

Geostrategic Business Group
**2021 Geostrategic
Outlook**

**The geopolitics of COVID-19
will shape the global business
environment**

December 2020



**Building a better
working world**

Introduction

The COVID-19 pandemic has been the defining feature of 2020. COVID-19 was unprecedented in the speed and severity with which it affected almost all countries around the world. Government responses to the pandemic are inherently geopolitical, involving issues such as national security, global leadership and international cooperation and competition. And within many countries, COVID-19 has exacerbated tensions around economic inequality, access to health care and social justice. So while the COVID-19 pandemic is a public health crisis, it is also a political risk event on a global scale.

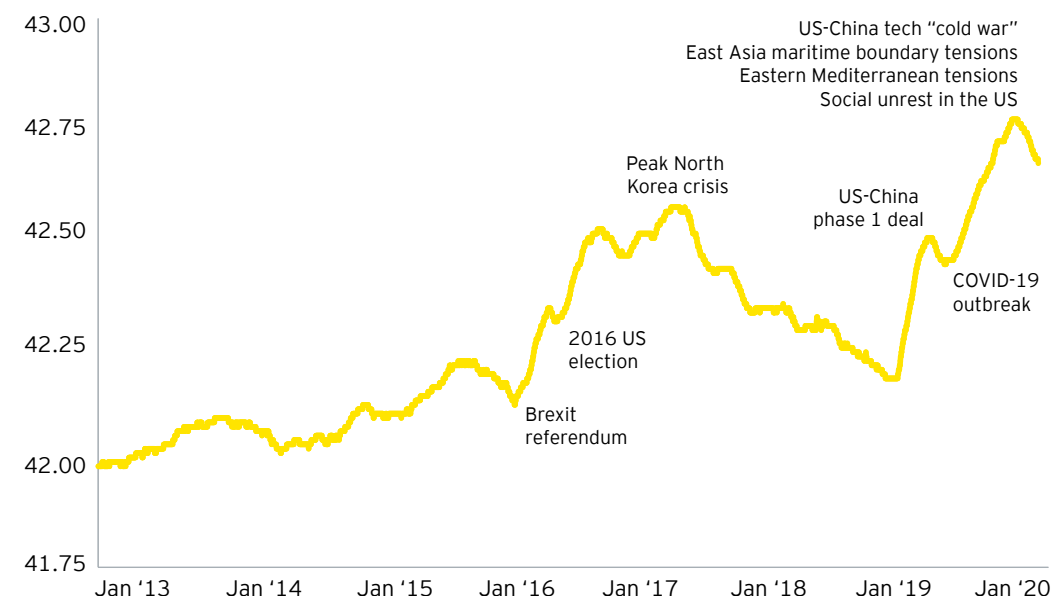
Other consequential political risks that shaped the global business environment in 2020 will continue to reverberate in 2021, including Brexit negotiations, US-China tensions and the US presidential election. The latter will be particularly impactful in 2021, as incoming President Biden ushers in an era of realignment on a variety of domestic policies and re-engagement with foreign allies and multilateralism. And, of course, how the US handles COVID-19 will also affect the trajectory of the pandemic, global economic prospects and geopolitical relations.

It is therefore no surprise that in 2020 political risk – the probability that political decisions, events or conditions at the geopolitical, country, regulatory or societal level will impact the performance of a company, market or economy – rose to its highest level in many years (see Figure 1). We expect this elevated level of political risk to persist in 2021, amid dynamic policy environments across virtually all countries around the world simultaneously. This will create a high level of uncertainty, challenging companies' strategy development and execution.

The geopolitics of COVID-19 is the first risk in the 2021 Geostrategic Outlook. This issue will permeate throughout the rest of the key political risks around the world in 2021 as well. The dynamics of COVID-19 will be a factor in US-China relations, the EU's accelerated push for "strategic autonomy," new FDI restrictions and industrial policies, the politics of emerging market debt, social unrest and a variety of other political risks. While 2020 was the year COVID-19 took the world by storm, 2021 will be when the pandemic's medium- to long-term effects on the geopolitical environment will begin to crystallize.

Figure 1: Global political risk reached a multiyear high in 2020

GDP-weighted global average of political risk



Source: GeoQuant.



Risks we're watching in 2021

Select any section below to begin.

Geopolitics of COVID-19

The COVID-19 pandemic has created new headwinds for globalization even as it has exacerbated strains in the global rules-based order. It has severely damaged world economic growth and accelerated great power rivalries. Travel restrictions and restrictive trade measures have proliferated in countries around the world. And as the race for a vaccine has heated up, “[vaccine nationalism](#)” has been on the rise. With some vaccines likely to be deployed by the end of 2020 and close to 50 vaccines in various clinical evaluation stages, which countries get vaccines to their citizens first will be key – and will help determine what the geopolitical implications of winning the vaccine race will be.

The geopolitics of COVID-19 will shape the global operating environment for companies in 2021. The country that wins the vaccine race is likely to get a boost in geopolitical standing and reputation (see Figure 2). Despite the efforts of the COVID-19 Global Vaccine Access Facility (COVAX) – which all major markets [except the US and Russia](#) have joined – to promote the fair distribution of the vaccine, distribution could be politicized and based more on ability to pay than on need. India and South Africa may further complicate vaccine deployment by pushing forward with their request at the World Trade Organization (WTO) to [waive intellectual property \(IP\) rights](#) related to medical products during the COVID-19 crisis to allow for wider vaccine production and distribution.

Countries are likely to continue imposing [temporary export restrictions](#) for critical medical supplies and pharmaceuticals as long as the pandemic persists. Such restrictions could create or exacerbate geopolitical tensions between some countries – particularly if export restrictions are applied only for certain countries. Trade flows may also be subject to additional tariffs as governments seek sources of revenue to finance COVID-19 relief efforts.

Cross-border movement of people will also remain restricted in 2021. The suspension in the US of many work visa categories is likely to be at least partially extended for as long as the economic crisis persists, for instance. And although about half of destinations had begun to [loosen international tourism restrictions](#) as of September 2020, travel limitations will continue to rise and fall along with subsequent waves of the pandemic. Some countries are removing travel restrictions in phases, which may hurt diplomatic relations with countries that stay on restriction lists longer than others.

COVID-19 will continue to have domestic political implications as well. Public trust in governments and vaccines will affect deployment and inoculation. With greater government intervention in economies, political debates in many markets will shift from whether to how the state should intervene. And the effectiveness with which governments control subsequent waves of the pandemic and distribute vaccines will have political consequences. Voters are likely to reward politicians that they perceive as in control of the situation and reject those seen as mishandling the pandemic and prolonging the economic crisis, which could lead to higher levels of government and policy instability around the world in 2021.



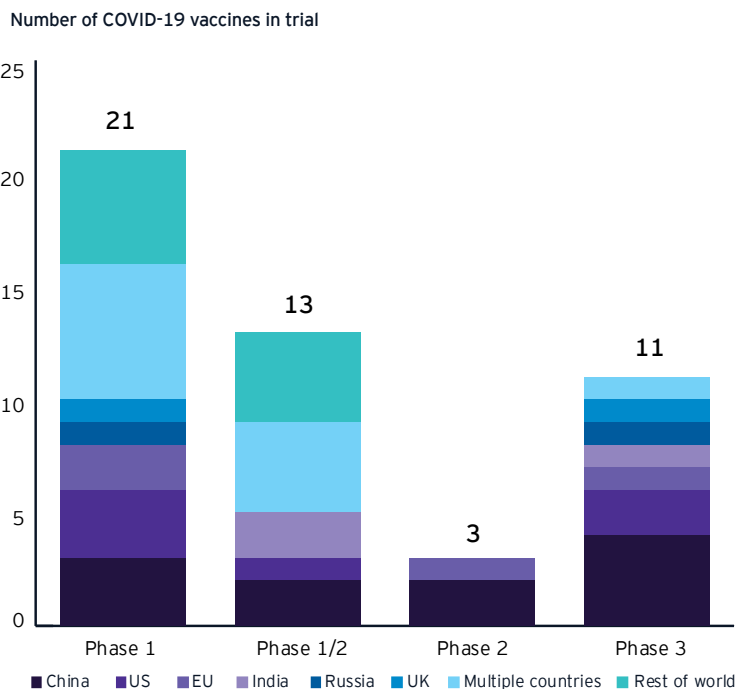
Business implications

- ▶ **Pandemic uncertainty will require a renewed approach to building enterprise resilience.** The geopolitics of COVID-19 are just starting to play out and there is still a high degree of policy uncertainty at both the geopolitical and country levels. Amid this rising uncertainty, business planning and budgeting exercises will remain complicated during at least the next 12 to 18 months. Greater use of data science and modeling scenarios may enable companies to make more intelligent decisions in this uncertain environment.
- ▶ **COVID-19 reinforcement of nationalism creates reputational and compliance risks.** Governments have adopted emergency measures to manage the crisis, and many of these policies are likely to continue even when the pandemic is over. Companies operating in strategic sectors such as pharmaceuticals are likely to continue to be pressured to serve domestic markets first. Government responses to the pandemic have led to a greater need for the public and private sectors to work together. This situation creates new opportunities for companies, but also reputational and compliance risks if companies are perceived to be serving foreign markets ahead of domestic ones.
- ▶ **The pandemic underpins the need to re-evaluate supply chains.** Even before the pandemic, a rise in protectionism in some markets had led companies to consider reshoring and nearshoring supply chains. And governments responded to COVID-19 by further restricting cross-border trade, further exposing companies to the risk of long international supply chains – particularly when dependent on a single country or region. Supply chains for essential items such as food, medical equipment and pharmaceuticals remain incredibly vulnerable. A diversification of supply chains with a mix of local, nearshore and global strategies is therefore likely to persist.
- ▶ **Immigration and travel restrictions will impact talent decisions.** International mobility will remain a challenge amid the varying restrictions on cross-border travel that many countries have in place. This will continue to affect business travel and the ability of companies to hire talent globally. The rise of remote work in some industries offers the opportunity to employ talent wherever they live – although this could come with complicated tax implications for the employer, employee or both. And there may be government policy shifts discouraging reliance on foreign labor to promote domestic employment. The high level of uncertainty that remains around vaccine availability and deployment means COVID-19 will continue to define international mobility and return-to-workplace decisions for the foreseeable future.

Geostrategic considerations

- ▶ Conduct **supply chain resilience assessments** and stress tests to anticipate future disruption from COVID-19 policies
- ▶ Put **people at the center** of your company's COVID-19 response policies
- ▶ Re-evaluate your company's **enterprise resilience** to enable better crisis management, recovery and reinvention
- ▶ Determine which government, civil society and other policy influencers will shape key policy decisions and make certain your company has voice in the debate
- ▶ Assess which governments are likely to increase **tariffs** or taxes to finance COVID-19 fiscal outlays
- ▶ Continually evaluate the financial impact of the COVID-19 crisis and how it may alter your company's short- and long-term capital needs

Figure 2: The limited number of vaccines in the final trial stages sponsored by countries in each of the major geopolitical blocs



Sources: World Health Organization, EY analysis.

Note: Vaccines in Phase 1 are in small-scale safety trials, those in Phase 2 are in expanded safety trials and those in Phase 3 are in large-scale efficacy trials. Data is current as of 12 November 2020.

Disentangling US-China interdependence

The [US-China relationship](#) soured on several fronts throughout 2020. The US expanded export controls and proscribed entity lists, explored restrictions on Chinese companies accessing US financial markets, sought to ban certain Chinese social media companies, further restricted Chinese companies in the telecommunications and semiconductors industries and sanctioned senior officials over Hong Kong's National Security Law. China responded by placing sanctions on US congressional members, reciprocating the closure of a consulate, sanctioning a US company over arms deals with Taiwan, imposing new export controls and publishing more details about a new "unreliable entities" list.

