distribution of the recovery, and voters are questioning the benefits of globalization and the distributed effect of new technologies. Additionally, growing uncertainty surrounds how the global economy will navigate the increasingly unavoidable shift from the unprecedented easy-money policies that followed the global financial crisis to a world of positive real interest rates.

¹ The Global CFO Survey was fielded during February and March 2018. Full methodology and details can be found at www.zurich.com/globalrisks.

² OECD (2018), "Consumer confidence index (CCI)" (indicator), <http://dx.doi.org/10.1787/46434d78-en> (accessed on 30 March 2018).



However, the news on global trade isn't entirely bad — the number of regional trade agreements doubled between 2007 and 2017,³ and the recovery in trade seen in 2017 as a result of the global economic recovery has continued into 2018 thus far.⁴ Despite this, the Global CFO Survey showed 68% of respondents expecting US protectionism to become prevalent or significantly more prevalent within the next three years, and 68% anticipating more restrictive US immigration policies.

Looking forward

Corporate strategy and planning can be difficult amid such potentially transformative shifts when policy and politics drive economic outcomes and determine the business environment. To better prepare companies and their CFOs for future uncertainties, this report looks at three possible scenarios for the future orientation of the US policy and the US economy: Isolationism, Atlanticism and Internationalism. Isolationism sees the US turning inward, focusing on boosting domestic industry and minimizing competitive influences from abroad, while Internationalism represents the opposite side of the spectrum. In the middle of those two approaches, Atlanticism represents a world in which the US forges closer ties with established allies in Europe and Asia, as well as near neighbors in the Americas but scales back involvement elsewhere.⁵

In the survey, we asked CFOs of foreign and domestic companies operating in the US to assess what they see now and in the years ahead. Then, after defining each of the three scenarios in greater detail, this report uses statistical modeling to determine the impacts on GDP and employment. With those data points in mind, we explore the

business implications for companies and identify key risks that should help boards and management teams better understand the potential impact on their financial and physical assets, and operations including supply chains and people. We then discuss a plan to help companies devise a road map for preparedness to handle geopolitical events.

In this report, the business implications and subsequent mitigation measures were generated with a combination of qualitative and quantitative research, including interviews conducted with specialists from EY and Zurich Insurance Group and a roundtable discussion with corporate and government leaders moderated by the Atlantic Council. This research is intended to catalyze strategy discussions among CFOs, risk managers and boards to help them understand, prepare and act on appropriate measures as current uncertainties unfold into new realities.

Key research inputs



**Scenario
Drafting**



**Global CFO
Survey**



**Economic
Modeling**



**In-Person
Workshop**



**SME
Interviews**

³ "Regional Trade Agreements Information System," *World Trade Organization website*, rtais.wto.org/UI/PublicMaintainRTAHome.aspx.

⁴ "World Trade Outlook Indicator," *World Trade Organization website*, www.wto.org/english/res_e/statis_e/wtoi_e.htm.

⁵ US policy and politics aren't the only factors to consider but are the main ones being explored in this report. Businesses should also examine other external factors, including environmental and cyber risks.

Global CFO Survey

Ten years into the global economic recovery, CFOs remain bullish on the state of the US business environment and confident about its near-term outlook. Our Global CFO Survey captured the views of almost 500 CFOs from 30 countries and found that 61% of CFOs felt confident or extremely confident investing in the US, and 71% of CFOs expect continued improvement in the economy in the next one to three years.

A majority (68%) of CFOs say US tax reform will have a positive impact on their bottom line, and nearly half of the companies anticipating tax savings said they would use them to invest in property plant and equipment. Nearly two-thirds of all respondents with US employees expect to increase US headcount in the next six months. Further, the survey results suggest some interest in increasing US presence for businesses that do not currently have employees in the US.

While the results indicate some variation by region and company size, CFOs are most concerned about policies that would restrict the flow of goods, capital and people — elements of Isolationist and, to a lesser extent, Atlanticist scenarios.

- 68% of global CFOs expect US protectionism to grow in the next one to three years, with 46% indicating this growth would negatively impact investment.
- 63% of companies expect increased US scrutiny of cross-border mergers and acquisitions, with 39% expecting increased scrutiny to negatively impact investment, but that number increases to 48% for “very large” companies — which are generally those well-positioned to pursue cross-border M&A.
- 68% expect more restrictive immigration policies in the United States, with 42% of companies expecting such policies would negatively influence investment.

In addition, CFOs expect an increase in cyber threats to the US (65%) and increased levels of innovation in countries other than the US (63%). Companies expect both of these factors to have a moderately negative influence on US investment (41% and 37%, respectively).

In each of the scenarios explored, the threats from cyber attacks and competitive innovation will become more prominent, as the survey respondents expect, but the characteristics will differ. In the Isolationist or Atlanticist scenarios, cyber threats emanating from countries with hostile relations with the US would become more prominent, while in the Internationalist scenario cyber risks are more likely as a result of increasingly complex global networks. Increased levels of innovation outside of the US are likely in each scenario as global competition increases. Isolationism would result in greater IP restrictions and fragmented global innovation, while increasingly integrated global value chains under Internationalism would cause innovation to proliferate globally, not just in the US.

Global CFO Survey

By the numbers...



497 Chief Financial Officers



30 Countries



51% < \$500 million **25%** \$500 million–\$3 billion **24%** > \$3 billion



Q1 2018 Fielded February–March

This survey was conducted by EY and also includes data collected by the Organization for International Investment from its membership. This survey was sent to both EY CFO clients and Organization for International Investment (OFII) CFO members.

A global view

CFOs of US-headquartered businesses were slightly more confident about investing in the US, more likely to benefit from US tax reform, and more optimistic about US economic growth. Further, our survey suggests a more favorable outlook for US-based businesses vs. foreign businesses.

Economic confidence and outlook

On a regional level, North American CFOs were most bullish about the future, with 75% of respondents expecting an improved business environment in the next one to three years. European CFOs followed, with 71% expecting an improved outlook. Asia-Pacific and South American CFOs were the least optimistic, with 68% and 65%, respectively, saying they expect the US business environment to improve in the next one to three years. By country, the results suggest that French and Italian CFOs were the most bullish on the US economy while German and Japanese CFOs were the least optimistic.

Bulls vs. Bears

Ranking CFO Confidence



France 86%
Italy 94%



Germany 38%
Japan 59%

A division on whether US business climate is improving for foreign companies

Despite trade tension between the US and China and the renegotiation of NAFTA, 62% of Asia-Pacific CFOs and 60% of North American CFOs are of the view that within the next six months the US business climate is getting better for foreign businesses, as compared with six months ago. Meanwhile, less than half of European CFOs say the business climate is improving for foreign companies in the coming six months.

As expected, respondents indicating that the US business climate for foreign companies is getting worse (15% of overall respondents) were also more likely to expect growing US protectionism (83% vs. 68% overall), a decline in US political influence (52% vs. 21% overall), and a decline in US exports (23% vs. 11% overall). Further, these same respondents said protectionism, the use of restrictive immigration policies, declining levels of growth, and increased reputational risk of using a foreign brand in the US were all more likely to negatively impact investment than overall respondents. These outcomes would be expected in the Isolationist scenario over time, as well as in an Atlanticist scenario to a lesser extent.

