

Global Risk Analysis Project, PHP Institute, Inc.

# **PHP Global Risk Analysis 2018**

**(Summary)**

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Publisher: Toshio Nagahisa (Chief Research Officer)

PHP Institute, Inc.

NBF Toyosu Canal Front Building

5-6-52 Toyosu, Koto-ku, Tokyo 135-8137, Japan

E-mail: [think2@php.co.jp](mailto:think2@php.co.jp)

# English Summary of the “2018 PHP Global Risk Analysis” Report

## Introduction

This English-language document summarizes the salient points of the “2018 PHP Global Risk Analysis” report in Japanese released in December 2017 by PHP Sōken (PHP Research Institute), the policy think tank of the PHP Institute.

In today’s age of globalization, an event in one place can have an impact elsewhere via unexpected paths. Uncertainty has been a feature of international affairs in every age, but today the fog of unpredictability has become thicker than before. So it is advantageous to pick up on the advance signs of major changes as soon as possible.

In this context, efforts at global risk assessment and analysis have come to be seen around the world in recent years. In Japan’s case, the increasingly harsh strategic environment that our country faces makes it particularly essential to conduct global risk analysis that can contribute directly to decisions about the appropriate actions to take.

Here at PHP Sōken we have responded to this need with the launch in 2012 of our Global Risk Analysis Project. This project brings together experts from a variety of fields to identify the key global risks that Japan faces in the coming year, focusing on their potential impact in four areas: (1) the Japanese economy, (2) Japan’s peace and its people’s security, (3) Japan’s international standing, and (4) the activities of Japanese businesses. Project members deliberate intensively on these topics and report their conclusions in the annual “PHP Global Risk Analysis” report. The 2018 edition is the seventh in this series. (The full text of this report is available in Japanese at [https://thinktank.php.co.jp/policy/4308/.](https://thinktank.php.co.jp/policy/4308/))

The reports have won a wide readership from people in the business world, government, and the media in Japan. And many enthusiastic readers have suggested that we should share the contents with people in other countries so that they can see how global risks are viewed from Japan’s perspective. In response, we have prepared this English-language summary of our latest report. The report in Japanese starts with an introductory “Global Overview” that presents the global context for the risks. The main body of the report consists of sections about 10 broad risks. Each section offers analysis of the risk in question, along with an assessment of its potential impact on Japan and its implications for Japan’s policy. In this English summary we present a full translation of the Global Overview and translations of just the main points in the sections about each of the risks. (Please note that the risks are not in order of their ranking by importance. We have arranged them in an order that we hope will make it easier for readers to see the interconnectedness among them and understand the overall risk structure of the world.)

We earnestly hope that this English summary will give readers useful perspectives meeting their interests.

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# Global Overview

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## Arrival of a post-globalization world

- The vision of a post-Cold War world where democracy and the market economy would expand on a global scale and become universal is losing its persuasiveness. The “end of history” has ended.
  - We see a shift from a world where globalization was seen as a panacea, where all would be well as long as the free movement of people, goods, money, and information were promoted, to a “post-globalization” world where self-centered nationalism and protectionism are coming to the fore.
- Against the backdrop of globalization and technological innovation, two contrasting trends are in progress: the “great convergence” described by Richard Baldwin, namely, the narrowing of the gaps between advanced and less advanced countries around the world, and the “great divergence” seen within countries as the income and wealth gaps among citizens grow wider.
  - The “great convergence” is bringing about a power shift, while the “great divergence,” particularly within the advanced countries, is fomenting anti-free-trade sentiment, opposition to immigration, and other types of populism. The confluence of these two trends is now challenging the liberal international order led by the advanced countries.
  - As political and economic problems continue to plague the major liberal democracies, their soft power is on the wane.
- Major countries will increasingly seek to build their own spheres of influence.
  - While the Trump administration seeks to restore America’s strength with a military buildup, in its trade policy it favors bilateral agreements and is cool to the formation of regional architecture. China, with Xi Jinping firmly in charge, is using its financial clout to extend its sphere of influence beyond Asia. In East Asia two hierarchical orders intersect, one centering on the United States and the other centering on China.
  - Former imperial powers other than China, such as Russia, Turkey, and Iran, seek to create their own spheres of influence on a regional level.
  - Should a great power vacuum occur in a geostrategically critical location, such as North Korea, the major powers involved will undertake a fierce struggle to bring the area in question into their sphere.
- With the major democracies reluctant to apply military force, it has become easier for a country like Russia, unconcerned about the international reaction to its use of force, to take the initiative.

