

# 2023

## How are global businesses managing today's political risks?

2023 Survey and Report | Produced for WTW



Oxford  
Analytica

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# 04 Executive summary

## *The year political risk became everyone's risk*

This is how an insurance broker typically describes political risk: “low frequency, high severity.” Political risk is, in short, a catastrophe risk, or “cat risk,” much like many types of natural disaster. Political risk losses occur rarely but tend to be devastating in effect. As with other catastrophe risks, these statistical characteristics tend to make political risks difficult to model.

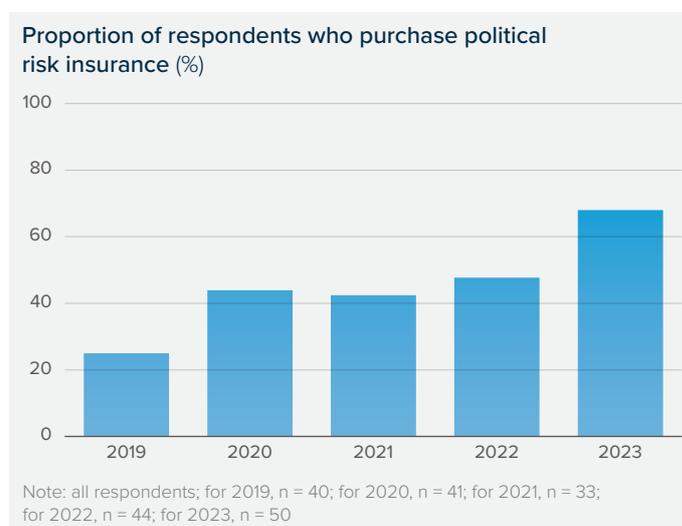
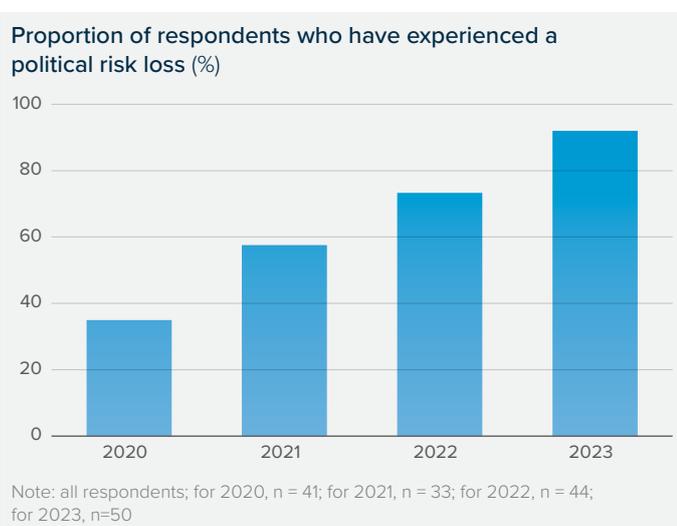
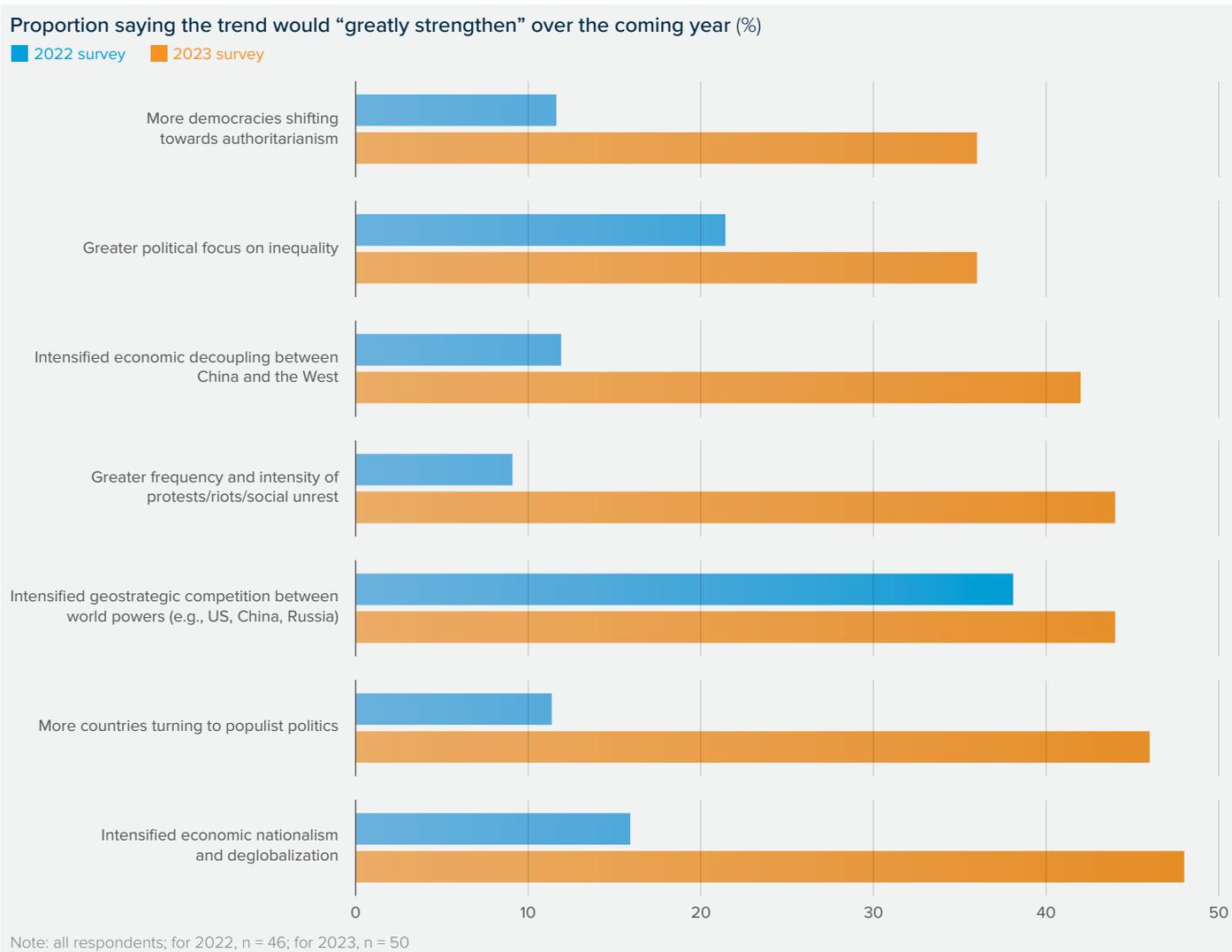
We are going to have to rethink that description: this year, more than 9 in 10 of the companies we surveyed reported a political risk loss (up from 35% only a few years ago). This year, political risk became everyone's risk.

The escalating conflict in Ukraine, on top of its humanitarian impacts, had a “devastating” business impact, according to a European member of the panel of business executives we interviewed. “We have decided to end all our operations in Russia and Belarus,” said a panelist from a US technology company. “We suffered a loss of almost 1 billion dollars.”

That said, we found a differentiated impact across world regions. 86% of Western European respondents reported a net negative financial impact of the conflict, while only 33% of North American firms did so.

Whatever the financial impact, the shock of war on the European continent had triggered a “paradigm shift” said one member of our business panel; it is a “watershed moment,” said another. An executive in the automotive sector perhaps put it best saying: “Business and politics have lived in two different realities. The events of the past year have now aligned realities.”

100% of the companies we surveyed had made at least some enhancement to their political risk management capabilities since February 2022. The proportion who reported purchasing political risk insurance nearly trebled from 25% in 2019 to 68% this year.



Following the escalation of conflict in Ukraine, “we find ourselves in a new investment climate,” said a panel member from the oil and gas sector, “and are trying to come to terms with this shift.” But what, exactly, does this new climate look like?

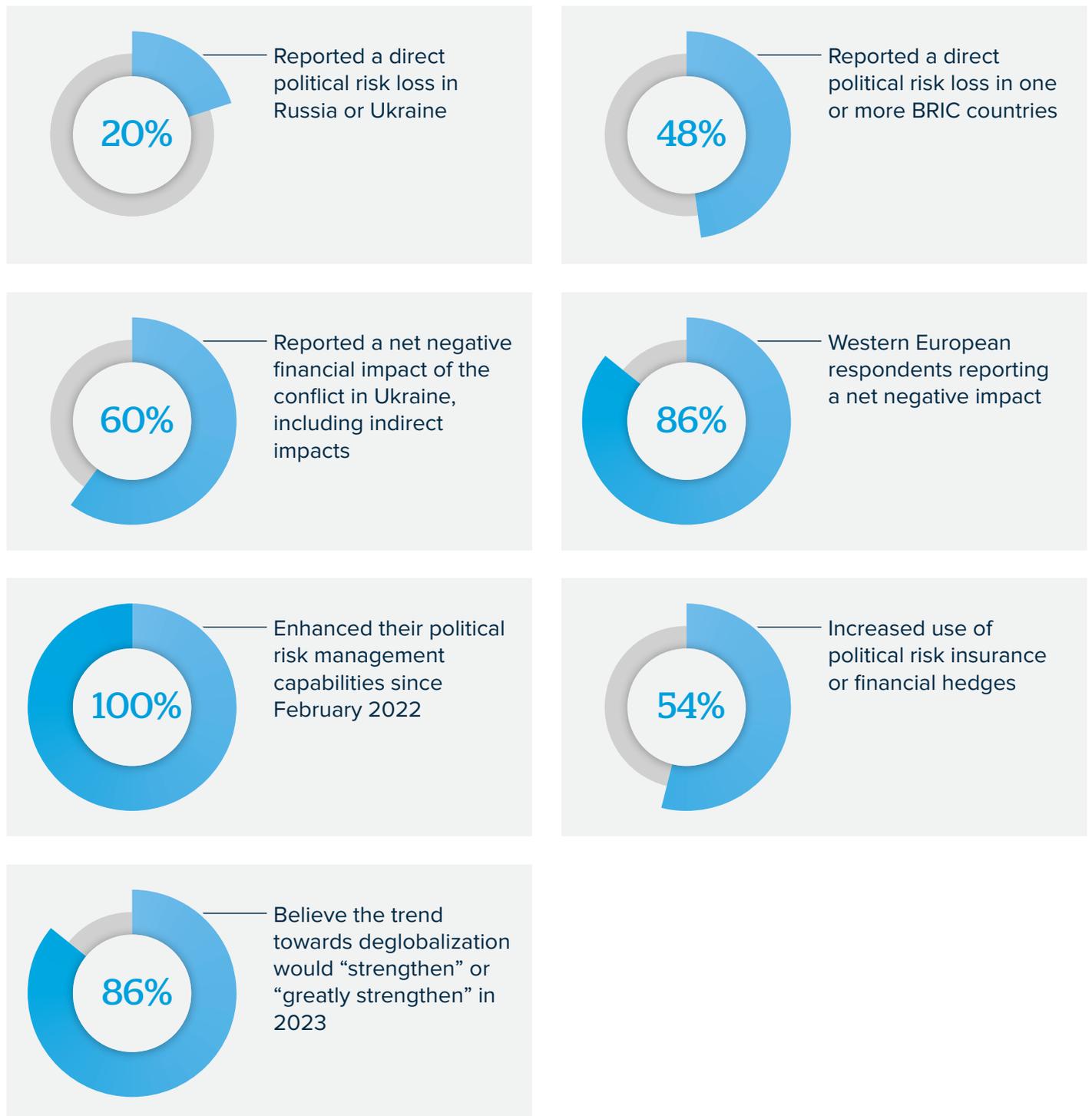
Compared to last year’s survey, respondents were far more likely to select the worst-case outcome across geopolitical trends. The proportion who predicted deglobalization would “greatly strengthen” was 16% last year; this year it was nearly 50%. The proportion who predicted decoupling from China would “greatly strengthen” was 12% in 2022, but 42% in 2023.