China and the US will continue to try to disentangle their strategic interdependence in 2021, with the Biden Administration likely to perpetuate many of the policies pursued under Trump. Competition is likely in four main areas. The first is the continuation of an acrimonious trade relationship (see Figure 3). Bilateral tariffs will remain in effect, although the Biden administration may reduce tariff rates or increase exclusions if doing so would support US economic growth. Beijing may offer concessions, such as expanding foreign access to certain sectors, to facilitate tariff reductions.

The second main area of competition will be technology, with a focus on 5G, semiconductors and AI. China will roll out its 14th five-year plan (2021–25), which emphasizes self-reliance in science and technology. The US is likely to try to support domestic technology companies and further limit Chinese companies' access to American technology inputs and commercial opportunities abroad. But the incoming Biden administration will likely reassess new restrictive actions, focusing instead on protecting intellectual property and strengthening

cybersecurity, while potentially decreasing action against specific Chinese companies. Biden will seek to leverage allies to put more pressure on China to incentivize Beijing to give some ground on these and other issues.

Closely related to this is industrial policy, through which both countries will try to disentangle bilateral economic ties, particularly in strategic sectors. Beijing will continue to implement its "dual circulation" innovation-driven economic development strategy, which seeks to maintain China's cross-border trade and investment flows while also boosting its advanced manufacturing sector to become more self-sufficient. Biden has indicated his administration will use this strategic competition with China to invest in domestic capabilities in which it believes the US has fallen behind – most notably, 5G wireless networks, AI and clean energy. The US will also focus on efforts to repatriate manufacturing broadly and supply chains for strategic industries such as medical supplies, pharmaceuticals and semiconductors.

Finally, there will be friction in areas of Chinese sovereignty, including its maritime territorial boundaries and its stance on noninterference in what Beijing considers to be domestic affairs. Washington will continue to push on both fronts, however, with sanctions, the likely increased use of export bans in response to the situation in China's Xinjiang region and continued engagement with Taipei.

But the US will seek to work with Beijing on some global issues. The most notable is climate change, with other areas likely to include public health and nuclear nonproliferation. Such collaboration would help to maintain open communication between the two governments, reducing the risk of miscalculation or a dramatic escalation of tensions.



Business implications

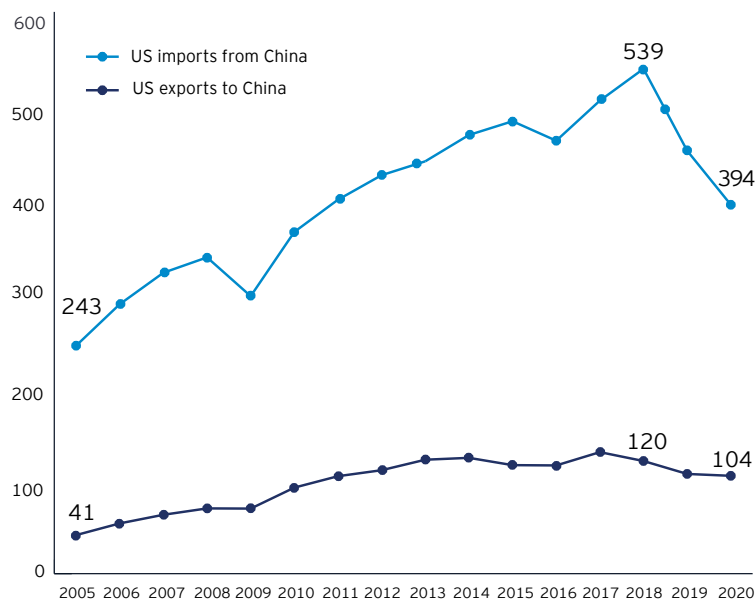
- ▶ **Companies will continue to face supply chain cost increases and disruptions.** Semipermanent and potentially expanding trade and investment barriers (as well as the ongoing COVID-19 pandemic) mean that companies that export inputs or products between China and the US will remain subject to extraordinary tariffs in the near to medium term. Companies face uncertainty about whether and at what rate their products will be subject to trade barriers, as shifts are likely in the bilateral tariff mix in the coming year. Further complicating the situation are sanctions on certain companies from each market. The US-China relationship may therefore require some companies to modify their operational strategies to improve supply chain resilience.
- ▶ **Sino-American economic disentanglement will affect growth and investment strategies.** Decisions on new investments should factor in the heightened political risk associated with doing cross-border business between the US and China. Chinese firms seeking to invest in the US – particularly those in the technology sector – will likely face greater regulatory scrutiny and may have their transactions rejected. If US-China relations continue to sour, US companies may face similar hurdles to entering or expanding within the Chinese market. This bilateral dynamic could provide investment opportunities in both China and the US for companies from other markets.
- ▶ **Technology sector competition will complicate data and intellectual property management.** The efforts of the US and China – as well as the EU – to establish [competing digital standards](#) around the world risk making cross-border digital

trade and data transfers more difficult for all companies. The most obvious example of this dynamic is in 5G wireless networks, but it will affect other digital technologies as well. Companies may face higher data management costs if they operate in both spheres – but they risk losing access to some markets if they fail to adopt both sets of digital standards. Companies with sensitive intellectual property and those contracting with the US Government may also need to perform expanded diligence on Chinese partners.

- ▶ **Companies operating in both markets could face reputational risks.** As US-China tensions persist, companies could be caught in the crosshairs of geopolitical competition. Particularly in areas where the two countries have divergent points of view – such as privacy and human rights – companies may face pressure from consumers and regulators for their behavior in the other market. Such reputational damage could affect operations and commercial sales. The likelihood of these impacts is highest for US companies operating in China.
- ▶ **Sanctions could affect access to capital and valuations.** If the US imposes additional financial sanctions on access to US capital markets, Chinese companies are more likely to raise capital in domestic financial markets. This could build on the trend in 2020 of the Shanghai Stock Exchange accounting for the greatest number and highest proceeds of [global initial public offerings](#) (IPOs). This could affect the valuation of companies, particularly those based in China.

Figure 3: US-China trade volume has fallen in recent years

Bilateral goods trade in US\$ billions



Source: US Census Bureau.

Note: All figures are on a nominal basis, not seasonally adjusted. 2020 data is an estimate based on the actual data through August.

Geostrategic considerations

- ▶ Assess the supply chain challenges and opportunities your company faces as a result of the changing US-China relationship and **build resilience** to future shocks
- ▶ Determine how US-China competition in the technology sector will affect your company's **digital transformation** strategy
- ▶ Ensure your company's board and C-suite have access to US-China geopolitical experts to help challenge mindsets and enable more informed, strategic decision-making
- ▶ Incorporate an assessment of the opportunities and challenges that Sino-American disentanglement presents in your company's **global transactions strategy**
- ▶ Determine whether your company is exposed to any sanctions risks imposed by the US or China, including through dealing with suppliers or customers



Toward European strategic autonomy

In a world of rising geopolitical tensions between global powers, the EU is seeking to define its place and role. In 2019, the new European Commission took office, describing itself as “geopolitical” and defining its aim to create a “[stronger Europe in the world](#)” by being “ambitious, strategic and assertive in the way that (the EU) acts.” The COVID-19 pandemic will continue to reinforce and accelerate this trend throughout 2021 as it has exposed EU dependencies on the supply of critical products. COVID-19 has also created a fragile economic environment in which the EU will try to protect its jobs and industries.

Throughout 2021, the EU will sharpen its policy tools and regulation to rebuild a post-COVID-19 Europe that is more open, strategic and autonomous both politically and economically. This will include a review of its [trade](#) and investment policies, as well as a [new industrial strategy](#) with a focus on green and digital capabilities. Importantly, this will involve the EU continuing to shape global norms and standards, especially in the fields of digital regulation and environmental policy.

On the foreign policy front, the EU will seek to define a common and coherent approach to China, which the EU recognizes as a [systemic rival](#) and economic competitor but also as a cooperation partner. This will be challenging, though, as EU Member States, including most importantly Germany, continue to have sometimes conflicting interests in their relationships with China. Reaching agreement on the EU-China Comprehensive Agreement on Investment will be a priority to create fair market competition and investor access, although the Europeans see the ball in China's court in terms of making concessions to move this forward.

It will also be another crucial year for EU-UK relations, as both sides continue to define mutual access to markets and the degree of regulatory divergence as Brexit plays out. And the EU will seek to renew the transatlantic relationship under a Biden presidency while not relying on global American leadership anymore. The recognition that the transatlantic relationship has fundamentally changed during the last four years provides further impetus to Europe's quest for a stronger and more independent role on the international stage.

The EU's “open strategic autonomy” trade policy will seek to balance the need for strategic supply resilience while remaining competitive and open to multilateral trade. Policies will focus on leveling the playing field for European companies at home and abroad, reinforcing action against unfair trade practices and producing “critical goods in Europe, to invest in [strategic value chains](#) and to reduce over-dependency on third countries in these areas.” One aspect of this will be reinforcing its screening of foreign subsidies and investments. Brussels seemingly has room to maneuver, as the US and China already have more restrictive FDI frameworks (see Figure 4). The EU will also review its competition framework, making changes to regulations to create a level playing field for its industry. And it will seek to secure the supply of critical raw materials to increase autonomy in the production of key digital technologies.

Business implications

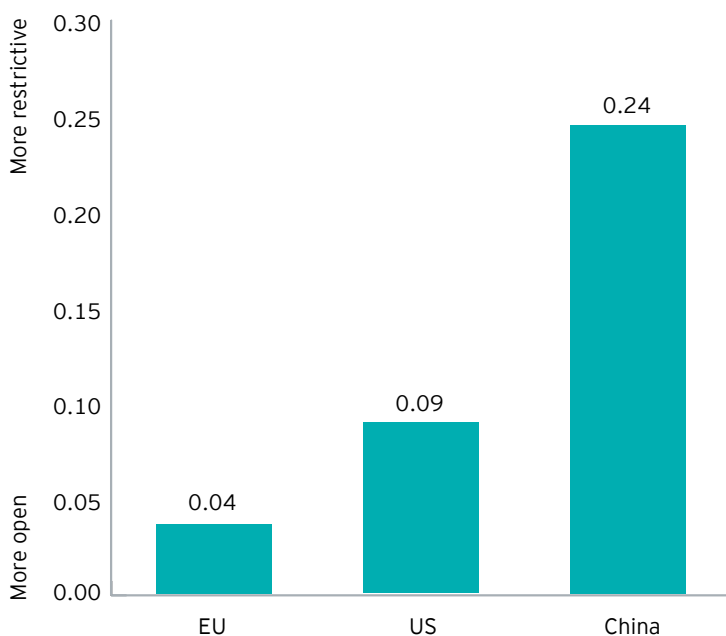
- ▶ **Growth opportunities in the EU's technology and life sciences sectors will skew toward European companies.** As the EU will seek to level the playing field, better counter foreign subsidies and adapt its competition framework, European companies – especially in “strategic” sectors such as technology and medical supplies – may face less competition on European soil. In contrast, non-EU companies in these sectors are likely to face stricter regulation or be entirely blocked from operating or investing in the EU. And companies relying on global supply chains in technology and health care could be forced to nearshore or onshore production to comply with new “strategic autonomy” provisions.
- ▶ **Non-European companies could face higher costs for EU operations.** Administrative hurdles could be increased or taxes could be introduced in an attempt to create a level playing field for European companies across all sectors. A prime example is a

carbon border adjustment mechanism that would price imports to reflect their carbon content. This could keep EU climate goals from being undermined by companies relocating production to countries with less strict goals – while also ensuring that EU companies are not disadvantaged by new climate regulations.

- ▶ **Foreign investment in strategic sectors could be delayed or rejected.** The new EU-level FDI Screening Regulation creates a system of cooperation and information sharing among Member States and the Commission. These new EU rules could be an incentive for Member States that do not have an FDI screening mechanism to introduce one. Foreign investors are therefore likely to face additional hurdles or have their transactions be rejected. These efforts will first focus on dual-use items that can be used for both civilian and military purposes but could gradually be expanded to include more sectors.