Our results indicate relative consistency in economic outlook among companies investing in the US as compared to companies not investing in the US. There were however, distinct differences in the perceived influence of almost every geopolitical driver. The biggest divergences were related to increased economic threats to the US posed by hostile entities (51.4% of companies not investing in the US vs. 33.1% of companies investing in the US); a decline in US exports (51% vs. 34.3%); increased reputational risk of using a foreign brand in a US market (51.4% vs. 34.9%); more restrictive immigration policies (51.7% vs. 35.6%); and increased cyber threats to the United States posed by hostile entities (48.3% vs. 32.8%). In each case, companies not already investing in the US considered the risks of US protectionist policies and external threats on the US economy to be more influential on their decision-making. In the context of the scenarios presented in this report — particularly the hardline protectionist Isolationist scenario — this may suggest that companies not already invested in the US are more cognizant of the likelihood of the risks to foreign direct investment in the US.

Differences by company size

CFOs of “very large” companies were overall less bullish on the US long-term outlook and less likely than smaller companies to expect increased US employment levels in the near term. Further, 26% of very large companies described the business climate for foreign companies as getting worse as compared with 15% overall. There was not a significant difference in response around tax reform as nearly all companies, regardless of size, expect tax savings and a positive financial impact as a result.

In addition to being less bullish than smaller companies, very large companies surveyed were more concerned about policies that might restrict their ability to do business. Very large companies were more likely than their smaller peers to expect growing US protectionism (83.1% vs. 68% overall), increased cyber threats (80.5% vs. 65% overall), further US scrutiny of cross-border mergers and acquisitions (73.7% vs. 63% overall), and more restrictive immigration policies (77.1% vs. 67% overall). Further, CFOs of very large companies were 50% more likely to expect a decline in the global political influence of the United States (33.9% vs. 21%). These differences leave open questions as to what drives the difference in sentiment — pessimism, or, are large companies inherently more sophisticated and attuned to geopolitical risk?

Are companies equipped to handle geopolitical disruption?

With only 1 in 10 CFOs anticipating a decline in US economic growth and a minority expecting a decline in exports, US political influence and the number of democratic governments, it raises the question — is the strength of the global recovery masking risks in an interconnected world?

In January, the IMF warned policymakers and business leaders be on guard for the next recession. IMF Chief Economist Maurice Obstfeld has said, “[t]he next recession may be closer than we think, and the ammunition with which to combat it is much more limited than a decade ago.” Despite global growth, Chinese growth has slowed, debt levels have risen worldwide, and central banks are raising interest rates after a decade of record-low rates. In the US the long-term impact of US tax reform may differ from its short-term shot in the arm. The IMF predicts recently enacted US tax reform will reduce economic growth beginning in 2022, reversing earlier gains as individual tax cuts expire and the US addresses its budget deficit.

Zurich’s base case includes a mild US recession taking hold in 2020, which is largely a function of limited excess capacity combining with a fiscal impulse at a time of rising interest rates and tightening financial conditions impacting a highly indebted economy. In addition, the world has only begun to feel the effect of recent policy changes.

The latest US economic cycle is now a decade old, and many CFOs doing business in the US have never experienced an economic downturn. Due to this continued economic growth, CFOs are overwhelmingly optimistic about the US economy, further influenced by the recent passage of tax reform. At the same time, the world is more uncertain due to a number of recent geopolitical events that might impact companies in many different ways; in the US, these include the recent dialogue and activities around trade. As a result, this raises the question of whether companies are truly prepared for the impact of potentially negative geopolitical events, which could be further exacerbated by an economic downturn. We believe that companies and their CFOs need to be focused on how these long-term trends might affect their strategy and operations, and be careful not to be too short-term oriented.

Scenario analysis

Overview

Our three discrete scenarios — Isolationism, Atlanticism and Internationalism — are not intended to serve as forecasted potential outcomes, but rather a spectrum of characteristics that could manifest as a range of economic policy, conditions and outcomes around which to build an exploration of contingent futures. None are likely to dominate over the next decade, but certain aspects of each may emerge depending on policymakers. By examining each of these scenarios individually, triggers can be more readily identified as they happen, and more importantly the nature of changes and their effects on the business environment can be more thoroughly scrutinized, allowing companies to respond appropriately to corresponding scenarios rather than to seemingly siloed singular events.



Isolationism

Isolationism is when a country voluntarily abstains from security- or economic-related politics in an area where it can exert control or significant influence globally.⁶

Isolationism took hold in the US during two periods: right after it became an independent nation (in the 18th century) and in the aftermath of World War I through the attack on Pearl Harbor (the 1920s and '30s). The country was wary of becoming entangled in disputes abroad, and domestic concerns became the primary focus. During the 1920s, that mindset led to limits on immigration and historically high tariffs on a wide range of goods (with rates linked to the wages of the exporting country).

Today, Isolationism could take hold if protectionist politicians win more elections as a result of a majority of voters perceiving that the government is failing to address wage stagnation, falling standards of living and growing inequality. Populist agendas would appeal to the perception that elites in the financial system, the corporate world and government drive economic policies that ignore the needs of average citizens. This position would draw from the belief that globalization has weakened US economic capabilities and is responsible for local job losses, through factory relocation and immigration, and that the US trade deficit with other countries is unfair and needs to be altered.

⁶ Modified version of Bear F. Braumoeller, "The Myth of American Isolationism," *International Studies Association*, 2010.

According to this narrative, the US's strategic economic competitors are making gains in trade and technology because of unfair practices, state subsidies and inadequate protection for intellectual property. This would be accompanied by the view that maintaining security alliances, or diplomatically engaging in other regions of the world through cooperative measures, costs too much and is too difficult politically.

Broad policy goals

- US political engagement abroad declines, especially in multilateral organizations and initiatives where the US public and policymakers believe the costs severely outweigh the benefits.
- Domestic economic bases are strengthened to reinforce the narrative that the US government is restoring or protecting local industry. Initially, this would focus on manufacturing, energy and industry but, as acceptance of isolationism grows, could spill over to service industries.
- Immigration is reduced, possibly causing lower GDP growth or even contraction. Some jobs may become more difficult to fill in the near term.



Atlanticism

Atlanticism is based on the idea that countries that border the Atlantic Ocean share a similar identity or have interests that overlap significantly, emphasizing cooperation and the exchange of ideas, trade and movement of people between these countries.^{7 8}

Atlanticism began during World War II with the adoption of the Atlantic Charter in 1941, initially by the US and the UK. The agreement defined the postwar agenda of the signatories to reduce the potential for future conflict and improve economic and social cooperation. Common values were protected and common security enhanced through cooperation between the US and Europe. In the wake of the war, Atlanticist objectives drove the creation of institutions such as NATO and the OECD.

At its core, a renewed Atlanticism would be driven by a US desire to strengthen economic and security cooperation with its allies, in which the US sphere of influence is expanded and strengthened. Atlanticism's 21st-century incarnation is

⁷ Teus Lebbing, "Atlanticism: The Rise, Development and Realisation of an Idea," *Atlantisch Perspectief*, Volume 20, 1996.