Companies reported that such geopolitical divides were being mirrored in their internal operations. “Global decoupling, which to some extent has been accelerated by the war, has meant that we have had to, or are in the process of, decoupling everything, including HR systems, production systems, and so on,” said a panelist in the industrial sector.

Each year we conclude this study by asking our business panel about the top risks for the year ahead. This year, complications from the Ukraine conflict led the list, followed by decoupling with China. A surprise third place was taken by the European Union, which faces an energy crisis, but is also reshaping the rules and standards of global businesses with its willingness to regulate in areas such as technology, data, supply chains and climate.

## At a glance

For details of respondents and sample size, see main report.



# Q2 About the research

In keeping with the past several years of this study, this year's research combined in-depth interviews with a broader survey of a larger sample of companies. There were 50 respondents to the survey; there were 18 participants in the interview panel.

In previous years, this study has been a client survey, in which only clients of WTW and Oxford Analytica were invited to participate. Because these clients invested heavily in political risk management, they tended to be exceptional. For instance, last year, nearly 70% of respondents worked for a company with annual revenues exceeding \$10 billion.

This year, we decided to survey a more representative sample of globalized companies (defined as companies operating in at least two geographic regions). Hence this year's survey sample is more representative of globalized businesses, across geographic regions, industries, and company size. We felt that having a more representative sample was important given that in 2022 political risk moved from being a niche concern to being, as we said in the executive summary, "everybody's risk."

As a result, some year-on-year changes in results may reflect changes in the sample composition. In the analysis that follows, we have flagged questions where we believe such changes may have played a significant role.

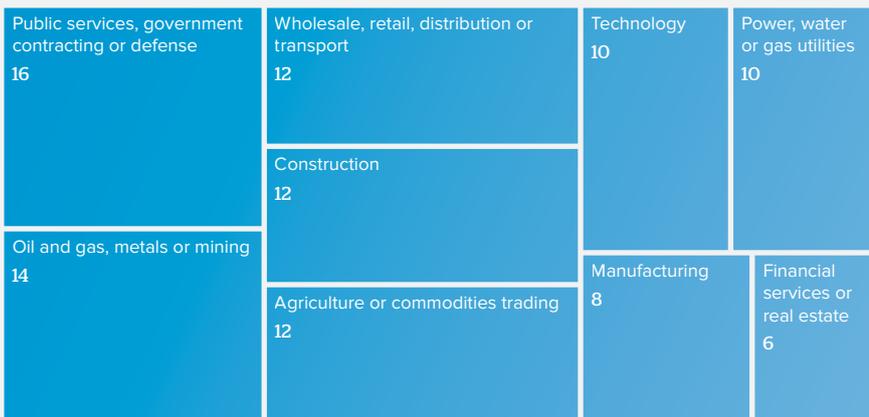
We thank the survey participants and panelists for their time and insights.

Job function of respondents (%)



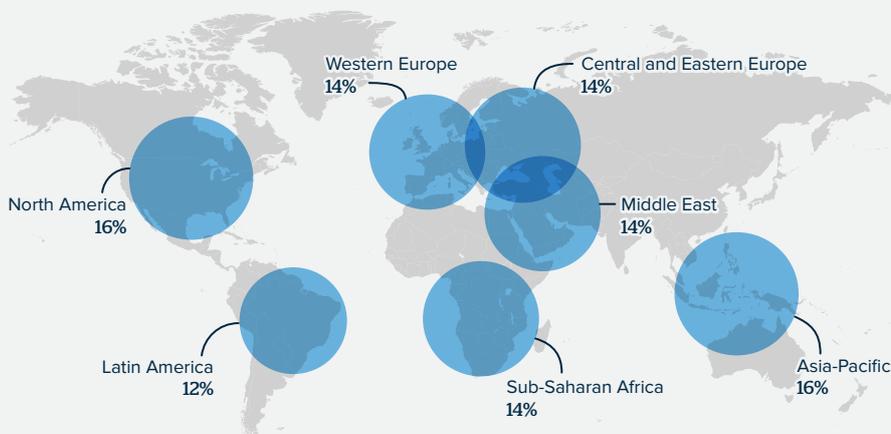
Note: all respondents; n=50

Industry of company (%)



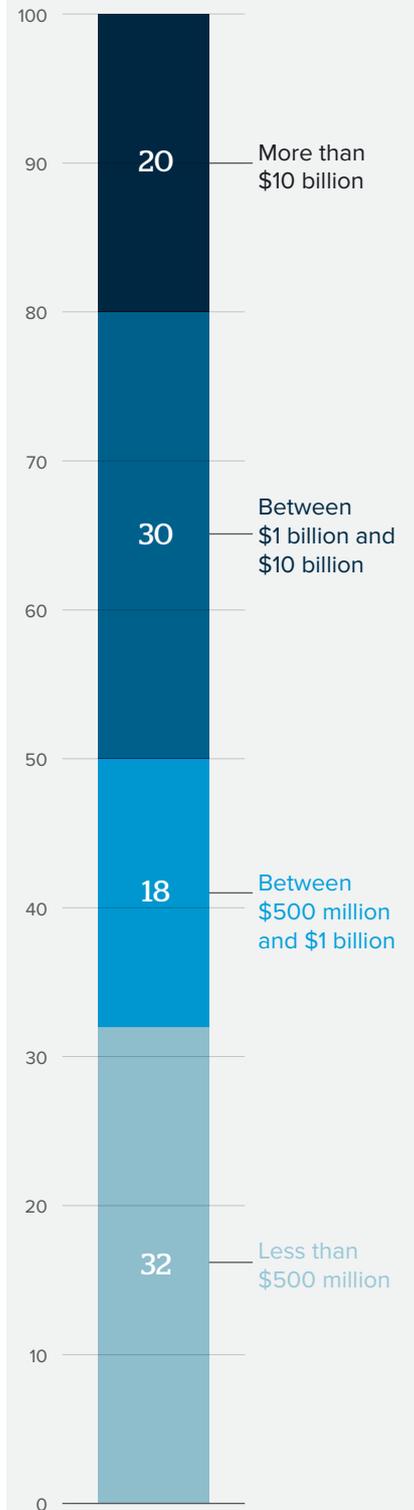
Note: all respondents; n=50

Headquarters location of company (%)



Note: all respondents; n=50

Annual revenue of company (%)



Note: all respondents; n=50

# Q&A The impact of Ukraine

## *The business consequences of the conflict*

Of the companies with which we conducted in-depth interviews, about a quarter, mostly headquartered outside North America and Europe, were continuing to operate in Russia. While those companies may have thus far avoided losses from write-downs of the value of their Russian subsidiaries, ongoing Russian operations pose challenges. “We are between a holding pattern and divestment, but for reasons that relate to the sanctions, negotiations with the Russians are not permitted,” said a panelist from an Asian multi-industry conglomerate. “In essence, we’re stuck.”

In other sectors, exemptions from sanctions have made it possible to operate more normally – although the executives from these sectors also talked of new risks. “Sanctions on Russian banks are making it difficult for us to collect payments,” said one healthcare panelist. An executive in the pharmaceuticals sector made a similar comment: “We are asking for payment upfront which has actually resulted in a lot of liquidity, partly due to the export controls [creating delays] in sending goods to customers.”