Figure 4: EU strategic autonomy may be putting it on a path to catch up with the US and China

FDI regulatory restrictiveness index



Sources: Organization for Economic Cooperation and Development, EY analysis.

Note: The FDI Regulatory Restrictiveness Index (FDI Index) measures statutory restrictions on foreign direct investment across 22 economic sectors. Restrictions are evaluated on a 0 (open) to 1 (closed) scale. The score for the EU is a GDP-weighted average of the index scores of the 24 EU Member States for which OECD data was available.

Geostrategic considerations

- ▶ Determine whether your company's **growth strategy** has been adapted to capitalize on the opportunities emerging from the EU's strategic autonomy policies
- ▶ Adequately plan for and price in the **financial and operational risks** stemming from new regulations
- ▶ Include an analysis of geopolitical and regulatory risks as part of **commercial due diligence assessments** in the EU
- ▶ Determine whether your company's **supply chain** is agile and prepared to adapt to new EU policies
- ▶ Assess whether your company's public policy function has a strategic view on regulatory developments and how they could present challenges and opportunities to the business

Neo-statism on the rise

In recent years, there has been a shift from a laissez faire approach to a greater role for state intervention in many economies. At least 110 countries, including both developed and emerging markets, have announced [industrial development strategies](#) or policy frameworks in the past decade. And the adoption of more restrictive FDI rules related to national security has risen dramatically. COVID-19 has accelerated these trends, driving many countries to tighten FDI regulations and impose export restrictions on critical medical supplies and personal protective equipment.

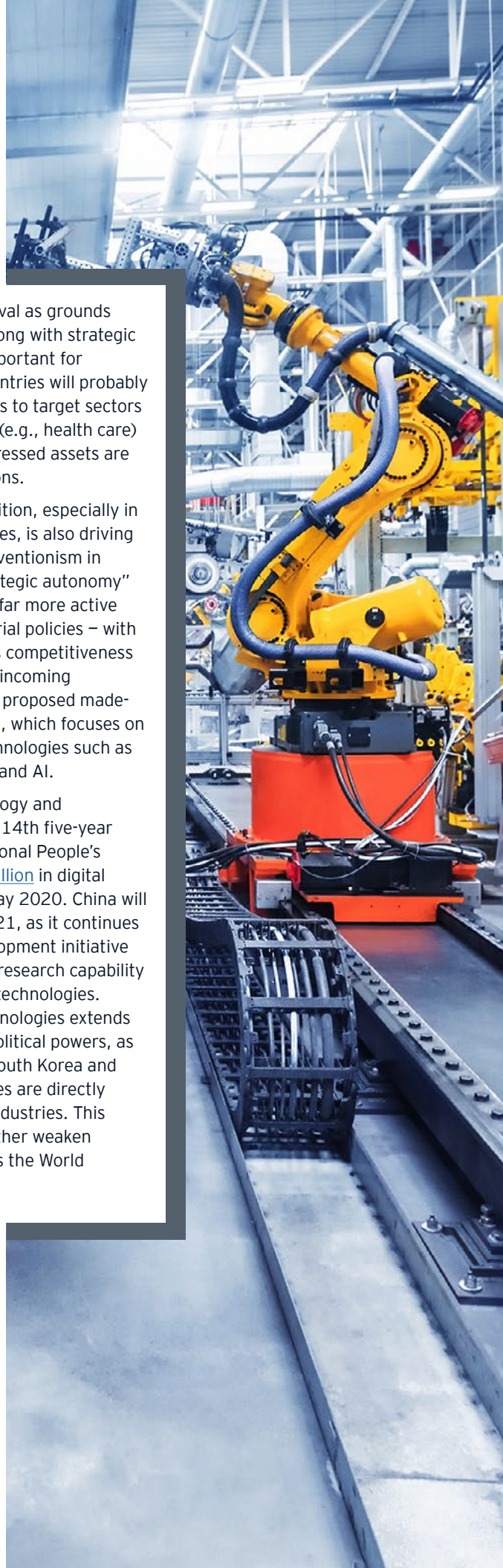
In 2021, the world will enter a new era of neo-statism as COVID-19 continues to heat up the debate on self-reliance (see Figure 5). This is causing many countries to launch efforts to reshore manufacturing or diversify supply chains. For example, Japan has offered US\$2.8 billion to companies as part of its pandemic stimulus package to reshore production. Similarly, Indian Prime Minister Narendra Modi has called for an “Atma Nirbhar Bharat” (“Self-Reliant India”), meant to support local manufacturing. More such measures are expected in 2021, potentially including in the EU (see risk 3) and the US (see risk 7), where reshoring and supply chain diversification of critical industries has been discussed.

Governments will not only deploy policy tools to support domestic production; they will also do more to ensure that domestic companies control this production. COVID-19 will drive the adoption of broader and higher number of [investment screening mechanisms](#) across the world. In countries where such measures were already being discussed, governments will use

the pandemic economic upheaval as grounds for fast-tracking legislation. Along with strategic industries or those deemed important for national security interests, countries will probably use these FDI screening policies to target sectors crucial for pandemic response (e.g., health care) or where critical, financially stressed assets are vulnerable to foreign acquisitions.

Increasing geopolitical competition, especially in 21st century digital technologies, is also driving a shift toward more state interventionism in many countries. The EU’s “strategic autonomy” initiative will continue to drive far more active competition, trade, and industrial policies – with a focus on improving the bloc’s competitiveness in key technologies. In the US, incoming President Biden will pursue his proposed made-in-America manufacturing plan, which focuses on R&D and manufacturing in technologies such as EVs, lightweight materials, 5G and AI.

And Beijing will pursue technology and innovation development in the 14th five-year plan and beyond, with the National People’s Congress approving [US\\$1.4 trillion](#) in digital infrastructure investment in May 2020. China will build on this momentum in 2021, as it continues to roll out its technology development initiative to strengthen its fundamental research capability and competency in key digital technologies. This competition in digital technologies extends beyond the three largest geopolitical powers, as well. Governments in Japan, South Korea and many Southeast Asian countries are directly intervening to develop these industries. This neo-statism may therefore further weaken multilateral institutions such as the World Trade Organization.



Business implications

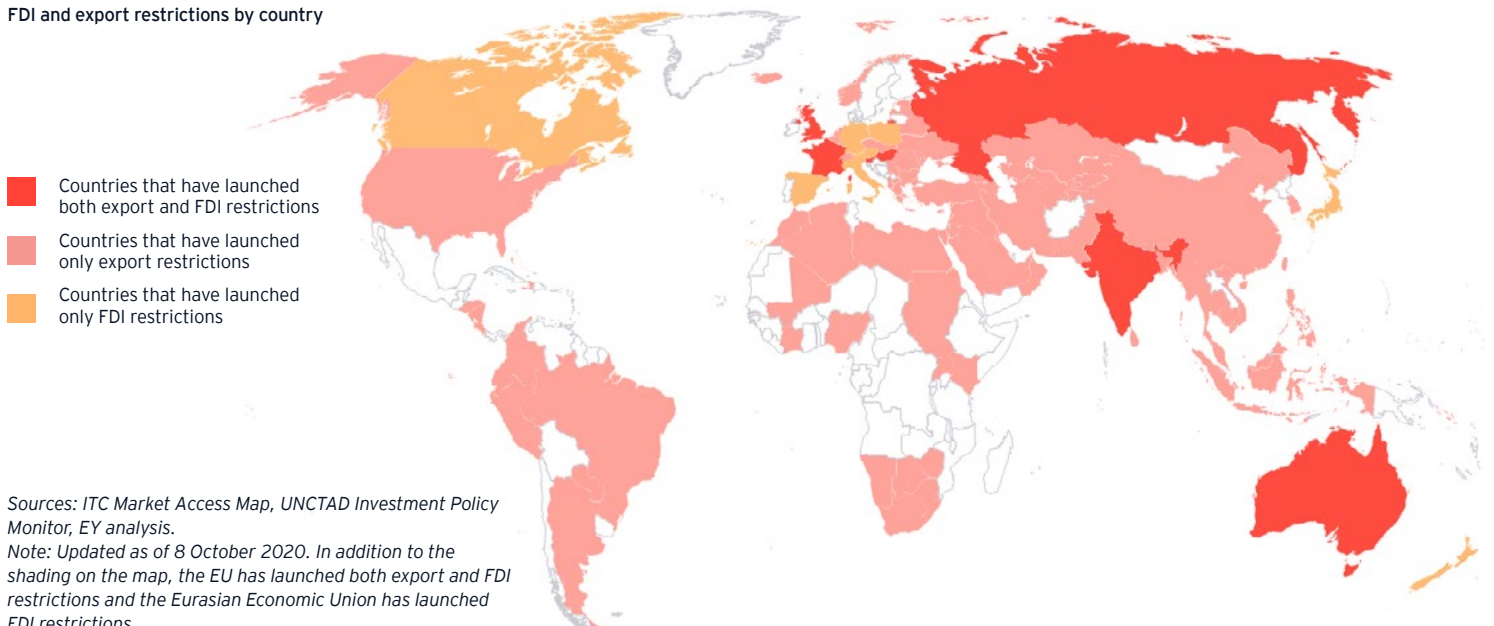
- ▶ **Trade and investment protections will affect supply chains and cross-border transactions.** Greater trade and FDI barriers will increase the cost of cross-border operations for businesses, discouraging fragmented and geographically dispersed supply chains. Companies will need to factor in greater scrutiny of FDI and exercise higher due diligence while considering cross-border transactions, especially mergers and acquisitions. Meanwhile, companies seeking foreign investments may face protracted timelines and a higher administrative burden of complying with stringent investment regulations.
- ▶ **Industrial policies will skew market dynamics and growth opportunities within strategic sectors.** The playing field in countries that pursue industrial policies is likely to become tilted in favor of domestic firms that benefit from greater state aid and potentially support to become “national champions.” Strategic sectors in particular are therefore likely to become more domestic in many markets around the world, which could result in reduced competition and fewer growth opportunities for foreign companies. A possible exception exists for globally recognized companies that have important know-how or IP, which may have opportunities for new alliances with local companies in some markets.
- ▶ **Potential politicization of companies creates reputational risks.** The rise in industrial policies is likely to renationalize the global economy to at least some extent, leading to the creation of more national champions. Such companies may face increasing pressure to support their home governments’ domestic and foreign policies, and to uphold the values of their respective governments and societies in their foreign operations. This would elevate reputation and compliance risks for companies in both their home and foreign markets.

Geostrategic considerations

- ▶ Engage in scenario analysis and contingency planning to assess the impact of new FDI restrictions and industrial policies on your company’s **supply chain** and operations
- ▶ Position your company to capitalize on new domestic-oriented policies in its home market
- ▶ Prepare your company for different **business or operating models** in terms of cross-border activities or international alliances
- ▶ Assess the risk of trade and investment barriers as part of your company’s commercial due diligence for **cross-border transactions**
- ▶ Ensure your company has the right structure and practices to manage potential reputational and compliance challenges and opportunities appropriately, including **engaging with stakeholders**

Figure 5: More than 100 countries have launched export and FDI restrictions due to COVID-19

FDI and export restrictions by country





– Risks we're watching in 2021

Reinvigorated climate policy agendas

Global CO₂ [emissions are expected to drop](#) by 4%-7% in 2020 due to COVID-19 lockdowns and sharp reductions in air travel. But climate change has not stopped, with 2016-20 set to be the warmest five-year period on record. Even though more citizens worldwide are concerned about climate change, regulatory responses are divergent. Countries such as Brazil and the US have pushed environmentally degrading policies in recent years, while markets such as the EU and South Korea have enacted plans for carbon neutrality by 2050. And China, the world's largest emitter of greenhouse gases, recently pledged to be carbon neutral by 2060.

