TOP RISKS 2021

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eurasia group politics first

Overview

Ian Bremmer, *President*
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At the start of 2021, the United States is the most powerful, politically divided, and economically unequal of the world's industrial democracies. China is America's strongest competitor, a state capitalist, authoritarian, and techno-surveillance regime that is increasingly mistrusted by most G20 countries. Germany and Japan are much more stable, but the most powerful leaders both have had in decades are out (former prime minister Abe Shinzo) or on their way out (Chancellor Angela Merkel). Russia is in decline and blames the US and the West for its woes. And the world is in the teeth of the worst crisis it has experienced in generations.

Happy New Year.

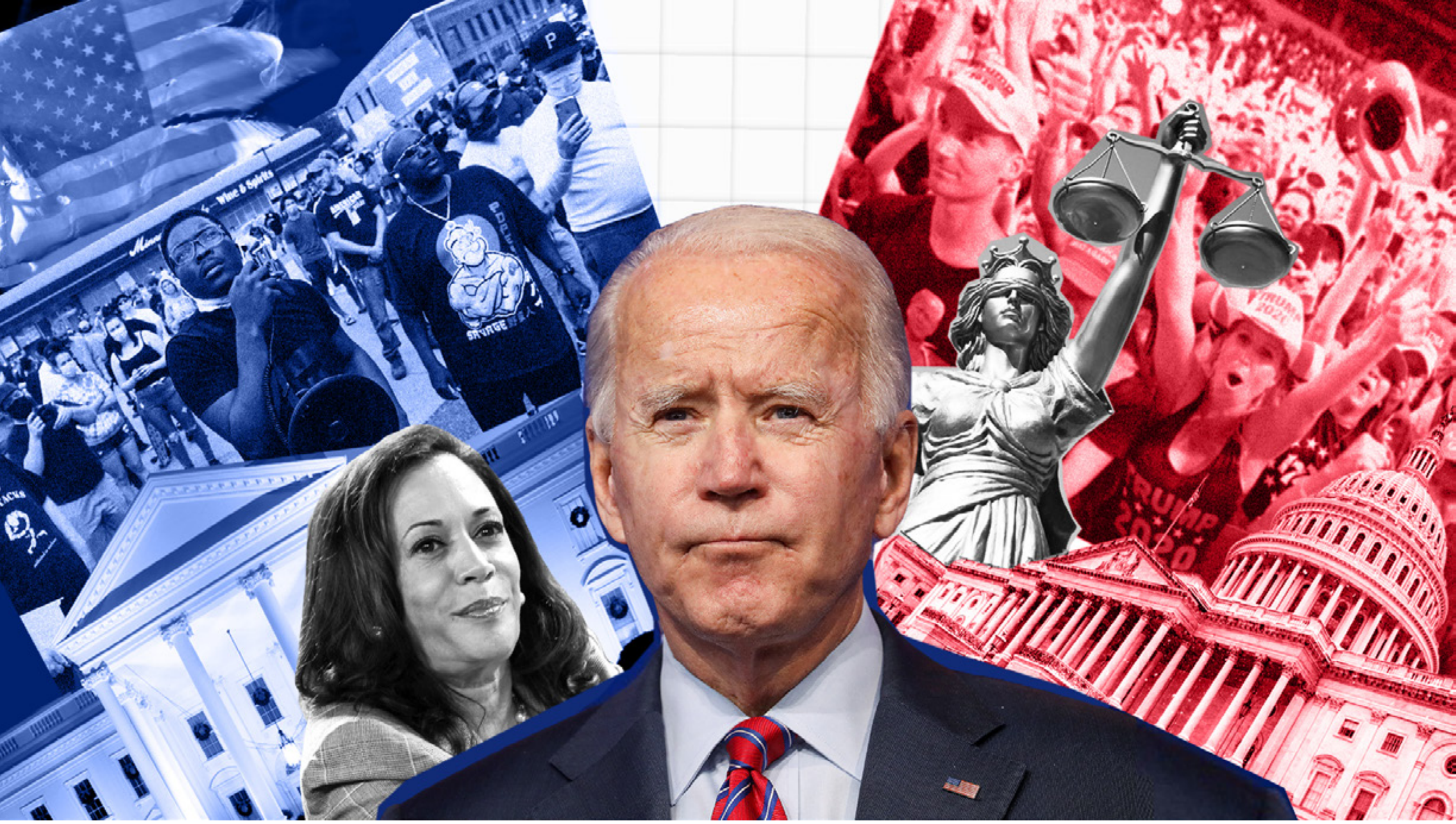
You'd hope a global pandemic would prove an opportunity for the world's leaders to work together. That was at least mostly true after 9/11 and the 2008 global financial crisis. Both were smaller in scale but set against a broadly aligned geopolitical order … and politically functional United States. Not so today.

That matters because just as 2020 was overwhelmingly about healthcare responses to Covid-19 (and how much many governments got wrong), 2021 will overwhelmingly be about economic responses to Covid-19's lingering symptoms and scar tissue (debt burdens and misaligned politics), even as vaccines roll out and the healthcare emergency fades. As economic issues come to the fore, there is no global leadership on political models, trade standards, and international architecture to follow.

In decades past, the world would look to the US to restore predictability in times of crisis. But the world's preeminent superpower faces big challenges of its own, from unemployment and lack of economic opportunity to questions about President-elect Joe Biden's political effectiveness and longevity, the future of the Republican Party, and the very legitimacy of the US political model. The credibility of US foreign policy and the sustainability of US domestic policy will be tested this year as they've not been in the postwar era.

A superpower torn down the middle cannot return to business as usual. And when the most powerful country is so divided, everybody has a problem. Despite an economic recovery, the geopolitical recession—and the factors driving our G-Zero world—will intensify as a result.

And so, we go to our Top Risk #1, 46*.



46*

1

Biden won the 2020 presidential election. On 20 January he will be inaugurated as the 46th president of the US. He received 306 electoral votes and more than 80 million popular votes, the most of any presidential candidate in American history. But President Donald Trump's refusal to accept the outcome of an election he declares was stolen is unique in American history, underscoring how divided the country has become—and will remain.

Trump himself won the second-largest number of popular votes in American history (74 million), and Republicans won enough votes down ballot to make inroads in the House of Representatives as well as critical gains in statehouses and legislatures. Add Trump's success in creating a decisively conservative Supreme Court, most recently with Justice Amy Coney Barrett replacing the late Ruth Bader Ginsburg, and Biden will emerge with the weakest mandate since Jimmy Carter in 1976. Few observers believe he will run for reelection in 2024.

A challenge for Democrats—increasingly a coalition of college-educated urbanites—is that Trump's popularity extends well beyond his most vocal supporters. He received 11 million more votes than he did in 2016 and, in so doing, constructed a broader electoral coalition that includes more Hispanics and Black Americans. A significant segment of that coalition sees Trump's refusal to concede as a display of courage, not an assault on democratic norms. While many Republican Party elders don't like Trump, public opinion is the reserve currency of politics, and he will leave office as (by far) the most popular and influential figure in the GOP. The last-minute push by members of Congress to delay or derail the election certification serves as a foreboding sign of what's to come. As long as a significant portion of Trump's voters remains loyal, he will cast a long shadow, compelling Republican leaders to support him to avoid alienating his backers. For them, Biden will be #NotMyPresident and considered illegitimate.

Facing an aggrieved opposition loyal to the Trump brand, Biden will find it more difficult to govern than under the "normal" conditions of split government. There will be neither a badly needed large stimulus package nor long necessary changes to the US healthcare system. Progressive priorities like a higher national minimum wage, a new voting rights act, and filibuster reform are non-starters. Markets typically welcome divided government, because it creates hurdles to tax increases and new regulations, but gridlock will be worse than in the past as Republicans block Biden's judicial appointments and challenge left-of-center executive branch appointments, hampering agencies that have critical functions.

Biden's supporters will criticize congressional inaction caused by an obstinate Trumpist coalition and encourage the president to take unilateral executive actions of questionable legality. Biden's detractors will accuse him of overriding the opposition and exercising excessive power when he governs by executive order. In truth, rule by partisan decree has become the norm under former president Barack Obama and then Trump, and major challenges—among them enacting entitlement reforms, increasing access to health insurance, reducing income inequality, and simplifying the tax code—will only grow harder to tackle as time passes. The more polarized the country becomes, the less likely its eroding democratic institutions will enable the compromises necessary to resolve fundamental problems.

