

# Global Agenda Council on Geopolitical Risk

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## Introduction

As the financial crisis unfolded in 2008 and 2009, the world lacked an appropriate and effective crisis response mechanism. To address this vacuum, the G20 emerged as a new entity of “global” leadership with a mandate that extended well beyond its prior limited economic agenda. The G20 thus was catapulted to global leaders’ stature by the need for a quasi-legitimate crisis response forum and the recognition that existing entities were simply not up to the task.

This incapacity of global institutions to handle such a threat was a long time in the making. In the period immediately following the end of the Second World War, global institutions were created that would serve as the bedrock of efforts to address global issues. The United Nations, the World Bank and the International Monetary Fund, among others, were established, in part to ensure that global conflicts were settled not through the exercise of raw power, but rather through governance structures built on agreed-upon rules, global membership and decisions taken by votes of its members.

While these organizations retain similar roles, they are meeting current challenges with diminishing returns. These institutions largely remain crystallized in their post-war forms, and their effectiveness is now under severe strain as today’s most pressing issues, primarily economic and financial, threaten to metastasize into full-fledged global crises. Today’s most acute problems are global, systemic and characterized by complex interlinkages that place increased demands on the very global institutions that have struggled to keep up with developments. Newer institutions have not filled the gap: since its largely successful 2009 efforts at a coordinated response to the global financial crisis, the G20 has been increasingly ineffectual as well.

The dearth of truly effective global institutions is part of a larger geopolitical trend, one in which the global agenda is increasingly driven in a patchwork fashion, influenced as much on a regional as on a global one. This rise of regionalism is exacerbated by the inability of global institutions to adequately address challenges, but it also arises from an

environment where nations acknowledge that there may not be sufficient response capability at an international level. There is general agreement that the unbridled pursuit of individual national interests would produce suboptimal results; in order to provide some leadership that extends beyond the national stage, there is a growing reliance on regionalism to stopgap this shortage of effective global decision-making. Increased regional efforts to address many issues – from finance, trade and energy to military security and religious tensions – are expected to continue. Regional institutions and affiliations will take on larger roles. The real challenge is managing the rise of regionalism in a way that it enhances, and does not impede, the pursuit of solutions to systemic and far reaching global problems – which is by no means assured.

Given strong incumbency effects and inertia, the existing system of global governance has some staying power. These include the United Nations system, including the Security Council, and the international financial institutions, which have been slow to evolve away from reflecting the interests of the post-war Western powers. Rising powers like China and India effectively hedge their bets, keeping one foot inside the system – just in case it might deliver the results they seek to embrace. But they appear unwilling to go all in and strongly back these institutions, not least because they do not want to share in the blame for possible failures.

In 2012, the Global Agenda Council on Geopolitical Risk will focus on the interplay between two distinct trends that build off one another – *global institutions*, whose effectiveness in addressing current and future global problems is being called into question, and the largely concurrent *rise of regionalism* that holds the potential to affect the global power balance.

The Council will focus on these two global trends as its first area of interest, before exploring the risks, opportunities and impact on the New Davos Agenda that such a fundamental shift will bring.

Discussions will break down into categories:

- A. Assessing the Effectiveness of *Global Institutions* amid the *Rise of Regionalism*
- B. Consequences and Key Takeaways: Expected Risks, Opportunities, Winners and Losers

## A. Assessing the Effectiveness of Global Institutions amid the Rise of Regionalism

### Global Institutions: Old and New

After decades of globalization, largely driven by the West, there is now a fundamental questioning and erosion of the post-war system. As the scope and scale of transnational/systemic problems increase, the basic tensions between international principles of global governance and the primacy of sovereignty, national interests and national decision-making become ever more apparent. The resulting stalemates increasingly undermine confidence that existing organizations, systems and structures of global governance are up to the task of addressing crucial issues and responding adequately to crises.

