

Research **Institute**

2018 Davos Edition

The Future of Politics

Introduction

It is no coincidence that we have chosen “The Future of Politics” as the leading theme for this Davos special report. Throughout the past decade, the Credit Suisse Research Institute, our bank’s in-house think tank, has been following a range of global developments and has contributed with original data and in-depth research to numerous debates around pressing economic issues. At the occasion of this year’s World Economic Forum, it is timely for us to consider the very framework of our societies: liberal, democratic international order. In a series of reports authored by leading experts from both within and outside Credit Suisse, we present current research around, among others, voter decision-making in a digital age and policy failures leading to the current rise in populism. We further explore the impact of the changing political environment on capital markets, addressing several topics for investors to consider.

A particularly important theme this year, which several of our experts take up in their contributions, is the political and social volatility across the world, alongside the moderate prospects for the spread of democracy going forward. As predicted by Samuel Huntington in 1965, we increasingly find cases where social modernization spreads faster than political or institutional modernization. As a result, new tensions arise between society and the state and we see the number of new democracies stall as of the mid-2000s, following a downward path since. Modern democratic states have established valuable principles, including a distinction between public and private space, as well as service for the public. As Francis Fukuyama states in his chapter:

“If the institutions of constraint, law and democracy are weak, the system tends toward dictatorship; if the state is weak or ineffective, it fails to deliver on behalf of its citizens.”

What we further examine are market reactions to the changing political environment. Recently, international markets have proved quite resilient to individual geopolitical events. Nonetheless, the consequences of the rapidly evolving political ecosystem are likely to be substantial going forward. The reversal of globalization in favor of regionalism will particularly benefit sectors focused on regional trade. Populist policies will likely lead to further monetary tightening. Ultimately, straightforward asset allocation models that have performed well so far and that saw credit and equity asset classes significantly outperform, are now unlikely to produce similarly satisfactory results.

This year’s World Economic Forum follows the leading theme “Creating a Shared Future in a Fractured World” and makes a point for international collaboration as a means of solving critical global challenges. Against this background, I hope our publication encourages critical thinking about the path and the prospects of our societies, as well as the alternatives ahead of us. I wish you a most inspiring read!

Urs Rohner
Chairman of the Board of Directors
Credit Suisse Group AG



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Outlook for liberal democracy

Until the beginning of this century, politics seemed headed towards a democratic future, as more countries adopted – in full or in part – the basic tenets of democratic process. The progress was jerky and uneven, but continuous: it seemed that Western-style liberal democracy was, albeit slowly, on its way to becoming the political system of choice for an ever-widening part of the world. In the last 15 years, all that has changed.

The Rt Hon Sir John Major KG CH
Prime Minister of the United Kingdom (1990 to 1997)

In many countries, I see a distaste for politics that runs deep, and that is a danger to democracy. What is democracy? It is surely more than electing a government through a universal franchise. Elections are an expression of democracy, but the ballot box alone is insufficient.

My worry is that democracy is in retreat, stifled by its own virtues. Democracy operates on consent. That being so, it is slower to make decisions than autocracy or outright dictatorship. Democracy must cajole. Must persuade. Must seek consensus. Not so autocracy. This can make autocracy seem more efficient than democracy, more decisive, more able to deliver its promises, more swift to act in crises. The rise of non-democratic China to economic super-stardom is one of the great stories of history, but there is a price to pay for its success. The price is a lack of personal freedom for the masses.

The heart of democracy

At the heart of true democracy is liberty under the law. Democratic government must be freely elected, for a fixed period, in a universal franchise, untainted by coercion. There must be checks and balances to its authority. The rule of law must apply. The judiciary must be independent, and there must be a free media, an independent academia, and a functioning opposition free to oppose without sanctions. Only then can freedom of speech and action be protected.

But these attributes are merely the trappings of democracy. Democracy in action is more than satisfying the material demands of the majority, or honoring the promises of an election manifesto. Democratic government must govern for the future as well as the present. A governing party must govern for political opponents who did not vote for them – and may never do so. It must govern for the unborn, and the country they will inherit. For minorities. For the wider international community. And all governments have a responsibility to

themselves for the manner in which they govern.

Today, we have a disillusioned, disinterested, preoccupied or (in some cases cowed or misled) electorate shrugging its shoulders and turning away from politics. In such a climate, democracy faces a threat from the rise of nationalism. This is not theoretical: in many countries it is a reality. In others, a clear and present danger.

In the democratic West, we have come to believe that our liberal, social and economic model of democracy is unchallengeable. It is not. Last year – as the United Nations has reported – 67 countries suffered a decline in political and civil liberties, while only 36 had gains. What has happened there can happen elsewhere. Over 20 democracies have collapsed during the last two decades, and there is widespread public dissatisfaction in many others.

“My worry is that democracy is in retreat, stifled by its own virtues”

Across Europe, nationalism has gained more than a foothold. It begins with a populism that masquerades as patriotism, but morphs into something far less attractive. In many countries, nationalist parties have significant support. They can attract true patriots – but are also a political vehicle for those who flavor that patriotism with xenophobia.

Nationalism is authoritarian. It turns easily towards autocracy or – at worst – outright dictatorship. Nationalists hide their threat under an exaggerated love of country, an unthinking patriotism: “my country, right or wrong.” Its leaders view other countries – and sometimes other races – as inferior. Nationalism is suspicious of foreigners. It accuses immigrants of “stealing jobs” or, in some other way, undermining the indigenous population.

Nationalism versus patriotism

There is a great difference between nationalism and patriotism. Patriotism is more than pride in country. A mature patriotism concerns itself with the condition of the people, as well as the prestige of the country. Such a patriotism worries about deprivation, opportunity and incentive. It asks itself: how can we spread our wealth and opportunity more evenly around our country? And it is as concerned with the growth of food banks as it is with a shortage of aircraft carriers.

The financial crisis – less security, low or no growth, and rising taxes – has created public dissatisfaction with the old, albeit fallible, politics. Anger about its shortcomings replaces cool dispassionate judgment. Despair gives a credibility to promises of easy solutions when – in truth – there are none.

“Politicians must understand that government is primarily about individual lives”

Our social and economic liberalism may be fallible, but it is not some “mish-mash of woolly headed do-gooders.” It protects individual liberties and human rights. It promotes market freedoms, ownership of property, and freedom of movement. We dare not take these familiar values for granted. We need to celebrate them, protect them and practice them: politics must not become a playground for demagogues.

Politicians must understand that government is primarily about individual lives – people’s hopes and fears, and their ambitions for themselves and their families – not simply a competition between competing political philosophies. Politicians must subject policy to one over-riding test: how will its implementation actually affect the people?

Politics has gone awry, but it can recover, provided the causes of its fall from grace are understood – and acted upon.

I, for one, am optimistic they will be. ■



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The rise of populist nationalism

The world experienced a political earthquake in the year 2016 with the British vote to leave the European Union in June and the election of Donald Trump as President of the United States in November. These events were the culmination of a longer-term trend away from the postwar liberal international order, one that had been building for at least a decade earlier, and marked the rise of a new form of populist nationalism. A critical question for the future concerns whether this is merely a “democratic recession,” in the words of political sociologist Larry Diamond, or marks a longer-term downturn in the fortunes of liberal democracy worldwide.

Francis Fukuyama

Senior Fellow at Stanford's Freeman Spogli Institute for International Studies and Professor, by courtesy, of Political Science

The liberal international order

The changes that occurred in 2016 need to be placed in the context of the liberal international order that has existed up to then. There are two components of this order, economic and political. The economic institutions consist of a series of agreements promoting an open global economy. These include the General Agreement on Tariffs and Trade (GATT) which evolved into the World Trade Organization (WTO), and regional arrangements like the European Union (EU), the North American Free Trade Agreement (NAFTA), and the like. These economic structures were designed to promote the free movement of goods, services, capital and people across international borders in a free trade regime that would expand markets and prosperity for everyone who participated in it. Other bodies like the G-7 and the G-20 were intended to promote cooperation in specific areas like monetary policy.

The political institutions were built around a series of security alliances binding the USA to a number of countries. These alliances include the North Atlantic Treaty Organization (NATO) and the bilateral security pacts between the USA, Japan, South Korea and the like. In addition, there were further regional agreements like the Organization for Security and Co-operation in Europe (OSCE), the Council of Europe, the Association of Southeast Asian Nations, and others that were designed to promote stability and political coordination.

Underlying both the economic and political components of the liberal international order was the USA as the world's dominant liberal democracy. The USA was instrumental in creating both the rule-based free-trade regime and the security alliances in response to the Cold War and, currently, the struggle against international terrorism.

This international liberal order worked exactly as advertised. Conventional trade theory tells us that

countries that are open to trade and investment will all grow richer in the aggregate, and this is exactly what happened over the past two generations. Between 1970 and the financial crisis of 2008, global output increased fourfold, leading to the creation of unimaginable amounts of new wealth. For countries in the developing world that participated in this system, hundreds of millions of people were raised out of poverty and new middle classes began appearing in China, India, Latin America and sub-Saharan Africa.

“Between 1970 and the financial crisis of 2008, global output increased fourfold, leading to the creation of unimaginable amounts of new wealth”

The stability and prosperity of this system was highly conducive to the spread of democracy around the world. In 1970, perhaps 35 of the world's countries could qualify as electoral democracies; the number had risen to nearly 120 by the year 2005. This constituted what political scientist Samuel Huntington labeled “Democracy's Third Wave” in 1991, beginning with the democratic transitions in Southern Europe in the early 1970s, and accelerating dramatically by the fall of the Berlin Wall and the return of most of Latin America to democracy by the end of the 1980s.

End of an era

We are now in a period, however, where many of these trends have been reversed. In Europe, a number of right-wing anti-EU parties have appeared



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such as Marine Le Pen's Front National in France or Geert Wilder's Party for Freedom in the Netherlands. The threat from the UK Independence Party (UKIP) succeeded in prompting Prime Minister David Cameron to call the Brexit referendum and shifted his Conservative party to the right. In Germany, the anti-immigrant Alternative for Germany (AfD) party gained representation in the Bundestag for the first time in September 2017, receiving just under 13% of the vote. In the USA, President Trump has withdrawn from the Trans-Pacific Partnership (TPP) and the Paris Accords on Climate Change, denounced NAFTA, and threatened to impose punitive tariffs on China.

“The number of new democracies stopped increasing in the mid-2000s and began to decline”

The consensus behind globalization as a positive force and the hope that institutions promoting closer international cooperation would steadily strengthen (e.g. Europe's aspiration for an “ever closer union”) have dissipated and been replaced in a number of countries with a new emphasis on national sovereignty. During his speech to the UN General Assembly in September 2017, Donald Trump repeated the word “sovereignty” twenty-one times. This would not be surprising coming from a Chinese or Russian leader, but is hardly typical of a US president.

The number of new democracies stopped increasing in the mid-2000s and began to decline; qualitatively, large new non-democratic players

like Russia and China appeared on the scene that did not accept the legitimacy of the American-led order. Turkey under President Tayyip Recep Erdogan has systematically sought to concentrate power in the executive and curb opposition to the president's rule. These setbacks have been described by Larry Diamond as a “democratic recession”¹ as authoritarian countries have gained in confidence and countries thought to be in transition to democracy have started slipping back into authoritarian practices.

What was perhaps most surprising, however, was the regression that occurred within the democratic world itself. Within the EU, new governments appeared in Hungary in 2011 and Poland in 2015 that set forth on explicitly nationalist agendas: the former's Prime Minister Viktor Orban stated that he was seeking to build an “illiberal democracy,” and understood Hungarian national identity in strictly ethnic terms, while the latter undertook a broad assault on the Polish judiciary and independent media. Both countries had made an early transition to democracy after the collapse of Communism; both were regarded as having successfully consolidated their democratic systems during the 1990s.

How do we characterize these changes and what are the larger forces driving them? We need to begin with some definitions.

Democracy and populism

Liberal democracy can be seen as a political system that joins three distinct elements. The first is a state that concentrates and uses power to defend the

1. [Facing Up to the Democratic Recession](#). Larry Diamond. *Journal of Democracy*, Volume 26, Number 1, January 2015, pp. 141-155

nation from foreign and domestic threats, as well as enforce the law and deliver basic services to citizens. A modern state is one that is impersonal and makes a clear distinction between public and private; the state exists not for the self-enrichment of the rulers but for public benefit. The second institution is the rule of law, ideally a system of transparent laws that are binding not just on ordinary citizens but on the most powerful political actors in the society. And finally, institutions of democratic accountability such as free and fair multiparty elections seek to ensure that governments are accountable to as broad a part of the population as possible and not just to the elites that run it.

Liberal democracy is therefore a balance between the power-generating and power-deploying institutions, the state, the rule of law and democratic accountability, which are fundamentally institutions of constraint. If the institutions of constraint, law and democracy are weak, the system tends toward dictatorship; if the state is weak or ineffective, it fails to deliver on behalf of its citizens.

What is distinctive about the new populist nationalist regimes that have appeared is that leaders are using the third pillar, democracy, to weaken or undermine the first two pillars of state and law. That is, they use the legitimacy conferred by democratic elections to corrupt the state and use it for their own private purposes, and seek to evade or otherwise undermine the rule of law.

“Leaders are using the third pillar, democracy, to weaken or undermine the first two pillars of state and law”

In 2016, the Law and Justice Party in Poland launched a campaign against the Polish judicial system, demanding the retirement of most sitting judges and seeking to replace them with others sympathetic to the party. The Fidesz party in Hungary has used its legislative supermajority to push through a series of constitutional changes that reduce the independence of various checking institutions. All of these regimes claim the mantle of democracy, but do not maintain the balance between state, law and democracy that true liberal democracy demands.

Three characteristics of populism

There is no consensus among political scientists as to the definition of populism, but there are at least three characteristics that have been associated with the term. The first is a regime that pursues policies that are popular in the short run, but unsustainable in the long run, e.g. price subsidies or expansive social services. This characterized the regime of Hugo Chavez in Venezuela, who used oil revenues in flush times to fund a series of social programs for the poor that collapsed when energy prices fell.

A second characteristic has to do with the definition of the “people” who are the basis for legitimacy: many populist regimes do not include the whole population, but rather a certain ethnic or racial group that are said to be the “true” people. Thus Viktor Orban in Hungary has defined Hungarian national identity as based on Hungarian ethnicity, something that would exclude non-Hungarians living in Hungary, and include the many Hungarians living in surrounding countries like Slovenia or Romania. Prime Minister Narendra Modi in India has similarly been trying to shift the definition of Indian national identity from the inclusive liberal one established by Mahatma Gandhi and Jawaharlal Nehru to one based on Hinduism. Sarah Palin, a precursor of Donald Trump, once defined “real Americans” as those like herself coming from small towns and rural America, which seemed to exclude the diverse populations living in big cities like Los Angeles or New York.

“Populist leaders tend to develop a cult of personality around themselves”

A third definition of populism has to do with the style of leadership. Populist leaders tend to develop a cult of personality around themselves, claiming the mantle of charismatic authority that exists independently of institutions like political parties. They try to develop a direct and unmediated relationship with the “people” they claim to represent, channeling the latter’s hopes and fears into immediate action. It is typically coupled with a denunciation of the elite who make up the existing institutions. This claim to directly represent popular wishes is what then legitimates the leader’s efforts to undermine institutions that would limit his or her power.

These three definitions allow us to distinguish between the different movements that have been given the label “populist” in the past. Latin American populists like Hugo Chavez or Nestor and Cristina Kirchner emphasized popular but unsustainable social programs, and tried to create personality cults around themselves. They did not, on the other hand, entertain a restrictive definition of national identity. The same could be said of Thaksin Shinawatra and his sister Yungluck in Thailand: they promoted redistribution programs for poorer rural Thais but did not have the same restrictive view of Thai identity as their yellow shirt opponents.