The new occupant of the Oval Office will be seen as illegitimate by roughly half the country

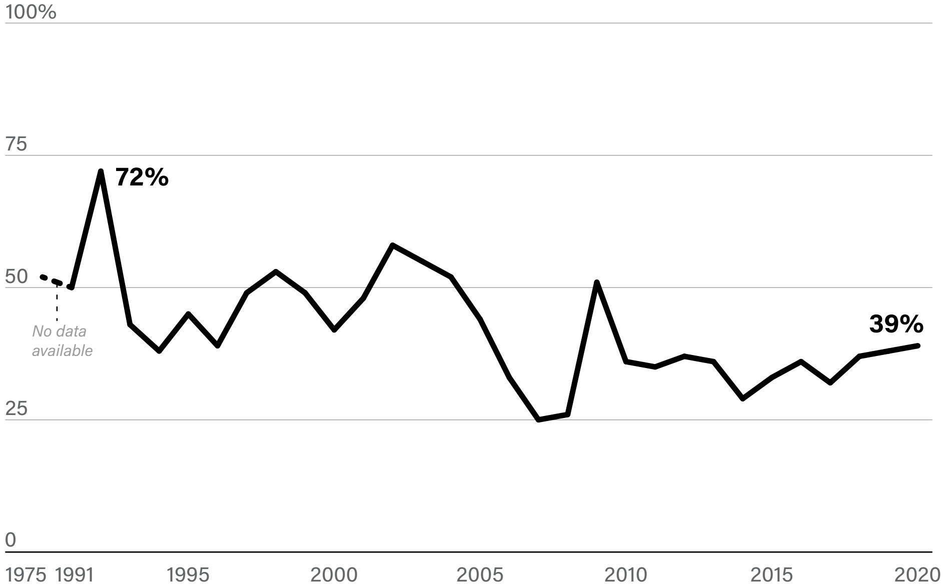
If the vaccine rollout proceeds as hoped, the pandemic subsides, and the economy rebounds strongly from the recession, Biden may win some political capital with Republicans, but there are massive challenges ahead for the most ambitious vaccination campaign in US history (see Top Risk #2). If it flops, and the country's health and economic emergency extends deep into 2021, Republican opposition will intensify and grow more rigid.

The major risks of 46* are domestic, but the consequences of no-holds-barred party warfare extend beyond America's borders. Aside from the shared desire of Republicans and Democrats to punish China (their complicity notwithstanding) for decades of technological and economic advancement at the expense of America's intellectual property and manufacturing workforce, they disagree sharply—with each other and among themselves—over the objectives of US foreign policy. Washington's mismanagement of the pandemic, meanwhile, is compelling its friends to ask why they should entrust it with the far bigger task of revitalizing the global order. Biden will try to reassert American leadership in global affairs, but polarization and an inability to manage crises at home means the US won't inspire as much new confidence as Biden hopes. Europe decided preemptively to buck Biden's goals by agreeing to a comprehensive agreement on investment with China.

In addition, the size of Trump's base and the demographic broadening of his political coalition will force allies to reckon with the possibility of another "America First" president taking office four years from now and overturning commitments made by the Biden administration. That's why Biden, a man with decades of experience in the Senate, must try to secure the kind of bipartisan buy-in on foreign policy that Obama, his Democratic predecessor and former boss, could not.

Biden presidency faces both structural and legitimacy challenges

US adults were asked "how much confidence you, yourself have in the presidency?" The results below are the combined percentage of those answering a "great deal" or "quite a lot."

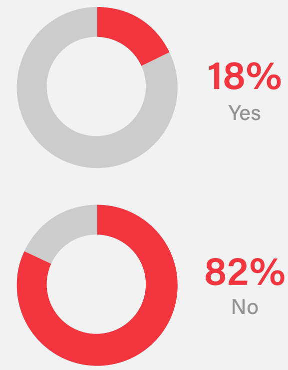


Source: Gallup Organization. CBS News

Is Joe Biden the legitimate winner of the 2020 presidential election?

registered voters

Trump voters



(8-11 December) margin of error +/-2.3 points

Calcified political polarization and declining global alignment make for a sobering basecase. Both phenomena will be more pronounced, though, if the office of the presidency is permanently delegitimized. It's not just Trump and his top surrogates, after all, who claim 2020's contest was rigged: 70% of Republicans polled afterward said the election was not "free and fair." An opposition that believes Biden stole the election will be far more aggressively rejectionist than one that merely wishes Trump had prevailed.

In short, following a Trump presidency that many Democrats believe Russian agents won for him, Biden's term opens the era of the asterisk presidency, a time when the occupant of the Oval Office is seen as illegitimate by roughly half the country ... and by the lawmakers these election skeptics send to Congress. Such a political reality has never occurred in another G7 country, but it's the reality of the world's most powerful democracy today.

Long Covid

This year begins with more promising news on Covid-19 vaccine candidates than experts dared hope for. Citizens around the world are more optimistic that life will begin to return to normal in the first half of the year.

But neither the coronavirus nor its wide-ranging impacts will disappear once widespread vaccination begins. Countries will struggle to meet vaccination timelines, and the pandemic will leave a legacy of high public debt, displaced workers, and lost trust. Evolution of the virus could meaningfully change the goalposts on population immunity and vaccine effectiveness over time. Sharply different rates of recovery, both within and among countries, will stoke anti-incumbent anger and public unrest. In addition, emerging markets could face a financial crisis.

Inside developed and emerging markets. A K-shaped recovery, in which some groups thrive and others increasingly suffer, will plague all countries. Those who have borne the brunt of the virus—low-income and minority communities, women, and especially those people who work in the service sector—will also experience the most protracted drag on their earnings potential and the most uncertain path back to stable employment. This is primarily because stimulus plans and budgets will fall short, while the ability of central banks to underpin demand with price stability will be in doubt. In the US, any further stimulus that gets through Congress will be insufficient to lift up the most vulnerable. Europe's recovery fund will provide meaningful support only from late 2021; until then, cash-strapped periphery

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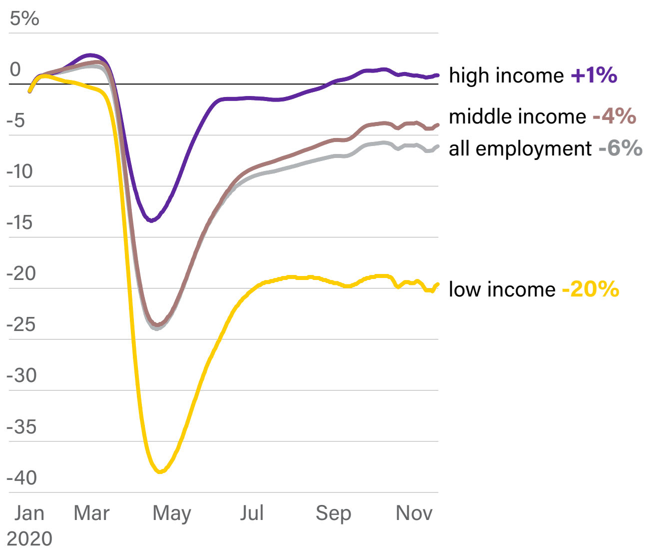
Neither the coronavirus nor its wide-ranging impacts will disappear once widespread vaccination begins

Changes in US employment



Source: tracktherecovery.org

countries will need to find other sources of finance and risk triggering a spike in bond yields if they move to take on more debt to stimulate their economies. In emerging markets, low capacity to provide stimulus and safety nets means these effects will bite harder. The problem will be more acute in Latin America, the Middle East, and Southeast Asia than in eastern and southern Europe and Northeast Asia, where safety nets are stronger.