### **The stronger impact of domestic politics on international affairs**

- With the rise of populism opposed to the conventional wisdom concerning international political and economic relations, domestic politics is coming to have a stronger impact on the shape of diplomatic, security, and trade policies.
  - There are worries that the Trump administration, looking toward this year's midterm congressional elections, might launch an all-out trade war.
- Major countries around the world, including Russia, China, the United States, Turkey, and India, are now led by strongmen. Since the decisions made by the leader carry more weight, the course of foreign policy is less predictable.
- Drives by ethnic minorities like the Kurds and Catalans to achieve sovereign status for their regions are being aggravated by overreaction from central governments and the involvement of surrounding countries.
  - The impact of Brexit will extend to Northern Ireland and Scotland.
  - In Japan, the 2018 elections for governor of Okinawa and mayor of Nago may bring the issue of the US bases in Okinawa to the forefront again.
- Authoritarian states have been meddling in the internal political and social affairs of democracies, exploiting the openness of democratic systems by hacking and spreading misinformation during election campaigns, selectively providing funds to the media and think tanks, and developing contacts with sympathetic political parties and politicians and offering them support. The exercise of this sort of "sharp power" (a term coined by the US National Endowment for Democracy), is becoming a normal phenomenon.

### **Concerns over a lack of ability to cope with the next major financial crisis**

- On the surface the advanced economies appear to be performing well, but government debts are continuing to grow as a byproduct of countries' efforts to counter the effects of the 2008 global financial crisis while also trying to keep growth from lagging.
- The major countries now have little fiscal or monetary policy leeway, and it is questionable whether the world will be able to deal with the next similar major crisis.
  - Given the Trump administration's cool view of international cooperation, the next crisis may weaken America's dominance over the international financial system.
- There is a danger that some major geopolitical event, such as a limited US military strike against North Korea, could generate a financial and economic shock.

### **Emerging technologies working to overturn existing industrial rankings**

- With the rise of artificial intelligence, robotics, "big data," self-driving vehicles, and other emerging technologies, the conventional theory of industrial development is being superseded.
  - Particularly in fields like AI, digitization, and big data, where it is easy for disruptive innovations to occur, we see the phenomenon of emerging countries leapfrogging over advanced countries, skipping the intermediate stages and jumping directly into leading positions.

- Japan and other advanced countries may suddenly lose their superiority in fields where they have traditionally excelled.
- The dominance of a handful of IT companies and their entry into other fields benefit consumers by causing prices to fall, but in many countries they also lead to the loss of jobs and declines in tax revenues. Such developments further exacerbate social strains.
- China is making maximum use of big data to control its economy and society – a system that Sebastian Heilmann has dubbed “digital Leninism.”
- Rivals will be competing intensively to form the rules for the new fields of industry arising from emerging technologies, such as electric vehicles and self-driving vehicles.
  - Once early leaders impose rules favorable to themselves, it will be difficult for latecomers to catch up with them.
  - The spread of EVs will increase demand for cobalt, while the decline of diesel-powered vehicles will decrease demand for platinum. New trends like these in industrial markets will lead to major changes in the prices of natural resources and in the strategic importance of resource-rich nations.
- As the ability to generate the surpluses that serve as the basis for external involvement moves from today’s advanced countries to the emerging economies, the power shift will accelerate further.
- The rise of FinTech will trigger a phase transition in finance.
  - The availability of new options for the provision of extending credit can be expected to promote dramatic business expansion, but the use of AI fund management tools and the spread of robot advisors could lead to a dangerous increase in volatility.
  - The entry of diverse players seeking to win in next-generation finance is bound to make the FinTech boom overheat, but those involved are rather a mixed bag. The survival of the fittest amid fierce competition will result in a major realignment of the players in the financial sector.
  - Bitcoin and other virtual currencies may come to challenge the authority of the state as the issuer of currency, and they could turn into hotbeds of money laundering and black-market operations. On the other hand, as they are easier to capture than cash, they could strengthen states’ ability to collect taxes, enhance the effectiveness of ultra-low-interest policies, and improve the transparency of financial transactions.