⁸ Strobe Talbott, "Atlanticism in the Era of Globalization," *Towards Mutual Security: Fifty Years of Munich Security Conference*, Vandenhoeck & Ruprecht, 22 January 2014.

likely to reflect greater diversity in geography and issues, looking beyond historical relationships from the World War II era. For instance, Japan, South Korea and India will have an interest in maintaining strong trading, investment and security ties with the US, and they all share strong incentives to only gradually allow changes in the global balance of power. Cooperation across the Americas would also strengthen through the expansion of regional trade and security agreements.

However, military cooperation would rise among countries that are not aligned with the US or its close European and Asian allies, and the cost of engaging in these alternative spheres — whether in terms of a military force or via military aid — increases. And a US focus on trade deficits with Atlanticists vs. those who fall outside of the bloc, such as China, would heighten scrutiny on trade flows and sourcing. Most multinationals with production in China or a significant Chinese customer base, for example, would need to significantly restructure their business model to address higher barriers of entry and tariffs for any cross-bloc trade.

Broad policy goals

- US-led cooperation would increase among allied nations, including through high-quality trade and security agreements.
- Barriers against non-allied countries would increase, including restrictions on trade and information sharing. Countries in the Atlanticist bloc would attempt to reduce their reliance on non-allied countries, including for commodities and raw materials. Increased tariffs may make them prohibitively expensive, or they may be difficult to obtain altogether, including from current significant source locations such as China.
- The US and the EU would launch a major joint development assistance program. In an era of competing spheres of influence, this encourages countries that may still be on the fence.



Internationalism

Internationalism is the pursuit of an open and rules-based world order centered on institutionalized cooperation among democracies. It acknowledges a diverse array of global interdependencies that must be managed to sustain peace and economic well-being.⁹

In the past century, Internationalism defined US policy during and after World War II and after the Cold War and through the 1990s. The US-led efforts to establish global institutions and rules reduce the potential of future conflict, strengthen economic linkages and avoid mercantilist policies. For instance, immediately after World War II, the US pushed to create the United Nations to improve international coordination. Two international financial institutions, the International Monetary Fund (IMF) and the World Bank, emerged in the postwar era, as did the General Agreement on Tariffs and Trade (GATT), to prevent a recurrence of 1930s-style protectionism. The goal was to avoid volatility and deep economic recessions that could trigger nationalist and nativist sentiments.

In the 1990s, the collapse of the Soviet Union enhanced the perceived primacy of western democratic ideas and systems. The US was popularly viewed as the sole remaining political and economic leader and the “world’s policeman,” and there was a push for a more comprehensive global trading regime. The so-called Washington Consensus, which advocated market-based reforms in developing countries to avoid economic crises (or in exchange for assistance during crisis), took root, and further trade and economic liberalization were pursued through the World Trade Organization (WTO), the successor to GATT, and other organizations.

Internationalism could take hold in the US if perceived threats from abroad diminished and the US economy continues to strengthen. In this scenario, corporate and individual balance sheets improve, and the US maintains its technological advantage in the largest sectors, both established and emergent. Meanwhile, the other major global economies and competitors for global influence — whether ideological, economic or military — are forecast to grow at a significantly slower pace and turn inward to address domestic issues, reducing their ability to extend policy outwards.

⁹ Daniel Deudney and G. John Ikenberry, “Democratic Internationalism,” Council on Foreign Relations, 15 November 2012.

Broad policy goals

- A renewed focus is placed on US industrial policy to build competitive advantages for a globally oriented economy.
- US leadership reasserts itself across multilateral organizations, including the UN and WTO, and the US becomes more engaged in high-quality multilateral trade agreements, including those encompassing China and other nations.
- The US renews (or modernizes) its key military alliances. These efforts take place especially with countries with which the US has mutual defense treaties.
- The US returns to its policy of promoting democracy and human rights. It realigns itself with established democracies and includes a focus on tackling climate change and global environmental challenges.

Economic impact

What impact could Isolationism, Atlanticism and Internationalism have on US economic performance in 2018 and beyond?

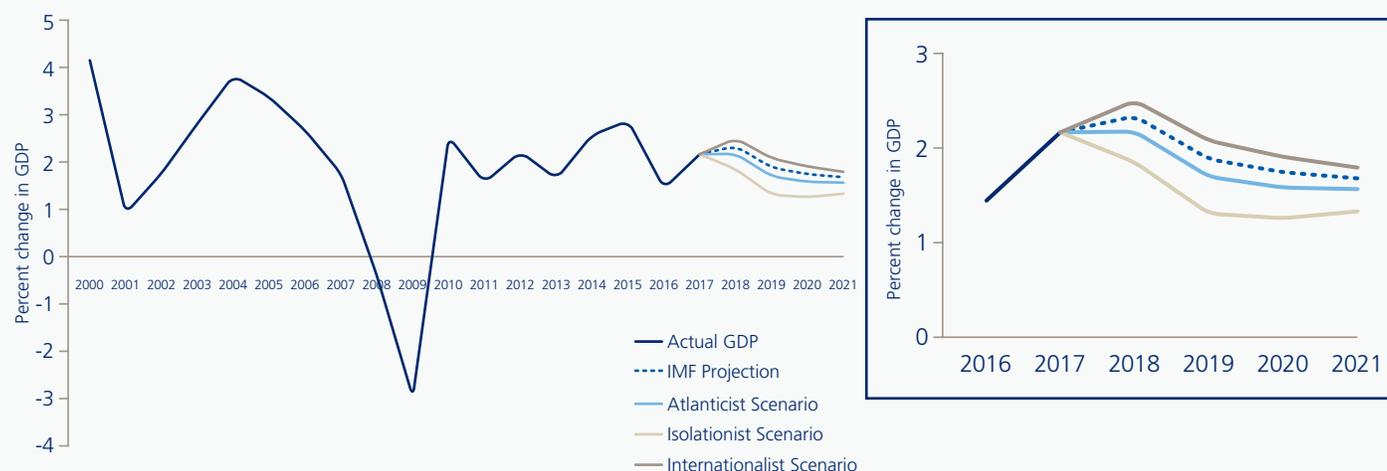
Given that the US's level of global economic engagement is what differentiates each scenario, to explore this question, we looked at the relationship among trade policy, trade and

Comparing scenario against scenario, this translates to a difference of \$998 billion going from Isolationism to Atlanticism, a difference of \$1 trillion between Atlanticism and Internationalism, and lastly, a divergence of \$2 trillion between Isolationism and Internationalism.

economic performance, using the experiences of advanced economies since 1980. In the extreme Isolationist scenario,¹⁰ observed trade was associated with a projected decline of up to 30% by 2022.¹¹ With the Atlanticist scenario, observable trade declines 10%, and in the Internationalist scenario, it increases 10%.