Leaders of the Brexit movement, by contrast, did not stress an economic program, nor did they have a single charismatic leader. But they did appeal to anti-immigrant cultural fears and traditional British identity, as well as the discontent about economic dislocation. Viktor Orban fits all three definitions: he has tried to protect Hungarian savers from “predatory” European banks, he has a restrictive definition of “the people” and he would certainly



like to be considered a charismatic leader. It is not clear whether Vladimir Putin fits any but the last of the three definitions: he has been cautious on expansive social programs and, while stressing Russian identity and traditions, he claims that tradition is not necessarily restrictive in ethnic terms. He has certainly built a cult of personality around himself, although it is hard to argue that he is an outsider seeking to overthrow the entire elite. The same can be said about India's Narendra Modi and even China's Xi Jinping: they have both become popular by attacking the existing elite, although they themselves are very much part of that elite.

It should be noted that Donald Trump seems to fit all three definitions. During his campaign, he focused on topics such as trade protectionism, while keeping hands off social programs like Medicare and social security. Also, he has sought an unmediated relationship with his core supporters: when accepting the Republican nomination in 2016, he said "I alone understand your problems," and "I alone know how to fix them."

Why populist nationalism now?

There are three reasons why we are seeing the rise of populist nationalism in the second half of the 2010s: economic, political, and cultural.

The economic sources of populism have been widely noted and discussed. The same trade theory

telling us that all countries participating in a free trade regime will be better off in the aggregate also tells you that not every individual in each country will be better off. The widely taught Heckscher-Ohlin trade model (developed by Swedish economist Eli Heckscher and Bertil Ohlin) suggests that low-skilled workers in rich countries will lose out to similarly skilled workers in poor ones, which has in fact been happening in many industrialized countries with the rise of China, Mexico and other developing countries. According to a recent IMF study², some 50% of Americans are no better off in terms of real income than they were in 2000; many more of those in the middle of the income distribution have lost ground than have moved up the economic ladder. In the USA, this relative economic decline of the middle or working class has been associated with a number of social ills, like increasing rates of family breakdown or an opioid epidemic that claimed more than 60,000 lives in 2015.

The second source of populism is political. Liberal democracies invite popular participation and over time tend to proliferate rules that complicate decision-making. When such political systems combine with polarized or otherwise severely divided publics, the result is often political paralysis, which makes ordinary governing very difficult. India

2. Ali Alich, Kory Kantenga, Juan Solé, "Income Polarization in the United States," (Washington, DC, IMF Working Paper WP/16/121)

under the previous Congress Party government was a striking example of this, where infrastructure projects and needed economic reforms seemed beyond the government's ability to deliver.

Something similar occurred in Japan and Italy, which often seemed paralyzed in the face of long-term economic stagnation. One of the most prominent cases was the USA, where an extensive set of constitutionally mandated checks and balances can be seen as a "vetocracy," i.e. the ability of small groups to veto action on the part of majorities. This is what has produced a yearly crisis in Congress over passing a budget, something that has not been accomplished under so-called "regular order" for at least a generation, and has blocked sensible reforms of health care, immigration, and financial regulation.

"Would-be strong men"

This perceived weakness in the ability of democratic governments to make decisions and get things done is one of the things that set the stage for the rise of "would-be strong men" who can break through the miasma of normal politics and achieve results. This was one of the reasons that India elected Narendra Modi, and why Shinzo Abe has become one of Japan's longest-serving prime ministers. Vladimir Putin's rise as a "strong man" came against the background of the chaotic Yeltsin years. And, finally, one of Donald Trump's selling points was that, as a successful businessman, he would be able to make the US government functional again.

"There have been major policy failures by elites in both America and Europe"

Moreover, there have been major policy failures by elites in both America and Europe. The USA embarked on two unsuccessful wars in the Middle East in the 2000s and then experienced the biggest recession since the Great Depression of the 1930s. The EU created a monetary union around the euro without a corresponding way to unify fiscal policy, leading to the Greek debt crisis. And it created the Schengen area and a host of other rules liberalizing the movement of people within Europe without establishing a credible mechanism for controlling its outer borders. While laudable from an economic and moral standpoint, internal freedom of movement became problematic in the absence of such controls. This turned into a legitimacy crisis in the wake of the mass migration triggered by the Syrian civil war in 2014.

The final driver of populist nationalism is cultural. Many years ago, Samuel Huntington pointed out that the most dangerous socio-economic class was not the poor and marginalized, who often lacked the time and resources to mobilize, but rather middle classes who felt they had lost ground economically

and were not being adequately recognized by the political system. Such people can make economic demands, but they tend to interpret their loss of status culturally as well: they used to constitute the group that defined national identity, but were now being displaced by newcomers who were being given unfair advantages over them. This reinforces the tendency to scapegoat immigrants and foreigners as agents of this change. In this respect, economic motivation overlaps substantially with cultural concerns, and in many ways cannot be distinguished from them.

This is what has made immigration such a powerful issue in driving populist nationalism. Rates of immigration have in fact become very high in Europe and the USA, and concerns over rapid cultural change have motivated many voters to support populist parties and leaders even if they have felt themselves to be under direct economic threat. In many ways, questions of identity – language, ethnicity, religion and historical tradition – have come to displace economic class as the defining characteristic of contemporary politics. This may explain the decline of traditional center-left and center-right parties in Europe, which have lost ground steadily to new movements built around identity issues.

What the future holds

For those who believe that liberal democracy constitutes the best form of government, the rise of populist nationalism is a very worrying phenomenon. The last time this happened in the 1930s, the Great Depression was deepened and prolonged by punitive tariffs and competitive devaluations, while Europe eventually plunged into World War II. The central question is then whether the current trend is actually just a democratic recession from which the world will eventually recover, or whether the forces visible today will strengthen and threaten liberal democracy as a form of government in more countries.

Answering this question is not a matter of empirics or simple trend projection. Leadership and a variety of exogenous factors like the sudden appearance of military conflict or a new financial crisis will affect outcomes, as will decisions taken by individual leaders. Here we can only make a limited series of observations to support the case that we are in a recession rather than a full-scale depression, and that the world will not descend into a 1930s-style cataclysm.

First, the solutions proposed by populist nationalists to the social problems they face are likely to be self-defeating. Latin America experienced its populist wave about 10–15 years before Europe and the USA with the rise of Hugo Chavez. Chavismo has left Venezuela in ruins, but has also had a useful minatory effect on other countries in the region that do not want to follow it into long-term decline. Argentina, for example, flirted with populism for a decade under the Kirchners, but has since reverted to a more sensible centrist government and is recovering economically and politically.

A second reason for hope is the fact that institutions in existing liberal democracies are much stronger than they were in the 1930s. There has been a great deal of social learning in the subsequent years; contemporary Germans, for example, are still aware of the threat that fascism posed to their society. While populist parties have made significant gains, they have not yet displaced the mainstream ones; in France, for example, they have been displaced by Emmanuel Macron's new centrist movement. The checks and balances of the US constitutional system were designed in many ways to limit the damage that a "would-be Caesar" would pose to republican government. Those checks – the courts, federalism, the substantial powers vested in Congress, the decentralized nature of the executive, and the media – have all

come under attack from President Trump, but have stood up fairly well until now.

Finally, there are policy steps that elites in Europe and the USA could take that would mitigate some of the underlying drivers of populism. Many observers have suggested a raft of economic policy measures that could lessen economic inequality and shore up existing middle classes. All of this is to the good and necessary given the technological forces driving inequality.

“There are policy steps that elites in Europe and the USA could take that would mitigate some of the underlying drivers of populism”

But fewer people have sought to address the cultural anxieties that are equally powerful sources of populist discontent. This would involve elites accepting the idea that states are territorial jurisdictions that have the right – indeed, the obligation as liberal democracies – to maintain control over their borders. For an entity like the EU, this would mean getting serious about control over its external borders. For Europe, it would mean acceptance of the fact that individual countries, as well as the EU as a whole, can legitimately take decisions regarding the speed and pace of immigration. For its part, the USA has been avoiding confronting serious immigration reform, which would inevitably involve balancing stronger enforcement of existing immigration laws with a path to citizenship for most of the 11 million undocumented aliens already in the country. At the same time, there needs to be a recognition that national identity is an important component of democratic self-government, and that identities need to be adjusted to meet the requirements of societies that have become de facto multicultural.

One of the advantages that democracy has over authoritarian government is its ability to make course corrections and hold accountable leaders who make bad policy mistakes. The future of democratic government in both Europe and North America will very much depend on how their political systems adapt to the large social forces that have been unleashed by globalization and technology. ■

NOTE: The views expressed here are those of the author and do not necessarily represent or reflect the views of Credit Suisse



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Voter misbehavior: How behavioral insights can help understand voters

Recent events have brought many questions about voters' influences and motivations to light. Despite some evidence of voter rationality, the gaps left by "homo economicus" in the electoral setting remain conspicuous. Behavioral economics can provide psychologically grounded explanations for these quirks in voter behavior. Understanding how citizens approach voting is of vital importance to the endeavor of improving electoral processes.

Michael M. Ting
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Humans are quirky decision-makers. This seemingly banal observation has generated intense interest among academics, policymakers and managers in recent years. The reason, perhaps, is that generations of analysts were trained to assume exactly the opposite. As countless undergraduates have learned, economic theories typically start from the assumption that individuals in markets or society are rational. Loosely speaking, rational actors are not quirky: they both know their objectives and can calculate how best to achieve them. This austere conception of homo economicus remains the foundation of economic inquiry today.

Behavioral economics challenges this foundation by recognizing a range of familiar decision-making flaws: we are often (among other things) inattentive, forgetful, impulsive, impatient, overconfident, inconsistent, or simply bad at calculation. The pervasive consequences of these flaws have now achieved mainstream recognition (DellaVigna 2009, Madrian 2014). The 2002 and 2017 Nobel Prizes in Economic Sciences recognized two of the field's pioneers, Daniel Kahneman and Richard Thaler. Across the world, institutions such as the UK's famed Behavioural Insights Team or "Nudge Unit" have arisen to provide policy remedies.

The fallibilities probed by behavioral economists almost surely extend beyond the economic realm. If consumers can make bad choices as a result of their cognitive limitations, then why would voters not do so as well? The present decade has seen numerous upheavals – the Brexit vote, the Trump administration, the rise of the far right in Europe – brought about through the ballot box. In light of these events, it is worth asking whether the insights of behavioral economics can help us to understand voters too. This brief essay argues that it can. Although it is by no means a comprehensive survey, it aims to convey a sense of both the value added and the limitations of modern behavioral perspectives.

Rationality and voting

The notion that voters may fall short of the rational ideal is hardly new to election researchers. The disciplines of political science and economics largely evolved independently throughout the 20th century and, as a result, political scientists never uniformly embraced rationality as an analytical starting point. Instead, the study of voters has remained pluralistic, incorporating in different corners elements of economics, psychology, and sociology (Diermeier 2015).

"If consumers can make bad choices, then why would voters not do so as well?"

Observations of actual voter behavior in various settings also support the idea that non-rational perspectives should be taken seriously. We are regularly reminded that many voters seem unprepared for the task of deliberating questions of national leadership (Delli Carpini and Keeter 1997). In a 2017 Pew Research Center study, only 60% of Americans surveyed correctly identified the UK as the country leaving the European Union, and less than half could identify their own Secretary of State.¹ Generations of academic studies have supported the view that voters are not particularly effective at optimizing their choices. For example, voters respond only weakly to what incumbent politicians do in office (Erikson 1971). They are too willing to incorporate irrelevant information in their voting decisions (Leigh 2009), and resort to simple decision heuristics in choosing whom to vote for (Woon 2012).

1. Survey details can be found at <http://www.people-press.org/2017/07/25/from-brexit-to-zika-what-do-americans-know/>, accessed December 10, 2017



The very act of voting represents perhaps the canonical challenge to homo economicus in politics (Feddersen 2004). To see why, suppose that voters care about the election winner and the cost of voting. Rational voters would then weigh the net benefits of voting, which imposes a cost, but raises the chances of victory for their preferred candidates, and not voting, which is costless, but raises the chances of a disappointing outcome. In an electorate of any reasonable size, the likelihood that any single voter will be pivotal in determining the election is vanishingly small. Thus if individual votes are effectively irrelevant to the election outcome, why should voters bother to show up?

This logic is of course at odds with the obvious fact that many voters participate in elections across the globe. In the United States, where turnout is comparatively low, 139 million, or about 60% of the eligible population, cast ballots in its 2016 presidential election.² Even in elections that are projected to be lop-sided, thousands, if not millions, routinely cast ballots that they know will not affect the outcome.³ These observations do not necessarily reject a central role for rationality in voting.

For example, rather than reflecting an inability to process information, uninformed voters might be rationally unwilling to invest in acquiring information

2. Data from the United States Election Project, <http://www.electproject.org/2016g>, accessed December 10, 2017

3. This does not imply that no one should vote: in that hypothetical situation, one person could then step in to determine the election unilaterally

that is unlikely to be useful (Prato and Wolton 2016). A classic argument is that rational actors can produce mass turnout if a sufficient number feel a sense of duty, or an intrinsic benefit from the act of voting (Riker and Ordeshook 1968, Feddersen and Sandroni 2006). This motive no doubt explains why some citizens vote, although it is hard pressed to account for the wide variations in turnout levels that are evident across societies and over time.

“If individual votes are effectively irrelevant to the election outcome, why should voters bother to show up?”

In fact, for all of their shortcomings, voters appear to behave quite rationally in certain situations. Consider the question of which candidates voters support when they do decide to vote. If we posit that voters are concerned primarily with public policies that benefit themselves economically, then most voters choose the correct candidate. In the USA, lower income voters tend to favor Democrats, while higher-income individuals lean toward Republicans (Bartels 2006). Voters also commonly abstain, or “roll off,” in races that they are less informed about on the same ballot – even though they have already paid the cost of showing up to the voting station (Feddersen and Pesendorfer 1996).

Thus it can be said that, in the aggregate, voters act consistently with their interests, and weigh in when they feel sufficiently informed about them. Some of the most intriguing tests of voter rationality arise in situations where optimal decisions depend on other voters' actions. For example, turnout is consistently higher in elections that are close; i.e. when a vote is more likely to be pivotal (Franklin 2004). In some political systems, voters may also confront the prospect of strategic voting, or supporting a less preferred but more electable candidate. Assuming that they care primarily about policy consequences, supporters of a candidate who will certainly lose should instead back their favorite "viable" candidate, if one exists.

This situation arose during the 2000 US presidential election, where the Reform Party candidate Ross Perot attracted a sizable following, but had no chance of winning. In strongly Democratic

and Republican states, Perot performed similarly well between the last polls and the election. However in close states, Perot lost significant support, indicating that many of his backers switched to one of the main candidates when the electoral stakes were high (Burden 2005). The extent of strategic voting is difficult to estimate, but recent studies suggest that it is substantial (Hall and Snyder 2015).

The overall assessment of voter rationality is therefore mixed. Treating voters as rational actors can be a useful shorthand for explaining how elections unfold, just as treating consumers as rational actors can be useful for understanding product markets. In both settings, there are limits to what rational actors can easily explain. The promise of behavioral economics is that it provides psychologically grounded explanations for situations where deviations from rationality are evident.

One might contend that behavioral insights are of limited use if the rational perspective on voters remains a serviceable workhorse. However the nature of political competition actually suggests otherwise: in competitive party systems, differences in turnout in a few states or electoral districts can and sometimes do determine control of the legislature or the presidency. Thus understanding how even modest-sized groups of citizens approach elections can be of critical importance.