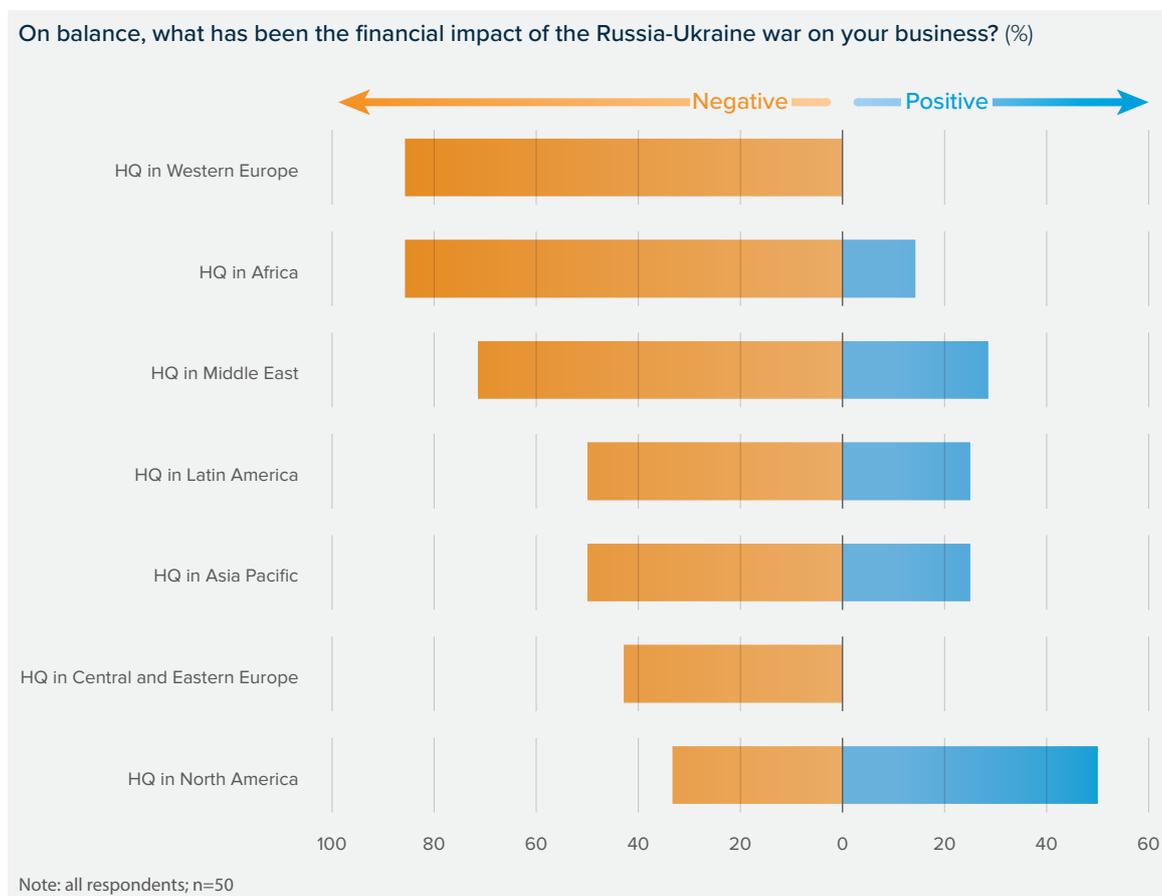
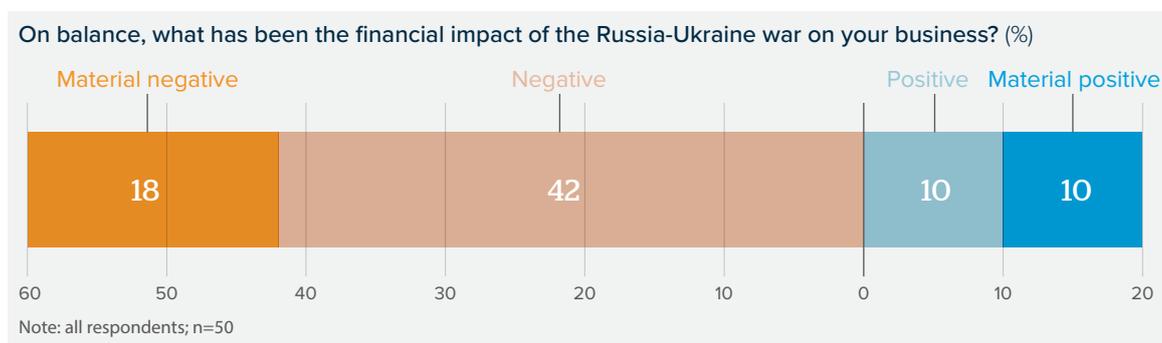
Most companies we spoke to, however, had left Russia, and in some cases Ukraine – resulting in significant write-downs, and in many cases continuing expenses. “Russia was quite a large market for us,” said a panelist from a European manufacturing company. “It’s now a case of moving out. We seek to ... do it in a way that finds employment for expats and locals. We don’t just lock the door and run. This takes time.”

In Ukraine, many executives reported “limited” operations, or temporary shutdowns, due to operational risks. “We had projects across the country [of Ukraine] and all operations have been suspended,” said a European utilities executive. “Anything that requires on-the-ground staff is impossible.” Others were more determined to keep at least some operations going. “Frontline offices were evacuated, but as far as possible we are still operating in Ukraine,” said the healthcare panelist quoted above.

Our survey found that a substantial majority (60%) of globalized businesses had suffered negative financial impacts of the conflict in Ukraine. Nearly one in five had suffered a material loss (with “material” being defined as “sufficient to require a restatement of earnings”).

In our panel interviews, the largest reported losses tended to relate to voluntary decisions to exit Russia. But many European companies had also suffered severe indirect losses resulting from the disruption of supply chains that had been integrated across Eurasia. “[The conflict] has also had a larger impact on surrounding countries, such as Kazakhstan [and] Georgia,” said an executive at a European industrial company. “In Poland, for example, our business was impacted because of sanctioned suppliers. There are a lot of hidden impacts.”

Our survey suggests a striking regional disparity in how companies have so far been impacted by the conflict: while European companies have been hit hard (the impact has been “devastating,” in the words of another European



automotive sector panelist), most North American companies appear to have remained largely unscathed. Nearly nine in every ten Europe-headquartered companies (86%) reported a negative impact from the conflict. For businesses headquartered in Africa and the Middle East, the figures were similar, perhaps because skyrocketing food and energy prices contributed to economic crises in several countries (including Egypt and Pakistan) as well as sovereign defaults in Sri Lanka and Ghana.

For North American companies, however, only a third reported a negative financial impact, and surprisingly, half of our North American respondents claimed that the impact of the conflict had been net-positive. How did these net-positive impacts transpire? Our interviews provided some hints. “The crisis has also meant higher energy prices, so windfall profits for us,” said an oil and gas executive. In a similar vein, a commodities trader pointed to higher profits from trading LNG (Liquid Natural Gas). (Indeed, annual US LNG shipments to Europe more than doubled in 2022, compared to 2021.<sup>1</sup>) An agribusiness executive noted that surging prices for many products had led to substitution, and thus higher prices for their core product, palm oil. An aerospace panelist reported: “our company supplies weapons to Ukraine (directly and indirectly) and this has led to our share price increasing.”

The finding that North American companies benefited should be taken with a grain of salt; our worldwide survey sample is 50 companies, so the number of North American respondents is only 6 companies. Still, the finding that North American companies were relatively unaffected is corroborated by available statistics. The US Bureau of Economic Analysis, for instance, reported that prior to the conflict, US companies had, on average, invested about four times as much in Barbados as they had in Russia, which would limit their downside risk.<sup>2</sup>

Of course, not all US companies escaped the conflict’s financial impacts. “We have decided to end all our operations in Russia and Belarus,” said a panelist from a US technology company. “We suffered a loss of almost 1 billion dollars.” An executive at a North American consumer goods firm noted ongoing headaches. “No authorized sales are permitted in the country [Russia] now and we are actively discouraging trans-shipment sales from our European operations, such as from Turkey,” they said. “While we can’t control this, we are trying to impact the outcome.”

### *Changes to corporate political risk management spurred by the conflict*

Even when financial impacts were modest, the shock of war in Europe appears to have spurred companies to action. Without exception, the companies we surveyed reported adding at least some new capabilities around political risk. In addition, to our surprise, we found that companies were almost as likely to have taken steps to hedge or transfer political risk as they were to adjust business processes.

To be sure, the most popular new capability, reported by 60% of survey respondents, was enhancements to business processes. “Information sharing and discussion groups on a weekly or bi-monthly basis ... are focused on key issues – e.g., Taiwan or Russia/Ukraine,” said an executive at an Asian conglomerate. A European commodities executive on our panel said, “we are now much more alert and aware of the power battle between the West and East, and people are much more inclined to conduct scenarios to think through the possibilities.”

For a majority of respondents, though, the effort did not stop at business processes: 54% reported taking financial or strategic adjustments, including new financial hedges or risk transfer programs. “[Tens of] aircraft we owned



were stranded in Russia after the invasion of Ukraine and subsequent sanctions by the West,” said a panelist from another Asian conglomerate. “This has been a major financial hit, and has led to us revisiting our leasing policy and increasing political risk insurance.”

This finding, that 54% of respondents had responded to the conflict with new financial tools for political risk management, is in keeping with the survey results (presented in the executive summary) about the takeup of political risk insurance. In our 2019 study, we found that 25% of respondents had purchased political risk insurance; this year, admittedly with a more representative sample, the figure had nearly trebled, to 68%.

At the time this survey was in the field, in early 2023, many companies were still struggling to manage the immediate impacts of the conflict. “We are carving out strategies to mitigate the loss of supply of essential commodities due to the conflict,” said a North American commodities executive. Other companies, however, had already addressed the immediate challenges and were looking to the long term. The idea of increasing resilience, even at a cost, was expressed by many interviewees. A panelist from an Asian conglomerate said, “going forward, we will work more with energy futures, and will invest in energy storage facilities, which are currently lacking.”

Several panelists commented on the “new normal” of a divided world. One of the most striking such comments was made by an executive from European industrial firm: “Global decoupling, which to some extent has been accelerated by the war, has meant that we have had to, or are in the process of, decoupling everything, including HR systems, production systems, and so on. Personal data, for example, can no longer be shared or handled globally.” Other executives made similar comments, for instance about their inability to communicate with colleagues in Russia due to sanctions.

It appears that global political and economic divisions are increasingly being mirrored within companies’ internal operations. It is hard to imagine these newly balkanized firms will be as efficient as they were a few years ago. But there may be no alternative. “We have operated as a globalized company, but the new reality is local,” the European executive contended.