Using IMF growth projections as a baseline, decreasing openness to trade depresses growth rates — although small, but cumulatively significant. In 2022, for example, the IMF projects US GDP growth to be 1.68%, but in the Isolationist scenario, it would be 1.45%; in the Atlanticist, it would be 1.60%; and the Internationalist, 1.76% growth. Although these GDP changes appear small, they have a large impact on the dollar value of overall GDP accumulation over this five-year period. This model estimates that, from 2017 to 2022, the Isolationist scenario would generate a loss of \$1.5 trillion of cumulative nominal GDP, a loss of \$502 billion cumulative nominal GDP under Atlanticism, and a gain of an additional \$505 billion in the Internationalism scenario. Comparing scenario against scenario, this translates to a difference of \$998 billion going from Isolationism to Atlanticism, a difference of \$1 trillion between Atlanticism and Internationalism, and lastly, a divergence of \$2 trillion between Isolationism and Internationalism.

Modeling the growth impact on the US economy (in % of US GDP)



¹⁰ Isolationism was quantified on policy and aggregate economic bases, using two trade policy indices generated by the Simon Fraser Institute as well as the ratio of trade (exports and imports) to GDP. The impact of Isolationism on GDP growth were estimated using a classic Solow growth model.

¹¹ The latest data point in the series, 2014, was used as a baseline for the increases and decreases in observable trade.

It is worth noting, however, that these figures only take into account the direct relationship between trade and GDP.

Isolationism would also likely result in a series of secondary or spillover effects, such as trade retaliation, increased costs and policy isolation that would make these estimates conservative. Previous studies have extrapolated on the long-term impacts of this possibility, indicating that if the US and China were to reduce their trade volumes, global cumulative GDP would fall by USD35 trillion by 2035.¹² Such a dramatic decrease would create a contagion effect, driving 20 million more people into extreme poverty and another 45 million people into living on less than USD 3.10 per day.¹³

The trade and growth impact of each of these scenarios would have a corresponding impact on US employment, according to the model. Lower trade volumes correlate with higher unemployment in the model, but spillover effects suggest this linear model is a conservative assessment of the impact. In the Isolationist scenario US GDP growth is lower than the baseline of the IMF's projected growth by an estimated 0.46 percentage points, a drop associated with an increase in unemployment by 1.2 percentage points or 1.3 million fewer people employed by 2022.¹⁴ The Atlanticist scenario produces an expected reduction of 0.15 percentage

In sum, the Internationalist scenario produces jobs for 1.7 million more workers in 2022 than the Isolationist scenario. This difference reflects near equal declines from the Internationalist to Atlanticist scenarios, 856,00 fewer jobs, and from the Atlanticist to Isolationist scenarios, 872,00 fewer jobs.

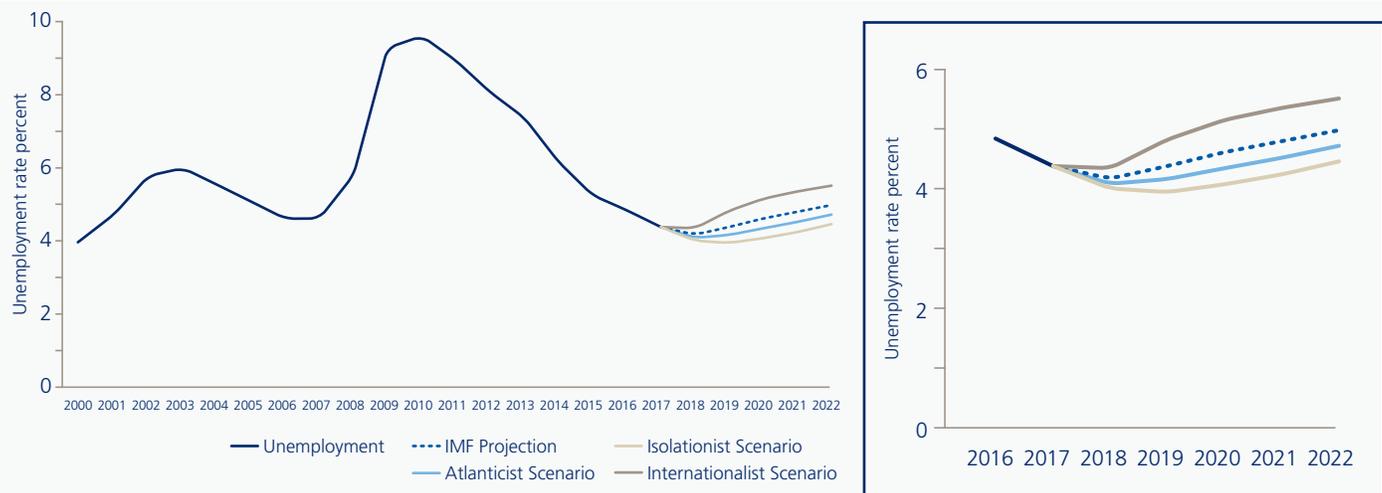
points in US GDP growth, which translates to an increase in unemployment by 0.8 percentage points, or about 428,000 fewer workers in 2022.¹⁵ Lastly, in an Internationalist Scenario, US GDP growth through 2022 would increase by 0.15 percentage points

over the IMF baseline, increasing the number of people employed by 428,000.¹⁶ In sum, the Internationalist scenario produces jobs for 1.7 million more workers in 2022 than the Isolationist scenario. This difference reflects near equal declines from the Internationalist to Atlanticist scenarios, 856,00 fewer jobs, and from the Atlanticist to Isolationist scenarios, 872,00 fewer jobs.

Policy risk factors and business impact

In further assessing the three scenarios, we analyzed their respective impacts on four broad areas of importance to companies: **(1) policy, (2) supply chain, (3) investment behavior and (4) reputation.** These categories were determined to have the most impact on a company operating in the US if trade policy changes.

Modeling the employment impact (in % of US unemployment rate)



¹² "Our world transformed: geopolitical shocks and risks," Zurich Insurance Group website, www.zurich.com/it/knowledge/articles/2017/04/geopolitical-shocks-and-risks-atlantic-council-report, 24 April 2017.

¹³ Ibid.

¹⁴ See Appendix for methodology.

¹⁵ Ibid.

¹⁶ Ibid.

Policy

When it comes to **trade**, isolationists seek to increase domestic output and employment, feeding the popular narrative of products being “Made in America,” with the US protecting its ability to manufacture essential and strategic goods. Tariff and non-tariff barriers are implemented on imports from countries that the US believes are unfairly competing with local industries, or where the domestic job creation benefits are significant. These policies do not ban such imports but raise their costs to the point where domestic manufacturing is more favorable.

Of course, these policies would likely elicit reciprocal and retaliatory actions by other countries. Trade barriers may be raised in countries affected by aggressive US actions or merely in response to a decline in imports by the US from countries heavily dependent on the US market. Within the US, higher prices may hurt the economy, but direct (budgetary) and indirect (subsidy) support to boost productivity can offset the damage. Such initiatives would include infrastructure development, education and workforce retraining. Tax policy can also be used to encourage reinvestment and consumption, intended to further drive growth.

Under Atlanticism, the US remains open and even increases coordination with countries that share many of its principles, including Singapore, Japan and South Korea, in addition to traditional allies in Europe, Oceania and North America. It also may embrace countries where it has a direct and clear interest in seeing free market and liberal democratic systems evolve, such as India and some of the larger countries in South America. But the US would use isolationist tools, including greater regulatory scrutiny of financial and capital flows, to countries that are outside the new Atlanticist bloc. Internationalism takes this a step further, reducing the overall barriers to the global free flow of ideas, goods and capital.