Reinvigorated climate policy agendas will shape the global business environment in 2021 and beyond. In the EU, an aggressive "Green Deal" codifying carbon neutrality by 2050 has been launched and 30% of the EUR750 billion COVID-19 rescue package is pledged to climate-friendly projects. Implementation will pick up pace in 2021, with the review of existing, and where necessary introduction of new, [EU laws and regulations](#) to align with the new climate goals. A more ambitious [EU strategy on climate change adaptation](#) – in addition to ongoing mitigation efforts – will incentivize businesses to integrate climate change into their risk management practices. While the carbon border adjustment mechanism will face political and legal difficulties within the EU, it may also prove difficult to implement and could be challenged at the WTO (where it already faces opposition from the US, China and Russia).

China's recent carbon-neutrality pledge may raise the bar for other emerging markets, most notably India, that are expected to be hard hit by climate change but where the discussion on achieving carbon neutrality is still nascent. Beijing's move could also put pressure on Australia and the US – the world's second-largest emitter – to do more to tackle climate change and improve their competitiveness in green industries (see Figure 6).

In recent years, the Trump administration has [unraveled a variety of environmental regulations](#). The pendulum is expected to swing back in 2021 with incoming President Biden planning to reinstate climate change regulations and rejoin the Paris Agreement. Although Biden will be unlikely to deliver on his proposed US\$2 trillion climate plan, the administration will seek to include some aspects of it as part of economic relief efforts. And the Biden administration will use executive orders and regulatory changes at agencies such as the [Federal Energy Regulatory Commission](#) to tighten environmental regulations.

Stakes are high for the UN climate change conference COP26, scheduled for November 2021, since negotiators at COP25 failed to agree to rules for carbon markets and financial mechanisms to protect poorer countries from climate change. COP26 is also the first time that the Paris Agreement will be reviewed since 2015. Many G20 economies were failing to reach their national pledges before the COVID-19 lockdowns. And since the onset of the pandemic, [G20 economies](#) have committed more than US\$200 billion in COVID-19 recovery packages to support fossil fuel energy, while about US\$140 billion has been dedicated to clean energy. The EU's leadership will likely be key to getting other countries to make stronger commitments to a green recovery.

Business implications

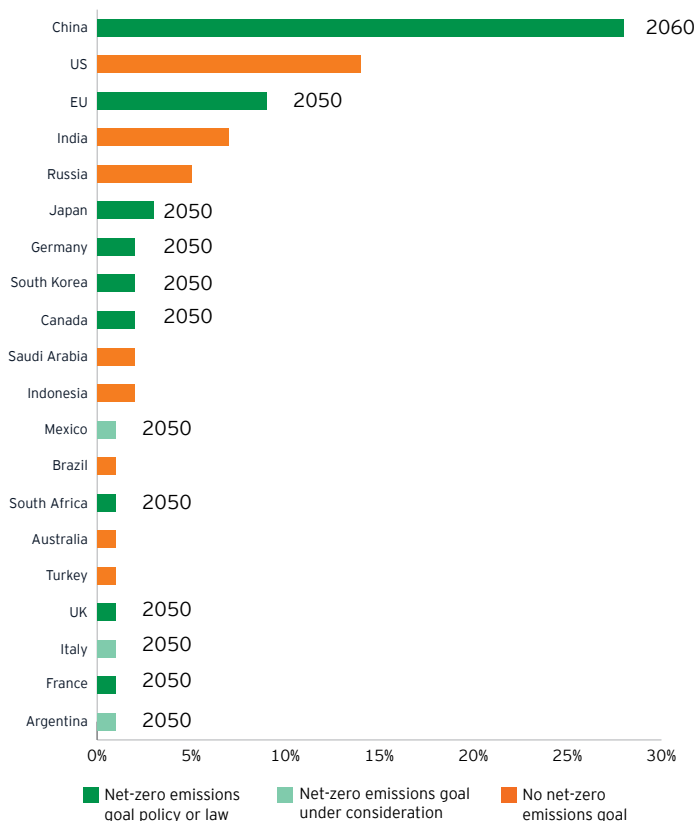
- ▶ **An expanding patchwork of environmental policies will complicate regulatory compliance.** There are close to 2,000 [climate change laws and policies globally](#), compared with less than 200 just 20 years ago. Companies are confronted with a disharmonious regulatory landscape, at both the national and subnational levels. Divergent environmental standards will increasingly complicate cross-border supply chains – particularly if any major economies enact a carbon border tax. Different regulations affect product design standards as well, as companies could either voluntarily comply with the highest standards across all markets or differentiate the “greenness” of their product to match regulations in each market.
- ▶ **Climate policies could shift business models toward being based on long-term value.** Carbon pricing will directly impact revenue streams for high-polluting industries such as oil and gas, mining and metals, chemicals, paper, and textiles and apparel. Some climate policies may upend business models. The energy transition will expand the available forms of energy, with [renewable sources](#) likely to benefit substantially in the drive toward the “electrification of everything.” Rooftop solar and other consumer-level technologies will give electricity users a greater say in their energy choices and more flexibility in adapting their business

models. Similarly, changes in vehicle fuel economy standards or CO2 emissions regulations in some countries will affect the shift of automakers toward electric vehicles. More broadly, companies in markets with more stringent environmental regulations may have a [long-term competitive](#) advantage from being first movers in renewable and sustainable business models.

- ▶ **Corporate climate strategies can elevate or damage reputation.** Environmental issues can threaten a company’s relationship with regulators, interest groups and the general public, affecting its social license to operate. Investors, consumers and employees are among the main stakeholders that are increasing pressure on companies to be more sustainable. And the [EY Center for Board Matters](#) found the percentage of Fortune 100 companies voluntarily highlighting environmental sustainability initiatives and commitments more than doubled over the past three years, jumping from 37% in 2017 to 77% in 2020. Companies that do not act on these demands are increasingly at risk of losing customers and employees and facing higher costs on capital. Climate reputation is not just a downside risk, though: effective stakeholder management can help firms realize new value from sustainability policies.

Figure 6: Although some major economies have made net-zero emissions goals, others have not

G20 countries by share of global CO2 emissions



Sources: International Energy Agency, Energy and Climate Intelligence Unit, Climate Home News, EY analysis.

Note: Emissions data is from 2017. Dates on the graph represent the year targeted under net-zero emissions goal, if applicable.

Geostrategic considerations

- ▶ Integrate climate policy risk assessment in your company’s strategic planning process and market entry analysis.
- ▶ Determine how environmental policies in key markets will affect your company’s **supply chain**
- ▶ Ensure your company has a dedicated C-suite-level official or function responsible for sustainability policies and climate change risk mitigation as part of driving **long-term value**
- ▶ Assess the environmental, social and governance (ESG) landscape and shifting expectations around disclosure and determine whether your company should voluntarily report and **disclose its carbon footprint**
- ▶ Position your company for the **energy transition** by assessing the regulatory and political landscape

Geopolitics of technology and data

Technology has become central to geopolitical competition – a trend that has been accelerated by COVID-19 as more aspects of work and life have moved online. Governments are intervening to build domestic capabilities while also inhibiting foreign competitors' influence or access. Tensions intensified in 2020, with the US putting more pressure on Chinese companies in 5G, semiconductors, AI algorithms and other strategic technologies. And the EU and China took steps to become more self-sufficient in key digital technologies through their “[digital sovereignty](#)” and “[dual circulation](#)” policies, respectively.

The geopolitics of technology and data will continue to play out in 2021. Industrial policies will be a key tool that governments use to compete in digital technologies (see risk 4). [Washington](#), Beijing, Brussels and others are likely to use export controls to support industrial policy goals. And India is likely to continue restricting Chinese technology companies' access to the domestic market in part to support Indian technology companies. Electric vehicles (EVs) are likely to be a technology of intensifying competition in 2021. [China is currently a leader in EVs](#) thanks to industrial policies. The US Government may enact policies in 2021 to try to close that gap. And the EU's [tighter emissions requirements](#) will continue to force its carmakers to shift production to EVs.

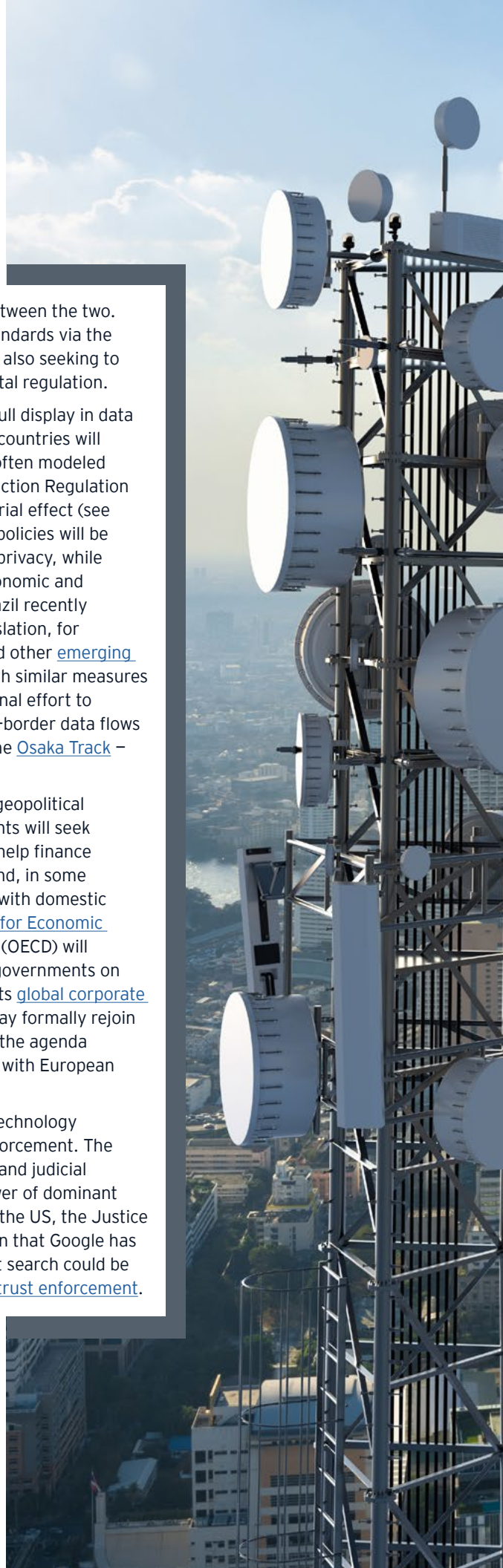
The increasing divergence of technology standards across markets is another aspect of this risk. Beijing's [China Standards 2035](#) plan will outline its set of technology standards and is increasingly focused on [influencing these decisions](#) in international institutions as well. This is perhaps most apparent for 5G wireless networks, as the US and China attempt to persuade countries to join their competing initiatives to set standards. Many countries are

likely to forge a middle path between the two. The EU may project its own standards via the so-called [Brussels effect](#), while also seeking to collaborate with the US on digital regulation.

The Brussels effect will be on full display in data privacy and localization. More countries will implement these regulations, often modeled on the EU's General Data Protection Regulation (GDPR), which has extraterritorial effect (see Figure 7). Some of these data policies will be based on individuals' rights to privacy, while others will be motivated by economic and national security concerns. Brazil recently implemented data privacy legislation, for instance, while India, [China](#) and other [emerging markets](#) may move forward with similar measures in 2021. There is an international effort to coordinate WTO rules on cross-border data flows and e-commerce – known as the [Osaka Track](#) – but these are still nascent.

[Digital taxation](#) will likely be a geopolitical flashpoint, as many governments will seek additional revenue in 2021 to help finance COVID-19 recovery efforts – and, in some cases, to score political points with domestic populations. The [Organization for Economic Cooperation and Development](#) (OECD) will continue to try to align major governments on digital taxation as one part of its [global corporate tax](#) reform initiative. The US may formally rejoin it to have greater influence on the agenda and manage the confrontation with European countries.

Another head wind for major technology companies will be antitrust enforcement. The EU will continue its regulatory and judicial actions to limit the market power of dominant technology companies. And in the US, the Justice Department's recent accusation that Google has an illegal monopoly on internet search could be the start of a [new wave of antitrust enforcement](#).