Behavior, economics and politics

Which aspects of human behavior matter for elections? The range of cognitive and judgmental biases is vast (Rabin 1998), and moreover voters and elections differ in some important ways from the consumers and markets often studied by behavioral economists. Notably, a vote provides relatively little in the way of immediate consumption benefits, and its effect is usually both minuscule and dependent on the actions of many others. The following six categories are a sampling of behavioral quirks that have gained the most attention in the voting environment.

Reinforcement learning

Compared to rational optimization, a less mentally taxing approach to decision-making is to repeat or "reinforce" actions that have a record of satisfactory outcomes. For example, the choice of a beverage or recreational activity might simply be the consequence of accumulated positive experiences with those alternatives. This classic rule in the study of learning is known as the "Law of Effect" (Bower and Hilgard 1981).

Reinforcement learning speaks directly to the paradox of voter turnout. Under this mechanism, voting occurs because it is more often associated with "good" election results, while not voting is associated with "bad" outcomes. Reinforcement learners not only turn out at high levels, but also collectively behave like rational voters by voting at higher rates in closer elections (Bendor, et al. 2011).



Photo: Shutterstock, Joseph Sohm

The Law of Effect suggests that voting is in some sense habitual: once started, it is likely to continue. This idea has been supported by numerous studies of real world voters. One such study leverages the fact that local voting rates are affected by the weather. When bad weather depressed turnout in one election, later elections (which were of course unaffected by the original bad weather) saw reduced turnout as well, as more voters discovered that staying home yielded satisfactory outcomes (Fujiwara, Meng, and Vogel 2016).

Overweighting small probabilities.

Humans are not by nature good statisticians. One shortcoming is the tendency to over-estimate the likelihood of very unlikely events, such as lightning strikes or winning a lottery (Kahneman and Tversky 1979). This can cause people to prepare excessively for small risks, or tempt them to seek untested medical treatments. Since lottery participants over-estimate their chances of winning, lottery-based prizes can successfully induce various kinds of good behavior, such as weight loss (Volpp, et al. 2008). In an election context, citizens may similarly have an inflated sense of their chances of determining the winner. This assessment could then cause otherwise rational citizens to vote (Duffy and Tavits 2008).

Framing

Winning a monetary prize brings some happiness to most, but losing an equivalent amount of money actually brings much more unhappiness. The reason is that outcomes often matter not in isolation, but relative to a reference point or frame. The reference point might be one's current wealth, but it may also be manipulated by clever marketing or persuasion. Around the reference point, people are loss averse; that is, losses are felt more sharply than gains. Additionally, which side of the reference point one is on affects his or her attitude toward risk. People are risk averse when considering gains, but risk acceptant when considering losses. Together, these ideas are known as prospect theory (Kahneman and Tversky 1979).

Prospect theory has seen many applications in the field. Saez (2009) manipulates framing to present contributions to tax-advantaged savings accounts in a way that suggested lower losses; the avoidance of loss aversion helped to increase investment take-up. Benartzi and Thaler (1995) invoke loss aversion to explain the divergence in returns between equity and bonds. In the electoral setting, prospect theory might affect voter perception of the desirability of risky candidates. In particular, when times are good and voters frame election results as possible gains, incumbents benefit from being better known and hence more appealing to risk-averse voters. By contrast, bad times favor more risky challengers (Quattrone and Tversky 1988).

Saliency

Not all information is evaluated evenly. Instead, according to the availability heuristic, people often focus on the pieces of information that are most

salient in memory (Kahneman and Tversky 1973). Saliency is driven by unusual or dramatic events, or simply by recency. Media coverage can play an important role in determining saliency. Barber and Odean (2008) show that individual investors are more likely than institutional investors to buy based on prominent news coverage or unusual performance. On a more positive note, regular reminders can successfully prompt recipients to fulfill objectives such as making payments or saving (Karlan, et al. 2016). The troubling implication for voters is that arbitrary cues might guide their decisions. In a study of elections in California, where ballots presented candidates in random order, minor parties did significantly better when they were listed first (Ho and Imai 2008).

Confirmation bias

Beliefs and predispositions also color the evaluation of facts. People readily accept evidence that supports their pre-existing beliefs, and reject contrary evidence too easily. Thus, incriminating evidence may have little effect on jurors who are convinced of a suspect's innocence. In fact, rather than forging consensus, new information can even drive people with different beliefs farther apart. Concerning specifically political information, Taber and Lodge (2006) show experimentally that people seek confirmatory information while expending mental effort to reject contrary non-confirmatory information. In turn, these tendencies increased polarization in attitudes.

“People readily accept evidence that supports their pre-existing beliefs, and reject contrary evidence too easily”

Confirmation bias raises questions about how voters have responded to the proliferation of news sources in the modern era. If consumers respond to news providers, then better journalistic standards might improve voter information. This informational role is diminished if news sources must instead cater to consumer ideology. Both phenomena no doubt occur, but a prominent study of newspaper coverage suggests a significant role for the latter (Gentzkow and Shapiro 2010). Even more recently, the 2016 US election drew great attention to the rise of “fake news” websites, many of which supported the candidacy of Donald Trump. A new study estimates that about a quarter of Americans visited such websites, and that these were predominantly Trump supporters (Guess, Nyhan, and Reifler 2017).

Social pressure

Nearly a century ago, researchers at the Hawthorne Works factory noticed that employees improved their performance when they knew that they were under

observation. The so-called “Hawthorne Effect” illustrates how the social context of decision-making matters. The desire to conform to social norms can lead to drastic differences in behavior as the level of social pressure changes. As an example, Mas and Moretti (2009) examined the physical placement of workers in a supermarket, where some workers could observe their peers, but otherwise had no interaction. Their study found that low-productivity workers performed significantly better when they were observable by high-productivity workers, but not when they were in the position of observing high-productivity workers.

In a society where social norms favor voting, this result has a potentially important implications. In a large field study of 2006 Michigan primary election voters, Gerber, Green, and Larimer (2008) examined the impact of several get-out-the-vote interventions. Households who received no treatment turned out at a rate of 29.7%, but for those receiving a reminder to vote that mentioned that they were being studied, the rate increased to 32.2%. To increase social pressure even further, other households received a listing of their past voting records (i.e. whether they voted, not whom they voted for) along with those of their neighbors. Recipients of this treatment turned out at a rate of 37.8%.

The list of behavioral applications to politics is still growing; recent efforts have scrutinized other phenomena such as impatience (Lizzeri and Yariv 2017) and overconfidence (Ortoleva and Snowberg 2015). Collectively, this body of work is obviously quite diverse, but its overall theme might be that many of the most prominent behavioral quirks are as relevant to politics as they are to economics.

Ultimately, the relevant similarity between the two domains might be that consumers and voters both make low-stake decisions with little direct aid from outside experts. Such settings naturally allow non-rational behaviors to go unchecked.

The candidate’s perspective

Candidates for office normally appeal to voters by offering some combination of ideological affinity, beneficial policies or common personal characteristics. These might be considered appeals to rational decision-making, in much the same way as competing firms advertise product features to consumers. The fact that voting decisions are also driven by non-rational considerations gives candidates an additional set of campaign incentives. While academic research connecting behavioral economics with campaigns tactics is nascent, the above-mentioned behavioral quirks can help to explain some common campaign tactics.

Cultivating voters

Under reinforcement learning, voting produces a feedback effect: as long as a citizen is not generally disillusioned with election results, the simple act of voting will increase his/her future propensity to vote. The implication for parties and candidates is that early political experiences matter for building support. The benefits of mobilizing low-turnout groups, such as younger and Latino voters in the United States, therefore extend beyond the next election cycle.

Next, the research on social pressure in decision-making suggests that candidates have much to gain from engaging organizations that are rich in social



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interactions, such as churches and unions. One recent American example is the advent of “Souls to the Polls” efforts that shuttled voters from Sunday services at African-American churches to polling stations (notably, African-American voting rates are similar to those of white Americans). In addition to possibly reducing voting costs, the social setting of these activities creates openings for citizens to experience both explicit and implicit peer pressure.

Since citizens must actually have someone to vote for, these arguments further imply that a party should run candidates even when its prospects for victory are dim. National parties generally do this. In this century, most elections for the 435 seats in the US House of Representatives have been uncompetitive, with the winner capturing at least 60% of the vote. However in 2016, 53 such races, or over 12%, went uncontested by one of the major parties. Although there was certainly little short-run benefit from nominating a candidate in these contests, the cultivation of friendly voters would benefit parties over the longer term.

Campaign messages

The framing of election messages can affect how voters perceive candidates, and negative campaigns have become a pervasive feature of election advertising. Why would candidates choose to accentuate their opponents’ scandals, lack of character, or poor performance in office over their own selling points? One channel might be loss aversion. As in other decision-making domains, negative news in politics produces stronger reactions than positive news, thus giving campaigns incentive to focus on the negative (Soroka and McAdams 2015).

“Negative news in politics produces stronger reactions than positive news”

According to the availability heuristic, voter perceptions of politicians will not be driven by even-handed assessments of their resumes or achievements in office. This elevates the likelihood that certain types of events – salacious scandals and terrorism stand out as examples – become campaign issues. Media coverage may amplify these tendencies. The coverage of the 2016 US elections was notable for its overwhelming focus on scandals as opposed to policies (Patterson 2016). The heuristic also means that voter attention will be biased toward more recent events. Facing these biases, incumbent politicians might work on policies that are complex or difficult to observe out of the glare of an imminent election, and switch to activities that produce more obvious results as elections approach.

Many features of modern election campaigns can divert voter decision-making away from a sober reflection on the relative merits of the candidates.

While the implications for the effectiveness of democratic governance may seem unsettling, two caveats are in order. First, the very competitiveness of elections in most democratic societies implies that any tactical advantages that benefit one party – behavioral or otherwise – are likely to be transient. An analogy from marketing is apt: a new technique to lure customers may boost a company’s fortunes in the short run, but this advantage will dissipate as the innovation diffuses across the industry.

Second, voters are not entirely helpless. They may stay home or choose the wrong candidate, but many actors are motivated to reverse these temptations. Political parties, for example, provide crucial assistance by associating informative brands to candidates and policies. Politically liberal voters might not understand the nuances of every candidate or policy, but rather than being vulnerable to manipulation they often use party labels as cues to guide their choices. In one set of experiments, Druckman (2001) eliminated framing effects by attaching party labels to policy proposals. Thus, the competitive environment provides at least some incentives to offset voter misbehavior.

Conclusions

In *The Republic*, Plato famously argued that citizen incompetence rendered democracy an undesirable form of government. While this argument would have few takers in modern, advanced democracies, recent events have brought to the forefront questions about how individuals process information and make voting choices. Simultaneously, the field of behavioral economics has steadily transformed the study of economic decision-making. These developments join a long-standing tradition of voting research by political scientists. The result has been an emerging agenda for exploring the political economy of voting. Despite some evidence of voter rationality, the gaps left by “homo economicus” in the electoral setting remain conspicuous. For both researchers and practitioners, behavioral economics is therefore a natural fit for analyzing voting.

Given the rise of policy prescriptions that address behavioral anomalies in various settings, it is worth asking whether behavioral insights can also be applied to improve voting. For this to occur, however, there needs to be broad consensus on society’s objectives. Somewhat paradoxically, it is unclear how rational citizens should be. Voting is widely viewed as a socially beneficial form of political participation, even if the best course of action for a rational citizen might very well be to stay home. Yet, at the point of choosing among candidates, we worry about the consequences of irrationality, given the immense social stakes of elections. The zero-sum nature of elections further implies that mistakes have direct beneficiaries. Achieving consensus in this very complex environment is a tall order. ■

NOTE: The views expressed here are those of the author and do not necessarily represent or reflect the views of Credit Suisse



中國人民銀行

Globalization and politics

The past three years have seen political volatility rising against a backdrop of improving economic growth across the major regions and increasingly becalmed financial markets. At a very broad level, it seems that there is no correlation between economic output and voter behavior and, in a stylized way, it seems that finance and economics escape blame for unexpected voter behavior. However, a deeper examination of the tectonic forces within the world economy suggests that there may be two trends that will shape politics. The first is the slowing of globalization and the rising costs associated with its progression. The other is the friction caused by the transition away from “globalization” toward a more decisively multipolar world.

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In this essay, we explore how the side effects and imbalances that are left in the wake of globalization may be contributing to voter behavior. Second, we analyze how the potential “end of globalization as we know it” will challenge politicians, and what kind of new political issues may be spawned by a more multipolar world order.

To many people, the rise of Donald Trump, the UK's vote for Brexit, increasing incidences of separatism and the deepening of support for right-wing parties in Europe are unwelcome confusing events. For others, they are the understandable and perhaps necessary choices of electorates confronted with political classes that they feel do not adequately represent their views and fears. On both sides, there are constituencies that lay the blame on globalization.

The notion that “it is all globalization's fault” is a very convenient one. Globalization makes for an expedient culprit. It has few defenders as it is now unfashionable and politically unprofitable to show support for it. It has no outright owner, though some international bodies like the Organisation for Economic Co-operation and Development (OECD) and the World Economic Forum (WEF) are closely associated with it. Then the public understanding of globalization is not clear. Few people take the trouble to sift through trade reports or examine the flow of labor around the world. In this way, as with the issue of “Europe” in British politics, globalization is vulnerable to becoming a catchall for the negative aspects of economic growth. In some cases this may be justified.



We see at least two trends...

Our reading of globalization shows at least two trends. The first is that globalization and its component parts are slowing. The second is that globalization has apparently produced a number of extreme side-effects. We define globalization as the increasing integration and resulting interdependence of markets, economics, societies and political systems. The sense behind this is that ideas, products, money and people can flow between regions and countries with a high degree of freedom.

The basic way of measuring this is trade activity. In the past year, world trade has picked up, although relative to the intensity of recent years, it appears to be plateauing (global trade to Gross Domestic Product (GDP) at 58% in 2015 is still below the peak level of 61% seen in 2008). Here, we also point out that barriers to free trade are rising. Launched in 2009 as a trade policy monitoring initiative, the Global Trade Alert (GTA) highlights that discriminatory or harmful measures (accounting for 76% of new interventions as of 20 November 2017) continue to dominate and restrict free trade. We also note the tendency for major trade deals such as the North American Free Trade Agreement (NAFTA) and the Trans-Pacific Partnership (TPP) to fall victim to protectionist rhetoric, thereby threatening well-established supply chains of multinationals as countries such as the USA seek to boost the contribution of local content.

In our recent publications on globalization¹, we have compiled a composite indicator of globalization incorporating data on trade openness, foreign direct investment, technological globalization (internet usage) as well as social globalization (flows of people and remittances for instance). Much like global trade, this indicator has not picked up in the last year (the index peaked at 1.05 in 2008 and stood at 0.99 in 2016) and very much gives the impression that globalization has “reached a limit.”

“The notion that “it is all globalization’s fault” is a very convenient one.”

To dig a little deeper, flows of people into countries like the USA are declining, although in Europe refugee-related people flows into the European Union are broadly at record levels (other more closed societies such as Japan took in only 28 refugees in 2016). The more interesting trends in migration today are within countries due to growing urbanization (most notably India, China and large African countries like Nigeria).

Financial globalization, despite record market levels, has not proven effusive either. Financial cross-border flows have not kept up with, say, the

volume of transactions within markets. There are some specific factors here, such as the People’s Bank of China crackdown on overseas financial flows or the trend decline in IPOs and merger activity (many smaller growth companies are bought before they reach the IPO stage).

Although it is difficult to measure, one might also suggest that the flow of ideas and of democracy has also come to a halt. These are readily associated with the spread of globalization. Since 2011, the number of strong democracies (which we classify as countries with a polity score of greater than 7) has peaked and declined over the past five years. In many countries, there is now a fashion toward “managed democracy” where a single, powerful individual takes over the powers normally associated with institutions such as the judiciary system, finance ministry and the media. In addition, more and more countries are beginning to curb the openness of their media and particularly the openness of communication across the internet. China, for example, has effectively ring-fenced its internet space. There is thus a developing picture of globalization that has lost its force, and where some of its specific elements are beginning to wither.