While demands on global institutions have increased, the ability for existing global institutions to respond effectively and quickly has stagnated and even weakened, for a number of reasons:

1. *Governance structures that lack legitimacy.* Many international institutions either fail to adequately represent all countries (for example, the G7, G8 or NATO – none of which claims to be a representative global institution) or, in the case of those that do aspire to a more global mandate, do so in a manner that effectively paralyzes decision-making and limits its effectiveness (for example, the G20, IMF or United Nations General Assembly). In neither case do existing institutions adequately reflect current and ongoing power dynamics and economic shifts.
2. *Insufficient support from today's great powers – the United States and China.* Both the US and China desire to see the existing global order and institutions evolve to meet their particular strategic needs. The US wants to preserve its existing institutional advantages while managing its relative decline and China wants to leverage its growing size and influence while seeking to defer leadership responsibilities. The European Union remains the strongest defender of multilateral global organizations and governance, but its global leverage has been declining, even before the Eurozone crisis, which exposed enormous internal faults. As a result, the EU has lost significant credibility and influence.
3. *Ineffectiveness.* Global institutions tend to be inert, inward-looking and process-driven, rather than focused on achieving well-defined goals in a timely and effective manner. They are often unable to adapt to a changing global environment and ever-evolving threats.
4. *Prone to Least Common Denominator Outcomes.* Given the inherent tensions between international principals of global governance and the continuing primacy of national sovereignty, interests and decision-making, outcomes, if they are achieved at all, tend to be weak compromises at or below the perceived least common denominator. The recent “success” in climate change talks in Durban is seen by many as an example of this phenomenon. While perhaps better than no agreement at all, weak outcomes can hardly be seen as enhancing the effectiveness and credibility of global institutions more broadly.

The G20, the most important recent global entity, is prone to all of the above, as well as a host of unique factors that make it suboptimal in providing global governance:

1. The G20's *agenda* has been continually expanded to include a broadening array of global issues, which effectively undermines and limits its ability to focus and address any individual issue.
2. The G20 is not a formal institution and its *legitimacy* is often questioned, given that its members constitute a small fraction of the world's countries and its membership selection lacks an overarching and consistent rationale.
3. The G20 lacks *coherence* (there is no consensus within it on fundamental political and economic values).

4. The G20 lacks *governance* (there is no formal voting structure, thus requiring unanimity on every issue and resulting in, at best, least common denominator “commitments”).
5. The G20 lacks *resources* (it has no secretariat, permanent management or staff and often calls other institutions, like the IMF, to undertake efforts to support its commitments).

Over time, new layers of complexity have been repeatedly added to already complex global institutions and systems. These often make cumbersome institutions and structures even less able to address problems, manage crises and make or enforce rules. After over 65 years, a radical overhaul of existing global institutions and governance systems might be appropriate. But, given vested interests and the lack of a post-war/crisis dynamic to spur agreement, these stand little chance of success. Thus, recent calls for a “new Bretton Woods” to redesign international financial institutions and frameworks go nowhere, as the task to do so is simply too enormous, daunting and lacking in support. Rising powers like Brazil and India often lament the apparent inability of existing institutions to effectively tackle a range of problems and challenges of global governance, and yet they fail to proffer viable alternatives beyond rhetorical calls for the reform of existing institutions “to take into account changed global realities”.

The structure of these evolving regional groupings might include some or all of the following:

1. *Coalitions of the willing/capable.* These serve as a preferred vehicle, especially for established powers, for more effective decision-making and action taking. They are fluid and lack legitimacy because of their selective membership. They often still rely on the UN system or other multilateral organizations to endorse and implement their decisions. NATO action against Libya this past year offered an obvious example of this construction.
2. *Small, functional groupings.* Ad hoc initiatives to fight malaria or deforestation are examples. These need a driving force, such as a big country or the Gates Foundation. They rely on voluntary contributions and compliance.
3. *Permanent sub-groupings.* These more formal groupings include entities like APEC or the Arab League, with membership determined largely by geography. The US has recently been at the forefront of the creation of a Trans-Pacific Partnership (TPP), which is a major initiative centred on regional trade and investment among nine Pacific countries. If perceived to be effective, these regional groupings may serve as an example of the increasing importance and centrality of regionalism. However, there is a risk that these more formal groupings can become victims of their own success, with membership and agendas expanding rapidly, thereby diminishing their effectiveness and becoming unwieldy.
4. *Financial/monetary backstops.* With the scale of global economic and financial vulnerabilities increasing, dedicated financial resources at international financial institutions like the IMF are increasingly seen as potentially inadequate. This has led to the creation of regional financial backstops, for example the Asian Chang Mai Initiative and the Latin American Reserve Fund. These potential providers of emergency liquidity necessarily depend on the willingness of some countries to provide financial support to others in need. In the end, their success or failure will depend on whether they are adequately funded and whether they can provide financial support and liquidity in a timely and effective manner to stave off or recover from a financial crisis. They are also vulnerable to regional correlation risk, where many countries in the regional grouping find themselves all in need of support at the same time.