# 04 Losses in 2022, risks for 2023

## *Patterns of political risk loss*

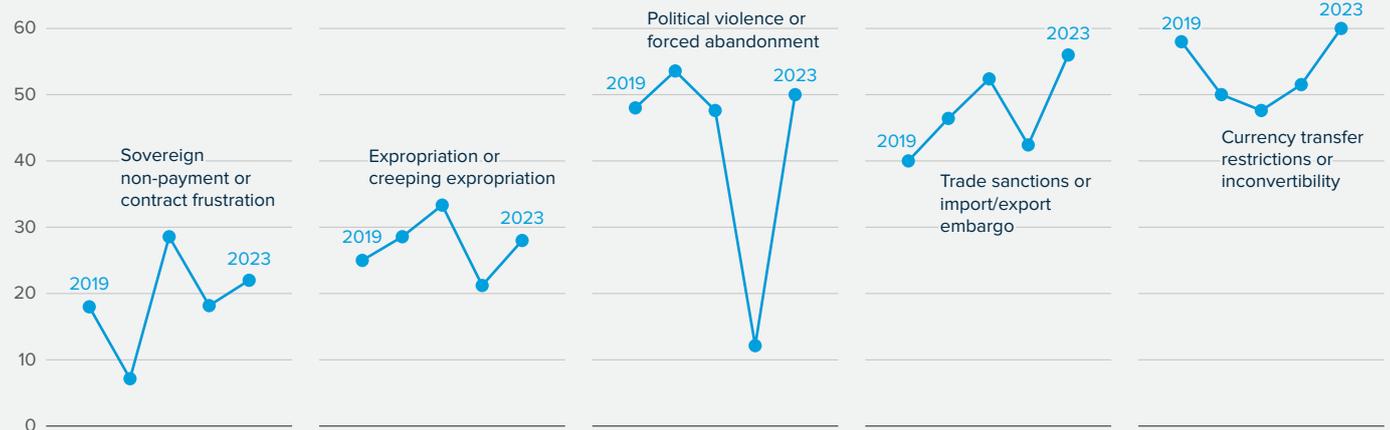
In a year of extraordinary disruption, there was some unexpected consistency with prior survey years. One example was the relative frequency with which companies reported losses from each of the insurable political risk perils. Currency transfer led the list, as usual, closely followed by sanctions and political violence (although, unsurprisingly, the frequency of both sanctions and political violence losses surged compared to last year's survey, presumably in relation to the conflict in Ukraine). Also as usual, expropriation and sovereign default losses were less frequent.

The conflict in Ukraine reshaped our annual list of countries where companies had suffered political risk losses – Russia tied for first, with seven out of 50 companies we surveyed reporting direct political risk losses there; Ukraine tied for seventh, with four companies reporting losses.

That said, Russia's ascendance did, in a sense, continue a trend of recent years. In the early years of the survey, high-risk countries that tend to receive little Western investment predominated in our annual list (in 2020, the top five were Iran, Venezuela, Zimbabwe, Angola and Libya). Over the past three years, by contrast, some of the world's most popular investment destinations have surged to the top of the table. In 2021, India appeared in the top five; in 2022, China and the US appeared (the latter apparently due to sanctions programs, as most of the US losses were reported by US-headquartered companies). 2023's top-five list includes all of the BRICs and, oddly, the UK. (Because the companies reporting UK losses were mostly headquartered in Europe, we might surmise this result represents a hangover from Brexit.)

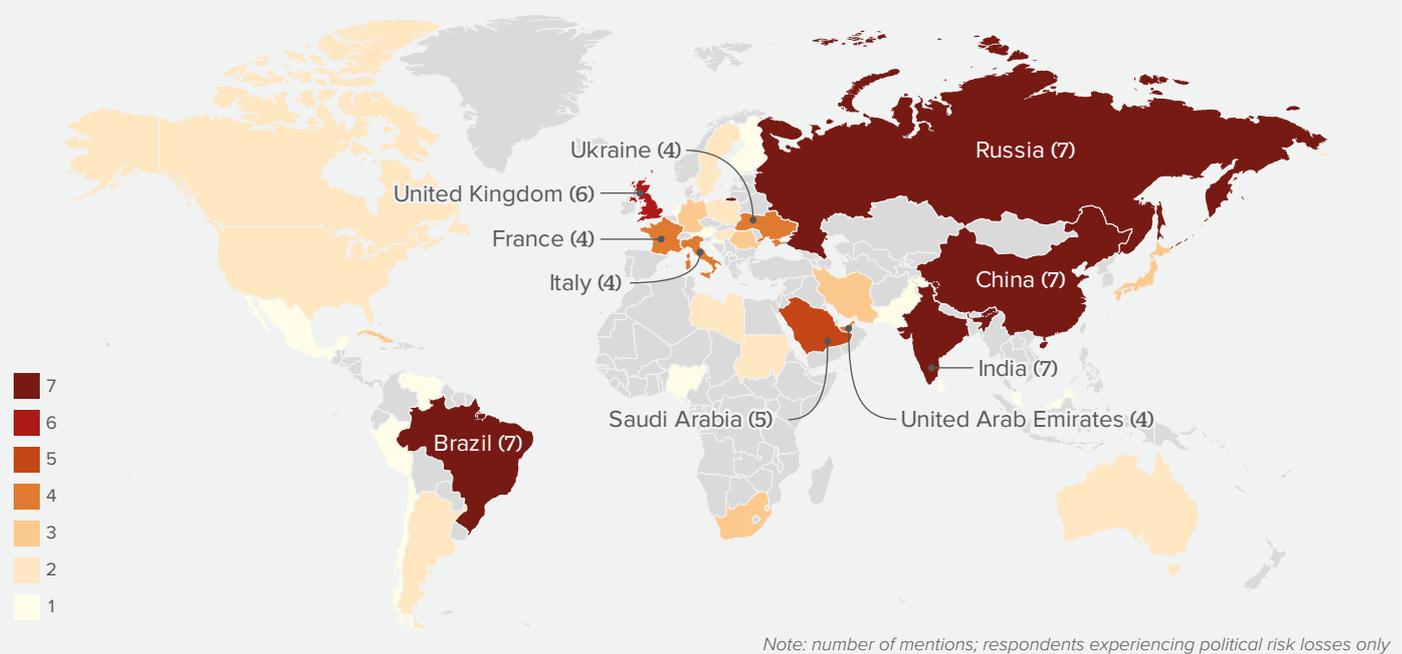
This degree of continuity from prior years is perhaps surprising, given the shock of escalating conflict in Europe. But there was one striking change in the pattern of political risk loss this year. In prior years of the study, we have found a U-shaped distribution of political risk losses: very small losses were relatively frequent, losses in the middle ranges rare, and very large losses more frequent again. We contended that this pattern reflected the status of political risk as a "catastrophe risk," tending to strike rarely but cause extremely large financial impacts.

Types of political risk losses experienced (%)



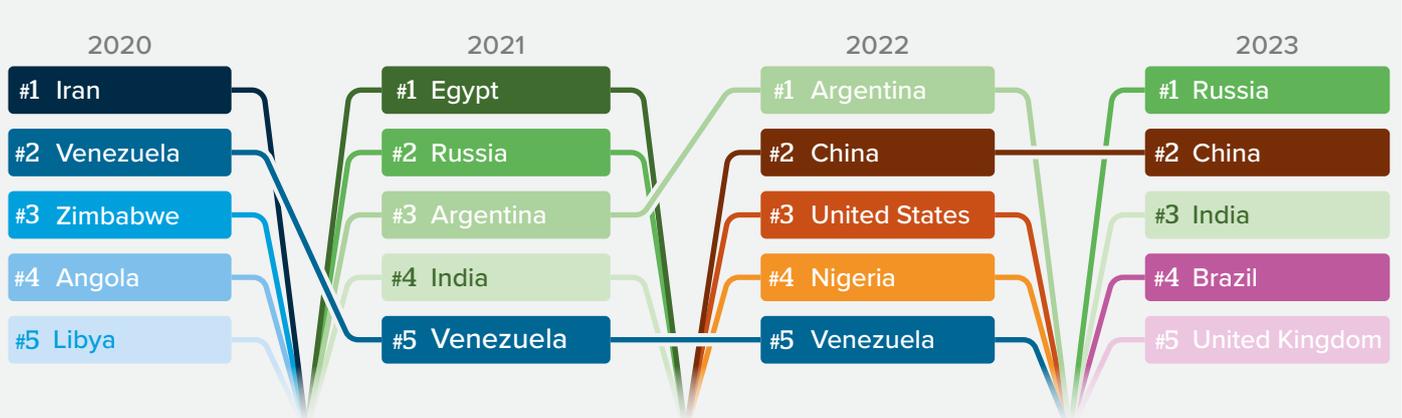
Note: companies experiencing political risk loss; for 2019, n = 14; for 2020, n = 28; for 2021, n = 21; for 2022, n = 32; for 2023, n = 46; "other" not shown

Countries where respondents experienced a political risk loss (number of mentions)



Note: number of mentions; respondents experiencing political risk losses only

Top countries where respondents had experienced a political risk loss (number of mentions)



Note: respondents experiencing a political risk loss only; ranked by number of mentions

This year, however, the pattern of political risk losses looked much more like a typical risk. Nearly 70% of losses were less than \$50 million; only 2% exceeded \$250 million. Speculatively, this finding may reflect the new status of political risk as “everyone’s risk” – as reported in the executive summary. The proportion of respondents experiencing a political risk loss surged from 35% in 2020 to more than 90% today.

Instead of impacting just a few large investors in risky countries, political risk this year impacted companies in most sectors, most global regions, and whether large or small. So it is perhaps not surprising that the loss distribution more closely matched that of a more traditional risk.

## *The geopolitical outlook*

In last year’s survey we began a new line of questioning, asking about the outlook for various geopolitical trends. This year we added a few new trends to our question set, but found the same general pattern we identified last year: globalized businesses expect that the geopolitical environment will worsen in the years ahead.

As with last year, large majorities expected intensified geostrategic competition, economic nationalism and deglobalization. “We are faced with doing business at a time of a paradigm shift,” as a panelist in the oil and gas sector put it. Perhaps in keeping with this idea, this year our respondents showed a greater consensus on several other trends, including the rise of populism and democracies reverting to authoritarianism. Last year, these trends divided business opinion; this year, large majorities predicted these trends would intensify.