For **immigration**, Isolationism tightens controls so that the local workforce captures the higher wages. To a more moderate degree, the same is true for Atlanticism outside its bloc, whereas Internationalism does not impose such limits. In 2017, the Pew Research Group estimated that, without immigrants, the US would have 18 million fewer working-age adults in 2035.¹⁷ But how this would affect the skilled workforce point is debatable, because immigrants are

not a majority in any industry or occupational group (although they nearly are within private household workers and farming, fishing and forestry occupations).¹⁸

Within **defense and security**, traditional isolationism focuses only on issues that directly affect US security, emphasizing the near-shores of the country, including tighter border controls and cybersecurity. In contrast, internationalist policies would be a continuum of the post-Cold War world, in which the US engages in an international system based on participation in global institutions. Although US global power shapes institutions and rules, the US is similarly willing to engage other countries and to commit to regional or global agreements to strengthen the rules-based system. An Atlanticist approach would strike a balance between these two, with greater security cooperation among bloc countries, and tighter security controls and scrutiny applied to non-allied countries. Under any scenario, increased US military spending, or a ramping up of military influence to combat Asian economic and geopolitical ambitions, would impact the US deficit and overall indebtedness (especially in combination with loose fiscal policies and low corporate tax).

No matter the scenario, **cybersecurity** will be a challenge, depending from where the threats are coming. The threat of state-backed attacks using private sector companies to inflict national-security-level damage to the economy or public trust is increased in the Isolationist and Atlanticist scenarios, in which US engagement with Russia, North Korea, Iran and China is limited. This is also the case for internal corporate espionage for intellectual property (IP) as the US tries to increase its innovative edge. In the Internationalist scenario, these remain a widespread problem, increased by greater global connectivity, creating more vulnerable links, but balanced against a spirit of more engagement worldwide. Supply chain and network management are areas for concern regardless.

Another concern if the US withdraws from the world would be direct open sectarian conflict or regime collapse in the Middle East, which could trigger spikes or prolonged periods of extremely high oil prices. While moderate price increases — probable in the Isolationist and Atlanticist scenarios — would enhance the earnings of US shale gas producers and most likely have a positive effect on the US economy, severe spikes could create a global recession.

¹⁷ “Immigration projected to drive growth in US working-age population through at least 2035,” *Pew Research Center website*, www.pewresearch.org/fact-tank/2017/03/08/immigration-projected-to-drive-growth-in-u-s-working-age-population-through-at-least-2035, 8 March 2017.

¹⁸ “Immigrants don’t make up a majority of workers in any US industry,” *Pew Research Center website*, www.pewresearch.org/fact-tank/2017/03/16/immigrants-dont-make-up-a-majority-of-workers-in-any-u-s-industry, 16 March 2017.

Policy (continued)

This is a snap shot of near- to mid-term policy making. These are concise, simple scenarios.

In reality, policies may evolve in reaction to economic outcomes.

|  Isolationism |  Atlanticism |  Internationalism |
|---|--|---|
| <ul style="list-style-type: none"> • Bringing in or retaining foreign talent becomes more difficult, which could lead to a short-term productivity challenge. More investment will be needed to develop the domestic workforce. • Tax incentives boost greenfield investment and onshore jobs, while tariffs and a border adjustment tax on imports seek to minimize imports. | <ul style="list-style-type: none"> • The origin of workforces will be more heavily scrutinized. Immigration policy will be divided between allied and non-allied countries. More investment will be needed to develop the domestic workforce. • Tax incentives aim to maintain US global competitiveness and attract foreign investment. • Critical and strategic commodities will generate more global competition. • Two tiers of tariffs will exist for those inside and outside the Atlanticist bloc. Given current trading patterns, electronics, electric machinery, furniture, toys and footwear are likely be subject to higher tariffs. | <ul style="list-style-type: none"> • Tax incentives are in place for priority industries (technology, advanced manufacturing and engineering) to maintain productivity and competitiveness and attract foreign investment. • More investment will be devoted to developing skills for a global digital era. |



Supply chain

US trade and security relations with the rest of the world — allies, friends and foes — strongly drive the complexity and resilience of supply chains and networks, influencing companies' sourcing decisions and their balance between localized and global value chains. Will you need to manufacture locally or transport globally — or regionally, based on trade policy and distance to the customer? That brings other factors to play: standards and regulations, how to manage security risks (including data regulations and cyber risks), and whether the supply chains need to be modernized — and how.

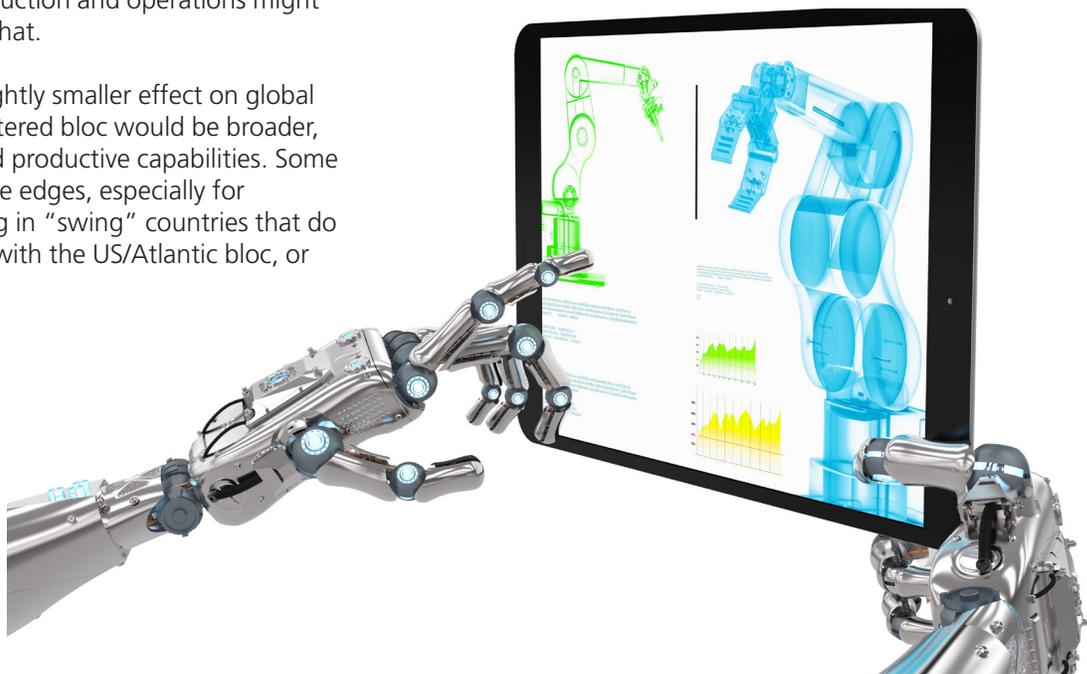
In the Isolationist scenario, with its tax cuts and domestic subsidies coupled with tariffs and other barriers to reduce foreign competition, the cost of goods will likely increase as the benefits derived from integrated global value chains (GVCs) are eroded. Domestic manufacturers are likely to concentrate in only a few geographic regions to maximize scale benefits and access to supplier networks, creating greater risk from disruptive events such as transport problems or natural catastrophes. Companies will likely face challenges in obtaining certain key raw materials and will therefore may face unexpected disruptions in the supply chain because of the lack of a material or part. In a number of sectors, US exports could be affected, such as in aerospace, for which local content can be demanded as part of any sale. A company's market may become limited to domestic customers, so production and operations might need to be scaled to reflect that.