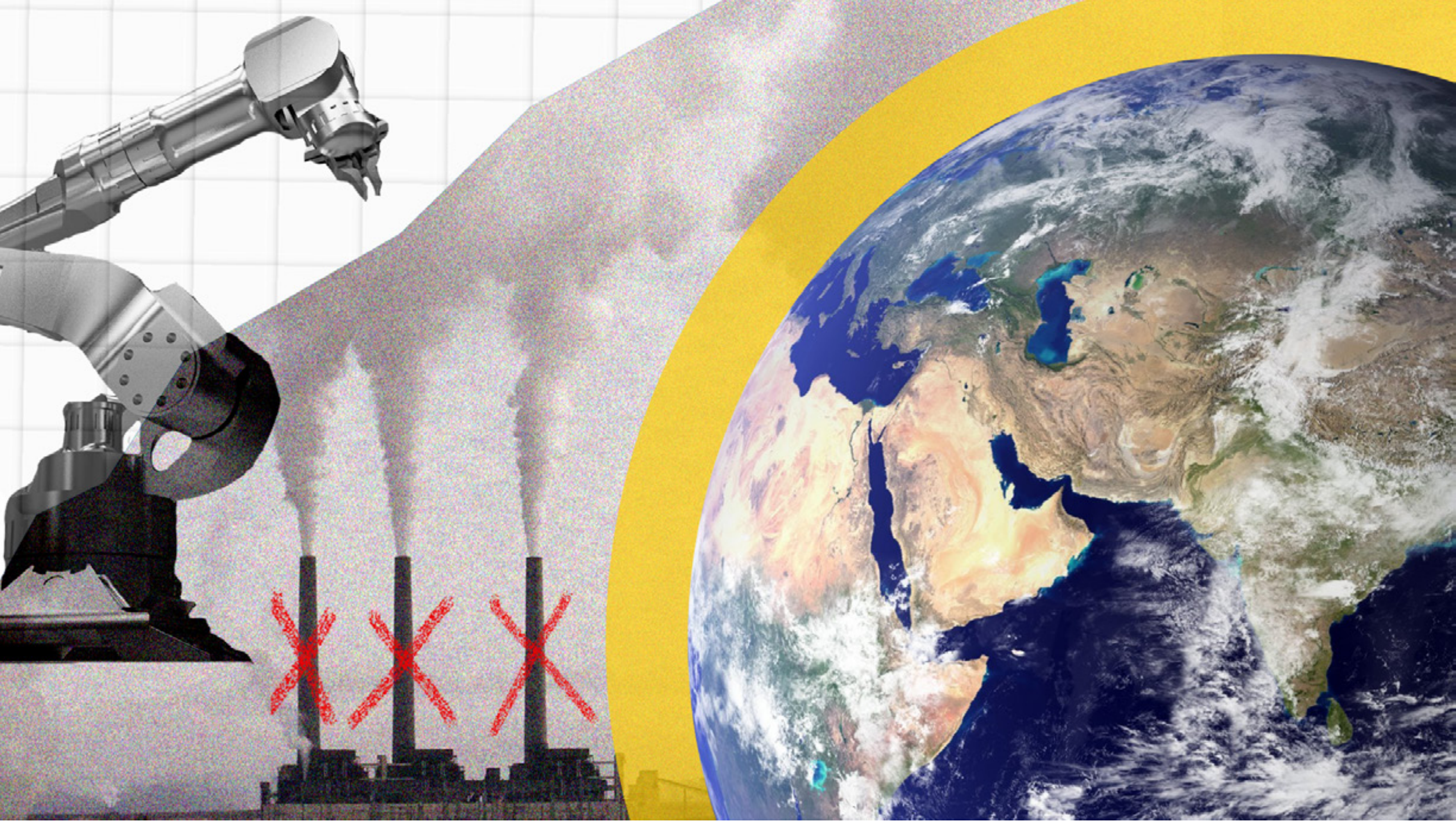
Among developed and emerging markets. Recovery paths will also vary greatly among countries—vaccine access, rollout performance, and debt being the main drivers—and emerging markets will suffer most. Many countries without their own vaccine manufacturing capacity will not receive supplies until later in 2021 or even 2022, because their inability to afford pre-purchases of vaccines leaves them at the back of the line. Vaccination programs in emerging markets will be slowed by poor infrastructure—for "cold chain" distribution, in particular—and leave out the most effective vaccines, which require it. Covax, the multilateral vaccination initiative, will help, but developing countries won't receive large numbers of doses until wealthier countries get their share. As a result, people in poorer countries will face tough travel restrictions, slowing growth. Even countries in Southeast Asia, where there have been fewer Covid-19 cases and deaths, will experience a prolonged trade and tourism dip, slowing economic recovery and exacerbating underlying class, ethnic, and religious divisions.

The wallop this year. With few exceptions, the pandemic did not destabilize governments in 2020 or create existential economic crises. Instead, it generated a rally-around-the-flag effect that compelled central banks to inject massive liquidity. But 2021 will expose the underlying vulnerabilities of many markets. Governments will grapple with the impact of the 2020 recession, massive debt increases, and thinner social safety nets.

Instability and anti-incumbent anger will grow around the world, leading to more protests and new opportunities for populist candidates. In the US, the K-shaped recovery will deepen the polarization discussed in Top Risk #1, sustaining Trump's following and decreasing the quality of governance. Across developing markets, the stratified recovery will make already difficult governance harder for similar reasons.

And then there's the debt crunch—an emerging markets problem for 2021. Facing rising fiscal pressures and more discriminating lenders, emerging markets will have limited space to cushion the economic blow from Covid-19. The canaries in the coal mine for EM distress will be Brazil, South Africa, and Turkey—major economies with weak fundamentals that rely heavily on international capital. A number of smaller, poorer countries (such as Costa Rica, El Salvador, and Zambia) already face these stresses and are either receiving or considering seeking extraordinary financial support from the IMF and other creditors; some will have to restructure their debts. In a G-Zero world, the rules governing these decisions are less clear and China's role not so transparent, compounding the uncertainty.

Emerging market economic crises could undercut nascent recoveries in advanced markets and significantly decrease global growth; the inequitable recovery will drive political instability. This year will reveal that the lingering symptoms of Covid-19 threaten not just our health but also the global economy.



Climate: net zero meets G-Zero

Last year was planet Earth's hottest on record, and governments and companies have announced new policies to address the growing crisis.

China, the European Union, the United Kingdom, Japan, South Korea, and Canada all committed to meeting economy-wide net-zero emissions targets by mid-century, while global firms and financial institutions set their own similarly ambitious goals.

Most importantly, the United States is now in the game. Biden has said he's ready to rejoin the Paris Agreement on day one and to commit the world's largest economy to net-zero emissions by mid-century or sooner. That's not just a reversal of Trump's climate neglect, but a step toward a new era of global cooperation, the triumph of net zero over G-Zero. Or so the story goes. In reality, there will be costs for companies and investors from greater climate ambition and risks from over-estimating how coordinated new climate plans will be.

The White House will indeed launch significant climate actions. These will have experienced personnel at the helm, with John Kerry leading the international climate effort and Gina McCarthy and Brian Deese—climate policy veterans from the Obama years—quarterbacking the domestic plan. That policy will have to come through executive action, given resolute Republican opposition in Congress, but there is

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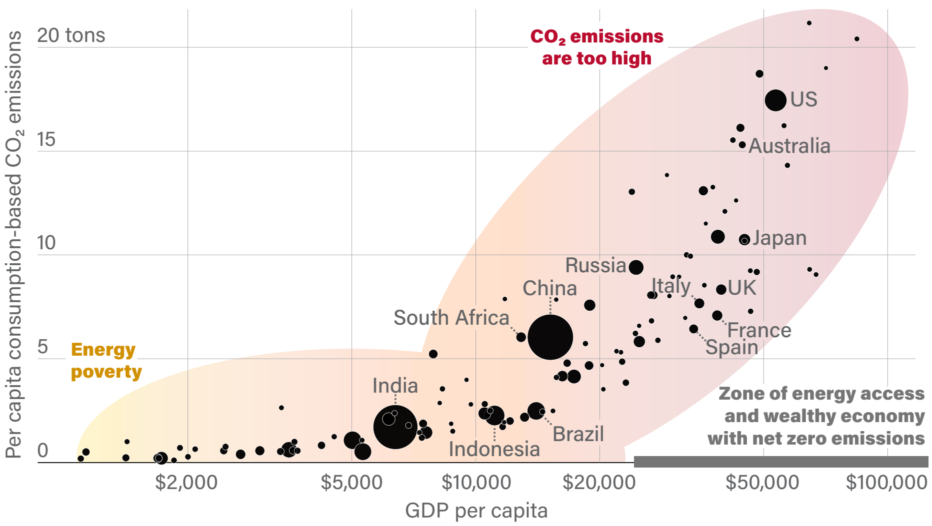
Beyond the headlines, the energy transition will be dominated by competition and a lack of coordination

still much the administration can do, from new methane pollution rules to fuel efficiency standards and the integration of climate considerations into financial regulation. States will also participate in the climate charge this year as Biden allows policy leaders such as California free rein to march ahead with ambitious agendas, including new bans on the future sale of internal combustion vehicles, new carbon pricing schemes, and low-carbon fuel initiatives.

For people and politics, net zero presents challenging trade-offs

Consumption-based carbon dioxide (CO_2) emissions per capita vs GDP per capita, 2017



Source: Our World in Data, Max Roser

Lawsuits adjudicated by conservative-leaning courts will loom large, as will the possibility of a Republican winning the White House in 2024, with the associated threat of regulatory rollback. But in the meantime, new executive action will press ahead, bringing new costs and constraints for the private sector, while setting into motion market realities—including an accelerated downward trajectory in clean energy costs—that will be difficult to reverse.