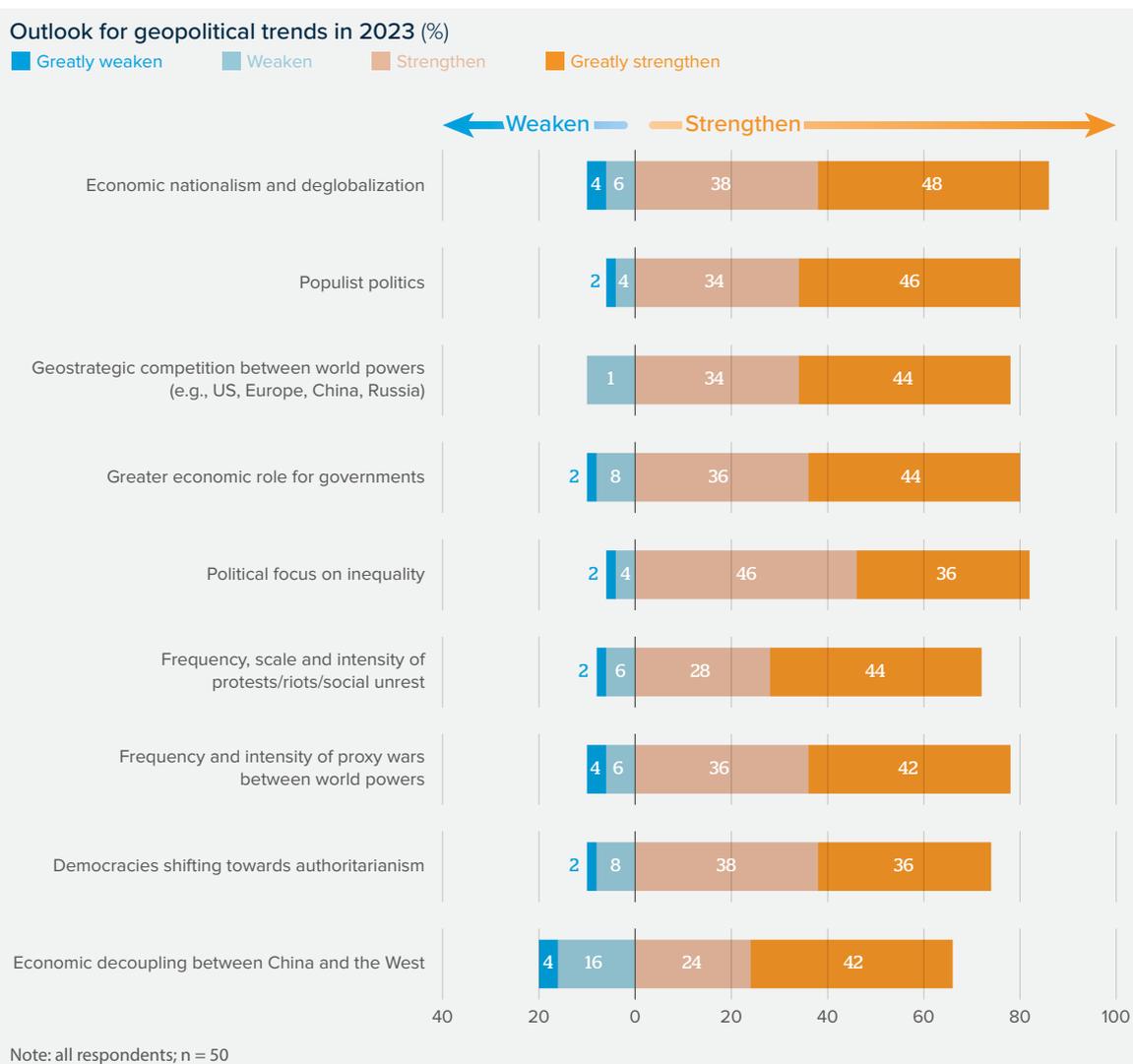
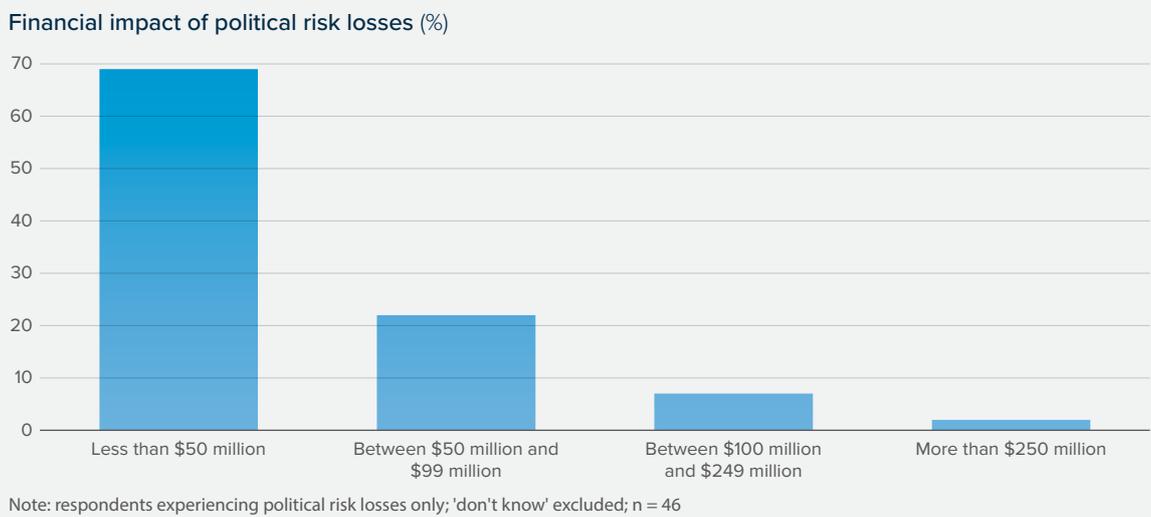
If one were searching for some optimism, one might find it in the trend that appears last: “only” 66% of companies surveyed predicted that decoupling between China and the West would strengthen or greatly strengthen, the least of any trend. That said, when this survey was fielded, in early 2023, Chinese officials were mounting a charm offensive. Shortly thereafter, a balloon triggered a political firestorm and, as of this writing, appears likely to undo much of that effort.

Indeed, decoupling between the West and China continued to top the future-risk concerns of our panel, discussed in the concluding section of this report.

## *Navigating the gray zone*

Elisabeth Braw, a senior fellow at the American Enterprise Institute in Washington, DC, defines “gray-zone aggression” as taking place “in the gray zone between war and peace and is used to weaken another country using means short of war.” Gray zone aggression tends to violate international laws and norms, but can be an appealing strategy for weaker states challenging stronger states, in part because responsibility and intent can be difficult to attribute, making retaliation more difficult.

The apparent sabotage of the Nord Stream pipelines in September 2022 is a case in point: the act was highly disruptive, but as of this writing, responsibility continues to be debated. Braw interviewed retired Rear Adm. Nils Christian Wang about the incident, who said: “These leaks are a brilliant example of the complexity of tackling hybrid aggression.”