Global entities and structures are thus likely to be increasingly challenged, or at least augmented, by regional alliances and organizations; some formal and some informal. Many of these formal regional alliances remain nascent and are currently, at best, marginally effective.

The creation of any new regional entity risks the alienation of those countries which balk at even the slightest encroachment on issues of national sovereignty. Thus far, many transnational entities serve mostly:

1. As little more than high-level discussion groups
2. With rudimentary governance structures and skeletal institutions, seemingly unable to tackle the common challenges facing their regions
3. With hang-ups stemming from bilateral differences, including, in particular, questions of financing commitments and support

Despite these shortcomings, however, these regional alliances continue to gain traction. One example is the increasingly assertive role of the Arab League in both Libya and Syria, and another the emphasis being placed on the TPP.

Because the rise of regionalism is still at a relatively early stage of development, there is an opportunity to affirmatively craft these evolving regional alliances, entities and institutions to optimize their ability to coordinate with one another as well as with existing global institutions. It is far from certain that, left to their own devices, these new institutions will develop along multilateral models similar to existing institutions and to one another.

The rise of regionalism raises a host of geopolitical concerns that directly impact bilateral relations between states:

1. *Involuntary or unequal regionalism.* The risk that regional powers could influence the creation of entities and institutions to bolster their own power status is real, and could lead to an upsurge of “involuntary” regionalism. Involuntary regionalism is when a strong local power coerces its neighbours into alliances, leading to diminution of their sovereignty. This risk is particularly acute for those countries that are not in a position to “hedge” themselves; that is, they are not able to rely on structural or strategic advantages to opt out.

For example, Russia has been known to play the role of regional hegemon, using overt pressure in bilateral dealings with its neighbours. It has demonstrated its willingness to do so by coercing Ukraine into its customs union with Belarus and Kazakhstan.

In regions with a hegemonic power, regional institutions that are based on notions of equality stand limited chance of success. For example, Russia will never truly accept equality with Armenia in a regional forum. In a China-dominated Asia, smaller regional actors may find it difficult to be heard in any future regional entities. The regions that do not have a dominant power, such as Africa and Latin America, have such weak traditions of governance that a rules-based governance model poses enormous challenges.

2. *Confrontation.* Some regional organizations may have the potential to evolve into a means to contain the influence of other regional organizations – or the US.

For example, the Shanghai Co-operation Organisation (SCO) was originally designed to build confidence on issues of border security, as well as a means to enable Central Asian energy supplies and to provide a larger market for Chinese goods. But, particularly at the urging of Russia, it has, at times, been pushed to serve as a quasi-response to NATO. The Gulf Cooperation Council (GCC), the political and economic union of Middle East Arab monarchies that is effectively led by Saudi Arabia, could evolve into a more influential organization with an outsized role in regional politics and beyond. The GCC played an integral part in responding to the Arab Spring, specifically within member states such as Bahrain, and it has expressed the willingness and capacity to potentially fill some of the void left by a United States that is unwinding its commitments in the region and increasingly focusing its attention domestically and on Asia. Down the road, the GCC could chip away at remaining US regional influence, or set a course at odds with core US interests more broadly. The organization is willing to evolve and grow – it has recently invited Morocco and Jordan to join its ranks.

