

## Political Risks Have Mostly Been Overlooked During Globalization. *Regionalization and 'Allies-ation' Are the New Paradigm.*

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The biggest single class of risks to globalization in the last ~30 years has always been political risks. These have mostly been overlooked by investors, multinational organizations, and some governments in a period of history that has been relatively stable and saw massive expansion of international trade and investment. This perception of benign risk started to change when the 45<sup>th</sup> US President instituted trade tariffs against the People's Republic of China (PRC) in 2018. It became obvious as the pandemic severely disrupted supply chains, and it has now ended with President Putin's re-invasion of a neighboring sovereign State. Larry Fink, Chairman of BlackRock, recognized this in his March 24, 2022 [letter](#) to shareholders, saying "the Russian invasion of Ukraine has put an end to the globalization we have experienced over the last three decades."



Political risks can be defined as “any governmental action **or inaction** that impacts an organizations’ operations.” They are no longer restricted to emerging, developing, or ‘frontier’ markets. The last 5 years has seen political events lead to massive changes, even in traditionally stable places like Hong Kong, the United Kingdom and the United States.

Government actions abound. Aside from the extremity of military actions, the huge variety of acts by foreign (or ones’ own) government include espionage and misinformation, state-sponsored cyber-attacks, economic coercion, censorship, corruption, coups, state-subsidized competition, nationalism and protectionism with tariffs on trade, an array of sanctions and import/export restrictions, public health policies, and day-to-day regulation activities. Governments can also fail to act, for example on climate change, to control inflation, or pay or reduce sovereign debt, and these failures can also lead to food shortages and mass migrations.

The PRC became the world’s largest manufacturer, and when the SARS-CoV-2 pandemic started in Wuhan and the PRC government instituted (and continues) its ‘zero tolerance’ policy, it caused severe supply chain disruptions. It also revealed the need for resilience, as those who came to rely on single country suppliers realized the basic risk management adage that it is never wise to have all your eggs in one basket. The move to diversify and regionalize supply chains began.

Emanating from shortages of personal protective equipment (PPE), early in his term as US President, Joe Biden said on [February 24, 2021](#): “We shouldn’t have to rely on a foreign country — especially one that doesn’t share our interests or our values — in order to protect and provide our people during a national emergency.” He signed an executive order to review the vulnerabilities in US supply chains across critical sectors of the economy and went on to say that the review of supply chains was meant to make “sure the United States can meet every challenge we face in this new era — pandemics, but also in defense, cybersecurity, climate change, and so much more.” Also, that resilient, diverse, and secure supply chains “... will mean increasing our production of certain types of elements here at home. In others, it’ll mean working more closely with our trusted friends and partners, nations that share our values, so that our supply chains can’t be used against us as leverage.”

For the US, the era of ‘allies-ation’ began with Biden rebuilding relations with various nations particularly the European Union (EU), forming the AUKUS security alliance, the Quad and developing its [Indo-Pacific strategy](#). And yet, the US is not a member of key trade agreements in the Indo-Pacific region like the Regional Comprehensive Economic Partnership (RCEP). RCEP includes 15 East Asian and Pacific nations, including the PRC, and became effective on January 1, 2022. It is now the world’s largest trading bloc by economic size – representing 30.5% of world GDP, according to a recent UN Conference on Trade and Development (UNCTAD) [study](#). Other trade blocs like the US-Mexico-Canada (USMCA) agreement represent 28% of world GDP, and the EU 17.9%.

The PRC’s sanctioning of European Union (EU) officials in 2021 as well as its coercion and discriminatory trade practices against Lithuania has endangered PRC-EU relations and led the EU to suspend its ‘Comprehensive Agreement on Investment’ (CAI) and to [launch](#) a case at the World Trade Organization.

The PRC [supported](#) Russia’s intervention in Kazakhstan in January 2022, and their “no limits” [friendship](#) was detailed in a [joint declaration](#) just before the Winter Olympics. The invasion of Ukraine has highlighted the Russia-PRC relationship, and puts China in a [difficult position](#) as it refrains from condemning Putin’s actions and tries not to offend the US and EU given the importance of these markets to its economy.

Russia’s invasion has reinvigorated both internal EU and US-EU relations and led Germany and the EU to increase defense spending budgets and a massive change in energy policy. On March 8, 2022, the EU announced [plans](#) to end its reliance on and reduce demand for Russian gas by two-thirds this year, while accelerating plans for its clean energy transition.

The war in Ukraine has further exacerbated disruptions to global trade and, the longer it continues, the more likely it is to have severe longer-term effects. In the short-term, price increases and shortages of goods are impacting economies more dependent on Ukrainian and Russian exports, especially commodities ranging from oil to minerals and food. UNCTAD’s March 2022 [update](#) report points to special vulnerabilities in Africa. Food crises, emerging market debt defaults, an increase in failed States, and new mass migrations can all be foreseen if the war is not stopped soon.

New challenges emanate from geopolitical risks as business organizations and their boards make decisions surrounding politics as well as environmental, social, and governance (ESG) issues. The requirement has never been greater for corporate diplomacy, social responsibility and business ethics that some [call](#) a new era of “corporate political responsibility.”

The geopolitics of globalization have changed for the foreseeable future. As organizations rush to exit Russia, its invasion of Ukraine is a tipping point in the realization of the importance of political risks. They are at the center of everything and are never binary. There is no black or white, only shades of gray.

What is clear is that autocratic leaders think very differently when making decisions. Two things are certain: political risks are here to stay and planning for them has never been more necessary.



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