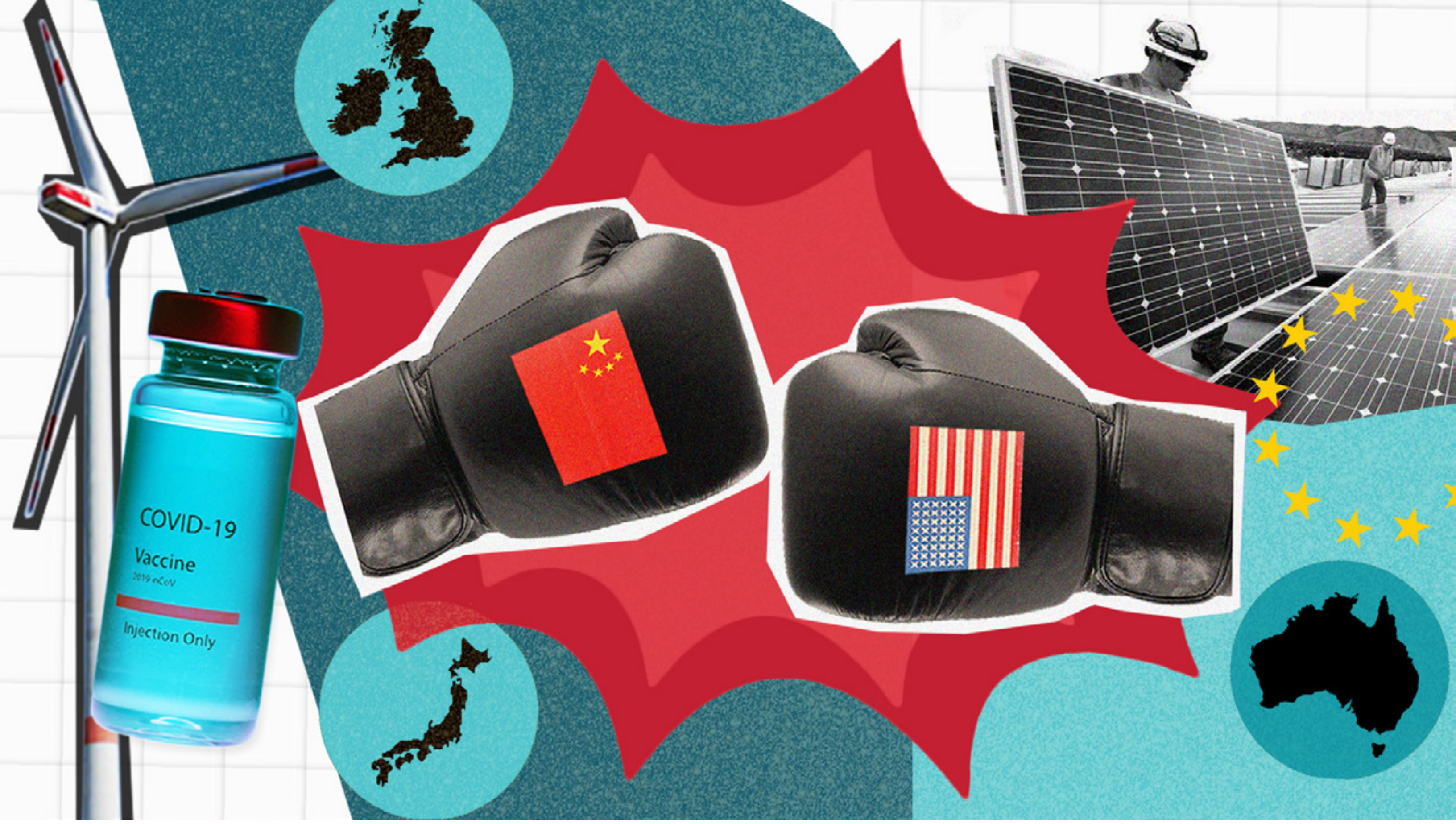
The Biden administration's approach will lead to a new wave of long-term climate commitments and targets, many of which will be aimed at achieving net-zero emissions by mid-century. The UN climate conference at the end of the year in Glasgow will provide a focal point for these announcements and overtures. In short, climate commitments will matter in 2021 like never before.

But beyond the headlines, the energy transition will be dominated by competition and a lack of coordination. India, Australia, and Brazil will fiercely protect their carbon intensive assets from international pressure and competition. Europeans will remain the biggest climate investors at home and abroad, and they will also prepare to start taxing imports from high(er) carbon countries such as China, Russia, and the United States. China will launch a massive domestic decarbonization program as part of its 14th five-year plan while using its state capitalist model to dominate global supply chains for new technologies. And as the US scrambles to catch up to China in what will quickly become a global clean energy arms race, it will make climate and the energy transition a matter of industrial and national security policy.

The bottom line: In 2021, climate will go from a playground of global cooperation to an arena of global competition. Across a range of clean technologies—but especially batteries, power control systems, and other commanding heights of the 21st century energy economy—China's longstanding industrial policy approach will be met by its new US counterpart across the Pacific. Some parts of the clean energy supply chain will come under bifurcation pressures not unlike those seen in 5G, particularly where the security of ever-more complex grids is involved, such as with transformer equipment.

Make no mistake, the push for net zero will create enormous opportunities for private capital, especially the growing pool of environmental, social, and governance dollars and euros. But politics will be decisive, and winners and losers will be determined by factors other than market forces.

The result will be an already fractured world drifting further apart. Of course, there will be plenty of triumphant handshakes and the appearance of climate progress with new net-zero announcements. Ironically, the prospects for limiting temperature increases to 2 degrees Celsius above pre-industrial levels have never been more robust than in 2021. But businesses risk big losses if they focus only on net zero and not on G-Zero.



US-China tensions broaden

Following Trump's exit, the US-China relationship will not be as overtly confrontational. Both sides will seek some breathing space. But the desire for stability will be offset by three new and underappreciated factors: a spillover of tensions from the United States to its allies, a competition to heal the world, and another to green it. On balance, this year will see a bilateral rivalry as intense as that of last year, and that's dangerous.

Unlike the Trump administration, which pursued a tougher China policy unilaterally, Biden will enlist and coordinate with allies in this area, seeking a multilateral front against specific Chinese economic and security policies. The European Union, Japan, and India will be key targets of the US outreach. Despite a setback on the China-EU investment agreement, the new administration will have some successes—suspicion of China is broadly growing. In turn, that will create deeper fissures between Beijing and these US allies. But creating a broad united front on China will not happen easily. Beijing will lash out at countries closely coordinating with Washington, as it did against Australia last year. In other cases, Beijing will offer its own economic incentives to push back against efforts at encirclement. That will create a battle of diplomacy that will serve as an additional irritant to US-China relations.

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The US and China will both try to increase their influence by providing vaccines to other countries. China is poised to outperform the US. Having largely contained the pandemic within the country's borders, China's powerful state apparatus will be able to export vaccines more easily. And unlike the best vaccines available in the US, current Chinese vaccines can be safely moved at a relatively warm temperature (35-46 degrees Fahrenheit), making them attractive to low-and-middle income countries that lack cold chain infrastructure.

These advantages will enable China to make good on the big bet it placed on vaccine diplomacy. Beijing has signed export deals for its vaccines and agreements to produce them in key emerging markets, allowing it to deepen friendships in Southeast Asia, Latin America, and sub-Saharan Africa. And these efforts come at a time when "wolf warriors," or hardliners, are ascendant in making Chinese foreign policy. The result will be hubris on Beijing's part, albeit with rewards for those in the Global South eager to be vaccinated.

Biden, on the other hand, will have to focus on domestic policies, including jumpstarting the economic recovery, leaving less time and fewer resources for competition with China. The US also faces a challenging vaccine rollout at home that could further dent its image internationally, and leave it with fewer bargaining chips to deal with countries such as the Philippines that seek to make vaccine access a precondition for greater foreign policy cooperation with Washington. The result will be a US elite and public increasingly resentful of Chinese gains during the vaccine phase, and that will add strain to bilateral relations generally.

The second new source of tension will be rivalry in green technologies. Having pledged to reach peak carbon emissions before 2030 and to become carbon neutral before 2060, China seeks to score public diplomacy points and put the US on the back foot before Biden takes office. Beijing already enjoys a big lead in many of the key clean energy supply chains of the 21st century, from batteries and electric vehicles to solar, wind, and beyond. Here, too, the US will be eager to catch up, employing industrial policy tools that mark a departure from the neoliberalism of the postwar period. It will make major investments to re-shore portions of these clean energy supply chains back to the US, seek to shame Chinese coal investment abroad, and rally allies to pressure China on climate and clean energy issues. China, for its part, has grown accustomed to its climate soft power boom during the Trump years and will not take this offensive lightly.

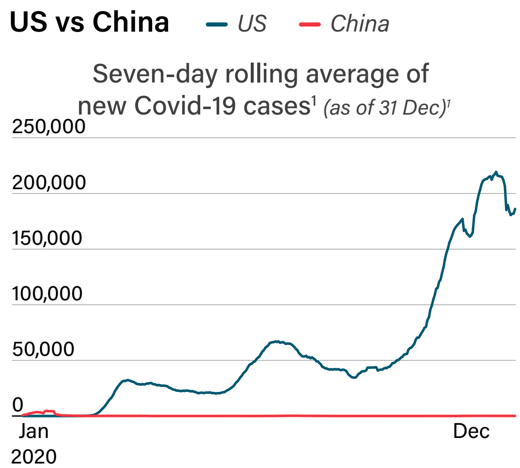
US efforts to enlist allies, vaccine diplomacy, and climate tech competition will interact with longstanding tensions to further complicate US-China relations. Disagreements over bilateral trade and technology, the treatment of the Uighurs, Hong Kong, Taiwan, and the South China Sea will fully carry over into this year ... all of which will sustain a significant chance of miscalculation and escalation during a crisis.