Other regional organizations could infringe on US interests and on other regional institutions on a longer time horizon. Down the road, China, for example, has the capacity to cement a regional sphere of influence that would directly challenge US economic and security interests in Asia and have knock-on effects for the global economy. Just where the lines of influence would be drawn remains to be seen, however – and the slow process will signal what is to come and impact other regional organizations such as the TPP in the nearer term.

3. *Fragmentation.* As these regional alliances and groupings evolve, the form of cooperation and integration will be shaped by a multiplicity of factors and they are likely to differ if the primary motivator in the alliance is economic rather than geopolitical in nature. Some have a strong security focus (the GCC), some are mainly economic (the EU). In any case, as they evolve, there is a risk that they result in different flavours of regional integration and alliances which are ultimately irreconcilable. Regional developments that emerge incompatible and contentious on a global scale pose long-term dangers and should be avoided.

This plethora of regional groupings will not be able to easily cooperate with one another. The result could be an inability to manage regional rivalries, the emergence of regional trading blocs or incompatible technical standards that undermine globalization.

4. *Global vs regional.* Global organizations such as the UN and the WTO have an inbuilt mandate to address problems that require international solutions: climate change, weapons proliferation, trade protectionism. Regional organizations tend to be focused on local issues and are often more pragmatic. They are less likely to take up global causes – which could be neglected in the new, regionalized world unless existing global institutions find a way to be more effective. It is important to focus on how regional groupings and institutions integrate into the existing system of global governance.

The IMF response to the European crisis has involved close cooperation with the European Union and the European Central Bank. To ensure that future crisis response and prevention are coordinated and coherent, the IMF has recently embarked on a process of seeking closer collaboration with regional financing arrangements (RFAs) like the Chang Mai Initiative precisely to address the need for better global-regional cooperation.

## B. Consequences and Key Takeaways: Expected Risks, Opportunities, Winners and Losers

### Overview

A global power vacuum is the most daunting potential consequence of this weakening of global institutions and rules. While regional alliances will likely gain in importance, neither they nor individual countries will completely fill this global vacuum. Many countries now have both national and regional ambitions, yet only a few have global ones. Only the US and China appear willing and able to spend considerable resources far beyond their borders. Yet, neither can assume overt global leadership and responsibility – nor does either want to. There is a significant difference between the respective levels of this reluctance on the part of China and the US. Each has a very different political philosophy, with those differences extending well beyond the issue of democracy. China remains primarily focused on its own domestic concerns – chiefly development – and tends to look at global issues through that prism. It is far more committed to addressing its own problems before advancing to a more internationalist agenda. The US, by contrast, retains incomparably greater diplomatic and military reach and is more outwardly engaged in the world, often requiring it to balance its own domestic and international concerns. The US remains willing to assume at least some of the functions of international leadership.



Though the decline of the US should not be overstated, the US economy today limits the country's ability to exercise unbridled global leadership. China still insists that its "developing country" status absolves it from shouldering too many global responsibilities, though it wants to make sure the world does not unify against it. No other mega-state is credibly thinking in global terms. As the world drifts towards what is increasingly seen as potentially a G2 world, with the US and China at the table, this could possibly lead to a world more prone to competition than a multipolar/multilateral world and could lead to more state-to-state conflicts. Yet, we might also be more likely to see conflicts within states, the rise of non-traditional threats including cyber threats and proxy conflicts, in which countries destabilize others in different ways. Such "new" conflicts could even escalate to a military level, especially if global crisis management mechanisms are weak.

Rising powers, in particular, have limited trust in global institutions perceived to be underpinned by the "Washington consensus". One lesson many have learned from the financial crisis is that countries that have accumulated large pools of reserves are safer and more independent than those that lack them. This potentially encourages countries to adopt mercantilist policies, recognizing that the WTO system, even with its enforcement mechanism, is either inapplicable or too weak to meaningfully counter these trends. At its worst, protectionism and populism could rise, thereby undermining prospects for restored global economic growth and development.