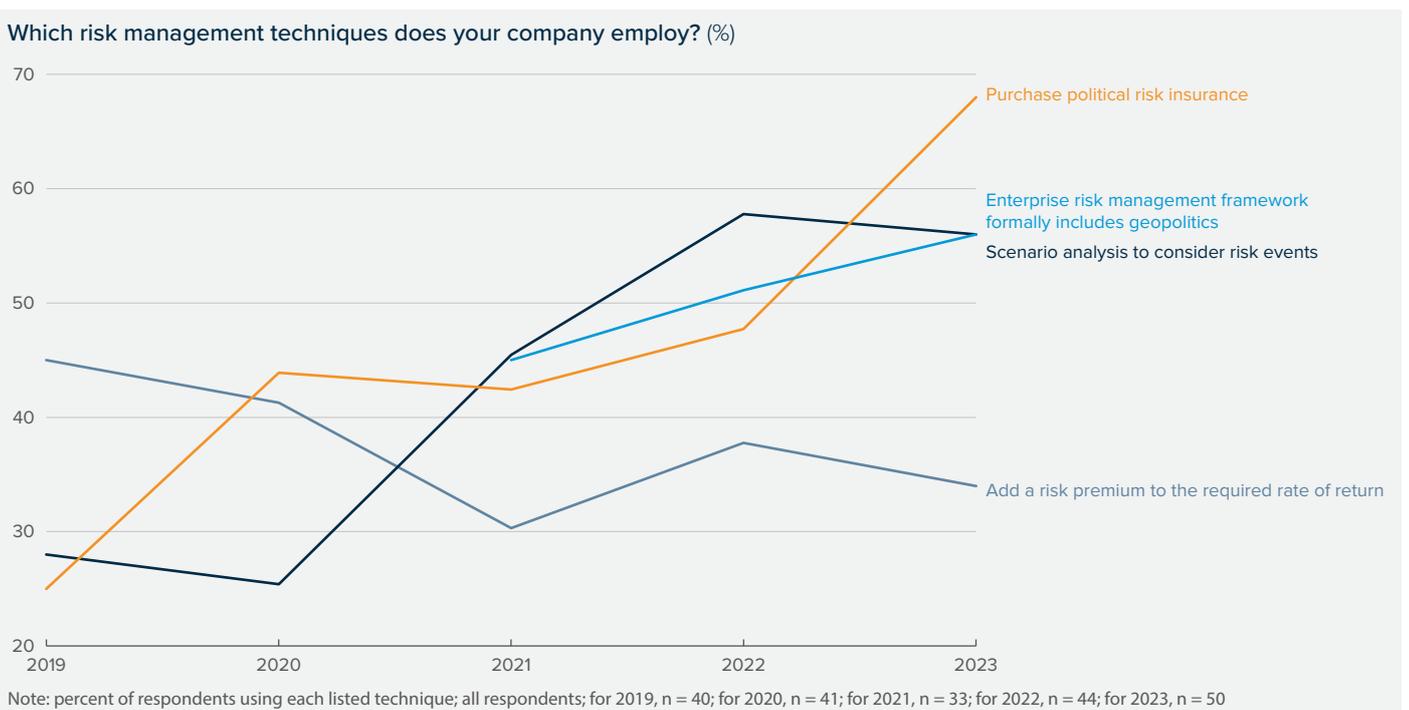
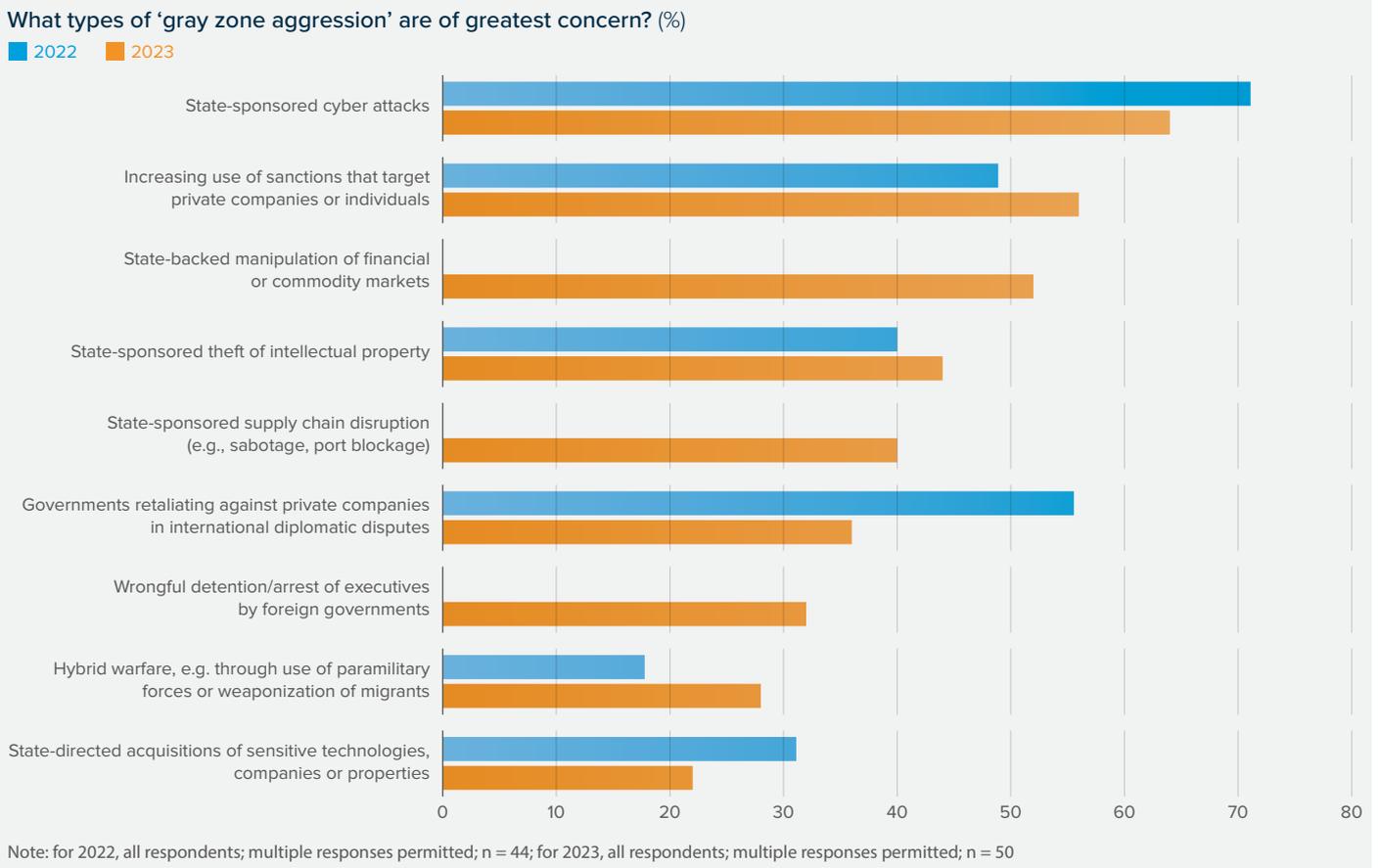
Like many acts of gray zone aggression, the Nord Stream sabotage targeted corporate assets. In last year's survey and again this year, we asked our business respondents about gray zone actions of concern. In both years, state-sponsored cyber attacks topped the list of concerns, and sanctions came close behind. This year, a new issue, state manipulation of financial or commodity markets, appeared in third place, possibly reflecting concerns about European energy markets (one potential target of the Nord Stream sabotage).

Taken together, our survey results paint a picture of an increasingly hostile and complex world for globalized firms. The conflict in Ukraine was an extraordinary shock – “a watershed moment,” in the words of a European automotive sector panelist. It appears to have changed the way businesses think about political risk. The conflict also, to some degree, put the US and China on opposite sides, changing the way companies perceive one of the world's most vital and vibrant economic relationships.

How are companies managing these new political risks? It is a question we addressed, to some degree, in the previous section, specifically in relation to the conflict in Ukraine; but for the past few survey years we have also asked a more general version of the question, which allows us to see how responses have changed over time (bearing in mind that some shifts may be due to changes in the composition of our sample).

This year, scenario analysis remained one of the most popular techniques, having gained dramatically over the years of this survey. The increasing use of scenarios presumably reflects the growing unpredictability of the global environment. The use of financial analysis, such as adding a risk premium to the rate of return, continued to be less popular than in years past, perhaps also reflecting today's heightened unpredictability.

A new development was the growing incorporation of political risk into Enterprise Risk Management, an approach that this year exceeded scenarios in popularity for the first time (although the difference between those two techniques was marginal). “We have set up various ‘rapid response teams’ – multi-disciplinary teams coordinated by the ERM team – e.g., Russia/Ukraine, China/Taiwan, ESG,” said a panelist from a Latin American industrial firm. Perhaps most strikingly, as noted in the executive summary, the popularity of political risk insurance continued to surge. While no globalized company can avoid today's geopolitical challenges, in a time of uncertain and exotic threats, having risk transfer as a backstop can bring peace of mind.



# 05 What next?

Perhaps the most striking finding of last year's survey was that companies were more concerned about political risks arising in China than in Russia – even though the survey was conducted on the eve of the escalation of conflict in Ukraine. Partly, that finding appears to have reflected wishful thinking. Many panelists may have imagined that the conflict would be averted by a last-minute deal, or, worst case, that the conflict would be limited to a small portion of Ukraine. Such hopes were to be dashed. As we shall see, the growing ripple effects of the conflict top this year's risk list.

At the same time, I would not bet against our panelists in a game of chance. As discussed in the first section of this report, while the conflict in Ukraine has been a humanitarian disaster, its financial impacts have been more limited, especially for North American respondents. Corporate financial exposures to China-related risks tend to be far larger.

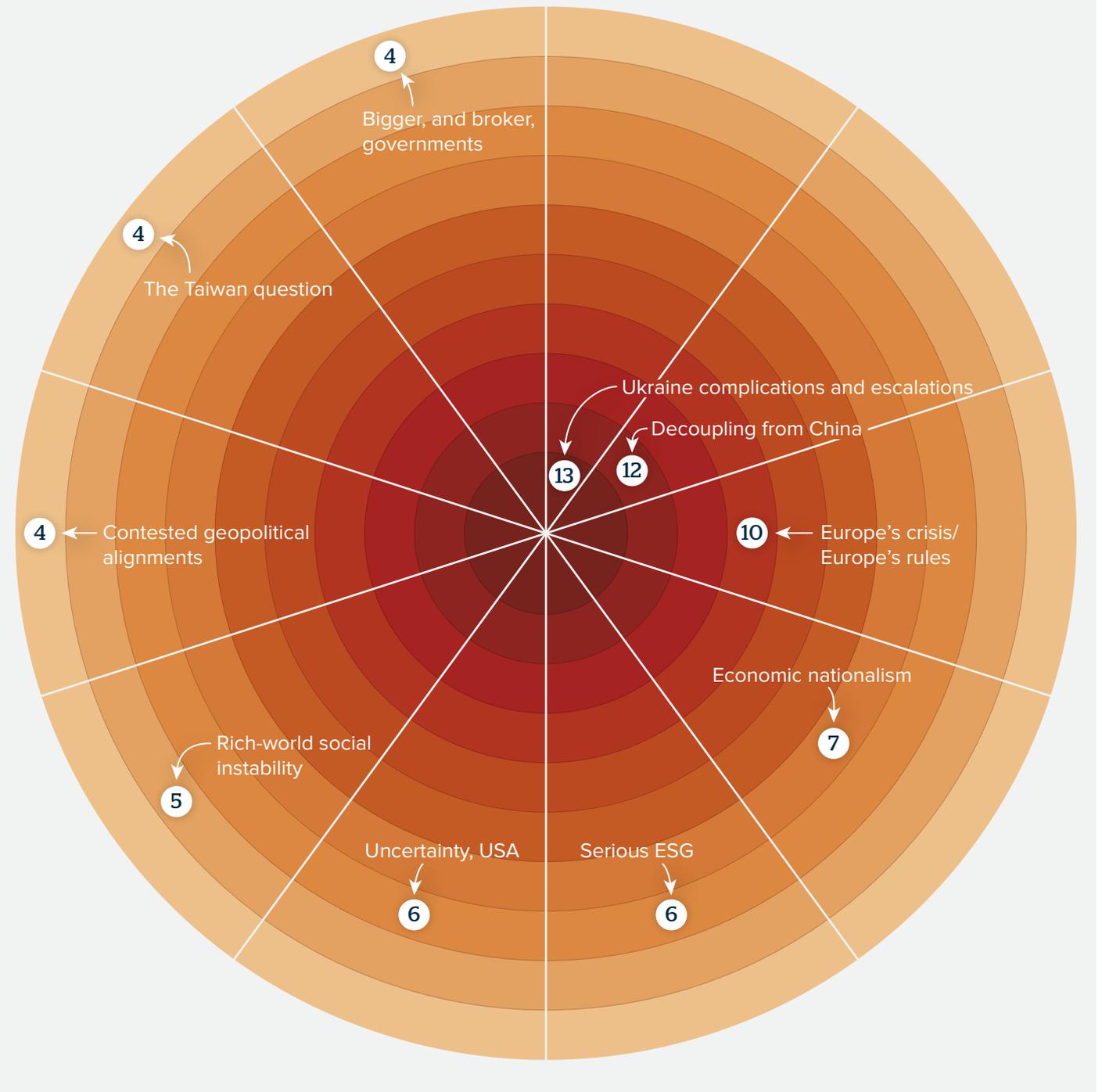
Meanwhile, over the course of 2022, the relationship between China and the West deteriorated in an alarming fashion. Most strikingly, the US government proved willing to impose large losses on its own companies to serve its national security objectives, with unprecedented restrictions on technology exports and US citizens working in China. Hence last year's focus on China was not unmerited.