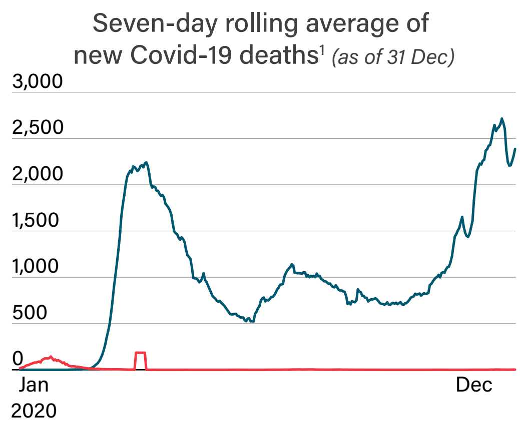
So, yes, the two countries will seek some breathing room after the 20 January inauguration, Biden to focus on domestic affairs and Chinese President Xi Jinping to further consolidate his power in advance of the 2022 Party Congress. But a detente is not to be. Overall, this year will experience an expansion of a high level of US-China tensions.

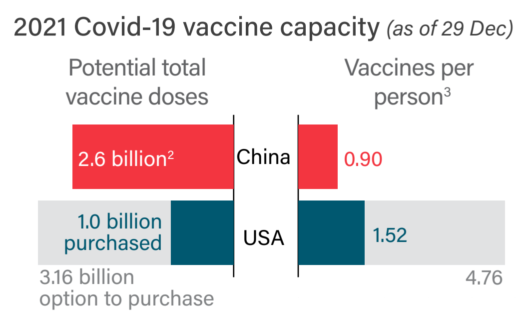
[redacted]

US efforts to enlist allies, vaccine diplomacy, and climate tech competition will further complicate US-China relations

US vs China







[1] China's cases and deaths data is likely an undercount but still well below the US
[2] China will likely be exporting some of its supply, further reducing domestic access
[3] Assumes two doses per person

Source: Johns Hopkins, Duke Global Health Innovation Center, Worldometer, Bloomberg, UNICEF, Eurasia Group

Global data reckoning

China used to be an outlier in trying to control the flow of digital information. Now its approach is the norm. In 2021, a slowdown or halt to the flow of sensitive data across borders will disrupt business models that rely on free flows.

Data will be a major battleground in the US-China tech cold war, which will continue under Biden. Beijing will accelerate its push for "data sovereignty" as it reduces its reliance on US technology and resists opening its markets to US firms in areas such as cloud computing and social media. The United States will try to ensure that Americans' personal information and the data produced by billions of internet sensors connected to power plants, transportation systems, and other critical infrastructure do not pass through equipment that could be controlled by companies under Beijing's influence.

The global data reckoning starts with strategic competition between the US and China but doesn't end there. Just as the data-driven 5G and artificial intelligence (AI) revolutions are gaining steam, other governments concerned about who is accessing their citizens' data—and how—are disrupting the foundations of an open global internet. The outgoing US administration's attempts to ban the popular Chinese smartphone apps TikTok and WeChat, coupled with India's moves to blacklist dozens of Chinese apps after border clashes last year, risk exacerbating a damaging trend. Authorities around the world have become increasingly preoccupied that their citizens' personal data could fall into the hands of adversaries who could use it to improve their AI algorithms, influence public opinion, or commit blackmail.

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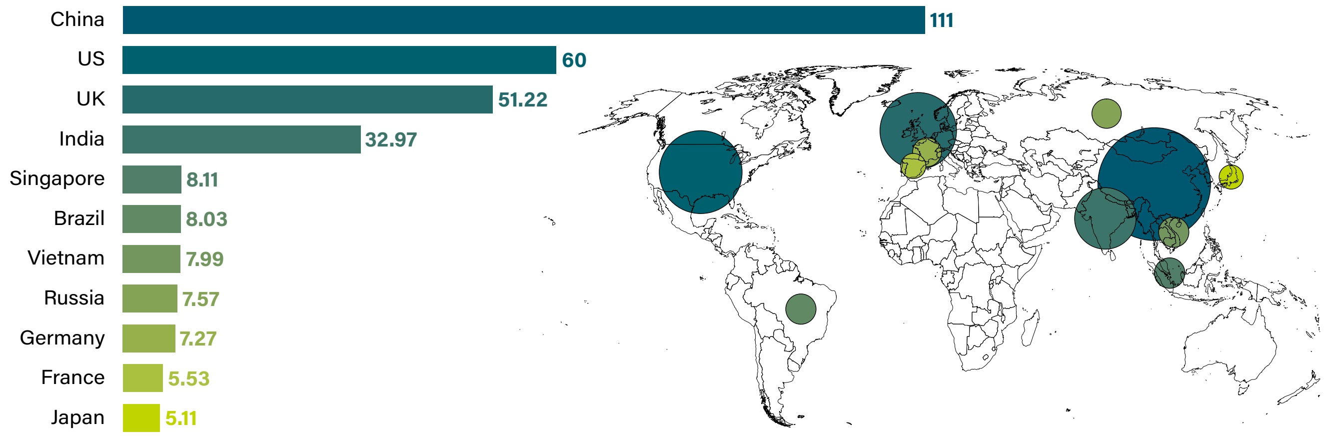
Countries with the most cross-border data

million Mbps, 2019



Source: Nikkei Inc.

When the world's biggest economy and its most populous democracy try to ban apps over these concerns, it encourages other countries to do the same.

Then there's Europe, where data has become a matter of political "sovereignty." Washington and Brussels have struggled for years to resolve tensions over government access to personal data, and the dispute is now getting serious. Last year, the EU's top court shredded "Privacy Shield," the main legal mechanism underpinning the transfer of personal data from the EU to the US, because of pervasive government surveillance. In 2021, Europe's data regulators will come under pressure to enforce the court's verdict. Legal uncertainty surrounding the data flows that support billions of dollars of transatlantic trade will raise costs for businesses. In the worst-case scenario, activists will force the issue and courts will bring data flows to a halt. A short-term fix is possible, but it would sink under the weight of political posturing and legislative obstacles on both sides of the Atlantic.

Growing data protectionism and sovereignty will spill over into fintech and digital currencies this year as well. This will be fed by concerns in Brussels, Washington, and within international financial watchdogs such as the IMF that innovation is getting ahead of regulation, and governments will react strongly to avoid losing control of their monopoly over financial sector data. Protectionist instincts will also be inflamed by China's prioritization of these domains to circumvent the US-dominated legacy financial network, using firms such as Ant Group as well as its central bank digital currency to pioneer alternatives for use in China and in Belt and Road countries. This, too, will challenge the US government's financial data control, creating pushback.

The Biden administration will explore an alliance of like-minded countries to keep data flowing. It could start small, with the countries of the G7 or the D10 (which includes G7 members plus fellow democracies India, Australia, and South Korea). But even if the United States and Europe could bridge differences over privacy, a tall order, other tech-related issues ranging from digital tax to internet platform regulations will complicate the transatlantic tech relationship. And India, whose 1.4 billion consumers make it a critical swing country on global data issues, would have to be willing to roll back protectionist policies that require firms to store sensitive Indian user data domestically.

Interruptions to data flows will force companies to invest in building new data centers and hire more lawyers to navigate a fragmented regulatory landscape. Business models for AI and other innovative tech sectors will be subject to new constraints. Drug and vaccine research will slow as researchers face new barriers to acquiring large data sets and sharing medical or other personal information. And as professional counterparts grapple with app bans and other barriers, they will hamper the world's capacity to coordinate responses to global challenges such as climate change.

To those who say that data is the new oil: Here comes the new Great Game.

To those who say that data is the new oil: Here comes the new Great Game

Cyber tipping point

More vulnerable devices, an absence of effective diplomacy, and greater emphasis on cyber responses mean the unstable status quo in cyberspace will be tough to maintain in 2021.

There's no one factor that raises the risk of a cyber tipping point. The digital realm, where any computer or smartphone can be an entry point for malicious hackers and nation states and criminals act with near impunity, is too unpredictable for that. Instead, a combination of low-probability, high-impact risks and inexorable technology trends make 2021 the year that cyber conflict will create unprecedented technological and geopolitical risk.

First, the technology side. Hundreds of millions of people will continue to work, shop, receive an education, and socialize from home in 2021 as the world waits on vaccines to change the public health outlook. The merger of home, school, and workplace isn't just a nightmare for parents, it's a nightmare for IT departments, since much of this activity uses less secure home computers and connections, giving bad actors more vulnerabilities to exploit.

This year will also see an explosion of new end devices added to the internet, as 5G networks expand coverage, and as Internet of Things sensors, cameras, and other devices proliferate. There is no broadly accepted industry standard for ensuring low-cost, commodity devices are secure and regularly updated to protect against hacking. This expanded "surface area" of vulnerability, created by more connected devices and online activity, is a playground for bad actors. In 2017, a cyberattack

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launched by suspected Russian state-backed hackers using stolen US hacking tools tore through corporate computer networks, inflicting more than $10 billion of damage. The next "NotPetya" will be worse.