# PHP Global Risk Analysis Project

## Global Risks 2018

- 1. United States:** Meltdown of the liberal international order due to Trump's "supporters first" stance
  - An America-first foreign policy consistently aimed at appealing to supporters
  - A US political scene clouded by polarization and a stream of scandals
  - Shakiness in America's soft power and ability to lead the international order
- 2. China:** Full-fledged drive to create a Chinese-led international order
  - Xi Jinping administration aiming to build up a record of diplomatic achievements
  - China's growing international clout
  - Threat from China to the existing liberal international order
- 3. Russia:** Multipolar offensive posture coming into clear view around the world
  - Long-term campaign aiming for the end of America's superpower status and the formation of a multipolar international order
  - Totally uncompromising position on Ukraine and NATO
  - Quest to take the lead in the Syrian peace process
  - Active involvement in efforts toward a breakthrough in dealing with the North Korean nuclear and missile development issues
- 4. North Korea:** Effectively join the nuclear club based on four-party talks among the United States, North Korea, China, and Russia
  - Freezing of the status quo under a four-party framework (United States, North Korea, China, and Russia) in response to the paradoxical strategic structure of stability balanced against mutual distrust on the Korean Peninsula
  - String of misunderstandings leading to the outbreak of a second Korean war
  - Crisis from a breakup of the US-South Korea alliance US-South Korea alliance in critical danger of breaking up
- 5. Middle East:** Realignment of the regional order triggered by an assertive Saudi Arabia
  - Risk of unrest within Saudi Arabia and of a military clash involving Iran
  - Acceleration of Turkey's move away from the West and a shift in the Middle Eastern power game
- 6. Europe:** A wave of moves toward the splitting of the EU spreading from Britain to the continent
  - Disarray within Britain over the remaining prospect of a "hard Brexit"
  - Widening of the rift in the EU between those favoring and opposing deeper integration
  - Loss of the EU's ability to serve as a global leader due to internal splits

**7. The Americas:** Extension of China's "Belt and Road" initiative to Latin America in response to a US retreat from engagement in the region

A sharp decline in US engagement in Latin America on three fronts: politics and security, economic integration, and development assistance

Lack of progress in renegotiating NAFTA, posing a major political and economic risk for North America

Rapid moves by China to fill the vacuum left by the United States by promoting its "Belt and Road" initiative

**8. Cyber security:** Inability of industry to adapt their cyber defense capabilities fast enough to keep up with the rising threat of cyber attacks

Increased vulnerability in the energy sector, where deregulation is progressing, and in the manufacturing sector, where technological innovation is required

Lack of progress in supply-chain risk management due to its difficulty and high cost

Rising difficulty of detection as state-sponsored attacks become common

**9. Terrorism:** Threat of new types of attacks based on planning by dispersed IS operatives and use of drones

Increased danger from dispersed IS operatives forming hubs and from remote-control attacks

Aggravated risk of new types of terrorism using drones and other advanced technologies

**10. Auto industry:** A shift to electric vehicles leading to a redrawing of the auto industry map

Heating up of international competition in making the rules for EVs

Impact on capital investment plans of auto parts makers from expectations of a short-term surge of business due to the "EV shift"

Decline in auto sales as the car-sharing business gets into swin



## **Project Members**

Masafumi Iida  
Senior Research Fellow  
National Institute for Defense Studies

Satoshi Ikeuchi  
Associate Professor  
University of Tokyo

Masafumi Kaneko  
Director/Senior Research Fellow  
PHP Institute, Inc.

Haruyoshi Mabuchi, CFA  
President  
Bouquet de Fleurettes

Seiya Nakajima  
Chief Economist  
Office of Niwa

Toshio Nawa  
Executive Director / Senior Security Analyst  
Cyber Defense Institute, Inc.

Noriaki Oba  
Energy Analyst

Izuru Sugawara  
Analyst of International Politics

Koichi Tajima  
Division Manager  
Research Division, Japan Credit Rating Agency, Ltd.

Toshiyuki Yasui, Ph.D.  
Guest Professor  
Graduate School of System Design and Management, Keio University