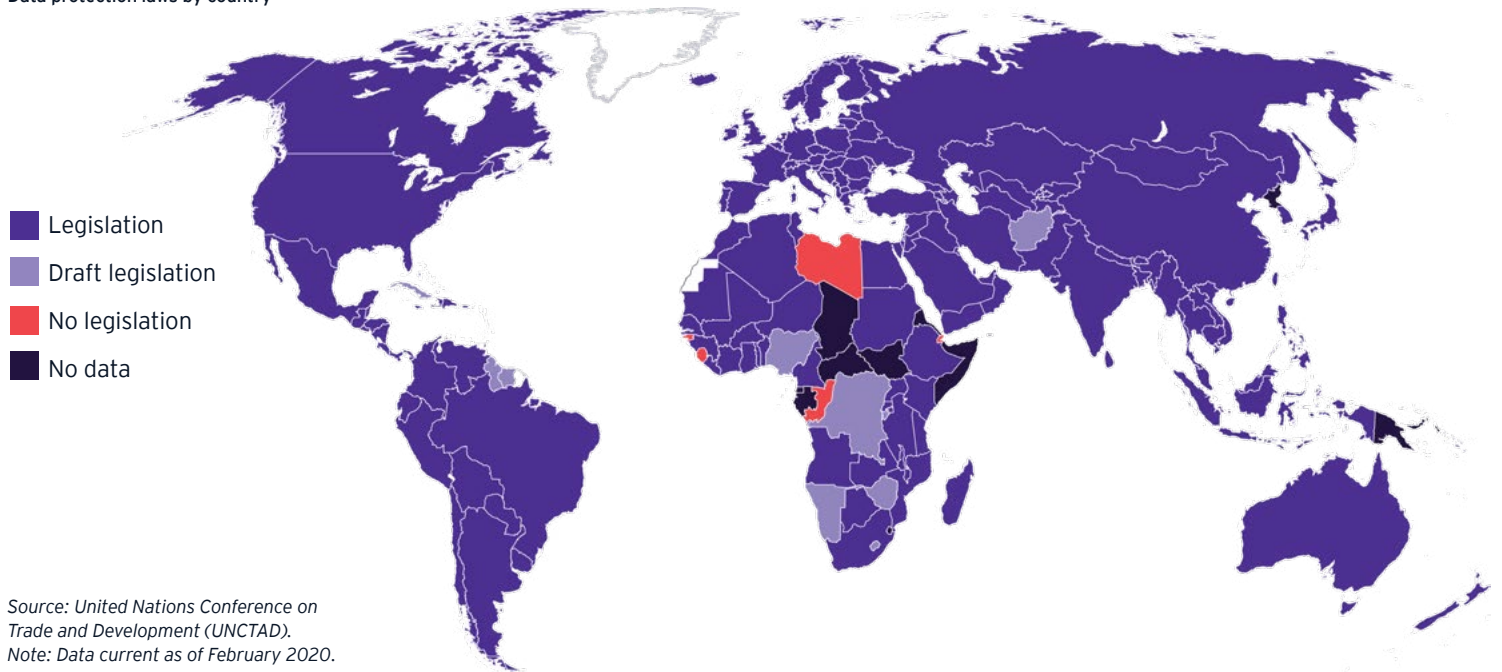


Business implications

- ▶ **Growth and investment opportunities may be constrained in strategic technology sectors.** Government policies to promote and protect domestic companies in the high-tech space, such as semiconductors, AI, 5G and quantum computing, are likely to disadvantage foreign companies in key markets. This could manifest as rejections of proposed cross-border M&As, preferential financing for domestic companies and the inability of foreign companies to purchase certain technologies.
- ▶ **Data management is likely to be complicated by new regulations.** Increased government attention to digital technologies and the data they generate is likely to create new data management costs, particularly when companies operate in a foreign market that is perceived to be a strategic competitor of its home market. The proliferation of data localization and data privacy rules in different markets will make moving or sharing data across borders more difficult. Multinational companies in sectors that use data extensively, particularly personal or consumer data, are likely to be most affected by these regulations. These include financial services, e-commerce, digital service providers and industrial equipment manufactures. The extractives industries, which operate in areas considered to be politically sensitive by host governments, may also increasingly be subject to data localization requirements.
- ▶ **Global companies may face higher operating costs associated with key technology.** Competing standards for 5G, the internet and other technologies in major economies will create a more networked, rather than global, digital economy. Particularly in sensitive technologies that relate to personal data and national security, standards may split between China and those applied elsewhere. While companies should be able to continue to operate across these different networks, diverging standards are likely to involve higher operating costs as unique technological systems may be needed in each market. This would affect not only technology companies, but also any company that relies on their services (such as cloud computing, e-commerce platforms and 5G-enabled sensors).
- ▶ **Companies may see greater enforcement of intellectual property (IP) laws.** With national governments increasingly focused on self-reliance in key technologies, many regulators are likely to become more active and stringent in their IP enforcement. This could help companies protect their IP from foreign competitors.

Figure 7: Data protection and privacy laws are proliferating in countries around the world

Data protection laws by country



Source: United Nations Conference on Trade and Development (UNCTAD).
Note: Data current as of February 2020.

Geostrategic considerations

- ▶ Assess whether antitrust enforcement against “big tech” could affect approval for your company’s **M&A** in the future
- ▶ Monitor and prepare for shifts in the **digital tax** landscape
- ▶ Determine how the geopolitics of technology and data could present challenges or opportunities for your company’s operations and **supply chain**
- ▶ Manage the directional shift toward more localized technology and data while maintaining globalized operations
- ▶ Determine how diverging technological regulatory standards in key markets will affect your company’s international footprint
- ▶ Engage with regulators and policymakers to address digital economy concerns and contribute to the direction of technology policy
- ▶ Determine how the geopolitics of technology and data will affect your company’s **cybersecurity**



← Risks we're watching in 2021

US policy realignment

Since the 2008-09 global financial crisis, the US has become a larger source of political risk – for both American companies and global companies that have interests in the US market or rely on the international system of rules and norms that the US has traditionally led. The contentious presidential election and the COVID-19 pandemic amplified the political risks emanating from the US in 2020, while also generating significant policy uncertainty for the medium and long terms.

The incoming Biden administration will usher in a US policy realignment in 2021. One area of significant attention will be industrial policy. The Biden administration will seek to invest heavily in American innovation, targeting US\$300 billion in research and development. The incoming administration will also continue the policy trend of incentivizing the reshoring of supply chains for strategic products, including pharmaceuticals and medical equipment. And Biden plans to increase existing “Buy American” government procurement provisions and offer tax incentives for businesses investing in the US, with support targeted at sectors deemed to be future growth areas, such as [renewable energy](#).

Environmental policies more broadly are likely to be another area of significant change in 2021. A closely divided Senate means that Biden's proposed US\$2 trillion plan including investment in renewable energy infrastructure, tax incentives for retrofitting buildings for energy efficiency, and restoring the EV tax credit is unlikely to be enacted in full. But the administration will seek to include some aspects of these proposals in economic relief efforts. Biden is also likely to use executive actions to restore many Obama-era environmental regulations (see Figure 8) – although these actions could be challenged in court, creating further policy uncertainty.

Other areas of policy volatility are likely to be immigration, antitrust and trade. Biden will likely take steps to restore the Deferred Action for Childhood Arrivals (DACA) program but will continue some restrictions on H1-B visas. Following the House Judiciary Committee's [sweeping antitrust report](#) in October 2020, the Biden administration is also likely to take a more aggressive and systematic approach to antitrust enforcement. And the use of tariffs is likely to decline, even as restrictive trade actions become more targeted at those the US considers to be strategic competitors. Tax policy could also shift if Democrats gain control of the Senate.

Finally, in terms of foreign policy, the US will re-engage in multilateralism. The US will rejoin the Paris Agreement. It may also join the WHO-backed COVID-19 Vaccines Global Access Facility (COVAX) initiative. And it is likely to play a bigger role in driving emerging market debt relief at the G20 and the IMF. Multilateralism will also be central to the US strategy vis-à-vis Russia and China.

Business implications

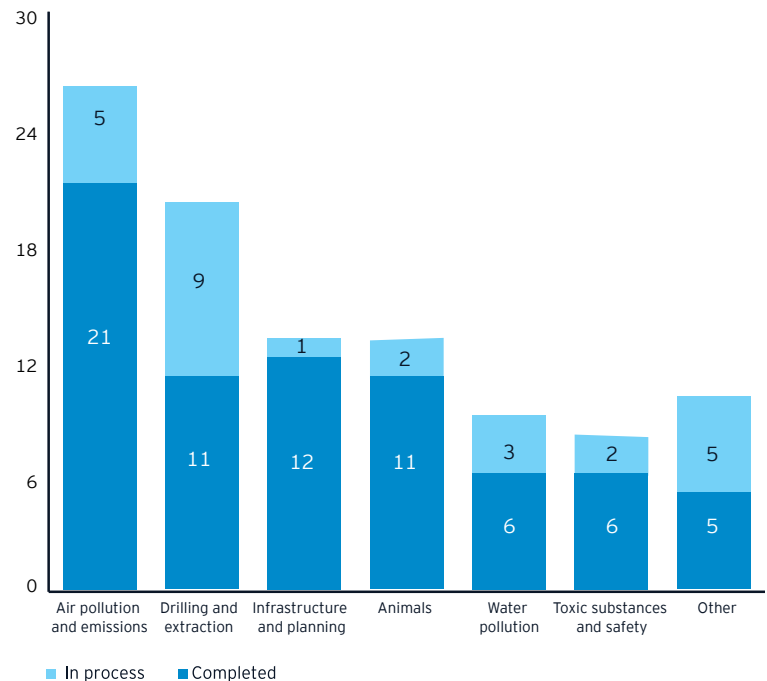
- ▶ **More supply chains and production in strategic sectors may shift to US economy.** High-tech companies will be particularly affected given technology's central role in geopolitical competition. And in the COVID-19 era, health care companies will likely also be targeted with measures to base supply chains within the US. Government support for US-based production is likely to be paired with more restrictive controls on foreign investment, potentially limiting growth and investment opportunities for foreign firms. There is also a possibility of new offshoring surtax and other changes to the tax code that remove incentives for companies to shift US jobs and physical operations overseas. Small and medium manufacturers in the US may have revenue growth opportunities from procurement commitments for a range of strategic products, from steel to medical supplies.
- ▶ **Green industries will have expanded growth and investment opportunities.** A [recent EY](#) survey of US executives found that 96% of respondents expect their portfolio strategy to be affected by sustainability regulations. The Biden administration's environmental policies will directly support green industries, such as makers of electric vehicles or solar panels, by stimulating demand for their products. Policies are also likely to facilitate cost reductions and enable green industries to scale up. Companies would face uncertainty about the longevity of specific policies, though, due to expected court challenges. In contrast, companies in the hydrocarbons and other high-emissions sectors would face a more restrictive regulatory environment. And companies in green industries in the EU and China should expect to face more competition from American counterparts.
- ▶ **Labor and immigration policy shifts will affect human resources.** The US labor market is likely to have excess capacity in 2021 due to COVID-19 economic disruptions. And more open immigration policies could provide companies with US operations greater access to immigrant workers. Costs will likely rise for employing low-skilled or seasonal workers, though, and the burden of proof needed to show that an American could not fill a high-skilled job is likely to increase. The Biden administration's labor policies could further raise the cost of employing workers in the US market.

Geostrategic considerations

- ▶ Establish a robust **political risk monitoring** system to identify potential policy changes that could present business opportunities or challenges to your company
- ▶ Determine how your company's global **supply chain and operations** are likely to be affected by shifts in US industrial and trade policies
- ▶ Position your company's business model and **strategy** to capitalize on any opportunities that a US policy realignment will provide
- ▶ Prepare for likely shifts in **climate change and energy-efficiency** standards and reporting requirements
- ▶ Explore potential **tax policy changes**, quantifying the possible effects and proactively engaging with tax policymakers

Figure 8: Many environmental regulations reversed by Trump are likely to be reinstated under Biden

Count of environmental rule reversals under the Trump administration



Source: *The New York Times*, <https://www.nytimes.com/interactive/2020/climate/trump-environment-rollbacks-list.html>, accessed 30 October 2020.