“Globalization and its component parts are slowing”

Political and popular backlashes

Equally, it appears that many of the components of globalization, such as immigration, have reached a limit in the sense that they are provoking sharp political and popular backlashes. The rise of right-wing parties across Europe is partly motivated by concerns over immigration. Moreover, multinational companies, described as the B-52s of globalization by Professor Jagdish Bhagwati, are at the center of debates on monopoly power, tax avoidance and income (the proportion of corporate profits to GDP in the USA is at a record high, while the proportion of wages to GDP is close to its lows).

The debate on inequality is also perceived by many to be anchored in globalization. For instance, the Credit Suisse Research Institute’s 2017 Global Wealth Report highlights that the shares of wealth held by the top 1% and the top 10%, respectively, are at the highest points since we started measuring them. This may also tell us something about the political climate in some developed and emerging countries. Between countries, there are also differences.

In the USA (which according to the Global Wealth Report is home to 43% of the world’s millionaires and has over 70,000 ultra-high net worth individuals), wealth inequality is high and the median level of wealth per adult is four times the level in Europe, nine times the level in China, almost 50 times the level in India, and more than 100 times the level in Africa. The example of the USA

1. “The End of Globalization or a more Multipolar World?” 2015 and “Getting over Globalization” 2016

should show that the socio-political infrastructure of individual countries is as much the driver of negative economic trends as globalization itself. This does not stop globalization getting the blame, however.

There is another reason that globalization may play an “agent provocateur” role in national politics. The sheer force and size of the many trends associated with globalization – the spread of social media, financial flows and the tension between free trade and labor markets – mean that it can dwarf national and regional governments. To this end, national and local politicians can appear powerless.

This is often the case in small open economies like Singapore and Switzerland, though many of these have developed institutions and policies to curb the more harmful side-effects of globalization. Nonetheless, to this end, national and local politicians can appear powerless. The prominence of trade, immigration and of supranational bodies like the EU and the United Nations in national politics belies this. Electorates appear to sense that, for a range of reasons, their elected officials can do little to limit the impact of globalization on their lives.

Gone too far?

This sense that globalization has “gone too far” may persist for at least three reasons. The first is that the perceived side-effects of globalization (the power of large corporations) show few signs of ebbing. Second, policy moves such as lower corporate tax rates in the USA will do little to ease the plight

of voters confronted with persistently flat growth in real wages. Third, slowing globalization will produce greater change and stress for economies, companies and societies. Here it is worth recalling that, despite the rally in global growth since the 2016 US election result, the consensus view has been that the world economy is in a state of “secular stagnation,” undercut by low productivity, high levels of debt and the need for central banks to shore up financial stability with quantitative easing. Many of these fault lines have not disappeared and will test policy makers in coming years.

Toward a multipolar world

The extent to which they can derail the world economy and thereby impact the political climate will depend on the direction globalization takes. In our 2015 report “The End of Globalization or a more Multipolar World?”, we outline three scenarios in terms of what happens to globalization – it continues as is, it collapses violently in the way the first wave of globalization ended in 1913, or it cedes to a more multipolar world.

As a scenario, or more simply a “scare story,” the 1913 scenario is perhaps more attention grabbing, though less likely. It is a little more plausible, however, when viewed through the lens of politics, e.g. the rise of strongmen, the growth of right-wing parties, the threat of wars in Eastern Europe and Asia – not to mention the risk of cyber-warfare and the encroachment of technology into politics.



This threat is balanced by the fact that, economically, the majority of the world's citizens are at the time of writing employed (the global unemployment rate is now at a 10-year low), at least living in growing economies and emerging markets, and still have rising income and consumption expectations. The next global recession, particularly if it emanates from China, will severely test the relative political calm in emerging markets and, in our view, will provide the real litmus test of the direct link between globalization and politics internationally.

Yet, as we mentioned earlier, our indicators suggest that while globalization has seen better days, rather than descend into a chaotic disintegration, a more multipolar form of world order is taking over.

A multipolar world is one where a small number of large regions develop increasingly distinctive models of politics, society, economics, finance and technology. Our sense is that the Americas, Europe and China-centric Asia are already on their way to becoming the three principal "poles" of a multipolar order, with perhaps India and the Emirate states together having the potential to be a future "pole." Independent, mid-sized countries like Russia, the UK and Japan may struggle for influence in this kind of world in the sense that they either lack the economic size or hard power required to match the larger "poles."

Measuring multipolarity

We have produced an indicator that measures the extent to which the world is becoming multipolar². It reads across economic activity, investment flows, population, budget size and trade, and indicates the extent to which economic, financial and social activity is dispersed. In recent years, it has reached its most "dispersed" level of the past fifty years. In spite of this, we believe that institutionally, politically and socially, the path toward multipolarity has just begun. From a political standpoint, we believe that multipolarity can reinforce some emerging political trends, while at the same time provoke other new ones.

"Politics has yet to fully deal with the end of globalization"

The first implication is that politics has yet to fully deal with the "end of globalization." This can take two paths. The first sees politicians internationally engaging in an attempt to sustain the form of globalization they and their countries have long enjoyed. This approach would have to take several steps, starting with pro-globalization political leaders developing a tangible narrative (in terms of examples and policies) on the benefits of globalization, followed by actions that might better distribute the benefits of globalization. This part could be controversial – more progressive tax structures in countries like the USA and the possibility of "taxes

on technology" or levies on monopolies would be an attention-grabbing means of turning public opinion.

On a more substantial basis, a new imaginative General Agreement on Tariffs and Trade (GATT) and/or World Trade Organization (WTO) trade round would need to be launched, possibly encompassing the implications of Brexit, a desire of the USA to constructively recast the North American Free Trade Agreement, and the cementing of more stable trade relations between Japan and China. Institutional changes would also need to be forthcoming, notably in the area of corporate governance (investor surveillance of compensation and corporate indebtedness) and in the workings of international institutions like the International Monetary Fund (IMF) – in terms of their relevance to the globalization process. This could take the form of overseeing more formal agreements on the fluctuation of major currencies and in policing national debt levels.

"Accepting the 'road to multipolarity' is a more realistic perspective in our view"

Then, more realistically, attempts to relaunch "globalization as we know it" may struggle in the face of entrenched skepticism over its benefits and the reality that demographics, indebtedness and to a large degree productivity weaknesses are likely to persist and hold down the trend rate of growth internationally. Accepting the "road to multipolarity" is a more realistic perspective, in our view, and certainly a scenario that is preferable to an "end of globalization" outcome.

However, multipolarity – especially in its adolescent phase – is prone to policy errors, rivalries and geopolitical tensions. It may be better to attempt to establish a set of rules and appropriate institutions now, so as to frame multipolar stability. This initiative could take several forms; for instance, an international cyber security agreement that follows the nuclear arms control agreements of the 1980s, or where migration becomes more intraregional and more restrictive between large "poles."

The second implication is that the perceived consequences of globalization – inequality, the power and profitability of large corporations, and legal and environmental spillovers to national jurisdictions – trigger political realignments. On the one hand, this may lead to the desire across a number of nations for more redistributive tax policies and curbing the influence of large corporations in areas such as data protection, environmental impact and financial flows.

The third implication is that the path from globalization "as we know it" to a multipolar world is more likely to encounter "friction". Debates over NAFTA, Brexit, fines by the EU on US technology companies are all part of this process whereby

2. "The End of Globalization or a more Multipolar World?," 2015

regional boundaries and identities are reinforced. Such a path is prone to costs in terms of trade disruption and shocks to investment flows. In addition, such transitions can be noisy in terms of the reactions they incur from consumers and political leaders. In this respect, there is likely to be a rising temptation for politicians to engage in trade-based rhetoric, with a “beggar-thy-neighbor” tilt.

Without sounding too gloomy, we believe it is likely in the next three years that one of the major economies – probably the USA or China – will fall into a recession as a simple consequence of the evolution of business cycles. Although, in our view, such a development is not explicitly linked to the transition to a multipolar world, it would represent an important test of politicians’ ability to resist a more national or regional bent to policy.

At a regional level, we note that the policy narrative in the two large economies has already taken a decisively singular tack. The Trump administration is driven by the desire to “Make America Great Again,” while China is ever more focused on the notion of the “China Dream.” In this respect, the new development is in Europe, which has struggled for some time with the political and economic consequences of EU enlargement and the shortcomings of the Eurozone framework.

However, following the election of Emmanuel Macron in France, there is a new audible narrative around the EU or “Europe” as it relates to the other large economic “poles.” One element may be the reinforcement of the EU’s prestige through its Brexit negotiating process with the UK. Another is the growing awareness that, while the USA and China are leaders in strategic technological fields such as batteries and robotics, Europe is not. Military power and spending constitute another relative shortcoming for the EU, which is slowly being redressed.

New political dynamic

Broadly, we expect a new political dynamic in the large “poles” to be an increasing focus on the purpose and identity of the large regions. Smaller powers may then increasingly identify themselves relative to their larger neighbors – Japan vis-à-vis China and the UK vis-à-vis Europe. As the USA and China are already “well-formed” in terms of their institutions, Europe has the greatest challenge in terms of making this narrative credible. In this regard, it is likely that what is broadly known as “the European project” will become a more contentious political issue in European nations across a number of areas – immigration and the principle of free movement, the need for a simple EU constitution that connects Europeans to the idea of the Union in a pragmatic way, and the economic management of the EU.

In summary, it is a little late now to blame globalization for the political recession the West finds itself in. Globalization is already past. Its consequences – the rise of emerging economies, the great power and size of corporations, the pyramid-like structure of the world’s wealth, flows

of immigration will all continue to color political debate for the next five years.

Beyond that, several other political tests will be posed. One of them is whether, once growth in Asia dips, the emerging world can prove it is immune to political volatility. Another is whether politics takes on a more nationalistic or regionally driven hue. This could lead to barriers to immigration, calls for trade barriers against multinationals, calls for central banks to defend trade and for the erecting of cyberwalls. On the other hand, it could lead to the establishment of new rules of the road for a multipolar world. ■



Photo: Shutterstock, Maryna Kulchytska



The 85 World

More than 85% of the world lives outside of northern America and Europe. Rapid urbanization, growing middle classes and unprecedented connectivity is shaping and reshaping this “85 World” across Africa, Asia, Latin America and the Middle East. The fate of our world lies heavily in what happens in this 85% of the non-Western world, with profound effects on business, politics, and society.

Afshin Molavi

Senior fellow at the Foreign Policy Institute of the Johns Hopkins University School of Advanced International Studies

Welcome to the 85 World

“Everyone has a plan,” the American boxer Mike Tyson once quipped, “that is, until you get punched in the face.” Policy-makers, strategic planners, corporate leaders, and analysts from all industries would do well to remember “Tyson’s Law.” Once you add Moore’s Law – the doubling of computing power every two years or so – to Tyson’s Law and you throw in a dash of geopolitical uncertainty, regulatory risk and Fourth Industrial Revolution technological advances, it becomes evident that punches will come at all of us over the next few years with even greater speed than imagined.

Given the certainty of change, how can we understand the future of world politics in our present age, an age with a new velocity? A good place to start would be to anchor ourselves in the most important demographic feature of our world today: The 85 World. More than 85% of the world’s population lives outside of northern America and Europe. This is not a forecast projecting outward to 2050 or beyond. This is our demographic reality today, and this fact should be imprinted in the minds of governments and businesses seeking to understand our world. As goes the “85%,” so goes the world of tomorrow.

It was not always this way. At the turn of the 20th century, Europe was home to a quarter of the world’s population. Today, it accounts for about 7%. A central demographic feature of the past century has been the steady and often rapid population rises in Asia and Africa, and the relative demographic decline of the “West.” Today, three out of four people in the world live in Africa or Asia. The West is not just a demographic minority, but a significant one.

While the 85% have been overtaking the West in terms of population growth over the past century, the picture of an advanced West and an underdeveloped “rest” largely held through much of the 20th century. This is no longer the case. In the early 1990s, the emerging and developing

economies accounted for about 40% of global gross domestic product (GDP) on a purchasing power parity (PPP) basis, according to International Monetary Fund (IMF) figures. Today, emerging and developing economies account for more than 60% of global GDP. The economic tectonic plates have already shifted and the landscape has been permanently altered.

For much of the 20th century, the Western world dominated the global production of culture, commerce and technology, and created the global architecture of institutions that still largely organize the international community. As a result of these “facts on the ground” created in the “Western century,” we are living in a world largely created by today’s 15% – or, rather, a few major countries of the 15%.

“More than 85% of the world’s population lives outside of northern America and Europe”

Of late, China has taken measures to challenge the Western-created world order with a series of institutions and policy initiatives, including the Belt and Road Initiative, the Asian Infrastructure and Investment Bank, and the New Silk Road Fund. But, while these initiatives are shiny and new and capture headlines, they still have a long way to go to unseat the entrenched order of institutions from the World Bank and IMF to the United Nations and the World Trade Organization.

China and India, of course, play a central role in “the 85%.” Combined, the two states account for more than one-third of the world’s population, but they are on different demographic trajectories. China’s population is aging, while India’s remains young. A million Indians turn eighteen every month, three Indians experience the internet



Photo: Shutterstock, cornfield

for the first time every second, and 30 Indians move from a rural environment to a city every minute. According to the United Nations, India's population will overtake China's over the next decade and, by 2027, India will have the world's largest middle class.

Beyond the two Asian demographic heavyweights, Africa's population is rising exponentially. Indeed, by the year 2050, Africa is expected to go from a population of 1.2 billion to a population of 2.5 billion, a mind-boggling leap that will have far-reaching implications for our world. What's more, urban Africa will leap from 470 million today to more than 1 billion by 2050. Africa's demographic story is a slow-moving tsunami with far-reaching implications for business, politics and societies on the continent and worldwide.

To get a sense of where we are headed, consider this: every year 129 million children are born, according to UNICEF. That's roughly 353,000 per day, 14,700 per hour, and 245 in the minute it requires you to read this paragraph. Where are they being born? Mostly in the 85 World – particularly in Asia and Africa. Barring a catastrophic natural disaster or a devastating geopolitical conflict in Asia, these 129 million births will remain steady. Thus, the demographic and economic weight of the 85 World requires our sustained attention in a globalized and continually globalizing world. It also offers analysts an anchor to begin looking anew at the future of global politics.

Four disruption-proof trends set to disrupt global politics

In an age of disruption, it offers some solace to find trends that are largely disruption-proof. The fact that 85% of the world's population will live outside of northern America and Europe is one such disruption-proof trend. As Europe's population ages and even declines, fast-growing Africa and Asia will continue to dominate global demographics. Over the next few decades, we may be discussing the "86 World" or the "87 World."

"A million Indians turn eighteen every month"

But within the current 85 World of Africa, Asia, Latin America and the Middle East, three trends stand out as enduring, resilient, and largely disruption-proof. They are rapid urbanization, rising connectivity, and growing middle classes. These trends will likely endure over the next two to three decades regardless of the latest coup in Africa or who sits in the White House or the Elysee Palace – and these trends will shape the future of business and politics worldwide.

As the old adage goes, "where you stand depends on where you sit." If you sit in the C-suite of a multinational company, these trends offer a signal to your future: the increasingly urbanized and

wired consuming classes of the emerging world have become the great commercial prize of the 21st century, chased by the likes of Coca-Cola and Unilever, as well as emerging markets companies like Emirates Airline or Tata Motors. They are right to chase the growth across the 85 World. In fact, their future may even depend on it.