Geopolitically, governments and the private sector have made no headway in developing global rules for state behavior in cyberspace. Instead, they've fallen back on unproven strategies such as targeted economic sanctions and "naming and shaming." Geopolitical rivalries among cyber capable states have also grown more acute. Suspected Iranian attacks on Saudi oilfields in 2018, which combined kinetic strikes with cyber operations, are a prime example. Iran and Israel are already fighting a shadow cyber war that targets each side's critical infrastructure, threatening the eruption of broader conflict.

"Usual suspects" Russia, China, and even North Korea are capable and difficult to deter. During the Trump administration, the US granted its own cyber warriors more leeway to go on the offensive against malicious hackers. But despite claims of victory, there has been an increase in cyber efforts to steal vaccine research and gain access to government and critical infrastructure networks. The lack of a global effort to shore up systems and impose penalties beyond symbolic gestures such as sanctions and travel bans will continue to embolden bad actors this year.

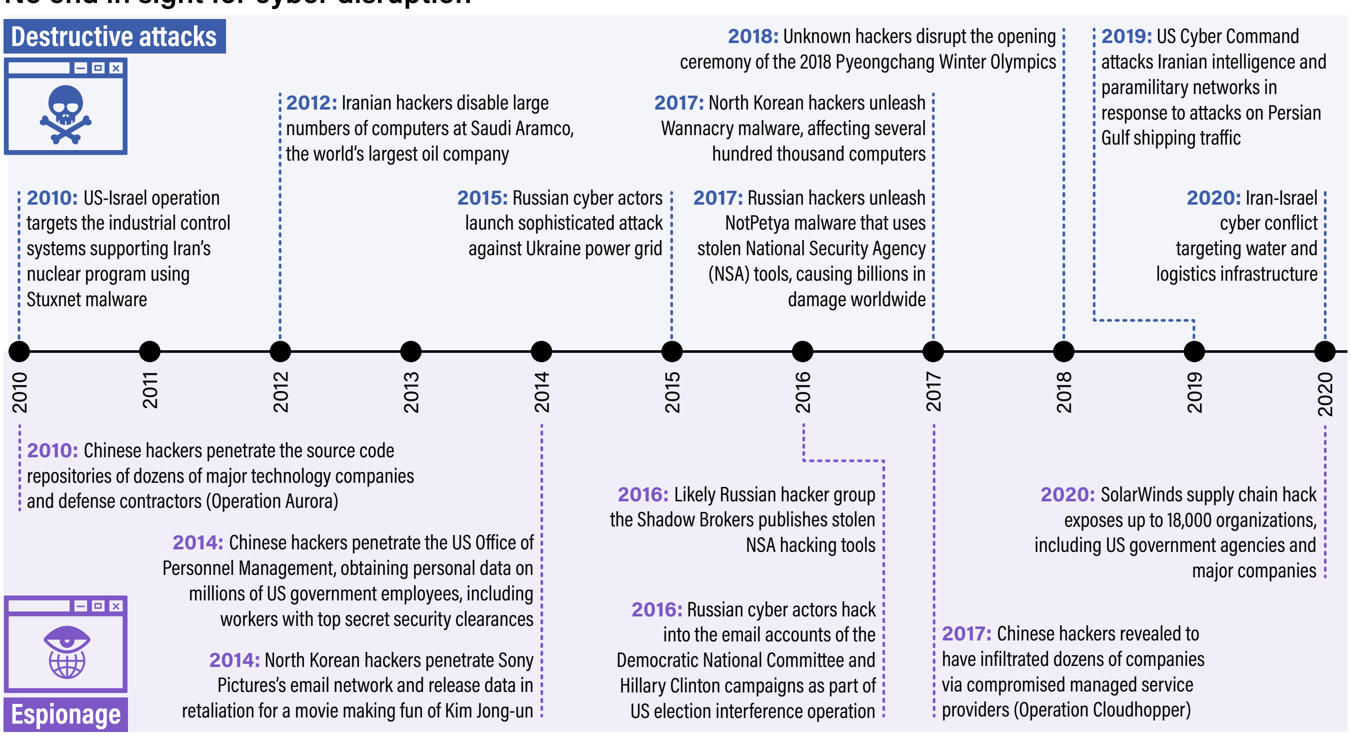
The Biden administration will attempt to stabilize the situation, mainly by trying to improve US government coordination on cyber responses. But a downturn in US-Russia relations will be a key factor in making 2021 ripe for cyber trouble.

Under Biden, the United States will pursue a tougher policy toward Russia, flowing from Biden's lesser tolerance for authoritarian leaders and anger over the massive hack last year—believed to be by Russia—of US companies and government agencies. Tough US sanctions against the perpetrators are likely. Also, the United States will retaliate against Russia in cyberspace, and more generally Biden will continue the more forward-leaning posture on cyber adopted during the Trump administration, seeking to deter Russia. In this atmosphere, the risk of miscalculation or unintended cyber-escalation between the US and Russia will increase.

Non-state rogue actors will also try to take advantage of the increased "surface area" to disrupt digital business as usual.

Finally, China's demonstration late last year that its photonic quantum computer has achieved "supremacy" over supercomputers marks a milestone with far-reaching implications. The Chinese technology exceeds the quantum advantage over classical computing that Google demonstrated in late-2019 and will increase concerns that quantum computing could render modern cryptography—the bedrock of today's cyber defenses—obsolete. This year won't be the one that quantum computing cracks the world's secrets, but it will crystallize this risk for many governments.

No end in sight for cyber disruption



Source: Eurasia Group

(Out in the) cold Turkey

7

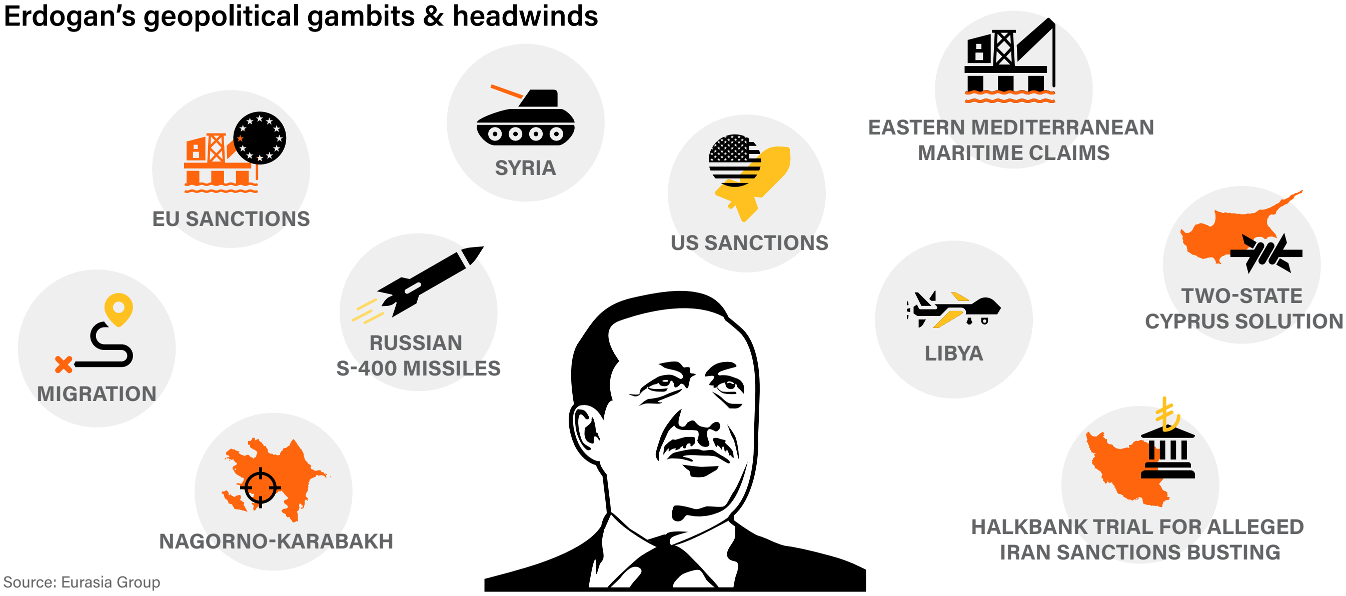
Turkey narrowly averted a financial crisis at the end of last year. But Ankara's fix was a Band-Aid and won't last through 2021.

President Recep Tayyip Erdogan approved a shift to more orthodox monetary policy in late 2020 with the appointment of a credible team and pro-market measures. Markets have given Turkey the benefit of the doubt, but Erdogan's return to transparent policies and inflation-targeting real rates will prove short-lived. Erdogan's political base will be among the worst affected by higher rates, with financial constraints hurting his party's patronage network and the small- and medium-sized enterprises that form the backbone of his support. As pressures grow at home and abroad in the second quarter, Erdogan will once again seek to spur expansion.

The first step will be premature monetary easing. Political pressures driven by the fallout from the coronavirus, a lack of cheap credit, rising unemployment, and plummeting household incomes will increase the risk of a rapid succession of interest rate cuts. This time, though, they will not only prove ineffective, they will also raise the likelihood of economic crisis. Coupled with Turkey's poor Covid-19 response, Erdogan will struggle to win back voters disillusioned with his two-decade rule.