Tipping point for emerging market debt

Emerging and frontier markets currently have about [US\\$11 trillion](#) in external debt. Debt levels were elevated before the pandemic – with Argentina, Ecuador, Lebanon and Sri Lanka facing default risk – and COVID-19 has [expanded the list](#) of debt-distressed markets. In particular, many countries that are part of the Belt and Road Initiative (BRI) have piled up considerable debt, with Pakistan, Angola and Ethiopia leading the list in USD terms. The G20 Debt Service Suspension Initiative (DSSI) was launched in April 2020 to provide short-term relief to eligible countries. But with the crisis persisting and some governments shying away from joining the initiative due to fears about their inability to raise additional debt, the G20 and Paris Club group of lender nations announced a broader [common framework on debt relief](#) in November.

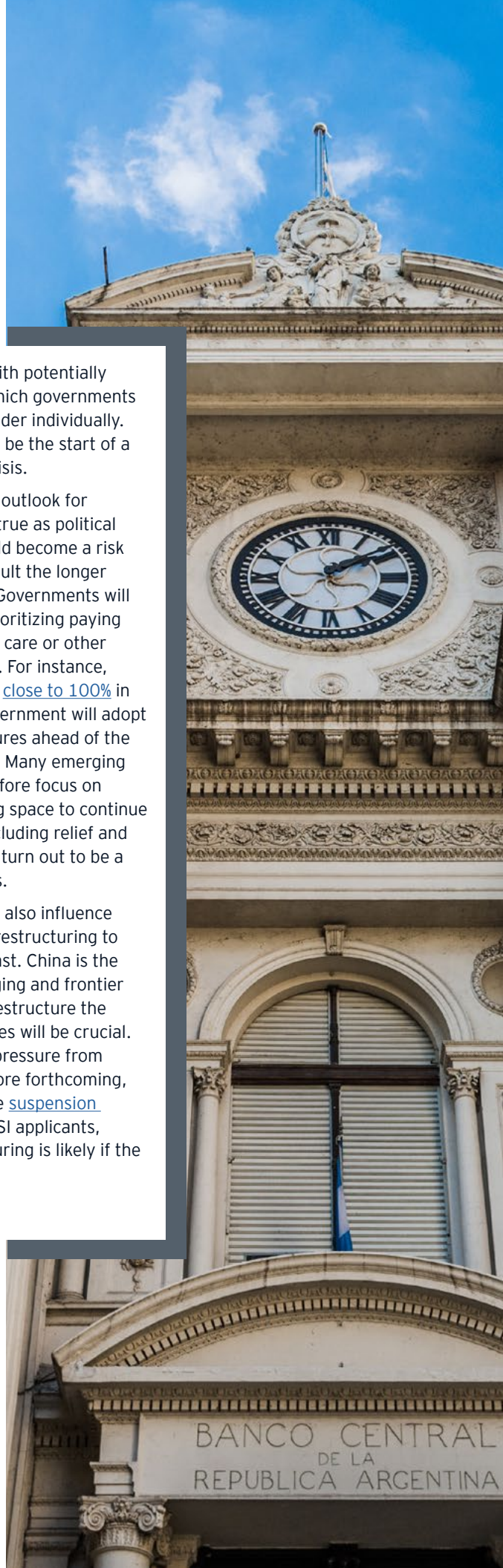
The sustainability of emerging market debt will likely hit a tipping point in 2021, as more governments seek debt relief or enter default. The International Monetary Fund (IMF) forecasts that emerging and frontier market government debt will rise to 64% of GDP in 2021, up from just 52% in 2019. The Institute of International Finance (IIF) estimates approximately [US\\$4 trillion of emerging market debt](#) will mature in 2021, almost 18% of which is denominated in foreign currency. Across the large emerging markets, the funding vulnerabilities are expected to be highest in Brazil, India, Mexico and South Africa (see Figure 9).

The current debt crisis is much broader than previous episodes, though, and the types of loans differ. So debt resolution is likely to vary country

by country and loan by loan, with potentially lengthy legal proceedings in which governments negotiate with each private lender individually. 2021 is therefore likely to only be the start of a new emerging markets debt crisis.

The pandemic complicates the outlook for resolution. This is particularly true as political willingness to service debt could become a risk factor for restructuring or default the longer the COVID-19 crisis drags on. Governments will not want to be perceived as prioritizing paying creditors over providing health care or other social services to their citizens. For instance, Brazil's debt-to-GDP jumped to [close to 100%](#) in 2020, but it is unlikely the Government will adopt any significant austerity measures ahead of the next national election in 2022. Many emerging market governments will therefore focus on gaining enough fiscal breathing space to continue to provide needed services, including relief and [public investment](#) in what may turn out to be a very prolonged economic crisis.

Geopolitical considerations will also influence multilateral and bilateral debt restructuring to a greater degree than in the past. China is the largest creditor to many emerging and frontier markets, so its willingness to restructure the debts of cash-strapped countries will be crucial. Beijing has come under some pressure from Western governments to be more forthcoming, and has already announced the [suspension of some debt payments](#) for DSSI applicants, suggesting additional restructuring is likely if the crisis continues.



Business implications

- ▶ **Consumer companies may experience lower revenue and reduced growth prospects.** Consumer-facing companies, such as those in the consumer and advanced manufacturing and mobility sectors, may experience revenue declines in emerging markets (especially those that default) due to currency depreciation and reduced household purchasing power. Companies are most likely to face such impacts in markets with high foreign debt levels (e.g., Zambia, Ukraine, Turkey and Mexico) and those with large financing needs for servicing existing debt in 2021 (e.g., South Africa and Turkey).
- ▶ **Divergent risk premiums will affect financial sector investments.** Given the growing heterogeneity of the COVID-19 pandemic, government finances and economic outlook, financial services companies will need to carefully monitor the debt dynamics of each emerging and frontier market and identify possible write-down and higher-yield investment options. On the flip side, well-performing emerging market corporates may provide significant opportunities for investors seeking higher returns on assets.
- ▶ **Government debt distress will affect companies' financial and tax burdens in both the short and long term.** Emerging market corporates' access to foreign capital will in large part be determined by their home government's relationship with international creditors. Companies raising capital in debt-stressed emerging markets should therefore expect capital costs to increase. And although many governments may be reluctant to stifle any nascent economic recovery, high debt levels and the necessity for additional fiscal relief make it likely that the corporate tax burden will rise in many emerging markets in the coming years.

Geostrategic considerations

- ▶ Assess the impact on your company's revenue growth targets if key **consumer segments** in emerging markets decrease spending
- ▶ Engage in scenario or contingency planning for **securing working capital** in case financing challenges crop up in emerging markets that are key to your company's global footprint
- ▶ Establish crisis management teams to manage the liquidity and repatriation implications of a sovereign debt crisis
- ▶ Consider the impact of a potential emerging markets debt crisis on your company's business plans and implement early warning systems for key markets

Figure 9: Debt stress for emerging markets is increasing

Debt risk indicators for select emerging markets

	Government debt (% of GDP)	2021 total financing need (% of GDP)	Foreign exchange reserves (months of imports)	2021 GDP growth rate (%)	Sovereign debt rating
Lebanon	172	12.7	20.5	n/a	C
Brazil	101	30.6	26.1	2.8	Ba2
Argentina	97	12.1	13.6	4.9	Ca
India	89	9.2	19.5	8.8	Baa3
Pakistan	87	16.9	4.0	1.0	B3
South Africa	79	17.0	7.8	3.0	BA1
Mexico	66	11.3	6.0	3.5	Baa1
Thailand	50	8.4	15.6	4.0	Baa1
Turkey	42	12.6	3.2	5.0	B2
Indonesia	38	8.9	11.2	6.1	Baa2
Nigeria	35	9.1	8.1	1.7	B2

Key Low risk Moderate risk High risk

Source: International Monetary Fund, International Institute of Finance, Oxford Economics, Moody's.

Note: Countries arranged in descending order of total sovereign debt (percentage of GDP). Government debt is gross debt. Total financing need includes forecasted 2021 government budget balance and sovereign debt redemption due in 2021.

Geopolitical dynamics in the Indo-Pacific

The Indo-Pacific is becoming the main arena of global competition in the 21st century. Economic disruptions related to COVID-19 prompted renewed focus on finalizing the Regional Comprehensive Economic Partnership (RCEP) trade agreement, which was signed in November. But the security situation is becoming more uncertain as countries enhance their military capabilities. Geopolitical tensions such as East Asia maritime boundaries and the India-China border have the potential to rupture into conflict if not managed effectively.

Geopolitics in the Indo-Pacific will likely be even more volatile in 2021 as the major and middle powers become more assertive (see Figure 10). The emerging Quadrilateral Security Dialogue (Quad) among [Australia, India, Japan and the US](#) is one example of the middle powers taking a multilateral approach to their Indo-Pacific policies. Australia, India and Japan also recently announced the Supply Chain Resilience Initiative (SCRI), which is likely to be implemented in phases in 2021. It will be used to accelerate the development of COVID-19 vaccines, as a part of wider attempt to reduce supply chain dependence on China in the pharmaceuticals sector.

Governments throughout the region are also acting unilaterally to shape geopolitics in the region. Under new Prime Minister Yoshihide Suga, Japan's foreign policy will continue to focus on wielding a regional leadership role while strengthening ties in multilateral settings. Economic diplomacy will remain a priority for Tokyo, including by seeking new members for the Comprehensive and Progressive Agreement for the Trans-Pacific Partnership (CPTPP).

In Australia, a dramatic [40% increase in defense spending](#) and [more stringent foreign investment rules](#) indicate tensions with China are likely to persist in 2021. But with some exporters, universities and property developers favoring more positive relations with Beijing, the Government may soften its approach.

India will seek to significantly expand its strategic and diplomatic footprint in the region through collaborative initiatives with countries such as Australia and Japan – and through its new military cooperation agreement with the US. But New Delhi's more protectionist trade stance may limit its influence in the region. And territorial disputes in the Indian Ocean and the Line of Actual Control in Ladakh will remain sources of tension with China.

Association of Southeast Asian Nations (ASEAN) members will focus on deepening regional economic integration, primarily through the RCEP, and maintaining their neutrality by avoiding alignment with the US or China. Discord is emerging among bloc members about how to respond to China's growing influence in the region, though. Similarly, South Korea will seek to balance its relationship between China and the US – although tensions between Seoul and Tokyo could complicate South Korea's foreign policy.

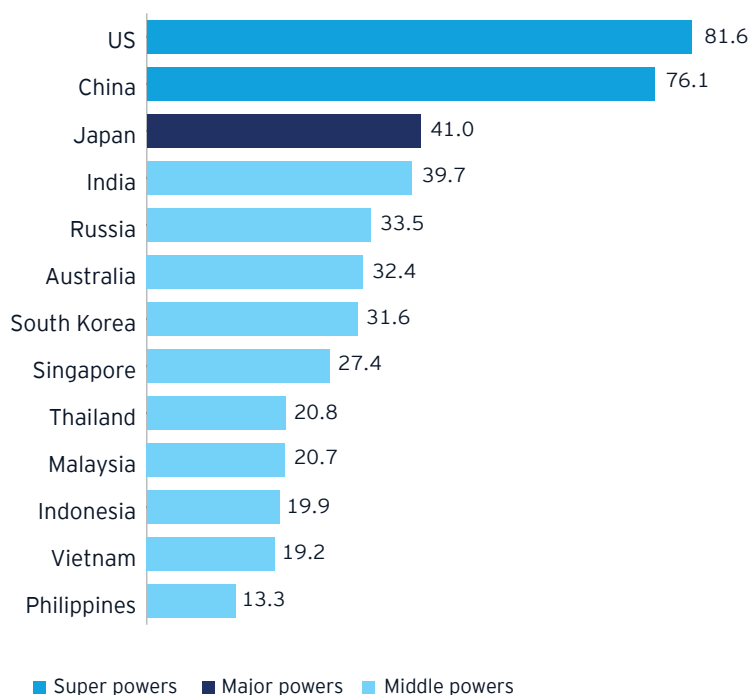
In fact, the ongoing strategic competition between China and the US will be a complicating factor for all Indo-Pacific countries. And Germany's recent adoption of an [Indo-Pacific policy](#), making it the second European country after France to have a formal strategy for the region, signals that European countries or the EU more broadly may become more active players in the region.