If, however, you sit in the chanceries or palaces or parliaments of the emerging world, or in the US National Security Council or the European Union, you might see the mix of urbanization, connectivity, and growing middle classes across the emerging world – particularly in weak or non-democratic states – as a combustible mix that could lead to the cycle of rising expectations, dashed hopes, and attendant instability that comes with seismic changes to societies and economies. And they, too, would be right.

Take Africa, for example. There is no doubt that the rising population, urbanization, and connectivity transforming the continent provides unique growth opportunities for consumer companies from telecommunications to fast-moving consumer goods, from healthcare to energy. There is also little doubt that even the most bullish cheerleaders of the “Africa is Rising” narrative could hardly imagine a scenario whereby the continent can keep up with the job demands of its youthful population.

Sub-Saharan Africa’s median age is 19. The European Union’s median age is 42. Thus, the same 19 year-olds that will be market-tested and targeted by corporations will likely storm the economic gates of Europe in large numbers in search of a better life over the next two decades. Yes, they will consume more, but they will also grow frustrated at their lack of opportunity. Thus, we can expect European politics over the next decade to be faced with an ongoing African migration challenge, leading to populist, nationalist, and anti-migrant politics. The African migration-to-Europe trend is one of those long-term simmering trends that are available for all to see and will shape European politics in the future, but will likely only gain high-level public attention when it is accompanied by disaster or violence.

The Age of Aspiration

It is hard to imagine a significant slowdown in urbanization or connectivity across the emerging world partly because – in the absence of massive government efforts to slow it down – urbanization and connectivity are part of the temper of our age: the Age of Aspiration. The rural-to-urban migration that has reshaped China and is reshaping India centers on the basic human aspiration of achieving a better life.

We are living in an era where small matters make headlines (think presidential tweets or daily political jousting), but the big ones hardly garner attention. The biggest of all is the revolution of aspiration. Never before in human history have so many people across so many continents been in a position to aspire meaningfully to a better life. That means in more places than ever, sons – and daughters – are no longer confined to stay in the social class or

educational level of their fathers and grandfathers and have a reasonable chance at upward mobility. Indeed, it has become unremarkable for the daughter of a Kenyan farmer or the son of an Egyptian taxi driver to aspire to and achieve a better life through education, entrepreneurial flourish, or migration.

As Steven Radelet, the Georgetown University economist and author of *The Great Surge: The Ascent of the Developing World*, points out, a billion people have been lifted from poverty since the early 1990s. Today, one in six people live in poverty, while a little more than a generation ago, one in two people lived in extreme poverty. For most of human history, the vast majority of people lived lives full of want, scarcity and insecurity. This is no longer the case.

This is, of course, good news on a macro level, but individuals do not live in a macro world. There are plenty of people who will not achieve their aspirational goals, and they will not be cheered by the positive macro numbers or the achievement of development goals laid out by the World Bank and other global multilateral bodies. Perhaps just as importantly, they will live in a world where others – even of their own social milieu – have succeeded. Feeling left behind by peers stings more than if everyone stays behind. And the “left-behinds” have been a powerful force shaping world politics for centuries.

“Never before in human history have so many people across so many continents been in a position to aspire meaningfully to a better life”

When the Tunisian dictator Zine El Abidine Ben Ali stepped down, he had fallen due to a combination of rising middle classes with rising expectations, unprecedented tools of connectivity mobilizing against an unjust ruler, and hollowed out support from an urban middle class that wanted better governance and less corruption from their elite. As the revolution spread across the Arab world, these urban middle class revolts used both the newer networks of connectivity and the older religious, tribal and neighborhood networks to topple leaders from Egypt to Yemen.

All across the Arab world, on the eve of the uprisings, ironically, Macro World Arabia looked reasonably good. Several decades preceding the uprisings witnessed considerable advances in access to tertiary education, quality healthcare, and access to technology. In the decade before the uprisings, several countries, including Egypt, became emerging market hot spots, attracting foreign direct investment from advanced to emerging economies.



Photo: Shutterstock, Mohamed Elsayyed

From 2004, Egypt began a series of market-opening and business-friendly reforms that won plaudits from the World Bank and international investors. Former President Hosni Mubarak's cabinet included technocrats and former business executives comfortable in the boardrooms of New York and the conference rooms of Davos. From 2005 to 2008, Egypt's economy hit steady 7% growth, and recovered fairly quickly from the global financial crisis to achieve 6% growth in the year before the revolution.

All of this took place amid a time of rising connectivity and growing middle classes in Egypt. The fact that Egyptians took to the streets just as their lot was improving – or at least their macro world was improving – might tempt the observer to fall on the de Tocqueville theory of revolution that “it is not always by going from bad to worse that a society falls into a revolution,” but rather, “it happens most often that a people, which has supported without complaint, as if they were not felt, the most oppressive laws, violently throws them off as soon as their weight is lightened.”

Revolution of rising expectations

This is, in essence, the revolution of rising expectations, and while there is some truth to this claim, something else is at play here. In Egypt and Tunisia and across the Arab world, what we witnessed is the corollary of the Revolution of Rising Expectations: the Revolution of Aspirations Unmet. In de Tocqueville's theory,

he could not have foreseen a world in which so many people had experienced and seen such dramatic material gain in their lives, and so many people felt an innate “right” to a life of economic and human dignity.

This is what the Age of Aspiration has wrought, and like all of the forces described herein, there is a double edge to this sword. On the one hand, meaningful aspiration fuels the ambition that leads to hard work, entrepreneurialism or innovation that serves as a key engine of The Good Society. Aspirations unmet, however, can lead to the frustration, alienation and disaffection that can tear societies apart.

The urban crucible

Our future, in so many ways, lies in cities. Today, we are 54% urbanized worldwide, according to the United Nations, and headed for two-thirds urban by 2050. Across the world, some 1.5 million new urban dwellers are created every week, either through births or through rural-to-urban migration. China surpassed the 50% urbanization mark in 2012 and will never look back. Cities are both extraordinary laboratories for human innovation and productivity as well as crucibles for potential political instability and searing human tragedy. The new urban dweller needs healthcare, water, jobs, and other basic services. The new urban dweller also needs hope – after all it is hope that propelled the move to the city and dashed hopes can be more dangerous than having no hope at all.

There has emerged a trope of our era about the West, of a dividing line between the city and the hinterland. The hinterland, this trope goes, wants to slow down globalization, fears mass immigration, and is skeptical of political and media elites. The city, on the other hand, is not threatened by immigrants, feels comfortable with globalization, and embraces progressive social change.

“Cities will determine the future of our global politics”

Putting aside the sweeping notion of these assertions, it is fair to say that the city will determine our economic future, not the hinterland. And thus, cities will determine the future of our global politics. Cities account for the vast majority of global economic output and, in some cases, they drive national economies. Imagine South Korea without Seoul, which accounts for nearly half of its GDP, or Indonesia without Jakarta, accounting for some one-quarter of its GDP.

Cities in the 85 World

Across the 85 World, cities have emerged as lodestars, as models of success and aspiration, like Hong Kong or Singapore of previous generations, or Dubai, Abu Dhabi, Shanghai, or Beijing of today. Young people are taking note. Over the past six years, when young Arabs between the age of 18 and 24 were asked by the global public relations firm Burson-Marsteller to choose any country in the world where they would like to live, their answer has been revealing: the United Arab Emirates, even besting the United States. What they really meant were the two principal cities of Dubai and Abu Dhabi.

This demonstrates that, when given a choice between staying in their own region, or migrating further, young people prefer staying close to home – if a city offers them meaningful opportunities to fulfill their aspirations. Thus the future of global politics lies in the future success or failure of emerging world cities. The cities that deliver the “goods” – opportunity, world-class infrastructure, decent healthcare, good schools, jobs and hope – will become, in a sense, zones of stability, prosperity and human dignity.

What is needed are more Shanghai’s and Dubai’s to ensure the Age of Aspiration does not lead to an Age of Anger. ■

NOTE: The views expressed here are those of the author and do not necessarily represent or reflect the views of Credit Suisse



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Long-term planning versus the “vision thing”

The international political system is facing a modern-day revolution. In this article, we analyze the impact of different political regimes on economic growth, and ask whether politics matters to growth and vice versa.

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The wave of consolidating authoritarian rule, growing nationalism and apparent widespread populism has left democracy struggling to not only find its original foothold, but also its original character and form. In the past 2–3 years alone, political crises and events have cut across regions (from Turkey to the USA), demographics and country age (from India to the UK) and disparate governance regimes (from Thailand to Europe). In countries like Turkey, we see more authoritarian leaders concentrating greater power in their own hands, while, in Europe, we have a hitherto tolerant electorate that is now through the words of more conservative and nationalist leaders seeking dramatic change in power structures and governing patterns. While the former is easy to comprehend, the latter is ironic, as this paradigm shift is most visibly arising from deep-rooted economic discontent.

“Governments need to be more disciplined in the attainment of other socio-economic goals”

We emphasize that, while economic growth is important, the ultimate goal of policymakers should be the attainment of a level of economic development (i.e. level of Gross Domestic Product) coupled with a more broad-based endeavor to enhance economic well-being (as may be measured by intangibles such as health and longevity, human development and education, and technological advancement). Unlike GDP growth, which is rather easy to track, governments need to be more disciplined in the attainment of other socio-economic goals. Not only does this process need to be forward-looking, it also requires sustainable planning, delivery benchmarking and administrative

responsiveness to initiate affirmative change and widen the scope of economic well-being.

This “process” makes life difficult for politicians, especially those who look to thrive on personal charisma and power (which people in Washington refer to as the “vision thing”), although it is very often good for societies and economies. Indeed, it is no surprise that the model we highlight is found more often than not in stable, consensus-driven countries.

Does politics matter for growth?

As a first step, we examine whether a political regime has any bearing on growth. A very simple comparison between GDP growth rates of the top and bottom percentiles of the countries ranked on political strength¹ is sufficient to highlight this difference. It is no surprise that GDP growth in stable countries (the likes of Austria, Canada, Finland, Germany, Netherlands, the UK, etc.) has consistently outpaced that of the most fragile states (e.g. Afghanistan, Iraq, Yemen, Myanmar, Nigeria, etc.). The dynamics may have altered in the post-financial crisis world as growth in stable countries softened and/or stagnated, but that is hardly to the credit of economic improvements in fragile states. The contribution of natural endowments to growth in chronically fragile states may well be negated by weak polity and the lack of institutional support, which has and continues to keep economic growth depressed in these countries.

Particularly in the context of politics in emerging markets, it is often argued that a more non-democratic and perhaps authoritarian form of leadership helps boost growth faster. Countries such as China and the United Arab Emirates (UAE), for instance, have been able to build significantly better infrastructure than India, in a shorter period of time. In a very interesting analysis, Easterly and

1. Based on the State Fragility Index from the Center for Systemic Peace



Photo: Shutterstock, Denis Kuvayev

Pennings² (2017) come to the conclusion that while leadership does affect economic growth, it is difficult to decisively declare that an autocratic leader contributes more to growth when compared with a democratic one. Taking Russia, for example, average annual GDP growth for the country between 1990 and 2011 was 0.7%. Vladimir Putin took office in May 2012. During his term and just before the Ukrainian crisis (2012–2013), average growth rose to 2.4%. While even including the post-Ukraine crisis phase with economic sanctions in place, growth averaged 0.5% (2012–2016), close to the longer-term trend.

At the same time, Thailand's growth has more than halved when compared with the long-term (1961–2013) average since the military government took control in 2014. By controlling for effects such as international business cycles, commodity booms/busts and country-specific effects (such as institutional framework), Easterly and Pennings highlight these mixed results with their panel analysis of the 25 best and worst global leaders with a tenure of over four years. While the 25 worst leaders were autocratic (categorized according to polity scores), the list of 25 best leaders came from both democratic and autocratic regimes, suggesting the relation between regimes and economic success (as measured by GDP growth) is inconclusive.

2. *Shrinking dictators: how much economic growth can be attributed to national leaders?*; Easterly, William and Pennings, Steven; May 2017, New York University and World Bank

Another trend increasingly dominating politics currently is incumbent leaders seeking re-election to strengthen their political mandates. In many cases, this trend is welcomed in financial markets. We have seen this happen recently in Japan and Germany (not to mention the UK). While a reinforced mandate to govern undoubtedly lends continuity, does it really also ensure economic improvement? Again, Easterly and Pennings (2017) do not find a very clear relationship between leadership longevity and its impact on economic success. However, it is perhaps critical to make a distinction between the longevity of political institutions in different regimes. The longer political power is held in democratic regimes, the greater economic growth will be, with the reverse effect in the case of autocratic rulers (Pereira and Teles³ 2011). Particularly in low-income countries, the longer the same elite are in power, the smaller economic growth will be.

Benchmarking governments

Political parties are also known to leverage the electorate's needs, particularly during times of election campaigning. In his analysis of political business cycles, William Nordhaus⁴ (1975) examined electoral choice, suggesting that inflation and unemployment had an impact on voter behavior. In recent times, politicians appear to have boosted their "connect" with the electorate by stressing sensitive social issues such as job insecurity.

3. *Political Institutions, Economic Growth, and Democracy: The Substitute Effect*; Pereira, Carlos and Teles, Vladimir; January 2011, Brookings
4. Nordhaus, D. William; *The Political Business Cycle*; 1975; Yale University

This was most notable perhaps in President Trump's "America first" campaign where he positioned unemployment not as a domestic labor market concern, but rather as a matter of competition from cheaper sources of manpower internationally, particularly from emerging market economies. The populist wave in Europe has also increasingly focused on immigration, job losses and stagnant incomes in the post-recession phase. While critics may characterize this persuasive tonality as part of the political rhetoric that enhances a politician's appeal – ethos (character of the politician), pathos (emotional connect with the electorate) and logos (logical argument) – it is interesting to examine whether political parties actually fulfill election promises or whether campaigns are merely empty speeches.

“The populist wave in Europe has also increasingly focused on immigration, job losses and stagnant incomes in the post-recession phase”

In many cases, politicians have low levels of credibility. For instance, an especially stark trend in Europe is dwindling trust in political parties. According to the European Commission's Eurobarometer, which monitors public opinion in the EU member states, only 4% of Greeks trusted political parties in May 2017 compared with 25% in 2001. Spain, France and Italy are some of the other countries facing an erosion of trust, thereby rendering the countries' political frameworks more fragile. A year after being elected in November 2016, President Trump's approval ratings have hit a record low. According to a Washington Post-ABC News Poll (November 2017), 59% of respondents disapproved of President Trump's performance (also the worst performance of any American president at nine months in office since such polls began). In the same poll, a staggering 65% also said they did not think President Trump is "honest and trustworthy." Interestingly, honesty is the most essential trait people desire in a leader (according to 84% of respondents from a January 2015 PEW Research Center survey).

While there may still be some debate about how well political parties measure up to their election promises, a number of significant studies come to their rescue. There is growing academic interest in tracking the transition of election pledges/programs from being mere promises during the campaign period to policies after the political party has been elected to form the government. Thomson et al.⁵ find that the strength of the program-to-policy

linkage is positively related to the extent to which executive governing parties' control government office (irrespective of legislative efficiency). In other words, they find that single-party governments are most likely to be successful in fulfilling election pledges. In the case of coalition governments, however, we often tend to observe a pullback or delay in implementation. Varying agendas of member political parties often dilute priorities of the coalition, thereby impacting delivery. It is no surprise that minority governments are the least likely to fulfill election promises. By country, Thomson et al. find that political parties in the UK and Sweden have fulfilled around 80% of the pledges analyzed, with those in Germany shy of 50% and those in Ireland at just around 33% of promises delivered.