Atlanticism would have a slightly smaller effect on global supply chains, as the US-centered bloc would be broader, both in terms of markets and productive capabilities. Some volatility would remain on the edges, especially for companies that are operating in "swing" countries that do not clearly align themselves with the US/Atlantic bloc, or

those on the edges — for instance, it may not be immediately clear if former Soviet states and Turkey sit with the US. These countries could then become proxies in the competition between blocs, likely raising costs for companies globally because they could no longer rely on one globally integrated supply chain and would need to potentially invest in several duplicate production facilities in each bloc.

For Isolationism or Atlanticism, the US would need to develop the infrastructure to produce parts that it previously imported — for example, components currently sourced from or produced in China. The chain reaction of that is significant: bringing in the technology and knowledge, and finding or training workers, creates longer turnaround times. Alternative sourcing options may be required — likely from higher-cost suppliers. Inventory handling can become pricier. New border controls and customs charges can lead to transportation delays. In the end, as mentioned, higher prices for goods or even potential shortages become much more commonplace.

The Internationalist scenario would encourage connectivity between competing countries, building upon the globalization of supply chains that have characterized manufacturing over the better part of the last half century. With trade initiatives on the Atlantic and the Pacific making progress, markets and supplier networks will become more globally entwined, allowing for more transparency and collaboration.



Supply chain (continued)

|  Isolationism |  Atlanticism |  Internationalism |
|--|--|---|
| <ul style="list-style-type: none"> • US policy encourages companies to localize operations. • Tariffs are increased on selective imports, raising the prices of some high-value, fast-moving consumer goods and some manufactured items (such as auto parts and small electrical appliances). • Supply is disrupted for imported commodities, including many rare earths and other metals and minerals. • More complicated rules and regulations govern trading relationships, with a focus on increased local content requirements. Foreign trading partners are driven to strengthen ties with China and Russia. | <ul style="list-style-type: none"> • Incentives promote cross-investment within trade blocs; industry tariffs are lowered and tax rates are harmonized. Fragmented blocs force companies to “pick sides” or manage political risks across blocs. • Modernized trade agreements facilitate improved and more efficient supply chain management within aligned blocs only. • Technology sharing would increase within the Atlanticist trade zone, but there would be restrictions on sharing with third (non-aligned) parties. • Cross-bloc supply chain blockages can develop; temporary quotas and caps or other non-tariff barriers. Security risks increase for supply chains that involve potential “swing” or proxy war countries. | <ul style="list-style-type: none"> • Trade cooperation eases global trade and facilitates complex supply chains. • An overall increase in transparency expectations and standard requirements force greater scrutiny across supply chains and third parties. • A rise in digital trade in goods and services and modernized trade agreements mean companies are required to adhere to new global digital regulations and standards; cybersecurity requirements increase as a result. • Supply chains must become more secure, collaborative and federated. Innovative services, such as blockchain, continue to develop to try to manage this complexity. |



Investment behavior

In an Isolationist policy, the US will vet foreign investments more closely to ensure that non-US firms do not acquire stakes in strategic industries, sectors and technologies important to national security. Scrutiny from institutions such as the Committee on Foreign Investment in the United States (CFIUS) and the Department of Justice (DoJ) will become more active and may extend to private equity investments.

However, the opposite may be true for investments into more traditional sectors, since job creation will be the primary goal. Furthermore, Washington may, through taxes and complementary public investment, encourage firms to locate more in the central US to revitalize domestic industry and demand and to generate jobs. The US government will focus on greater public investment in infrastructure and education, both to offset the slower growth that may be the initial effect of tariff barriers and to improve internal productivity. US firms that continue to invest overseas are likely to find that foreign governments are not as welcoming. That may manifest in a more difficult business environment or even outright hostility toward US firms, raising the risk of discriminatory treatment.

In an Atlanticist US, scrutiny of foreign investments would apply to those from nonaligned countries, including Russia and China, but would be less severe for those within the US bloc. US allies would receive the benefits of internationalist policy, but others would face greater scrutiny on investment partners and third parties, including greater compliance and security-related regulations and requirements for cross-bloc investment flows.

In an Internationalist scenario, scrutiny remains driven by national security objectives and on cyber and technology compliance and regulations in an increasingly digitized world. Free flows of capital are encouraged, but the government may still encourage public and private investment in the US, primarily the non-coastal areas, given the prevailing narrative that they have suffered the most from globalization. However, unlike in Isolationism, the objective will be to build up industries capable of competing globally, instead of attempting to revitalize industries that have decreased domestically.



Investment behavior (continued)

|  Isolationism |  Atlanticism |  Internationalism |
|---|--|---|
| <ul style="list-style-type: none"> • Foreign investment in productive capacity inside the US rises. • FDI and M&A of US targets is more heavily scrutinized. Foreign companies face more requirements on investing in the US, including local content and employment generation. • Equity investment increases in companies that are seen as benefiting from greater protection. • Alternative centers for finance increasingly develop around the world. | <ul style="list-style-type: none"> • CFIUS and DoJ scrutiny on FDI and M&A is lower when coming from allied countries, but increases for non-allied countries. • Increased incentives for allied countries to increase investment in the US. Tax rates and capital controls are harmonized to restrict cross-bloc arbitrage opportunity. • US remains strong as a center for finance, but alternative global financial hubs also develop with strong alignments to one bloc or another. | <ul style="list-style-type: none"> • CFIUS and DoJ scrutiny on FDI and M&A of US targets is reduced except when national security concerns, critical infrastructure and, increasingly, technology are in play. • Increased global competition spurs US to create greater incentives to increase investment in the US. • US remains strong as a center for finance, but alternative global financial hubs also develop. • Alternative currencies gain strength in global transactions, but US dollar remains preferred globally. |

Reputation

Public trust is a vital commodity in today’s marketplace, and a company’s reputation — on whether it is seen as contributing enough to US workers and the country and the regions in which it is based — can ultimately determine how well it fares under the three geopolitical scenarios.

Under an Isolationism scenario, political preference will be given to US industries and workers that account for substantial parts of domestic economic activity, such as automakers and steel producers, or are strategic to long-term

US economic security, such as aerospace, renewable energy and artificial intelligence. Therefore, it is important that companies without a headquarters in the US and US companies with a global footprint be seen as contributing to these goals, through building homegrown capacity, paying the proper amount of taxes, training workers and reinvesting profits into the US. Given these expectations, firms may also be under greater scrutiny regarding how much they remit in dividends to their home countries or whether they engage in transfer pricing. To what extent a company hires US workers will also be important.