Business implications

- ▶ **Government interventions will affect growth and investment strategies.** Governments are increasingly focused on boosting national competitiveness, with COVID-19 reinforcing the [importance of these policies](#) to economic recovery. Governments will encourage domestic production in “strategic” industries such as pharmaceuticals and medical equipment, creating new challenges for companies that seek to export such products. And there is a rising expectation that companies – both foreign and domestic – demonstrate their commitment to the local economy.
- ▶ **Trade agreements and maritime policies could reconfigure supply chains.** The RCEP is expected to enter into force in 2022, bringing with it a new common rule of origin for its 15 members. This could encourage companies to develop or begin to shift their Indo-Pacific supply chains to the markets that are part of the RCEP to reduce tariff and compliance costs, perhaps following a “[China Plus](#)” model. At the same time, continued tensions over maritime boundaries have the potential to disrupt some shipping routes – which would affect the supply chains of many companies, given that [a major portion of global trade](#) travels through the East Asia region’s seas.
- ▶ **The politicization of the technology, media and telecommunications sector will complicate data management.** As 5G wireless networks continue to roll out throughout the region, the increasing digitalization of the economy will generate new political risks for companies. This is particularly true for Chinese technology firms, which are facing restrictions or bans in some key markets. More broadly, companies will face competing systems, standards and regulations for digital technologies across markets, complicating cross-border data flows and management.

Figure 10: A rising number of countries in the Indo-Pacific region are becoming more assertive geopolitically

Asia Power Index 2020



Sources: Lowy Institute.

Note: Only select “middle powers” are included.

Geostrategic considerations

- ▶ Assess how potential **trade agreements** or the expansion of existing agreements in the region will affect your company’s footprint and corporate strategy
- ▶ Engage with regulators and policymakers on shaping the future direction of supply chain regulation, balancing redundancy and resiliency
- ▶ Utilize scenario planning for new trade and investment patterns emanating from shifting alliances in the Indo-Pacific
- ▶ Assess the economic implications of government policy-driven shifts and adjust **corporate strategy** accordingly

Another wave of social unrest

Social unrest has emerged as a global phenomenon in recent years and is posing a systemic threat to some countries. In 2020, social unrest is forecast to hit its highest level since the 2011 Arab Spring (see Figure 11). While COVID-19 temporarily interrupted the surge of protests in early 2020, the masses returned to the streets midyear to demand social justice and, to a lesser degree, an end to pandemic restrictions. And COVID-19 has intensified other drivers of discontent, such as inequality and poor governance. Another common dynamic has been [citizens losing trust](#) in their government and other institutions.

The [conditions are set](#) for another wave of social unrest in 2021. Many protests will be continuations or echoes of the unrest that occurred in 2019 and 2020, while others will be new. Five primary issues are likely to motivate protestors in 2021: pandemic restrictions, inequality, social justice, climate change and governance issues.

Pandemic restrictions have already fueled some protests against governments in a diverse set of countries around the world, including Germany, Spain, the US, Australia, Brazil, India, Israel, Chile, Nigeria and South Africa. As governments impose new restrictions on commerce and socializing to contain localized hotspots that flare up, it is likely that small-scale protests will continue to pop up as well.

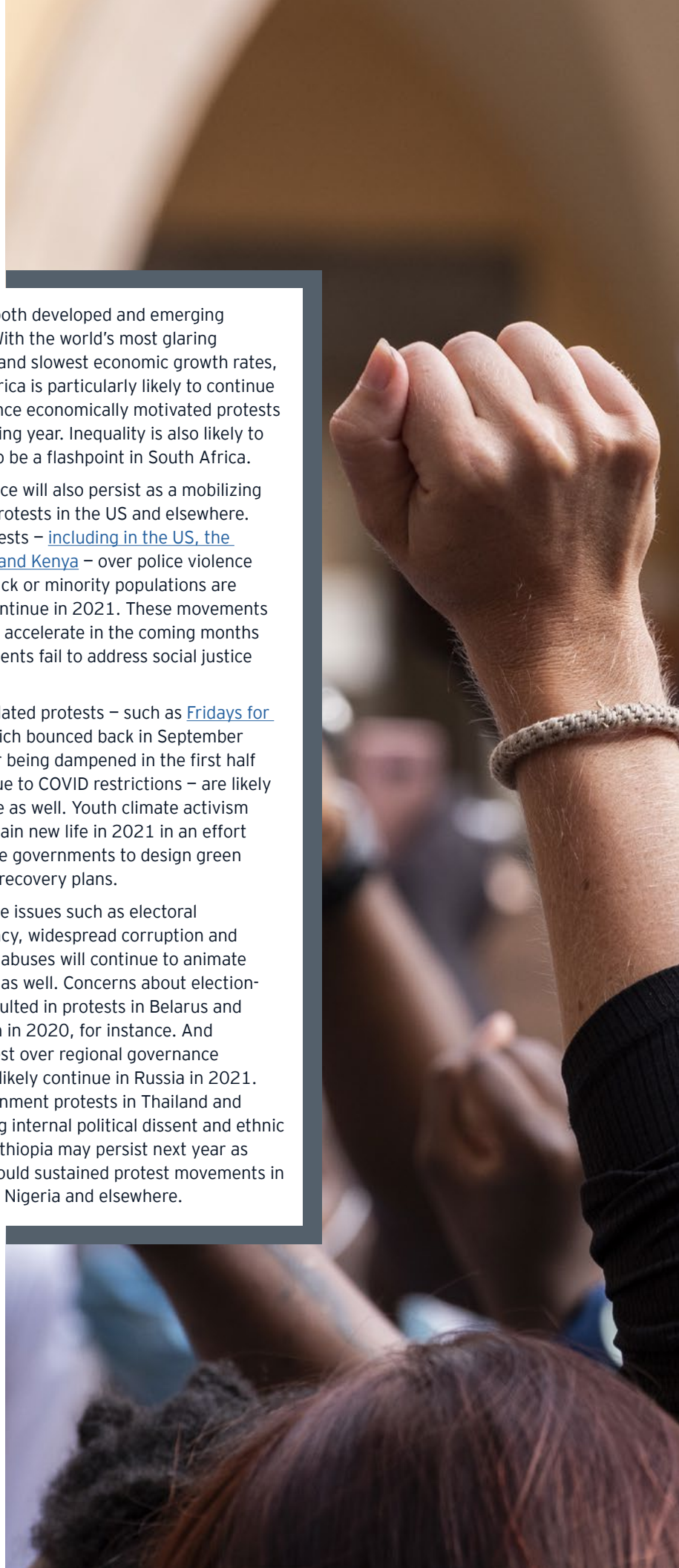
Another driver of social tensions continues to be inequality, including the lack of opportunity and social immobility. The pandemic is exacerbating these issues in many countries,

including both developed and emerging markets. With the world's most glaring inequality and slowest economic growth rates, Latin America is particularly likely to continue to experience economically motivated protests in the coming year. Inequality is also likely to continue to be a flashpoint in South Africa.

Social justice will also persist as a mobilizing force for protests in the US and elsewhere. Major protests – [including in the US, the UK, Brazil and Kenya](#) – over police violence against black or minority populations are likely to continue in 2021. These movements could even accelerate in the coming months if governments fail to address social justice concerns.

Climate-related protests – such as [Fridays for Future](#), which bounced back in September 2020 after being dampened in the first half of 2020 due to COVID restrictions – are likely to continue as well. Youth climate activism will likely gain new life in 2021 in an effort to influence governments to design green COVID-19 recovery plans.

Governance issues such as electoral transparency, widespread corruption and civil rights abuses will continue to animate protestors as well. Concerns about election-rigging resulted in protests in Belarus and Kyrgyzstan in 2020, for instance. And social unrest over regional governance issues will likely continue in Russia in 2021. Anti-government protests in Thailand and intensifying internal political dissent and ethnic unrest in Ethiopia may persist next year as well – as could sustained protest movements in Chile, Iraq, Nigeria and elsewhere.

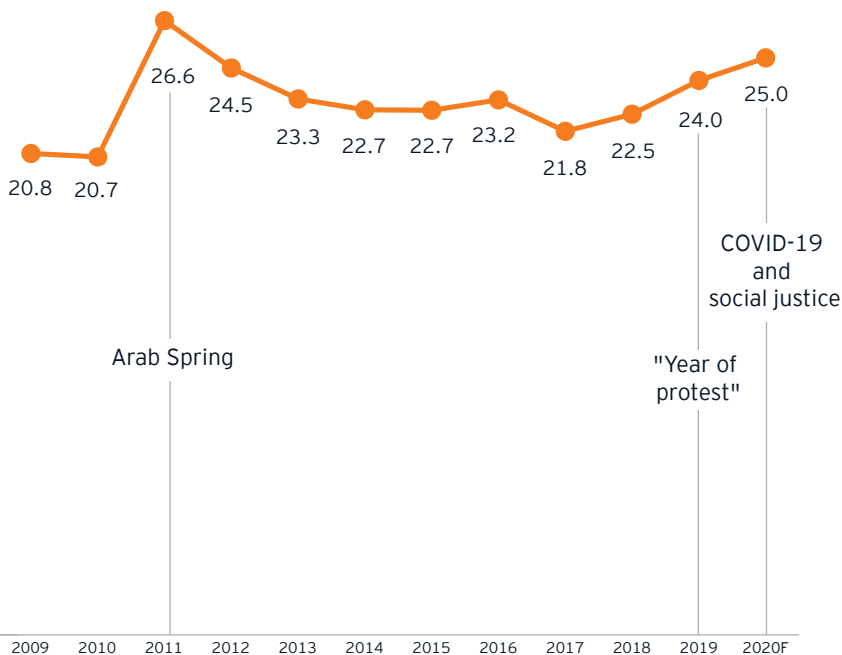


Business implications

- ▶ **Protests pose a risk of disruptions to business operations.** The fallout of social unrest can interrupt business operations, resulting in disrupted production and supply chains – due to either worker absenteeism or protestors blocking transitways. This could lead to cost increases for companies. Social unrest can also disrupt commercial operations, slowing sales volumes in cities that experience protests.
- ▶ **Heightened stakeholder expectations magnify reputational risks for companies.** Expectations are growing for companies to respond to the underlying causes of social unrest, creating a challenge for public relations, human resources and the entire C-suite. Rising inequality has sharpened demand from companies to create and demonstrate value for all stakeholders. Inaction may erode trust and damage the organization's reputation. There is an increased pressure on executives to manage their organizations in a way that cultivates a culture of sustainable long-term value creation.
- ▶ **Companies face the risk of new taxes from the policy responses to social unrest.** To address many of the protestors' grievances, governments would need to provide additional social services or increase expenditures in other ways. But generous fiscal policies will put pressure on government budgets that are already stretched due to reduced tax revenues during the COVID-19 crisis. Governments are therefore likely to increase taxes on companies to finance these measures. Companies in sectors that are deemed to be part of the underlying issue of the protests are at greatest risk of tax increases – for instance, high-emitting industries in response to the climate protests.

Figure 11: Social unrest has been rising in recent years - and is likely to continue to do so

ILO World Social Unrest Index



Source: International Labour Organization, EY analysis.