Political pledges

Judith Bara⁶ notes that political parties today make far more pledges than they used to. In the UK, for instance, the 1945 Labour Party election manifesto made just 18 pledges, compared with 207 pledges in the 2001 election manifesto; which further rose to 550 ahead of the 2010 elections (Constitution Unit, University College London). Presumably, however, with the number of pledges rising, their specificity also appears to have been compromised. Bara found that, between 1987 and 2005, some 88% of the party's pledges were implemented within the life of the parliament following the election, but only 16% of those pledges were specific in nature. Tracking unmeasurable promises and collating performance evidence becomes difficult, thus leaving a credibility gap.

Moreover, a pertinent point is that election promises are more likely to be fulfilled in times of strong economic growth. When growth is healthy, government finances are supported by stronger revenue streams and pro-cyclical expenditures are easier to finance. However, as one may expect, the electorates' expectations are more likely to grow. In order to win voters over, politicians then tend to over-promise and eventually under-deliver during economically tough times and financially constrained conditions. Also, governments are known to expand fiscal spending ahead of election years in order to undertake populist projects (such as building bridges, enhancing social security and health care coverage), which need to be scaled back over time. Here, mapping election dates with the business cycle of the USA since 1857 (based on peaks and troughs identified by the National Bureau of Economic Research), we find that the majority of slowdown or contraction phases in the economy are preceded by elections and, in fact, usually occur within six months of the election.

5. Thomson et al; *The program-to-policy linkage: a comparative study of election pledges and government policies in ten countries*; August 2012; American Political Science Association

6. Bara, Judith; *A Question of Trust: Implementing Party Manifesto*, July 2005, University of London, cited in the Guardian's article 'Curb your cynicism: politicians do keep their manifesto promise', April 2015 and the BBC's article 'Reality Check: Do parties keep manifesto pledges?', April 2015

Contrary to popular belief, if political parties do deliver most of what they promise during elections, why has the recent wave of populism resulted in a change away from establishment politics toward more radical/extreme ideology? Growing discontent has increasingly pushed electorates across countries away from the political process, as is clearly visible from steadily declining voter turnouts. In this context, numerically smaller numbers of voters have

managed to initiate political change. For example, Donald Trump's US election victory in November 2016 came on the back of a poor turnout of just around 65% (versus nearly 96% in the 1964 US presidential elections). Similarly, in France, despite significant enthusiasm for Emmanuel Macron and his newly created political party, the voter turnout of 75% in the April 2017 presidential elections was the lowest in the country's modern history.

The state of democracy

A revival of trust in the political process is possible with the benchmarking of political parties. In 2008, the IPU (Inter-Parliamentary Union) international organization of parliaments of sovereign states⁷ published a self-assessment toolkit for evaluating parliaments based on key democratic principles such as representativeness, transparency, accessibility, accountability and effectiveness. The findings based on 75 national parliaments show that most democracies are keen on a continuous process of reforms. A project that stands out as a proactive investigation into the state of democracy is the Canadian Democratic Audit that began in the spring of 2001 on the back of what was often referred to as a "democratic deficit" and "democratic malaise" in Canada in the 1990s and early 2000s. Institutional reforms backed by the findings of the 5-year audit process have today resulted in Canada being ranked in the top category of countries globally across metrics and rankings on economic freedom, governance quality and polity scores by reputed institutions. An interesting reform initiative is the OECD Toolkit for Risk Governance that has a collaborative online forum for the exchange of best practices in governance and risk management (natural hazards, cyber threats, terrorism, industrial accidents, etc.) across countries and across institutional levels (government, quasi-government and private sector).

While monitoring is important, perhaps it is time to also examine if GDP is the best yardstick for a country's progress. In the post-financial crisis period, added disillusionment with politics comes from the erosion of income and economic opportunities, particularly in the last decade. Take the USA, for example, where decadal growth in real GDP per capita in 2016–2017 has been the weakest since the late 1950s. Given the notion of convergence or the "catch-up effect," one would expect high-income countries to grow at a slower rate when compared with their lower-income counterparts. However, as examined earlier, globalization-driven agitation has recently come to strongly dominate the rhetoric around weak income growth in developed economies. In reality, factors such as dipping productivity and inequality may well be as endogenous as they are extraneous to each economy. The fact that the USA has the highest income inequality among developed economies cannot entirely be blamed on globalization and highlights that there is a need to look beyond just growth.

7. Evaluating Parliament: a self-assessment toolkit for parliaments, Inter-Parliamentary Union, 2008, Switzerland



Photo: Shutterstock, Cineberg

Is GDP the only measure of economic success?

In his analysis of economic growth in the USA, Robert Gordon⁸ makes some pertinent observations about future growth in the USA. His analysis linked periods of slow and rapid growth to the timing of three industrial revolutions: from 1750 to 1830 when steam engines and railroads changed economic activity; from 1870 to 1900 when electricity, internal combustion engines, communication, chemicals and petroleum were some of the key drivers; and from 1960 to the present when computers and the internet have permeated daily life. Gordon credits the second phase of industrial revolution with being the most important one, leading to rapid productivity growth. He emphasizes that headwinds such as demography, education, inequality, globalization, energy/environment and the overhang of consumer and government debt are likely to drag down long-term growth in the USA. Going by this singular notion, if the marginal increment in growth in the USA and potentially other developed markets consistently drops, there must surely be other sources of improvement that enhance “well-being” in these nations.

Again, Canada’s case further serves as an important example to prove that, despite being a wealthy nation, there always remains scope for improving qualitatively to add further value to the economy. With globalization often credited or rather discredited for poor income growth and growing inequality, perhaps it is time to shift the focus to a more normative approach of measuring well-being. In fact, we find that wealthier nations (higher per capita GDP) do not necessarily boast of a better quality of life (either in the form of life expectancy, intangible infrastructure such as education and technological advancement, or political freedoms). Accordingly, we developed the Credit Suisse Country Strength Index – a measure that captures more multi-dimensional economic strength other than that noticeably displayed by GDP. First published in 2014⁹, the index is based on crucial parameters such as human development, institutional quality, governance and adaptability to globalization to truly measure the success of a country.

As reflected in the index, developed economies already have a well-established institutional framework and their incremental contribution is expected to remain limited. Political institutions fundamentally matter only for incipient democracies and not for consolidated democracies, which have already internalized the effect of political institutions (see Pereira and Teles, 2011). Our model shows that for countries that are already relatively wealthy and well developed institutionally, there are other potential areas of enhancement such as the ease of doing business in Switzerland, trade openness in

the USA, technological and financial sophistication in Singapore to take a few examples.

“A growing trend, particularly in emerging markets, is institutionalizing economic progress with the help of long-term visions”

For developing and emerging economies, on the other hand, there are significant gains to be reaped from improvements in institutional quality. A growing trend, particularly in emerging markets, is institutionalizing economic progress with the help of long-term visions. We increasingly see this as a driving force for more holistic changes. Most notable are Middle Eastern economies that are seeking diversification from oil dependency. But the focus on developing political credibility and ensuring greater well-being (through medical facilities, education, vocational training, alternate and clean energy) go beyond just a simple need to ensure high incomes (which they already have). China’s 5-year plans are another example. On an inter-generational basis, the PEW Research Center (January 2015) finds that millennials (as opposed to the GenX, baby boomers and silent generation) have the strongest desire for leaders to be ambitious. Long-term visions and priorities should bode well as a governance strategy and a benchmarking method for governments as the proportion of the population governed grows to be increasingly dominated by millennials. There could, however, be a risk of overstating goals or reforms, particularly in the context of timelines. Being realistic and sustainable is the key to future governance. ■

8. Gordon, Robert; *Is U.S. Economic Growth Over? Faltering Innovation Confronts the Six Headwinds*; August 2012, NBER

9. The Credit Suisse Research Institute report “The Success of Small Countries,” July 2014



The impact of political trends on capital markets and investment

The impact of political events on capital markets and on the performance of different asset classes can be reviewed from a number of different perspectives. First, the role of geopolitics versus regional changes versus domestic political changes. Second, ideological shifts to the “left and right;” and third, structural policy changes such as a shift to privatization versus nationalization, independence versus control of central banks, or capital market deregulation. Ultimately, cyclical shifts in the mix between monetary and fiscal policies.

Robert Parker

Chairman of the Asset Management and Investors Council

There is currently an apparent investor consensus that there are two key political trends impacting markets. First, there is a case for a reversal from globalization back to regionalism or nationalism and, second, there is evident electoral dissatisfaction with traditional political parties and ideologies, together with the creation of new parties or a shift in power to a more populist stance within existing parties. The investment conclusions from this consensus would be to avoid sectors that are vulnerable to trade protectionism and/or a reduced supply of immigrant labor (both skilled and unskilled) and that are candidates for re-nationalization, to focus on sectors that benefit from regional rather than global trends both in activity and demand, and to be sensitive to disruptive political events with clear downside risks for asset valuations, both domestic and geopolitical.

Key political and social themes

Inevitably, however, this consensus masks a series of more complex trends. It is possible to identify some key political and social themes that are having an actual or a potential impact on capital markets and asset class performance.

The first and perhaps most prominent theme is the creation of new political parties. The notable example is the creation of France’s newest party En Marche led by Emmanuel Macron on the back of heavy losses experienced by the Socialists in the previous French presidential election. Another example has been the development of Five Star in Italy (with 30% of the vote in the latest opinion polls). More recently, the Party of Hope has been created in Japan, albeit with a low probability of achieving power at least in the short term. However, new parties have struggled in many cases, for instance UKIP in the UK and Five Star taking control of Rome, while Unidos Podemos has failed to boost its 20% position in opinion polls in Spain. New parties typically fail when they cannot

expand beyond one political issue, are subject to infighting or fail to appeal to the broader electorate. Where new parties succeed, structural reforms are introduced with significant implications for asset class performance. A historic example of where an existing party shifted its ideology significantly is the reformist policies pursued by the Conservative UK Government under Thatcher, which eventually boosted UK growth and equity market performance. Over the next 2–3 years, investors will be carefully monitoring the success or failure of the Macron government in its ability to enact structural reforms in France with obvious implications for French equity markets.

Increasingly fragmented

The rise of new parties is making politics increasingly fragmented. The electorate is divided between ideologies and is almost compelled to “cherry-pick” with regard to issues raised by different political parties with no particular affiliation or loyalty to a single party. Fewer parties have secured majority support and clear mandates to form governments in recent elections. For example, the German coalition with the CDU/CSU forming a government with the Greens and the FDP has proved difficult, as was the formation of the Dutch government. The May government in the UK, having lost its majority, is now dependent upon a difficult relationship with the DUP. And in some cases, despite a majority (significant or slim), the debate with the opposition – as is the case of the Trump administration and the US Congress – is becoming increasingly problematic. Political “gridlock” obviously slows the process of political and legislative initiatives. In the absence of political initiatives and structural reforms, investors are likely to focus on defensive strategies, such as higher-dividend sectors, while the pressure on monetary policy should remain intense.

The second theme, populism, has seen varying trends and the impact on financial markets has certainly not been uniform. In Europe, for instance,

the Party for Freedom or PVV (the Netherlands), UKIP (the UK), True Finns (Finland) and the Front National (France) have all seen reverses. A large part of the failure of PVV and FN was due to their weak economic policies and their inability to broaden their appeal among voters. Simultaneously, the Alternative for Germany (AfD) gained as much as 13% in the 2017 German elections, its relative success largely being a reaction to Angela Merkel's immigration policy. Meanwhile, the Labour party – one of the front-running political parties in the UK – has also gained traction, driven by a populist agenda with a structural ideological shift to the “left.” The Labour party appears to be steadily growing its appeal among young voters who have reacted negatively to key issues such as rising education costs, income inequality, job insecurity and housing costs.

Toward a more populist stance

There are a number of very clear populism-driven trends. Dissatisfaction with wealth inequality and poor wage growth will likely drive public opinion and result in the creation of more new parties or a shift to a more populist stance by existing parties. Populist policies cover a broad range of areas that can be divided between “left-” or “right-” leaning stances (it is accepted that this distinction is a generalization). Populist initiatives can include an expansion of fiscal policies, a relaxation of budget deficit targets and increased spending (left and right), control of migration (right), defensive trade policies (left and right), tax breaks for low income earners (left and right), increased taxes on wealth/higher-income earners (left), higher welfare and health spending (left, partially right), a trend increase in infrastructure spending (left and right), increased expenditure on low-cost real estate (left and right), higher state borrowing (left and partially right), increased corporate taxation (left) and low corporate taxation, but greater tax compliance (right).

Meanwhile, in the USA, President Trump – and his originally populist agenda – is currently challenged by a progressively weaker position in opinion polls. It is difficult to generalize on the impact of populism on markets except where it triggers major changes in fiscal policies and notably in taxation (for example, the current Tax Reform Bill in the USA) and in public spending (potentially in the UK, Germany and currently in China).

Specifically in Europe, populism has been directly linked with anti-European Union (EU) concerns, which have perhaps culminated with the UK's vote to leave the EU. Other anti-EU political parties have faltered and, at least for the moment, the trend in the EU is one of potentially greater unification led by French President Macron's ambitious plans for a more integrated fiscal policy, debt issuance mechanisms and common social and defense policies. The threat to President Macron's plan could come from the four Central European economies of the Czech Republic, Slovakia, Poland and Hungary – the so-called CE4 countries (or what may be termed the “CE5” if Austria is included) – and from a period of political

uncertainty or instability in Germany following the formation of what could eventually turn out to be a weak coalition. If, however, banking union and capital markets union develop further in the Eurozone with a more centralized fiscal policy, a number of structural flaws in the euro will be addressed with positive implications for Eurozone markets.

As the EU struggles with structural issues, the USA is grappling with balancing (in)action and hopes/expectations. In hindsight, US President Trump was elected against a background of weak wage growth, flat real incomes, fear of competition from global forces, job insecurity from the perceived threat of immigration, foreign competition (notably from China) and insecurity over personal safety. So far, economic and trade measures have been minor, while the administration has become distracted by other issues.

“In the absence of political initiatives and structural reforms, investors are likely to focus on defensive strategies, such as higher-dividend sectors”

Contingent on the magnitude of these reforms, the spotlight may or may not shine once again on the USA. This brings us to our third theme that has dominated global markets and economies in recent times – the global retreat of the USA, accompanied by a retracting globalization (more a slowing down of the process rather than a reversal). In the past, we have seen positive geopolitical developments in the form of opening up the Central and Eastern European (CEE) economies and markets following the move from Communist or centrally managed societies; the opening up and improved performance of Latin American economies such as Chile, Peru and Colombia, and the regional economic integration boosting ASEAN (Association of Southeast Asian Nations) economies and their markets.

However, the world today appears to be shifting away from globalization and conventional US hegemony toward a more multipolar world economic order. Key to note here is the economic and political expansion of China in Asia (e.g. the development of the island platforms), the renewed cohesiveness of the EU and the increased cooperation of the Latin American countries, particularly in their joint approach against the Maduro regime. The shift away from the USA as the fulcrum of the global economy is further accentuated by its withdrawal from the Trans-Pacific Partnership (TPP) trade agreement and the Paris climate change agreement coupled with ongoing difficulties in renegotiating the North American Free Trade Agreement (NAFTA) – all of which emphasize greater investment performance in domestically focused companies and sectors, rather than those with a more global exposure.

As discussed earlier, US economic and foreign policy under President Trump is to re-emphasize “American interests” even if it entails withdrawal from its “conventional” pre-eminent global role (although there is active support for South Korea and air support for the Iraqi government and the SFA/Kurds) to encourage other countries to increase their spending and activity in the North Atlantic Treaty Organization (NATO), to withdraw from trade partnerships (e.g. TPP and the current difficult trade negotiations over NAFTA), and to withdraw from international agreements (e.g. the Paris climate accord).