These dynamics will not only stoke social tensions and prompt a crackdown against the opposition, but they will also lead to more foreign-policy adventures to stoke nationalist sentiment and distract Erdogan's supporters. And this year, the president won't have friends to shield him from the consequences. Trump has

Erdogan's geopolitical gambits & headwinds



Source: Eurasia Group

Erdogan's misadventures will boomerang painfully against the economy

restrained the US foreign policy establishment's impulse to end longstanding cooperation with Turkey, while Germany's Merkel has taken an even-keeled approach toward Erdogan. But Trump is leaving, and Merkel will soon follow. Even Erdogan's on-and-off supporter Russian President Vladimir Putin has grown more frustrated with the Turkish leader. And Turkey's financial backer, Qatar, will have more flexibility to distance itself from Erdogan as the pressures it faces within the Gulf Cooperation Council ease.

Cornered, Erdogan will take tougher action in the Eastern Mediterranean and across the region, especially on energy, selectively escalating tensions with the European Union—particularly France, Greece, and Cyprus—as well as with Middle Eastern rivals led by the UAE. Diplomatic efforts managed to stave off crisis in 2020 in the form of a costly proxy war in Libya or direct conflict with Greece and France in the Aegean. But they face higher hurdles this year, as does the United Nations process for mediating a reunification of Cyprus. While open war involving Turkey and Cyprus or Greece is unlikely, the possibility of military confrontation is increasing.

With Merkel on her way out, France's Emmanuel Macron will be Europe's most powerful leader. Macron's disdain for Erdogan is no secret—they have clashed openly about Turkey's policies in the Mediterranean, Libya, and Syria, and more recently over the role of Islam in Europe. The French president will likely push successfully for new EU sanctions this year, souring relations further.

In Washington, Biden's effort to reset relations with Ankara will quickly run into trouble. Trump's move to impose sanctions on Turkey over its Russian S-400 missiles relieves Biden of a decision that could pose an obstacle to more positive engagement. But the new US president will nonetheless struggle to tout the importance of ties with a NATO ally while Erdogan refuses to give up the S-400s or settle the Iran sanctions-busting case in the US against Turkish state lender Halkbank. That means more US sanctions later this year.

Erdogan's misadventures will boomerang painfully against the economy, because Turkey needs international goodwill to revitalize growth. It will remain dependent on predominantly Western financing, despite Ankara's best efforts to find alternative funding sources—including China. As geopolitical pressures drive Turkey's financial risk premium higher, the odds of a balance-of-payments crisis will rise, making Ankara look more like the economic basket case that it was in the 1990s than the emerging-market darling Erdogan led until the 2010s.

Middle East: low oil takes a toll

The Middle East and North Africa's energy-producing countries faced a tough 2020. This year will be worse.

The collapse in global energy demand left governments from Algeria to Iran with less cash flowing into their coffers as the pandemic sickened their citizens and weakened their economies. Energy prices will remain low, even as vaccine distribution ramps up, keeping the pressure on governments that already faced instability before Covid-19 struck. Many will cut spending, damaging nascent private sectors and fueling unemployment. Protests will intensify and reforms will slow.

Iraq faces the greatest challenges. Oil accounts for 90% of government revenue. Low prices mean not enough money to cover basic state spending, making currency depreciation unavoidable. Along with pervasive corruption and the government's disastrous handling of the pandemic, worsening economic conditions will trigger new, more violent protests. Fragile political institutions will come under greater pressure, eroding Baghdad's ability to control the Iran-backed Shia militias that operate as a parallel security service. The result will be more instability and violence in OPEC's second-largest oil producer.

8

The risk of unrest is also high in Algeria, home to a fragile political transition after protests forced the resignation of longtime leader Abdelaziz Bouteflika in 2019.

Algeria will hold parliamentary elections later this year, and officials have drafted a new constitution, which will cement modest governance reforms. Low energy prices will exacerbate the country's economic malaise and drive up the cost of living, making it harder for the government to pursue reform and sending more angry citizens into the streets.

Low oil prices are a headache for Mohammad bin Salman. The Saudi crown prince and king-in-waiting has been forced to slash spending on his signature Vision 2030 projects while lowering subsidies to the population. The long-term revenue outlook is troubling, and recent hints that the UAE is reevaluating the utility of OPEC compound the uncertainty. The crown prince's popularity with young people will decline unless he delivers more economic opportunity.

Energy prices will remain low, keeping the pressure on governments that already faced instability

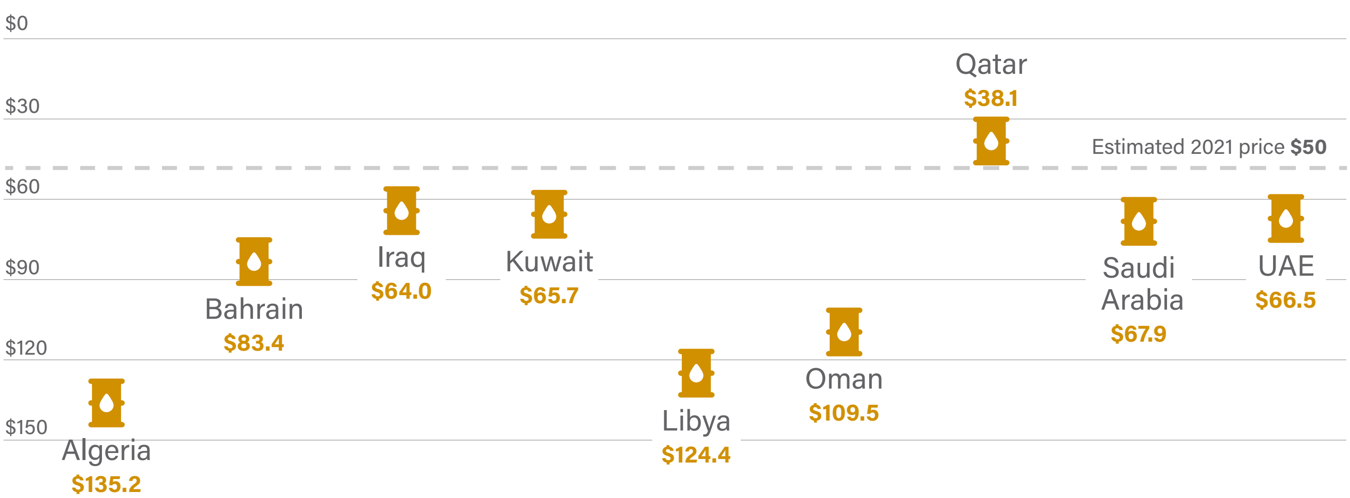
Nor will Mohammad bin Salman have a close friend in the White House. While Biden will disappoint his progressive supporters by not severing ties with Saudi Arabia, the crown prince will find American neglect jarring after four years of a blank check (and sword dancing) under Trump. Biden support for a green energy transition is a big hit to the kingdom's global influence in the medium term, even as the Saudis work to find areas for clean energy cooperation with the new US administration. Softer commitments on defense cooperation with Saudi Arabia will come with renewed US outreach to Iran, a worrisome mix from Riyadh's perspective. The risks to Mohammad bin Salman's succession are low but real.

State finances will also weaken in Oman and Kuwait, which both have new leaders. The new sultan of Oman is pursuing fiscal reforms with greater confidence, but the transition will remain challenging, and he has little margin for error. Kuwait's new emir is inheriting a bloated public sector and will struggle to cut the salaries that represent nearly half the state's budget. Kuwaiti elites are openly discussing a plan to repeg the currency, which could trigger a chain reaction across the Gulf.

Finally, low oil prices mean that Saudi Arabia, the United Arab Emirates, and Qatar will have fewer resources to spend on their regional clients and proxies. Consider Lebanon, whose traditional Gulf friends have been unwilling and unable to bankroll a government amid an existential crisis. Tunisia, Egypt, and Jordan will also be left without a security blanket.

Fiscal breakeven oil price in 2021 (projection)

$ per barrel



Sources: IMF, October 2020 (page 7 of the statistical appendix)

Europe after Merkel

For all the horrors of Covid-19, it boosted Merkel's political fortunes. It saved the German chancellor from becoming a lame duck and set the stage for the European Union to secure its landmark €750 billion recovery fund, a game-changing development that represented the best (and perhaps only) use of the pandemic as a political opportunity for strengthening multilateralism.

Without Merkel's deft political skills, the EU would have faced an unprecedented internal split, between Poland and Hungary, on the one hand, and the remaining 25 member states on the other; also at risk was the unity of France and Germany, with their competing visions for Europe's future. The continent's economic recovery would have hung in the balance, with far more pressure on the European Central Bank.

In short, Merkel has been Europe's most important leader. Her departure later in 2021 after 15 years as chancellor drives the continent's top risk.