The BRICS (Brazil, Russia, India, China and sometimes South Africa) have not emerged as a united global group. While this grouping may have provided an attractive means for investors to gain exposure to a diversified group of large emerging economies, the grouping together of these disparate countries, with different national interests, agendas and philosophies, has failed to take hold in the international political arena and seems unlikely to do so in the foreseeable future. Any perceived unified front on the part of these developing countries does not usually last beyond headlines and broadly themed UN General Assembly sessions.

## Winners and Losers

Classical winners will likely be those with hard power and/or financial or other resources that can defend and advance their interests in a less orderly, more competitive world. These include:

1. The United States
2. China
3. Saudi Arabia
4. Germany

Classical losers come in a few broad categories:

1. Smaller, poorer countries that find themselves next to a big potential bully (i.e. Georgia and its relationship with Russia)
2. States that stand to suffer from a reduced US appetite for Middle East related risk and/or the rise of political Islam as a result of the Arab awakening (Israel fits the bill for both)
3. States that remain largely politically paralysed and continue to haemorrhage regional influence (Japan)
4. States that find themselves caught between regions in a detrimental fashion (The United Kingdom is neither North American nor fully European)

In a world of weakening global governance and institutions concurrent with a rise of regionalism, however, a new host of winners and losers – and nuanced scenarios that fall in between – will take root.

New winners include countries that can "hedge" against domination or exogenous economic threats, for example by:

1. Building an independent economic base (Singapore)
2. Maintaining productive commercial relationships with a number of larger powers (for example, Kazakhstan trades with Germany nearly as much as it does with its powerful neighbours, Russia and China)

3. Strengthening political and commercial ties with global powers like the US or China – or even both (Brazil is effectively balancing substantial commercial relationships with the world's two preeminent powers, while maintaining its role as powerbroker in its own region; also, Canada is a success story, as it continues to rely on the US as its largest trading partner, but hedges its bets by increasing trade with China and the rest of Asia)

In conjunction with this new category of winners that can hedge, there are states that stand to lose because they cannot. Losers when it comes to hedging include:

1. States that bet too heavily on a single larger power (Mexico, like Canada, benefits immensely from its ties to the United States, but most, if not all, its eggs are in one basket: even if the outlook for the United States improves, Mexico has left itself with no buffer against an unforeseen shock to its neighbour)
2. States that are involuntarily tied to a neighbour for geographical reasons (Ukraine struggles to increase ties with the EU alongside existing ones with Russia; despite recent visit from the US and the United Kingdom, Myanmar is firmly affixed to China for the foreseeable future with no viable means of hedging)

There are other powers that have ample opportunity in this new global dynamic:

1. Germany is a potential winner, yet perhaps reluctantly so, as it remains less than fully enthusiastic about the increasing leadership role it currently plays in Europe. No other state is financially able or willing to meet so many of the current challenges facing the region. And yet, Germany's historical attempts to play a leadership role within Europe have not always gone well, and this remains a defining characteristic of its bilateral and multilateral relationships within the EU.
2. China's one-party governance model serves as an attractive tool for authoritarian regimes in some developing countries seeking to legitimize their own regimes. However, there are serious questions about whether there really is such a thing as a "Beijing consensus". Moreover, there are questions about whether and when the attractiveness of the financial resources China provides to other developing and emerging countries (especially Africa) are outweighed by the lack of explicit normative conditionalities and whether, in the end, there really are, in fact, "no strings attached".
3. Turkey is clearly an emerging power with regional ambitions. The country can hedge its bets between several national, regional and global powers. Further, it benefits from cohesive leadership and democratic legitimacy. Turks and the Turkish model present a quiet threat to Arab monarchies. The Saudis, for example, are likely not pleased with Turkish statements and actions regarding its relationship with Israel. The US had previously viewed Turkey as a bridge into the region, but increasingly it finds itself caught in the tensions between Turkey and Israel.

## Conclusions and the New Davos Agenda

As the world stumbles from one economic challenge to another, the failure to adequately respond to or prevent these crises has increasingly exposed the weaknesses of the political and governance systems established to respond to them.