“Populism and the move to regional independence tend to fail when they are not backed by a strong economic message”

This change is encouraging new geopolitical relationships, e.g. Saudi Arabia and Russia, Turkey and Russia, the expansion of Chinese influence and a discordant relationship between the EU and the USA. The investment implication is that regional markets will be more influenced by regional or local factors rather than global trends and that correlations between regions will break down – emphasizing the opportunity for more active investment management rather than global passive asset allocation.

A fourth theme and an extension of regionalism is the desire for certain regions to become independent states. We find that Madrid is resisting the independence of Catalonia and the independence of Scotland has been delayed for many years, but that independence movements are developing in a number of countries, notably in Europe, such as Flanders and Northern Italy. The separation of Sudan with the creation of South Sudan has been, by any criteria, a significant failure. These unresolved conflicts could persist. However, the fear of regional independence is likely to have only temporary negative effects on markets.

Populism and the move to regional independence tend to fail when they are not backed by a strong economic message. The results in the Scottish referendum and for FN/PVV in the French and Dutch elections are prime examples of failing to promote an attractive economic message, in our view. The policies of FN and PVV of leaving the euro were particularly unpopular given the perceived negative impact on voters’ wealth, while the vulnerability of Scotland to the weaker oil price undermined the case for independence.

A fifth theme in a similar vein to regionalism is authoritarianism. This trend has become evident in Turkey, Russia, China (as demonstrated at the 2017 National Congress) and certain African countries. While it may potentially have a profound impact on the economic outlook for specific countries, the impact on investor behavior so far seems minor. The recent setback in Turkish capital markets appears



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to have been driven more by the deteriorating relationship with the USA and vulnerable economic data, not by domestic Turkish political factors.

The sixth theme and another reason for active investment management is widespread geopolitical tension. Major sources of tension are North Korea versus the USA, potentially (again) the South China Sea, Saudi Arabia versus Qatar/Turkey, the USA versus Turkey, the de-certification of the Iranian nuclear agreement, potential disagreements over the breakup of Syria after the ISIS defeat and the use of sanctions against Venezuela. However, the historic evidence is clear that adverse geopolitical events tend to have a short-term impact on capital markets and can represent “buying opportunities” for investors. Negative geopolitical shocks inevitably lead to investors switching to perceived “safer” asset classes such as gold, the Swiss franc and Japanese yen, and to high-quality government bonds, notably US Treasuries, Bunds and Japanese government bonds.

Markets generally resilient to geopolitical events

Contrary to popular belief, geopolitical risks and authoritarianism are evidently not increasing relative to historic norms, and market movements have generally proved to be resilient to geopolitical events. Daily trading patterns in Korean assets on and after the North Korean missile launches in 2017 and thereafter demonstrate this. Turkish assets have been more vulnerable to the relationship with the USA rather than being driven by domestic political events. All the available evidence shows clearly that geopolitical events only have a short-term impact on markets unless there is either a “major and longer-term shock” to commodity markets (e.g. the 1970s oil price shock on the development of OPEC (Organization of the Petroleum Exporting Countries)) and a long-term global outbreak of hostilities (for instance, the two Gulf Wars only had a short-term impact on markets and the complex international involvement in Syria has had almost no impact).

The current level of geopolitical risk is largely being ignored by investors, as shown by the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market’s expectation for 30-day volatility, and which has been stubborn at around 10 at best in the second half of 2017, the relatively weak Swiss franc against the euro, the stability of the yen, the uptrend in US Treasury yields and the inability of gold to trade decisively higher. Oil prices have not traded higher on Gulf Cooperation Council (GCC) tensions and/or Middle East conflicts. Obviously, the relationship between Saudi Arabia and Iran needs monitoring and any escalation could lead to a temporary oil-price hike.

Seventh, and on socio-economic aspects, inequality has become a leading political question in a number of elections. After the 2007–09 financial crisis, political shifts led to increased regulation of the banking industry, with the financial sector deleveraging and underperforming, while the monetary and fiscal mix changed dramatically with unprecedented monetary easing offsetting

generally tighter fiscal policies. Since 2009, the cyclical shift in monetary policy has underpinned the performance of credit and equity markets, in turn driving the increase in wealth inequality. While wealth or asset inequality has been driven by the rise in equity markets and other asset classes (see the Bank of England paper on the impact of quantitative easing (QE) on inequality), income inequality has been a function of weak wage growth, a lack of union power and job insecurity.

“Inequality has become a leading political question in a number of elections”

Political backlash against the financial sector after the financial crisis of 2008 has compounded inequality as a (if not the) key political issue in a significant number of countries. This issue has extended to the corporate sector, with particular attention to technology and other companies concentrating profits and cash flows in low-tax centers. The publication of “hacked” documents disclosing examples of possible tax avoidance via low-tax centers has increased the political focus on this issue. Consequently, the political agenda has shifted to calls to take action against tax avoidance, to introducing more progressive tax regimes and increasing tax on areas of asset overvaluation, e.g. real estate. The implications are negative for companies using low-tax centers and for the real estate markets.

The eighth theme and a major topic in recent political rhetoric, especially elections, is migration – be it President Trump’s campaign (and potential building of the wall with Mexico), the Brexit referendum, (although areas with high migration did not necessarily vote to “leave”), the recent German election (emphasized by the AfD) and potentially the 2018 Italian election (after the surge in migration from North Africa over the last five years). Restrictions on immigration could induce a structural change in industries such as leisure and agriculture, which are dependent on migrant labor and can be expected to underperform. On the other hand, we may see increased investment in border security.

As terrorist activities remain a source of threat for developed economies, expenditure on security and defense will remain high. A number of “failed states” (i.e. Libya, Somalia, Afghanistan, Syria, South Sudan and Venezuela) are often attributed as being the source of such terrorist activity in developed countries. Simultaneously, reformist oil producing countries (particularly in the Middle East) that wish to disassociate themselves from terrorist acts and are keen to establish themselves as economic powers and culturally progressive are investing in diversification. Markets have increasingly grown vulnerable to energy supply shocks and oil-dependent countries are also investing more heavily in shale and alternative energies.



Companies with high-quality corporate governance likely to outperform

On the institutional side (our ninth theme), positive trends have been the crackdown on corruption in China, the attack by the independent Brazilian judiciary on Brazilian corruption, and the resilience of most countries to the US disagreement to the Paris climate accord as countries become more sensitive to environmental, social and governance (ESG) standards. However, as evidenced by the number of corporate issues, i.e. the quality certification issue with Kobe Steel, Volkswagen's diesel emissions scandal, Tesco's inappropriate accounting practices, Uber's compliance and disclosure issues in London, and the arguments over the Saudi Arabia's Aramco initial public offering, governance still has major scope for improvement. There is increasing evidence that companies with high-quality corporate governance are likely to outperform and that, where governance issues surface, share price downside can be extreme.

“Traditional political communication channels are becoming less powerful and parties that exploit social media will clearly have an advantage”

Our final theme (number ten) is a very contemporary concern that has already begun to shape politics and its impact on financial markets, i.e. the use of social media/technology. Part of President Trump's success in the US presidential election was the use of social media that ensured

more regular communication of ideas and a deeper connect with the electorate. Other examples have been the changes in the mobilization of opinion in the UK Labour party, Five Star in Italy, En Marche in France and the control of social media output by the Chinese authorities. Russia is arguably a “master” at using social media in other countries. Traditional political communication channels are becoming less powerful and parties that exploit social media should clearly have an advantage. Social media companies, however, may be vulnerable to more regulation or threats to their market shares and excessive market valuations could experience setbacks. A related issue is the increased investment in cyber-security and anti-hacking technology.

Key economic and financial market implications

From the complex web of issues discussed in this article, we can clearly filter out some key economic and financial market implications. Although globalization is potentially under threat, global trade figures and the complexity of supply chains suggest that global trade is, so far, intact. The International Monetary Fund (IMF) growth forecast for 2018 has been revised upward to 3.7% and recent export growth data are robust, e.g. Japanese exports are up over 14% year-on-year (YoY), Eurozone exports are close to a record high, Chinese exports are up over 8% YoY, India up 25%, Russia up 25%, Brazil up 18%, the UK up 9% since September 2016, while even the USA has seen its highest level of exports since 2014. Despite protectionism being part of the Trump agenda, the impact on global exports has so far been minimal and in the future may boost non-US country-to-country trade and notably increase

intra-Asian, Latin American and European trade. The implications of the UK, post Brexit, trying to develop trade deals with the USA are not positive nor is the growth of UK trade with the EU. The economic implications of globalization reversing are probably a higher rate of growth in the EU, Latin America and Asia relative to the USA and UK, as is implicit in the recent revisions to the IMF growth forecasts.

More specifically, since the end of 2008/early 2009, the defining features of capital markets have been the decline in credit spreads (with investment grade spreads now at a historically low 60 basis points and high-yield spreads less than 350 basis points), the rally in equity markets, the historically easy monetary policies with the Fed expanding its balance sheet by over five times and with QE programs including purchases of mortgage bonds (US Federal Reserve), corporate bonds (European Central Bank) and equities (Bank of Japan), the strong growth in the asset-management industry of exchange traded funds (ETFs) and capital flows into illiquid assets, the increased regulation of the financial system and the deleveraging of the banking system. These trends have been set against a background of tighter fiscal policies, while regulators have focused on the need to prevent any future state-led bail-outs of banks and attempting to push market activity onto regulated exchanges away from over-the-counter (OTC) trading.

Change in monetary and fiscal policies

Going forward, populist policies are likely to lead to a change in the mix between monetary and fiscal policies and, at least in the USA, China and Europe, result in further but slow monetary tightening. A central case assumption would be that the US Federal Reserve (Fed) starts to reduce its balance sheet by USD 50 billion per month in the second half of 2018 and that the European Central Bank (ECB), while extending QE into the second half of 2018, will probably end the program in early 2019. The Fed Funds Rate could be increased by a further three times in 2018 with the ECB starting to move away from its negative deposit rate policy. In 2019, the Bank of Japan may at least start to slowly reverse its easy monetary stance. The policy of the People's Bank of China (PboC) is clear, namely to reduce the shadow-banking market, to minimize speculative real estate excesses and to clean up non-performing loans (NPLs) in the state-owned enterprises/loan associations, while following a relatively tight liquidity policy as shown by the high bank reserve ratio policy. In the USA, bank regulation is likely to be eased, with lower capital and liquidity buffers. The trend towards higher government bond yields is inevitable, particularly given that, in most markets, real yields are currently negative. A working assumption would be 10-year US Treasury yields in excess of 3% at end-2018, 10-year Bunds close to 1% and 10-year Japanese government bond (JGB) yields over 50 basis points. Fixed income asset management will likely become more challenging. Given a probable increase in

inflationary expectations and more substantial government borrowing due to fiscal expansion, the risks in these assumptions are skewed to higher yields. Tighter liquidity conditions suggest that credit spreads will widen with investment grade spreads potentially back to 100 basis points in 2019. The credit rally since the end of 2008 has now probably ended with a trend of slowly widening spreads, and the high level of investor exposure to credit and high-yield markets in particular may be reduced.

“Equity market gains may be constrained, volatilities will rise and market correlations will reverse from the current high levels”

Against this background, underperforming themes and sectors would include sectors dependent on low-cost labor, suffering from increased minimum/living wages and tighter migration policies, e.g. leisure and agriculture, while complex supply chains could be disrupted by increased protectionism/tariffs, implying that outsourcing policies could be reversed, thereby impacting service centers (e.g. India and the Philippines) and component suppliers. Companies dependent on imports will potentially face higher costs or uncertainty over supplies if trade agreements are canceled. Over-leveraged sectors are vulnerable to higher yields, reflecting the trend toward a less-accommodative stance by central banks. Liquidity and low-yield support for equity markets will likely be less persuasive, implying that equity market gains may be constrained, volatilities will rise and market correlations will reverse from the current high levels.

The change in correlations implies a lower volume of capital flows into broader index ETFs, with a greater focus of investors on country and sector funds. The high-yield bond market will likely underperform and could suffer from decreased liquidity. Excessive valuations, notably in the high-tech and biotech sectors (e.g. the FANG stocks – Facebook, Amazon, Netflix, and Alphabet) will likely be adversely impacted by higher yields and spreads. Debt-financed merger and acquisition (M&A) activity will likely slow, sending a negative signal for investment banking. The shadow-banking market will face even greater regulation, as clearly announced by the Financial Stability Board. Utilities subject to price regulation and higher yields will likely continue to underperform.

Low-tax-paying companies/sectors subject to greater tax compliance and companies with underperforming governance standards will be vulnerable to regulation and shareholder pressure. Finally, where populism has a leftist approach, investors will be sensitive to the risks to companies vulnerable to potential state acquisition.

Conversely, outperforming themes/sectors in the financial sector include US banks, where profitability should be boosted by US deregulation, although this trend will be less apparent in the EU and Japan, while commercial banking/fintech will likely outperform investment banking, particularly as OTC trading activity is switched to exchanges. Market exchanges should benefit from higher volumes and greater market share of transactions. In the infrastructure sector, we think social infrastructure (particularly education and healthcare) should perform positively, while the focus on “affordable housing” should support home builders, although real estate owners cannot be guaranteed higher prices or rents. Telecoms/IT infrastructure should benefit from the continued expansion of the digital economy, although telecoms owners will face pressure on prices. Healthcare suppliers (except for pharma companies subject to price regulation) should benefit from increased public and private expenditure. Consumer sectors benefiting from higher wage growth will likely outperform, i.e. consumer discretionary versus staples.

The trend toward regionalism should benefit sectors focusing on regional trade in Asia, the EU, and Latin America. We expect companies demonstrating solid corporate governance standards to attract investors. Transport and energy infrastructure should experience an acceleration in investment with a bias toward alternative energy. In the transport sector, the focus will likely be on mass transit systems and high-speed train networks and the engineering and logistics companies building these networks. The shift in political trends should favor asset sharing, e.g. car sharing in cities. Under-leveraged companies with strong-enough cash flows to generate dividends to compete with higher yields is one major investment theme. We expect that robotics will become widely used in response to wage growth and labor policies. In the asset-management industry, we think managers will move increasingly outside their traditional areas to provide “market-based finance,” longer-term illiquid assets, and transparent smart beta products (i.e. ETFs).

Significant and complex changes

In conclusion, the global political ecosystem is being buffeted by a number of significant and complex changes, including the reversal of globalization in favor of regionalism/nationalism and the numerous aspects of more populist agendas. Since 2008–09, fixed income and equity markets have rallied strongly against a background of aggressively easy monetary policies. Political changes, irrespective of whether the ideology is “right or left” are now likely to change the cyclical mix between monetary and fiscal policies, while geopolitical factors will boost regional trade patterns. We expect the key losers to be those sectors vulnerable to this policy change and globalized trading, while the opportunities in investment strategy are likely to be focused on the building and ownership of all aspects of

infrastructure and technology to improve productivity and the efficiency of the use of assets. We believe simple asset allocation models, which have worked well over the last eight years seeing credit and equity asset classes significantly outperform, are now unlikely to produce satisfactory results. ■

NOTE: The views expressed here are those of the author and do not necessarily represent or reflect the views of Credit Suisse



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An outlook on global politics

The year 2018 promises to be a year of significant challenge to global stability and peace. As an uncertain United States under President Donald Trump continues to back away from its traditional leadership role, it remains to be seen if other democratic powers, most notably Europe, India and Japan, can fill the vacuum created by an increasingly self-isolating American administration.

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The most consequential change in global politics today is rising concern about American dependability as well as doubts about the increasing dysfunction in the US Congress and the quality of presidential leadership in the White House. Strengthening authoritarian powers Russia, Turkey and China will seek to take advantage of American weakness by extending their influence in Europe, the Middle East and Asia, which leaves much of the traditional responsibility for the defense of western interests and values to Europe.