So, what are our panelists worried about in 2023?

## *Ukraine complications and escalations*

"As part of the company's annual 'risk watch' ... which used to center heavily on competitor considerations, I was recently asked for my views on the risk of nuclear escalation and its potential impacts on our supply chain," noted one panelist from a European automotive company. It was a sign of the times: the ripple effects and potential escalation of the conflict in Ukraine were the most frequently mentioned geopolitical threat this year.

Top risks 2023 (number of mentions)



Below the radar

Political impacts of climate change

Debt crisis in the emerging world



That said, only a handful of panelists worried about escalation – two about the possible use of nuclear weapons, and three about the conflict spreading. At the time of the interviews, the front lines were largely at a standstill, with Ukraine gaining in some areas and Russia in others. This year, we elected not to publish the results of our annual question about countries where companies avoided investment due to political risk. However, Poland, Germany and Russia all appeared in the top five, an odd collection of countries that may be linked by proximity to the conflict.

Instead of escalation, most panelists were worried about sanctions and inflation, particularly in prices of energy, food and fertilizers. An executive at an Asian conglomerate operating across multiple industries worried that senior executives could be arrested for facilitating avoidance of sanctions. While, as of this writing, some of the conflict-related price shocks have eased, many panelists were already looking ahead to the autumn of 2023 and beyond. “If the winter in 2023/24 is cold, there are likely to be efforts to renegotiate [our] energy contracts,” said a panelist based in Latin America. Executives in the commodity trading and agribusiness sectors worried that global food markets were not out of the woods. “The world is going towards a global food crisis,” was one such warning, from an agricultural producer based in Australasia.

Thinking further ahead, some panelists were just as worried about the conflict ending as it carrying on. “Does it finish because Russia internally collapses?” asked one mining executive. “We are likely to see a very different Russia in 10 years,” added a panelist from a European industrial firm. Whatever outcome one hopes for the conflict, there are associated risks.

### *Decoupling from China*

It was our top risk last year; this year it appears at second. Most panelists struggled to imagine how the US-China economic relationship could be unwound without overwhelming damage to the world economy. And yet, in 2022 it became clear just how determined Washington is to treat Beijing as a strategic rival.

A panelist from an Asian conglomerate summed up the challenge nicely: “a lot of companies are getting nervous about continuing business with China,” they said, “[but] how do you divorce yourself from such a major market?” Or, in the words of a European automotive sector panelist: “every day is China strategy day.”

While most panel members appeared to believe that decoupling would be a long-term project (“not a 12 or 24-month thing,” as a European commodities trader put it), there were also concerns about short-term flare ups.



“Think back to when we had the EP-3 incident under [US] President [George W.] Bush and if that had happened in today’s climate,” said a North American panelist in the consumer goods sector. (Comments borne out by rising tensions over balloons.)

While many panelists were primarily concerned about the policy of the US and other Western nations, there were also worries about potential action by China. “We are concerned about how the Chinese government could retaliate against EU companies operating in China, but we have little way of understanding when and how this might happen,” said a European automotive executive. “In the shorter/immediate term, industrial espionage [by China] is the main risk,” a panelist in the pharmaceutical sector argued.

A few panelists already reported difficulties arising from tensions between China and the West. “The cost of the raw materials that we buy from China has increased, driving up the price of finished goods,” said a North American technology executive. A European manufacturing panelist echoed the concerns about deglobalization of operations discussed in the previous section. “Data stays in China,” they said. “Cross-country collaboration [is] more difficult ... Our solutions are now less efficient.”

### *Europe’s crisis/Europe’s rules*

In recent years, Europe has had a difficult run, from the Eurozone debt crisis to tensions with the European Union’s eastern members to Brexit and now the conflict in Ukraine. But the EU has tended to emerge from these challenges stronger, and, at least among its core states, more centralized and unified. The EU has issued its own debt instrument; it has launched a Green Deal; and EU laws have increasingly begun to set global standards, for instance in data privacy. Thus far, the conflict in Ukraine, and resulting energy crisis, appears to have fostered greater European unity – and with it, the prospect of new rules, especially on a clean energy transition.

Thus, Europe’s crisis creates risks for business – but so do the rules Europe creates in response.

Europe’s willingness to regulate, especially in areas such as technology and the environment, has exceeded much of the rest of the world, with the result that European regulations have become the “gold standard,” and many companies voluntarily adopt these standards and apply them in markets globally. Or sometimes not so voluntarily: “the Green Deal will require us to rewrite all internal policies and procedures,” said a European industrial company. “The cost implications are massive.”



For foreign companies, the EU's willingness to regulate can pose a headache. "Europe's shift to sunflower from palm oil has trimmed our profits from Europe," said a panelist at an Asian agribusiness firm. The executive noted that European regulation often had a follow-on ESG impact, creating negative reputation effects for companies flagged by the EU as, for instance, contributing to deforestation. Panelists worried that the EU's new carbon border tax could touch off trade wars. An executive in a North American technology company complained about new EU conflict minerals regulations, and the dilemma of whether to comply with US rules, EU rules, or both. "Because our US activities do not follow European regulations, negotiating and settling takes time and cost," they said.

Several panelists mentioned Europe's energy crisis. Through a mix of energy conservation, drawing down of reserves, and a fortuitously mild winter, Europe managed to limit the economic damage from the cutoff of Russian energy supplies. But "this issue is unlikely to go away," warned an executive at a European manufacturing firm.

There were also a few lingering concerns about European stability and unity. A European panelist worried about "right-wing parties in Hungary, Poland and Italy;" an Asia-based executive worried about a "change of governing authorities in several major countries of Europe ... like Sweden and Germany in 2022, Switzerland (2023), United Kingdom (2024) and the European Union (2024)."

### *Economic nationalism*

It is an issue that has run through each of the previous three risks, but also a broader concern: economic nationalism is on the rise. Panelists worried that decoupling from China would be pursued not only for reasons of national security but also protectionism – "China is one of few bipartisan issues on which there is consensus [in the US] so it's less about foreign policy and much more about protectionism," said an executive at a European pharmaceuticals company, perhaps a bit cynically. Panelists worried that new US and EU rules around climate had protectionism as a secondary objective. "The US Inflation Reduction Act, for example, does mean we have to rethink our North America strategy," said a European manufacturer.

Deglobalization trends may have begun to reinforce each other. Whatever the original motivation of a policy, national security interests can find common cause with industries seeking protection from foreign competition. The broad coalitions necessary to pass sweeping climate bills are easier to form when protectionist interests join. The recent experience of the pandemic gave further fuel to economic nationalism. (“The made-in-America initiative for generic medicine is proving very costly,” a panelist at an Asian pharmaceuticals firm complained.) In 2022, the global food and fuel price shocks led countries to forbid exports of goods they believed to be vital and scarce, preferring to preserve these commodities for domestic consumption. (“The ban on the export of phosphorus from China has also hindered our production because phosphorus is an essential ingredient used in making fertilizers,” noted an agribusiness executive.)



Some of these shocks may be temporary. But, as discussed in the previous section, our survey respondents overwhelmingly foresaw a negative outlook for deglobalization trends. “We find ourselves in a new investment climate,” said an oil and gas panelist, “and are trying to come to terms with this shift.”

## *Serious ESG*

Two years ago, ESG risks topped our radar; last year the issue dropped to a below-the-radar position. That was a miss: in 2022, ESG risks and political risks collided in spectacular fashion. Following the escalation of conflict in Ukraine, many western companies voluntarily pulled out of Russia because of public pressure. While some corporate ESG efforts have been dismissed as superficial, for many companies the decision to exit Russia resulted in billion-dollar write downs.

ESG is thus becoming increasingly costly and serious. “Companies are going to have to put their money where their mouth is,” a mining sector panelist predicted, referring to corporate ESG reporting. An executive in the consumer products sector said “we are devoting a lot of time to [new ESG reporting requirements in the US and Europe], and we have needed to have a more structural approach to ESG. We are treating this in the same way we treat a GAAP disclosure.”



For multinationals headquartered in emerging markets, ESG pressures can arrive in the form of advanced economy regulation (such as new EU rules, discussed above) or activist attention. “We are concerned about any country that may have significant human rights issues,” said a panelist based in Asia; a Latin American panelist noted activist pressure to exit Israel and India, the latter due to weak environmental regulations for their industry.

### *Uncertainty, USA*

Somewhere in the American heartland is a town called Uncertainty, which voted for Barack Obama in 2012; Donald Trump in 2016; and Joe Biden in 2020. Is this apocryphal town isolationist or internationalist? A climate sceptic or leading investor in green energy? Seeking to build an alliance of democracies or facing accusations of undermining democracy at home? Until the next US election, no one knows.

A point often made when Biden was elected was that no matter what position the US took on climate change, trade with Europe, or any other geopolitical issue under his leadership, that position would likely be reversed if his political opponents won office four years later. Presumably, that point would give pause to any country wishing to sign an international agreement with the US.

Some of our foreign business panelists were politic in their comments. A European aerospace executive noted “doubts about America.” Others were not so polite: “the US is a geopolitical risk,” said a mining sector panelist based in Canada.

No one was harsher, though, than the Americans we spoke with. “What happens if the [2024] election is again between [current US president Joe] Biden and [former president] Trump,” asked a panelist in the consumer goods sector. “What happens with the alarming trust deficit, does it make the US even more ungovernable, and does it further erode confidence in our institutions and our democracy?”





### *Rich-world social instability*

One striking trend of recent years has been the migration of political risk from emerging to advanced economies. Greece's sovereign default was perhaps the watershed moment when it became clear that companies operating in the rich world could face risks they had believed to be confined to emerging markets. Indeed, for a time, emerging market sovereigns were among the world's most favorably-rated, while rating agencies downgraded European states, the US, and Japan. That situation has now shifted (see the below the radar section). And yet, as the comments for the previous risk indicated, advanced economies are by no means free of risk.