Some of these dynamics are still likely to be present even in the Atlanticist and Internationalist scenarios. Given the long US history of firms being involved in the communities in which they operate, how much they contribute to local economies and employment, including training, remains a real reputational issue. Indeed, in an Internationalist scenario, concerns regarding inequality and corporate citizenship continue to grow, alongside rapid global

communication flows that support consumer demands and business priorities and principles around environmental, social and governance (ESG) practices. However, there may be less scrutiny regarding reinvestment or the remittance of dividends. And for firms operating internationally (or within the Atlanticist sphere of influence), there are greater expectations to meet on labor, sustainability, cybersecurity, IP and privacy.

Reputation (continued)

|  Isolationism |  Atlanticism |  Internationalism |
|--|---|--|
| <ul style="list-style-type: none"> • Scrutiny will increase on companies' standards globally; requirements vary across jurisdictions. • Risks exist for companies that do not invest in and contribute to the local economy and job market. • Foreign-owned firms face increased market pressure to provide "American" credentials. • International cooperation on climate change will not exist; internet protocols and cybersecurity may leave companies vulnerable. | <ul style="list-style-type: none"> • Cybersecurity risks increase, given competition among geopolitical blocs. • Companies operating across blocs will face government pressure and social risks, including boycotts, increased regulatory scrutiny and other risks by association. • Pressure remains to maintain a license to operate in the US and to address inequality, particularly in rural areas or those in need of economic (re)development. | <ul style="list-style-type: none"> • An increased focus on human rights drives scrutiny on governance issues. • More consumer concerns regarding privacy and data use continue to be debated; international cooperation results in global regulations on internet, data and privacy. • An increase in US aid and democratization efforts may leave companies susceptible to attack from countries that remain against US foreign policy objectives and actions. |



Business and risk management implications

While the future of the business environment in the United States remains unknown, **organizations** have a choice to make — manage geopolitics or be managed by them. Leading organizations understand that they don't need to "roll with the punches" — they can take action, be proactive, and incorporate geostrategy into business strategy and operations. We believe the board, management and risk functions of an organization each have a role to play in managing risk and opportunity.

Step 1: understand

The first step in understanding a company's exposure to geopolitics is a global footprint assessment in which organizations consider the economic activities they engage in across the globe and how each might be impacted by geopolitics.

- **Supply chain** — capturing the geographic footprint and trade flow of global value chains including sourcing, manufacturing and distributing. In addition, they must consider how the interconnectedness of these chains is impacted by geopolitical forces such as tax and regulatory issues, trade agreements, war and climate change. Firms may generally have a good sense of their exposure to Tier 1 critical suppliers, but not for those further down the chain.

A company should also be aware of alternative options in its operations — from substitute sourcing to alternative transport routes — and have a clear understanding of the costs involved to enact a change. These costs should also be considered in line with margins, with risk premiums factored into decisions following a thorough risk assessment of significant investments, so that executives understand how much flexibility there is within margins to bear external and unexpected pressure.

Insurers are working with large multinational clients to develop supply chain risk assessment methodologies to understand and benchmark critical supply chains, even seeking to ascertain the exposures at the lower levels in the chain. These tools and methodologies can help insurers not only understand the asset exposures but also value flows that are at risk. These can be used in a geopolitical context, similar to how they are used in assessing logistical exposures.

- **People** — considering where an organization's people are located globally and how globalization (or de-globalization), demographics, technology, innovation and regulation impact human capital. Trade policy, education investment and immigration laws all impact an organization's ability to attract, develop and retain talent.
- **Corporate functions** — assessing a company's physical locations around the world including corporate, treasury, accounting, legal, marketing, information technology (including servers) and the use of outsourced facilities. With regard to treasury, organizations must consider financing sources and how changes in regulatory structure or ruling parties impact the availability and cost of capital.
- **Stakeholders** — organizations must also consider the social and environmental impact they have on the communities in which they operate. In early 2018, Blackrock Chairman and CEO Larry Fink told CEOs that if their company does not engage with the community and have a sense of purpose "it will ultimately lose the license to operate from key stakeholders." An understanding of geopolitics, including the expectations of various stakeholders is key to long-term success.

| Recommendations for key members of an organization | | |
|---|---|---|
| Board of directors | Management | Risk |
| <ul style="list-style-type: none"> • Embedding geopolitics in strategy • Regular briefings on key geopolitical trends and events • Open communication with management on its "geostrategic" plan • Stakeholder mapping and engagement | <ul style="list-style-type: none"> • Regular footprint assessments to monitor exposure/opportunity • Assessment of internal capabilities and knowledge • Education through external advisors/experts | <ul style="list-style-type: none"> • Understanding of organizational and extended enterprise risks and exposures • Holistic understanding of organizational strategy and extended dependencies • Understanding of insurance coverage and key vulnerabilities |

Step 2: prepare

Once an organization understands its geographic footprint and how its strategic goals could be impacted by geopolitics, it is time to prepare. Leading organizations prepare their business — cross-functionally — with the full involvement of the board, management and risk function. They understand the need to invest in knowledge and networks, to avoid hysteria and sensationalism and focus on their strategic goals.



Leading organizations understand the need to invest in knowledge and networks, to avoid hysteria and sensationalism and focus on their strategic goals.

Decision-makers at all levels are equipped with the knowledge and tools to understand and assess risks. Further, they proactively establish global and local policy positions that are rooted in holistic and comprehensive understanding of the needs of the business and its employees, as well as its reputation, consumers/clients, stakeholders and community.

- **Strategic redundancies** — advanced planning and investing in strategic redundancies can allow a company the flexibility to ride out the storm while, in the worst-case scenario, permanent alternative solutions are found — whether achieved through flexible contracts or new suppliers, locations or local partners. This can take the form of holding greater inventories of inputs, backup servers or extra surge capacity and is especially important to consider when dealing with critical components with few global sourcing options.
- **Modularity assessment** — it is important to factor in modularity so that an affected division of operations can be cauterized effectively. In 2011, severe flooding struck Thailand, which supplied 40% of all hard drives (HDs) in the world, creating significant supply problems. Even though some nameplate HD manufacturers, such as Seagate and Western Digital, did not experience flooding at their facilities, their local component suppliers did, which ultimately halted their production. Recovery took about a month and a half, at a cost of several hundred million dollars for these HD firms.

| Recommendations for key members of an organization | | |
|--|--|---|
| Board of directors | Management | Risk |
| <ul style="list-style-type: none"> • Assess whether the board has the right members/ advisors • Challenge and oversee management strategy and planning, driving governance • Focus on medium- and long-term geopolitical issues | <ul style="list-style-type: none"> • Financial modeling • Considering redundancies • Training and educating for employees • Building a structure/ organizational alignment around geopolitics including having procedures and protocols in place | <ul style="list-style-type: none"> • Scenario planning, stress testing, vulnerability monitoring • Business continuity planning • Supply chain, trade credit, political risk insurance • Hedging currency, commodity risk |

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Total Risk Profiling® (TRP®)

A tool to help guide a company's broad yet nuanced risk management culture is Total Risk Profiling® (TRP®), a structured approach to identifying, assessing and monitoring risks and improving reactions. The method is based on the premise that a company knows its own business, operations and markets best; therefore, it operates in a facilitator-run workshop format with a team of professionals from the company having expert knowledge of the scope of analysis. Together this team develops a risk profile by determining relative ratings of risk scenarios to define underlying issues, breaking them down into vulnerability, trigger and consequence.