Note: 2020 forecast is based on EY analysis of index data trends and social unrest events.

Geostrategic considerations

- ▶ Work with governments to reduce income inequality and promote **inclusive growth**, such as through job creation and upskilling opportunities
- ▶ Establish a monitoring system to identify early warning indicators of the **risk** of social unrest in key markets
- ▶ **Engage your company's employees** to better understand how they feel about the underlying drivers of social unrest
- ▶ Create a contingency plan to ensure continuity of operations in case of social unrest

About the Geostrategic Outlook

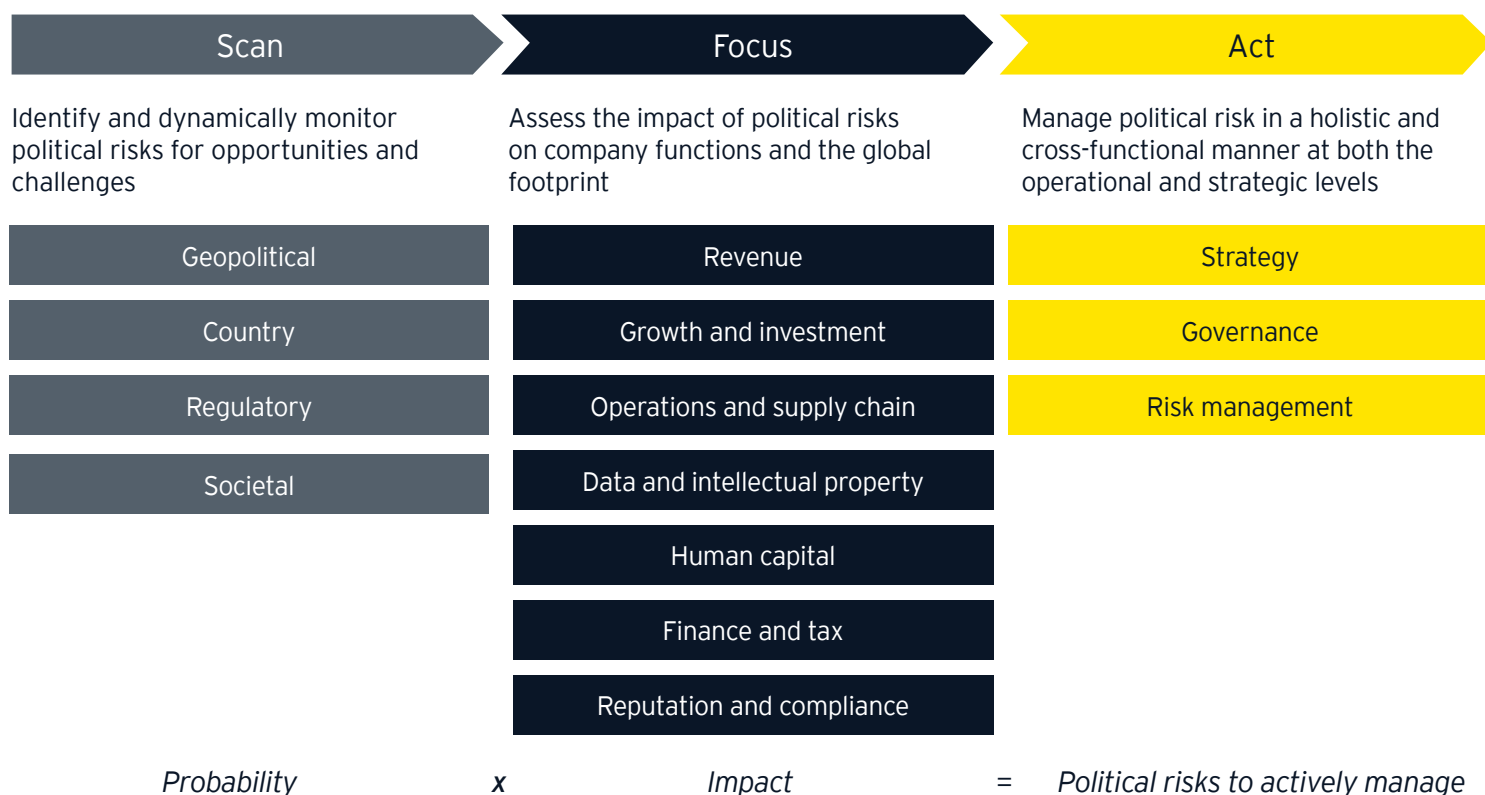
The annual Geostrategic Outlook presents analysis by the EY Geostrategic Business Group (GBG) on the global political risk environment in the year ahead. The GBG defines political risk as the probability that political decisions, events or conditions at the geopolitical, country, regulatory or societal level will impact the performance of a company, market or economy. Importantly, this definition of political risk includes both challenges and opportunities for business. Scanning the external environment to identify such political risks is the first step in implementing a geostrategy – the holistic and cross-functional integration of political risk management into broader risk management, strategy and governance (see Figure 12).

The GBG conducts its scan for the Geostrategic Outlook across the four categories of political risk in the geostrategy framework: geopolitical, country, regulatory and societal. The GBG also scans across all regions of the world and the four [primary forces of disruption](#) that EY teams monitor.

As discussed in the [2020 Geostrategic Outlook](#), each of these forces interacts with political risk dynamics in complex ways in the current global environment:

- ▶ **Globalization.** There is an ongoing shift from ever-expanding globalization toward rising regionalization of the global economic and political systems.
- ▶ **Technology.** The fourth industrial revolution is accelerating geopolitical competition and exacerbating social and economic grievances at the heart of populist movements.
- ▶ **Demographics.** COVID-19 is exacerbating the societal, economic and political risks in countries with very old or young populations.
- ▶ **Environment.** Climate change mitigation policies face resistance in some countries, while global action is complicated by the shift from a unipolar to a multipolar geopolitical system.

Figure 12: The geostrategy framework lays out the integration of political risk management into broader risk management, strategy and governance



Source: EY Geostrategic Business Group.

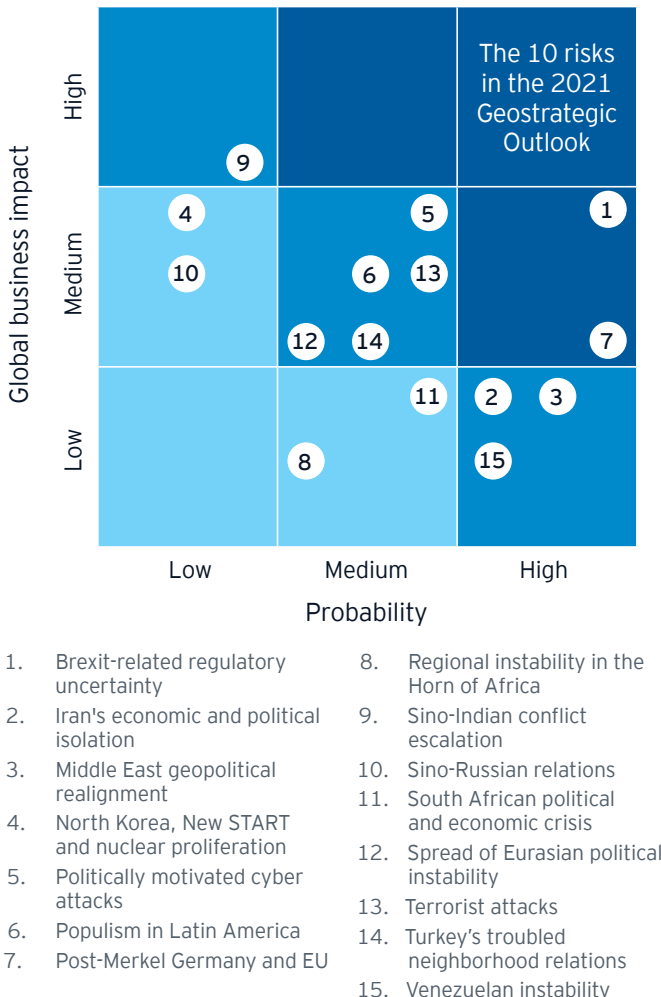
Geostrategic priorities in 2021

The 10 political risks in the 2021 Geostrategic Outlook were selected based on an assessment of their probability of occurring and the degree to which they would have impact on companies across sectors and markets. The 10 top risks included in this Outlook were assessed to be both high probability and high impact. Several other political risks that did not meet these criteria are still important for companies to monitor, based on their geographic footprint, sector and risk tolerance (see Figure 13).

While the analysis in the 2021 Geostrategic Outlook emphasizes the “scan” aspect of the geostrategy framework, it also includes an assessment of the impact of each political risk on specific business functions (“focus”) and questions that executives can ask to determine whether they are actively and adequately managing each risk (“act”). Companies that implement this three-part geostrategy framework and integrate political risk management into broader risk management, strategy and governance are likely to enjoy greater enterprise resilience in the year ahead.

Figure 13: A variety of other political risks may manifest in 2021

Illustrative 2021 political risks



Source: EY Geostrategic Business Group.

Agility in decision-making, operations and strategy will be crucial for maintaining **enterprise resilience** as the world continues to deal with the fallout from COVID-19 and associated political risks in the year ahead. To manage these political risks, companies need a geostrategy – the holistic and cross-functional integration of political risk management into broader risk management, strategy and governance.

While the specific geostrategy considerations differ for each of the top 10 risks in the 2021 Geostrategic Outlook, there are five overarching actions that companies should take to **manage political risks in the year ahead**:

- ▶ **Dynamically monitor your company's political risk environment.** Include political risks as part of your company's risk register or other risk identification processes and then dynamically monitor them throughout the year. This will be especially important in 2021, given the high levels of political and policy uncertainty generated by COVID-19. Two key risks that bear monitoring, as they are likely to evolve as the year progresses, are US policy realignment and the debt situation in a variety of emerging markets.
- ▶ **Assess how these political risks could affect your company.** Model the impact of potential political risk events across key business functions, such as revenue, supply chain, data and intellectual property. A regular assessment of how evolving US-China relations affects your company is prudent. And the geopolitics of technology and data also warrants close assessment, as some executives may be unaware how widespread the impact of this risk could be on their business.
- ▶ **Incorporate political risk analysis into strategic decisions.** Use scenario analysis about political risks to capture the uncertainty associated with their trajectory in the coming years and inform strategic decisions – including market entry and exit, M&A, and other transactions. This is particularly important in the current environment, in which COVID-19 is acting as a great accelerator for geopolitical trends. For instance, how geopolitical dynamics in the Indo-Pacific and the EU's pursuit of strategic autonomy play out in 2021 are likely to affect the global business environment for years to come.
- ▶ **Communicate and coordinate political risk management across the company.** As revealed in our **Geostrategy in Practice 2020** survey of global executives, too often political risk identification, assessment, and management is siloed within various business functions. Companies should leverage the cross-functional teams and lessons learned from COVID-19 crisis management to enable better communication on the political risks stemming from the pandemic. Such coordination should also help foster greater agility and flexibility in company operations – another capability sharpened by the pandemic.
- ▶ **Leverage stakeholder relationships to manage political risk.** Public opinion and political intervention will continue to target companies on a variety of issues. But your company's relationships with policymakers, employees, customers, NGOs, community groups, and other stakeholders can be leveraged to manage political risks – often turning potential challenges into opportunities. This is particularly true for shifting climate policies, neo-statism shaping domestic economies, and the rise in social unrest in a variety of markets. Companies should proactively engage stakeholders on these issues.



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About the EY Geostrategic Business Group

The EY Geostrategic Business Group (GBG) helps organizations translate geopolitical insights into business strategy. Geopolitics affects every global organization, from strategy to supply chain. Yet many companies struggle to assess and manage this disruption and the impacts it has on their business. The GBG harnesses the EY global footprint and local knowledge, and collaborates with third-party firms to bring an added independent political risk perspective. With the breadth of our strategic and operational knowledge, our teams develop actionable plans to help organizations better monitor, assess and manage political risks.

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