The world is experiencing the most profound leadership transition in a generation. Among the key issues to watch in the year ahead are (1) whether a strengthening Europe can continue to cope with a multiplicity of serious internal and external threats, (2) whether Middle East countries can manage to contain the powerful forces that make theirs the most violent and unstable region in the world, and (3) whether China and the USA can find a balance in their complicated relationship as both partners and rivals, while avoiding a possibly catastrophic conflict in North Korea.

A rebounding Europe faces new threats

Could 2018 be the year when Europe comes all the way back from the low growth, uncertainty and uneven leadership of the last decade? The past year was successful in crises averted. Right-wing nationalists did not win in the Dutch, French and German elections. The economy of most European Union members returned to positive growth. Most notably, in German Chancellor Angela Merkel and the new French President Emmanuel Macron, Europe has again a strong leadership duo to meet the challenges ahead.

Macron has impressed in his first months in office, managing simultaneously to keep Trump close and Russia's Vladimir Putin at bay. His labor reforms are designed to boost French competitiveness and self-confidence. Macron's late 2017 international

summit on climate change signaled that Europe will lead on a major global issue even if the USA is unwilling to do so.

Chancellor Merkel had a more challenging second half of 2017 when her Christian Democrats performed below expectations in the September elections. While she may have a weaker domestic political base than in years past, she is still Germany and Europe's strongest leader. Many now see her as leader of the West and of its values and interests. Recent news flow indicates that she will very likely emerge by February as the leader of a renewed Grand Coalition government with the Social Democrats, which is good news for Germany and Europe.

Together, Merkel and Macron have major opportunities ahead. If the German leadership can be convinced of Macron's staying power, Berlin and Paris could push through needed reforms to strengthen the EU's banking and finance powers, expand defense spending and cope with the inevitable aftershocks of Britain's exit next year. They may also emerge as the world's leading defenders of human rights and democracy at a time when both are being challenged by authoritarian powers.

Europe's rediscovered German-French axis will need to address a demanding foreign policy agenda. Brexit is the most urgent. The UK (United Kingdom of Great Britain and Northern Ireland), Europe's second largest economy and most capable military power, will orbit out of the EU by the spring of 2019 absent a last-minute change of heart by the British Parliament. Britain's departure looks to be messy and acrimonious. It will surely weaken the EU's ability to cope with a more aggressive Russia and a suddenly unreliable USA. Brexit will also reduce the UK's influence on both sides of the Atlantic. It could also create internal fissures so deep that this once powerful country could be reduced to the United Kingdom of England and Wales in a decade or two if determined Scottish and Irish nationalists have their way.



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In addition to Brexit, European leaders will need to cope with a rising tide of terrorism in 2018, particularly in France, Belgium, the UK and Germany, where returning jihadists from Middle East Wars will continue to pose a major threat to internal security. Europe has not seen the end of anti-democratic populists aiming to upend the established order. Many, like France's National Front, are relatively well funded and have a grievance – immigration and refugees – for those on the continent who do not favor the long-term trend of multi-racial and multi-religious societies. Such populists have already gained control of the governments of three EU and NATO member states in Central Europe – Hungary, Poland and the Czech Republic. And while the refugee crisis seems past its most critical point, it will continue to challenge the EU's unity.

During the last decade alone, Russian President Putin has effectively re-divided Europe to the south and west of the Russian Federation in the wake of his invasion of Georgia in 2008, his continuing destabilization of Moldova, annexation of Crimea, occupation of the Donbass in Ukraine and pressure on the Baltic Countries – Estonia, Latvia and Lithuania. Merkel and Macron will make sure the EU maintains sanctions on Russia over its illegal intervention in Ukraine. Their greatest test may be to keep President Trump on board.

Turkey also presents a challenge to European stability and unity. President Recep Tayyip Erdogan holds the key to stemming an inflow of more Syrian refugees across the Aegean Sea into Europe. His increasingly autocratic and anti-democratic rule makes his country an uneasy and often unreliable partner of Germany and other European states.

While all these challenges will test the continent's

governments mightily, a combination of German and French leadership, rebounding economies and newly found self-confidence may make this the year of Europe in global politics.

The Middle East Crisis continues

Seven years after the start of the Arab Spring, the report card is clear – nearly all of the Middle East's twenty-two Arab countries are worse off, not better off, as a result. After the failed revolutions and crushed hopes of the largely peaceful and often inspiring popular movements of January 2011, stability and hope in the region are in very short supply.

Four important Arab countries – Libya, Yemen, Iraq and Syria – are essentially “failed states.” Libya's warring tribes continue to contest for power with the outcome in doubt. Yemen is the victim of a proxy war between the great Sunni power Saudi Arabia and the great Shia power Iran. The United Nations fears a major famine and outbreak of disease should the war not abate in the coming months. Iraq will likely remain divided into three parts – an autonomous Kurdish region, the Shia-dominated government in Baghdad and Basra, and a now liberated but far from content Sunni majority in Anbar Province.

Syria's brutal civil war will likely continue for months if not years absent a more effective international effort to stabilize the country's borders and to produce a durable power sharing arrangement between the Assad government and its many foes, particularly in the Sunni community.

Syria's massive refugee crisis will likely continue to weaken the region and Europe for another year to come. Of its pre-war population of roughly 22

million people, the United Nations believes at least 12 million were made homeless by the war either inside or outside the country. Europe, led by Merkel, has made a herculean effort, to accept Syrian refugees. But, the USA under President Obama managed only to accept 12,500 Syrian refugees. President Trump refuses to accept any refugees from Syria or a number of other Moslem-majority countries. A greater commitment by the USA and other leading nations to take some of the burden off European shoulders is required if this crisis is to be finally ended in the years ahead.

Long the most important and influential outside force in the region, the USA, under Presidents Obama and Trump has diminished its role in the Middle East considerably. That trend has been clear in the slow, halting US steps to seek international talks on the future of Syria. It was a big factor in Trump's decision to distance the USA from the Syrian and Iraqi Kurds after the fall of the Islamic State. Russia has filled the resulting gap in Syria, Egypt and Libya and appears the far more confident and capable military power. Trump has done well, however, to establish close ties to the leadership of Saudi Arabia and other Gulf States, and to Egypt and Jordan.

The region's most serious unfolding crisis may be the deep, acrimonious rivalry between Saudi Arabia and Iran for power in Iraq, Syria, Lebanon and Gaza. Despite the reformist veneer of President Rowhani and Foreign Minister Javed Zarif, Iran's policy in the region is dominated by the ambitious, violent and ruthless Revolutionary Guard led by Qassem Suleimani. Iran arms and supports the Houthi rebels in Yemen. It is now the most powerful outside force aligned with the Iraqi government. Its forces, along with those of its client Hezbollah, continue to threaten Syria's Sunni population as well as Israel from inside Syria. And its export of arms to Hezbollah in Lebanon may well provide the ammunition for another rocket war with Israel at some point in the next year or two.

Saudi Arabia is equally determined to exert its power in the region. Its young and relatively inexperienced Crown Prince, Mohamed Bin Salman, is actively contesting Iran's power moves. Saudi and Emirati prosecution of the bombing campaign in Yemen has been erratic and often needlessly brutal in the loss of thousands of civilian lives. Their trade blockade of Yemeni ports has led to the deplorable humanitarian crisis inside the country. And the Saudi Crown Prince's attempt to capture absolute control of power in the Kingdom led him to take the unprecedented step of arresting many senior Princes last autumn.

The defeat of the Islamic State in both Iraq and Syria was a singularly positive event in the Middle East in 2017. A rebuilt Iraqi Army and US Special Advisors and airpower led to the liberation of Mosul and northern Iraq in the autumn. In Syria, the Assad government, backed by Russian airpower, reclaimed most of its lost territory from ISIS. US Special Forces, Syrian Kurdish groups and a massive US-led air campaign destroyed the

ISIS presence in Raqqa. While this is a significant victory, the problem of terrorism in the Arab World will not disappear anytime soon. The terrorist threat, in fact, has spread from the Levant to the Horn of Africa and all the way across the African continent – through Chad, Nigeria, Niger, Mali and Mauritania on the Atlantic coast. The presence of indigenous and foreign terrorist fighters in this region will bedevil African, Arab, European and American forces for many years to come.

As a result of the Iraq and Syria wars, as well as the failed revolutions in Egypt, Libya and other countries and the lack of economic reform, there is every reason to believe that, outside of the Gulf, most of the region will continue to be victimized by violence, instability and a continuation of the failed politics of many of its governments.

US-China rivalry and the North Korea Crisis in the Indo-Pacific

For decades to come, global stability should hinge more on the US-China relationship than on any other. China's historic Communist Party conference this past autumn signaled a shift in the balance of power between Beijing and Washington. While the USA will remain the single strongest political, economic and military power for some time to come, there is no question that China is determined to narrow the gap.

With Trump's America First policy drawing the US away from its traditional leadership role, China appears the more assertive of the two under Xi Jinping's powerful leadership. China's One Belt, One Road Initiative makes American, Indian and Japanese leaders uneasy. But, to many in Southeast Asia, Central Asia and beyond, its extraordinary scope and ambition is alluring as well as beneficial in the development of rail, road and port construction. Its sheer scale and ambition make it a 21st Century version of the mid-20th century Marshall Plan. Symbols are often important in national and global politics. While the USA is offering somewhat uncertain leadership to many of its traditional allies in Asia, China presents a self-confident brand of which the sheer magnetism is difficult to deny.

Stability in the Indo-Pacific will be tested in the month ahead on two fronts – the South China Sea and the Korean Peninsula.

China under Xi Jinping has become a more assertive power beyond its borders unlike any Chinese regime going back to Mao Tse-Tung. The Chinese military's push into the Spratly and Paracel Islands of the South China Sea has trampled on the territorial rights of five other less powerful claimants. In the East China Sea, China continues to contest Japanese claims to the rocky, largely uninhabited Senkaku Islands. That is a more difficult project for Beijing given the power and determination of the Japanese Defense Forces and its ally the USA. In both of these crises, principles important to the international order are at stake – the sanctity of a country's territory and sovereignty, the rights of small nations versus more powerful neighbors and the rule of law.



“China under Xi Jinping has become a more assertive power beyond its borders unlike any Chinese regime going back to Mao Tse-Tung”

China appears to be winning in this strategic struggle so far. While the US Navy continues to conduct freedom of navigation exercises in the South China Sea to demonstrate the right of all to passage in international waters, the Chinese military machine has worked methodically to create what many have called “facts on the water” – new airstrips, ports and land reclamation projects to support the Chinese conviction that possession is nine tenths of the law.

The South China Sea crisis illuminates the larger, long-term dynamic between China and the USA. They are rivals for long-term strategic predominance in the region. The USA, through its vast alliance and partnership system – which includes Japan, South Korea, Australia, Thailand, Vietnam and India – is determined to remain the region's strongest power. China's ambitions, as articulated by Xi at the Party Conference, are to eventually supplant the USA in the region.

That is why the USA during the presidencies of George W. Bush, Barack Obama and now Donald Trump has created a close military alignment with Japan and India to balance China and to prevent its future dominance of the region.

While the USA and China will remain strategic competitors, they are also, in many ways, each other's most important strategic partner. They have a common interest in addressing the challenge of climate change as the globe's two leading carbon emitters. They have dual responsibility with Europe and Japan for the functioning and stability of the global economy. As governments with enormous capacity, they will be called on increasingly to work together to address some of the major transnational threats – drug and crime cartels, pandemics and terrorism.

The key challenge for Washington and Beijing is to learn how to balance the open military competition between them on the one hand and the need for partnership on the other. This will require mature leadership and wisdom in both capitals.

This uneasy relationship between Beijing and Washington will be tested as never before in the ongoing North Korea nuclear crisis. Trump and Xi have established a relatively effective working relationship. They have also been cautious in dealing with each other. Trump has not implemented his 2016 campaign to brand China a currency manipulator as he needs Chinese help to expand sanctions on the North Korean regime. Both have opposed Pyongyang's nuclear and missile tests and its tendentious threats against South Korea and Japan.

But Trump will have to make a major decision on North Korea in the months to come. Will he seek to continue to deter and sanction Kim Jung Un and steer the conflict to the negotiating table? Or, will the USA decide to launch a preemptive attack on North Korea's nuclear and conventional arsenal in the belief that Kim is irrational and thus not subject to effective

long-term deterrence? Would China react to a US attack by intervening militarily in the northern part of the Peninsula to protect its own borders?

While some believe the probability of war with North Korea is rising rapidly, the more likely scenario is the continuation of the current stand-off. While this contest for power continues, the greatest danger may be a conflict produced by miscalculation or even accident as the two Koreas and the two great powers – China and the USA – circle each other uneasily in the most heavily militarized region of the world.

The uncertain United States

The most significant factor in the future of global politics is the changing nature of American leadership. The USA – through its strong and innovative economy, first-rate military and prodigious diplomatic strength – is still the world's leading power and organizer of the international system. But for the first time since before World War II, an American president is putting into place new policies that appear to be diminishing that leadership role. Trump's ambivalence toward NATO and other US Alliances, disavowal of free trade and severe crackdown on immigration and refugees is overturning seventy years of consensus among Republican and Democratic leaders about how the USA should lead in the world. In withdrawing the USA from the Paris Climate Change Agreement and two United Nations agencies, he is signaling a more reclusive American leadership role.

It is possible that Trump could also decide in 2018 to withdraw the USA from the Iran Nuclear Deal. That would create a crisis not just with Iran, Russia and China, but with Washington's closest allies – the UK, France and Germany. Trump may choose to dissolve the NAFTA agreement with the aim of renegotiating bilateral deals with Canada and Mexico, respectively.

During his first year in office, Trump chose not to champion the traditional leadership role of the USA as defender of democracy, human rights and the rule of law. His embrace of authoritarian figures such as Xi, Putin and the Saudi leadership stands in sharp contrast to his persistent public criticism of Merkel, British Prime Minister Theresa May and Australian Prime Minister Malcolm Turnbull. An important element of US power since World War II has been its leadership of the democratic world – the West. Trump's silence in the struggle to defend democracies against more assertive authoritarian powers has been a key factor in the poor state of relations between his administration and the European allies in his first year in office.

This major shift in America's leadership role has unsettled global politics. It has reduced the credibility and influence of the USA. It has caused many of our traditional allies to recalculate how to defend their own interests in a world where the "America First" banner of Donald Trump appears to signal a distancing, if not a full retreat, of American power for the first time since 1941.

The USA, however, remains a deep and vibrant democracy. Republican and Democratic leaders in the US Congress have voted to impose economic sanctions on Russia over Trump's objections. The press and the courts have acted to question and sometimes block the worst excesses of his unsteady and often unpredictable rule. California and other states are vowing to implement the Paris Climate Change commitments President Obama made for the USA in 2015. Recent defeats of candidates favorable to Trump in Virginia and Alabama are a warning sign that his majority in Congress will be tested in the November 2018 mid-term elections. The world will have to deal with a more inward-looking and unsteady America as the domestic battle for power in Washington dominates politics in 2018.

“For the first time since before World War II, an American president is putting into place new policies that appear to be diminishing that leadership role”

When Winston Churchill visited Harvard University in 1943 as World War II was at its crucial turning point, he addressed students training to become military officers at a time when the USA was overtaking Britain as the lead global power: Churchill had this advice for his American audience: “The price of greatness is responsibility.” To be a great power, Churchill implied, is to be responsible for the world beyond your own borders.

That requires engagement with the rest of the world, the assumption of responsibility for the global problems that afflict all countries such as climate change. It requires being an active ally and partner to those countries committed to the USA. This is the kind of advice that many of America's closest friends are giving the new US Administration now. Whether Trump listens or not will be a major factor in the future of politics and of global security for years to come. ■

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