TRP® on protectionism — vulnerability identification

We recommend using the TRP® exercise to address protectionism. Potential key questions to identify the vulnerabilities related to the isolationism scenario, to develop risk scenarios, to quantify financial severity and to assess probability can include:

Characteristics of your business

- Based on your geographical spread and/or concentration, how much of your turnover will be vulnerable to various protectionism scenarios?
- How much are your various suppliers (Tier 1, 2 or even 3) affected? How well-known are your bottleneck suppliers, and how easy and expensive will it be to substitute them?

Management style and strategy

- How vulnerable are you to license and contract term cancellations?
- Could protectionist measures affect your creditworthiness or that of your suppliers and customers?

External factors

- As supply chains become disrupted, how likely is it that second-order knock-on effects to your buyers and suppliers could default?
- What is the likelihood that third-order effects, like lower economic growth resulting in political violence, will result from protectionism in one of your key production countries, supplier base or markets?

TRP® on protectionism — vulnerability identification

Operations and procedures

- How likely could increased protectionism raise costs for manufacturing, such as higher inventory handling costs, alternative source options from higher-cost suppliers, transportations costs/delays due to border controls and customs charges?
- How well-established and tested are your contingency plans?

Timing and availability

- How big is the potential that embargoes will affect the supply of raw material or components?
- How resilient are you in terms of inflation, interest or currency exchange rate fluctuation in your markets?

Key feature

TRP® is a highly efficient way to optimize the risk/reward balance across your enterprise.

The structure of the TRP® risk identification process provides a sound basis for detailed quantification of more complex risks.

TRP® helps to set the agenda for internal audit or enterprise risk management to monitor risks at or just below the risk tolerance boundary.

The opportunity to define multiple triggers with different consequences helps to identify the true drivers of a risk undertake.

The principles of TRP®, which can be applied in a wide variety of circumstances, represent a tried and tested approach to address these challenges.

Vulnerability identification and assessment

Vulnerability catalog



Risk mapping/risk tolerance boundary

Risk profile



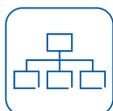
Risk reduction/risk improvement advice

Risk improvement catalog

Step 3: act



Create flexibility and resiliency in organizations by developing an open, un-biased culture



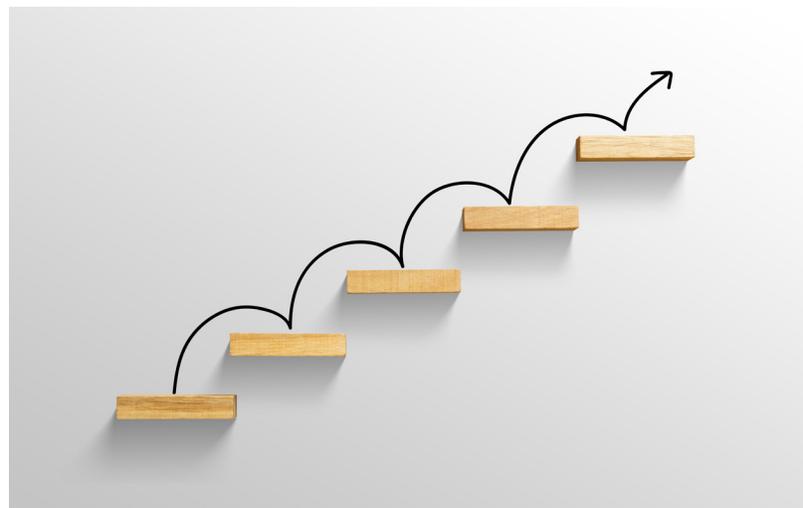
Develop a robust public affairs strategy based on political risk analyses to articulate position on critical issues and to monitor for risks



Proactively engage with stakeholders and policymakers on local and national levels

Finally, a company needs to act when geopolitical disruption occurs, as early as possible. There will be situations that can be proactively prepared for well in advance, and other situations where it will be important to quickly determine a course of action that minimizes disruption and cost. For example, potential protectionist measures, whether in the form, tariff or quotas, are something that a company can clearly prepare for. However, there will always be geopolitical events that are hard to predict (e.g., shock events). In the face of uncertainty, companies need to create flexibility and resiliency in their organizations, focusing on people and processes. This is the combined responsibility of the board, management and risk function.

While understanding and preparing for potential external situations that might affect a company's operations is an imperative, it is just as important to develop a culture that is able to organize, communicate and act decisively when disruption occurs. An open culture is required, as are curiosity and diverse views to develop new ideas and overcome natural biases. Training and techniques to combat bias should also be incorporated into company culture and talent management. It is also very important not to be siloed but very integrated when developing views and approaches. To truly be ready to handle all of this complexity and uncertainty, companies need to make sure that their culture allows for cross-functional silo disciplines as well as flexibility in dealing with these challenges. This starts at the board level and needs to cascade down deep into the organization.



In politically uncertain environments, with a complex interconnected global footprint, it is increasingly important for a company to adopt a well-researched public policy position on critical issues that is driven by business values and needs. Many of the risks outlined in this report evolve from public and political pressures that question the role of business and its contribution to the local community and economic developments. To safeguard against risks emerging from these questions, firms should understand how political risk feeds into developing a robust public affairs strategy to articulate and communicate their contribution to the domestic economy and social development, as well as to monitor for risks. A supported government affairs function can provide engagement with local stakeholders to advocate for priorities in regulatory and policy changes. Proactive stakeholder engagement programs at the local and national levels can support positive relationships with key stakeholders and policymakers, making sure the organization has a seat at the table prior to decision-making.

Conclusion

The world is at an indelible crossroads, and the way in which the US responds to these changing times will have political, economic and social implications for doing business there and for the world over. Changes in the direction of US policy domestically and its global engagement will have a direct impact on gross domestic product and unemployment — key drivers of the country's economic health.

While our survey indicated overwhelming bullishness from CFOs concerning the economy — albeit with midterm policy concerns that may somewhat influence their investment decisions — our research shows that the C-suite needs to be better prepared to reflect current and potential geopolitical events into short-term and long-term strategic planning. As evidenced throughout this report, new policies such as tax reform may have vastly different effects on the economy and business, depending on the period being considered. Companies must assess all of these possible policies in the context of their strategic priorities to build resiliency to withstand and the capacity to harness the opportunities presented by various potential economic and geopolitical scenarios.

Through the uncertainty, we believe the future will favor those organizations that understand, prepare and act. Leading organizations that understand their place in this changing atmosphere, that prepare their business with the necessary tools and knowledge and that act decisively will effectively manage the change. A disciplined, integrated and holistic approach to assessing the impact of these external factors on a company's strategy and operations is something we consider geostrategy. By implementing a robust geostrategy that tackles the potential risks identified in all three scenarios, boards, management teams and risk managers can be well-positioned to shield their operations from potential harm and take advantage of new opportunities that emerge as a result of this disruption.

Uncertainty may be the only certainty in this unique moment in time. Business leaders need to realize they do have a choice in this environment and it is possible to stay ahead of the risks and prepare to seize opportunity. In a time when the difference between borders and barriers is increasingly opaque, geostrategy and an exploration can lead organizations to navigate uncertainty.



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