The panel's most frequently-expressed concerns regarding political risk in the rich world had to do with populist politics. "[Anti-establishment] political movements and dismissal of the rule of law by jurisdictions that have traditionally respected the law present real challenges, especially at a time of disinformation and limited global leadership," said a mining sector panelist. Other worries had to do with social unrest, potentially stemming from the energy crisis in Europe or the 2024 U.S. presidential election. Companies needing a so-called "social license to operate" – that is, the approval of the public – tended to be most concerned. "Our end customers being citizens means that we operate in a political environment," said a European utilities executive. "This means pricing is very sensitive."

An oil and gas panelist summed it up: "the difference that we in the past used to look at between those [political] risks in the OECD world and the non-OECD world is much less than it used to be."

### *Contested geopolitical alignments*

In the winter edition of our Political Risk Index, "Mapping the New Geopolitical Divides," we assessed the national security orientation of 61 emerging market countries and territories. Countries were rated on whether they aligned with the West (North America and Europe) or the East (and thus opposed Western countries on many national security issues).

We found that, compared with five years ago, the Western bloc has lost ground in all world regions. Five years ago, 30 of the 61 countries/territories we analyzed were in the Western bloc, against 25 today. Perhaps most strikingly, five years ago, 13 of these countries were strongly allied with the West. This year, only six countries or territories in the WTW Index rated as strong Western allies (including Jordan, Mexico, Qatar and Taiwan). Meanwhile, seven rated as leaning strongly East (including Belarus, China, Mali, Myanmar and Russia).

For some panelists, such shifts in alignments were analogous to a new Cold War. “In Mali and the Ivory Coast there is a real risk of instability ... due to competition [for influence between East and West] in Africa,” said a mining sector executive. “You can go to bed and all is hunky dory and the next day there’s been a coup or junta and your assets are seized.” A utilities sector panelist made a similar comment: “we are taking in account geopolitical alignments between countries ... the Russians are emerging as a threat/competitor in the [African] region.”



Perhaps the most frequent comment, however, was some form of plea for East and West to moderate their competition. “We are under immense pressure to pick a side or country to do business with because of the conflict [in Ukraine],” a commodities executive based in Asia said. Another Asia-based panel member noted: “We’re working to encourage the US government not to do this [apply sanctions in Southeast Asia]. Applying sanctions risks creating a vacuum, which could potentially be filled by the Russians or Chinese.”

### *The Taiwan question*

There were several surprises associated with the conflict in Ukraine. One surprise was the degree to which Russia’s seemingly superior forces have struggled. (Especially given the speed with which conflict in Crimea progressed in 2014.) Another surprise was the unity and severity of the western response, with intense sanctions and the seizure of Russian reserves helping to push Russia into default by June 2022. Both surprises went against the apparently stronger state in the conflict, and thus might be seen to reduce the odds of a conflict involving Taiwan.

But there was a third surprise: the realization, by senior business executives, that war was a real possibility in developed world regions, amongst countries that are major trading partners. “Business and politics have lived in two different realities,” said an executive in the European automotive sector. “The events of the past year have now aligned realities.”



That shocking realization has spurred corporate boards into action, and to look at the possibility of conflict in Taiwan. Most panel members thought such a conflict, if it were to occur, would be years in the future. But not all. “At the moment, I regard the biggest threat as Taiwan escalation,” said the automotive executive. Undoubtedly, if such a conflict were to occur, the impact on global supply chains would be devastating, given the key role that both mainland China and the territory of Taiwan play in microchip production.

### *Bigger, and broker, governments*

“Polycrisis” has become a popular term to describe the simultaneous shocks from geopolitics, disease and climate. Whatever one thinks of the term, there is something these crises have in common: they have demanded more from the state, in areas including national security, public health or a green transition. From the bailouts of the global financial crisis onward, central banks and politicians have stepped in, taking steps that have been rare or even unprecedented in the postwar era, including quantitative easing, providing basic income payments to households, locking down societies, or forbidding technology exports.

It seems that the appetite grows with the eating. Industrial policy has come back into fashion, with the once laissez faire US government putting forward an Inflation Reduction Act including nearly \$400 billion in clean energy spending, and the EU pledging to match it with subsidies of its own.<sup>3</sup>

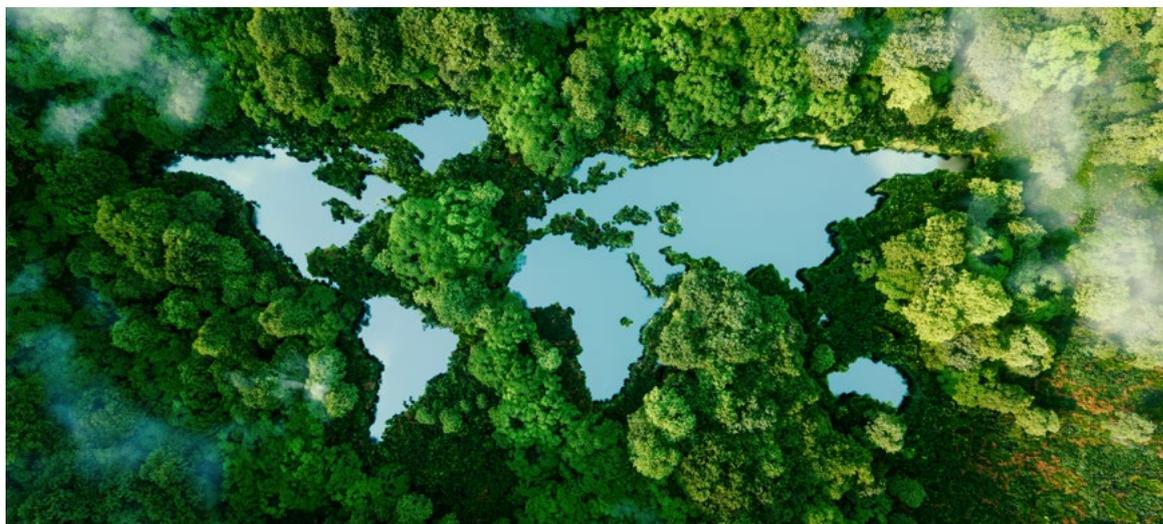


There is a problem, however: it is unclear that governments have the money to match their new ambitions. With poor timing, just as government's role is growing, levels of public debt have hit postwar records in many advanced economies, including Italy and Japan, and sovereign defaults have been rising in the emerging world (see the below the radar section).<sup>4</sup> So, what will big, but broke, governments do?

Some panelists reliant on public spending worried that budgets would be cut, including in healthcare and even (geostrategic competition notwithstanding) defense. Others, particularly in the oil and gas and mining sectors, expected changes in tax and royalty regimes. "There are questions about whether framework conditions we have traditionally operated under will still apply given that state finances are stressed," said an oil and gas executive. Many panelists expected an increasing focus on generating revenue, by means including, in the words of a commodities executive, "taxation, royalties, resource rent taxes and even increased sustainability obligations and sometimes penalties on breach of code of conduct."

### *Below the radar*

Sometimes it is the bottom of the risk list that matters. "Russian interventions" was number ten on our list last year, but, in effect, leads this year's list. ESG shocks fell from the top of the list in 2021 to the bottom in 2022, but returned with a vengeance this year. What threats might be flying below the radar, emerging to top next year's list?



Here we present two candidates, each of which narrowly missed the top ten in terms of number of mentions. The first candidate is the political impacts of climate change. That threat appeared ninth last year, but most panelists appeared to believe the risk, while severe, would arrive in the future. A mining executive begged to differ, claiming that Pakistan's 2022 economic crisis was partly attributable to climate ("environmental crises will drive political risk," they claimed). Interestingly, panelists in the oil and gas and utilities sectors noted that climate policies would change their business models and thus the types of political risks they faced. "As you invest more in low carbon solutions you are pushing further downstream, which adds risks," as the oil and gas executive put it. "This change means that we need greater resources to managing these types of risks."

Our final below the radar candidate has been on our radar for many years now: debt crises in emerging markets. We began to predict such issues at the beginning of the pandemic, as shocks to tourism pushed countries such as Sri Lanka into trouble. Although the past few years have witnessed significant sovereign defaults, in a sense, the damage has been less than expected. Many shocks have pushed in opposite directions. For instance, the pandemic downturn was accompanied by central bank interventions that made capital easily available, even for risky borrowers; the oil price crash of the pandemic was followed by an oil price surge triggered by conflict in Ukraine.

In theory, with US interest rate rises appearing to moderate, the worst has now passed for many developing country borrowers. Emerging market equity indices have certainly rebounded. And yet, there are many countries still suffering the hangover of past shocks. A large and unexpected default could put this issue back on the radar. “The interest rate environment and strength of the dollar means we are looking more closely at the macro picture,” as a utilities sector panelist put it.

# 06 Conclusion

Some panel members claimed the change had been evident for years. “We’ve been flagging [geopolitical] concerns and risks for a long time,” said an executive in the manufacturing sector. “The financial crisis and the various crises in the Eurozone, Russia, China, Trump, etc. have meant that we’d already rejigged our old ideas.”

But it is undeniable that the tragedies of 2022 produced a further shift. Every company we surveyed had taken new measures to address political risk since February 2022; more than nine in ten reported a political risk loss; large majorities predicted that trends towards decoupling and deglobalization in general would strengthen.

For the brokers at WTW, the world changed as well. Until this last year, the primary challenge was helping clients understand the political risks they faced. By the summer of 2022, the risks were well-understood and the challenge was convincing carriers to write cover.

In 2023, globalized companies will face the further challenge of taking the hard decisions necessary to adapt to new realities – without losing hope that the world might recapture some of the cooperative spirit that enabled such tremendous gains in human prosperity in recent decades.

## Endnotes

- 1 <https://www.reuters.com/business/energy/us-lng-exports-both-lifeline-drain-europe-2023-maquire-2022-12-20>
- 2 WTW analysis of the tables downloadable from <https://www.bea.gov/data/intl-trade-investment/direct-investment-country-and-industry>
- 3 <https://www.mckinsey.com/industries/public-and-social-sector/our-insights/the-inflation-reduction-act-heres-whats-in-it>
- 4 <https://www.reuters.com/article/us-italy-budget-debt/italy-public-debt-to-hit-new-post-war-record-in-2021-at-158-5-of-gdp-source-idUSKBN29L0PP>; <https://www.foxnews.com/world/japanese-government-debt-record-1-quadrillion-spending>

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