Democracies and institutions built on consensus-driven governance models are often prone to paralysis and seem politically incapable of taking bold crisis-response measures. Their ineffectiveness has made them less attractive to developing and emerging countries striving to balance their governance models between efficiency and legitimacy. Authoritarian/hybrid structures provide an alternative to liberal democratic structures for countries and institutions seemingly incapable of undertaking bold responses in crisis situations. A less open, market-based economic growth model similarly provides an alternative to free-market capitalism that creates cycles of boom and bust. These alternative models, however, come at the expense of long-term resilience, sustainability and legitimacy.

The European model of cooperation and institution building is not the only blueprint for transnational groupings and the EU model itself is losing its attractiveness because of the Eurozone crisis and the EU's inability to operate as a unified cohesive international player. After all, the EU is currently focused on shoring up the support of its own members, and is not actively seeking to advance its model elsewhere.

Countries like Turkey and Brazil are among the most interesting models in which liberal democratic governance structures and market economies have been both popular and successful in navigating their emergence as responsible and legitimate global stakeholders. Their experience is worth studying and exploring in greater detail.

But whether and how Europe emerges from its current crisis is still of the highest importance to the future of international organizations. To date, Europe has been the only area in the world where countries have successfully pooled sovereignty, on the principle that all countries are (more or less) equal and they should all follow collectively agreed rules and work through supranational institutions.

Even with its influence in decline, the EU model of regional cooperation is still the most highly developed in the world, and the evolution of its governance structures, rules, institutions and power dynamics that emerge from the current crisis will likely be looked upon with great interest by those contemplating regional alliances of their own. While the eventual shape of the EU is currently more uncertain than it has been for decades, there is already increasing doubt that the EU will remain as concerned with equality for smaller countries, which may, as a result, find themselves less influential. We have already seen the *de facto* creation of a smaller steering group for Europe – the Frankfurt Group – which allows stronger and more influential leaders and actors to discuss issues in a less formal setting than the EU or Eurozone treaties prescribe. And even that ad hoc grouping has been somewhat supplanted by the bilateral French-German relationship, where many crucial issues appear to be discussed and agreed and then presented to the broader EU or Eurozone, effectively as a *fait accompli*. While this smaller decision-making dynamic may result in some discomfort for smaller countries, enhancing this more realistic approach to decision-making could, in the end, allow the European Union to ultimately emerge stronger and with greater international influence.

In conclusion, a world where regional groupings and organizations address regional and perhaps wider issues is second-best to a world of effective global governance. But it nevertheless is preferable to raw nationalism as an alternative outcome, and reflects the broader diffusion of international power away from a pure "might-makes-right" world. Regionalism may well provide the most effective means of hedging against the potentially hegemonic ambitions of great or regional powers. Examples include the ASEAN position vis-à-vis China on the South China Sea, or Central Asian countries vis-à-vis Russia on diplomatic recognition of Abkhazia and South Ossetia in 2008 via the Dushanbe SCO summit.

The World Economic Forum has demonstrated that globalization is most often a force for good. Hence, it is desirable to draw rising powers and peripheral countries into the global governance system that fosters open trade and the free flow of capital, seeks to address global challenges from climate change to women's rights and strives to give all countries a say in shaping the global agenda.

But the global economic and financial crisis has called into question the benefits of globalization and the predominant model of consensus-driven governance. In many developing countries, people are focused now on improving their economic positions, and are not necessarily looking to the existing global powers and institutions to provide them with the best model with which to do so. In short, the West and the global institutions it dominates are no longer uncontested models for transition economies and regional alliances.

The move away from belief and trust in existing structures and institutions of the global order to solve global problems leads to a potential for fewer shared/transnational values.

The challenge for the New Davos Model is to ensure that new regional institutions that rise alongside existing global institutions:

1. Embody values such as openness, equality, transparency and intellectual honesty
2. Are open and compatible so they can work together
3. Integrate with, not undermine, the existing system of global governance
4. Reinforce existing efforts to address global problems
5. Do not turn into tools for regional hegemons to bully their neighbours