After finishing her EU presidency at the end of last year, Merkel and her government will now turn their focus inward to ensure a strong result for the Christian Democratic Union (CDU) in September's elections. This will leave France's Macron, already weakened by the pandemic, alone at center stage of Europe. The conclusion of German elections will do little to strengthen the bloc's leadership, as

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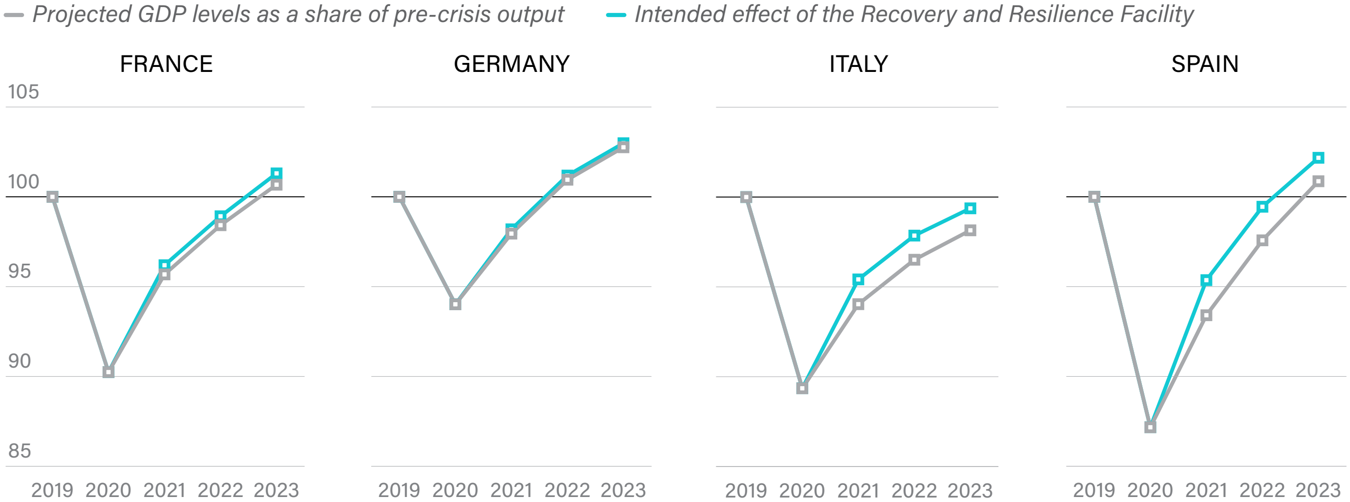
Economic recovery in the EU and the impact of the recovery fund



Source: IMF, World Economic Outlook, European Commission, Eurasia Group

the resulting German coalition of the CDU with the Christian Social Union and the Greens will take time to settle in. Macron will not view the new German chancellor as his equal and will become preoccupied with domestic affairs of his own, with next year's French elections on the horizon and a difficult economic situation to manage. The French president will be less capable of leading the EU ... and there will be challenges aplenty.

Economically, Europe faces a hangover from intensified lockdown restrictions in several countries over the winter. The limited additional stimulus from EU member states with fiscal space will not galvanize a strong recovery. A sharp economic deterioration would trigger discussion about accelerating spending from the recovery fund, not scheduled to begin disbursements in earnest until later this year. There will also be calls to make relief more generous for weaker EU member states. But the dim growth outlook of wealthier EU countries recovering from the second wave, combined with the leadership deficit, will prevent another fiscal deal. The so-called frugal four coalition of Austria, Denmark, the Netherlands, and Sweden, or some other grouping, will not only prevent any recovery fund expansion, but may chip away at the fund's ability to spend in order to meet the demands of their own domestic politics.

Merkel has been Europe's most important leader, and her impending departure drives the continent's top risk

European populism will also wake from its (short) hibernation. The shock of the virus strengthened pragmatic technocrats and moderates, but this will run its course in 2021. Restriction fatigue and frustrations with vaccine rollout create fertile ground for populism to once again gain traction. Missteps by parties in power will create openings for populists in Italy and in the Netherlands this year, and in France ahead of next year's elections.

In foreign policy, as noted above, Turkey presents a serious challenge for a distracted European Union. Without Merkel to serve as a strong negotiator, diplomatic efforts to resolve energy and territorial disputes in the Eastern Mediterranean will struggle, as will the UN-led Cyprus peace process. The EU's position will become more hawkish as France enlists more member states in its quest to get tough with Turkey, pursuing more sanctions and raising the odds of diplomatic rupture. That, in turn, will provoke Ankara into threatening another refugee crisis to destabilize Europe, as well as moves in the Eastern Mediterranean that could reignite a naval standoff and the risk of direct conflict.

Latin America disappoints

As they emerge from the pandemic, countries in Latin America will face sharper versions of the political, social, and economic problems they were confronting before the crisis.

There will be no widespread availability of vaccines until well into the second half of this year, and Latin American countries are poorly positioned to deal with another coronavirus wave before then. The main political flashpoints are presented by the heavy electoral calendar this year: legislative elections in Argentina and Mexico, as well as presidential elections in Ecuador, Peru, and Chile. All five of these countries have experienced significant fiscal deterioration, the result of increased spending to mitigate the pandemic's economic impact. Given rising poverty, growing inequality, and high unemployment, weak incumbents will be unwilling to make politically costly decisions, such as cutting spending on social services; indeed, elections will incentivize politicians, especially those in the legislative branches, to push policies that further strain their countries' balance sheets.

10

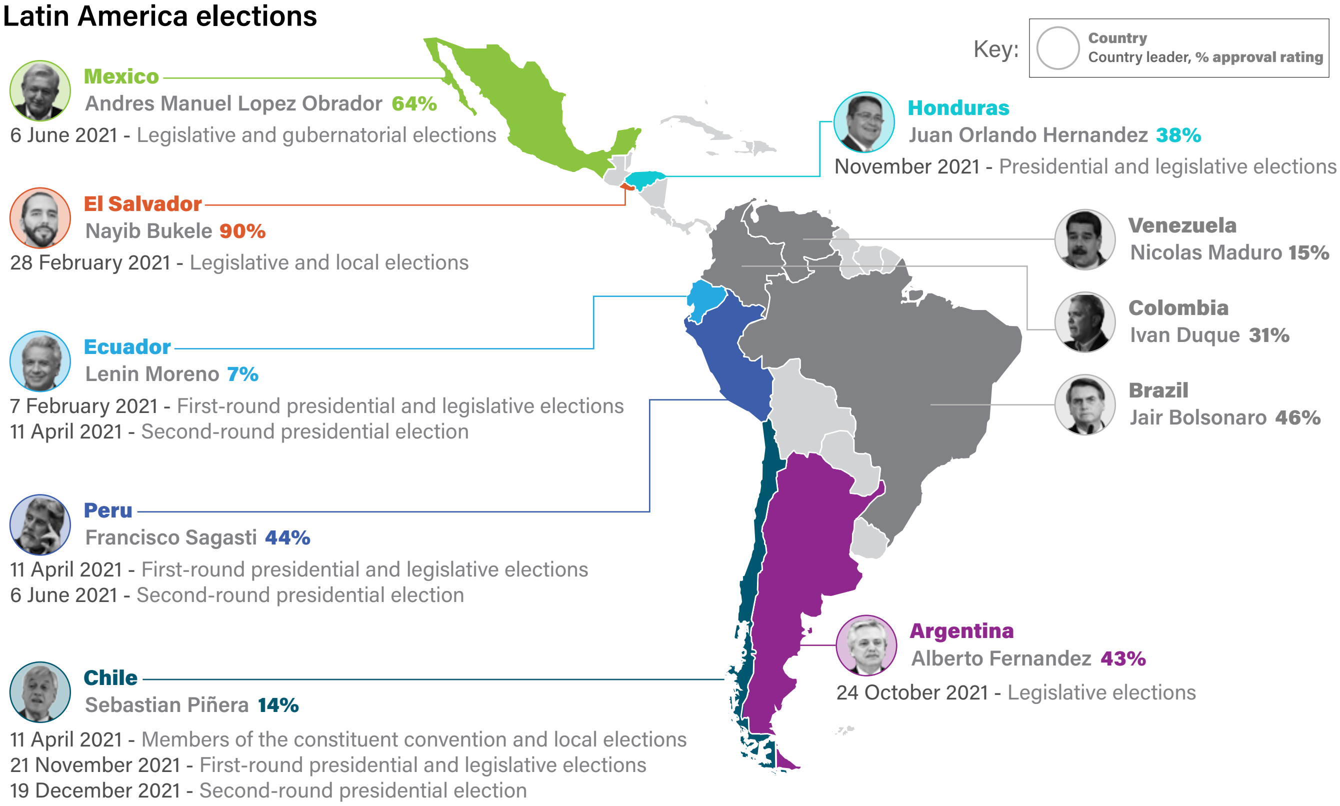
In Argentina, President Alberto Fernandez will emerge weakened from the midterm elections, given the economy's dire state, further reducing his ability to impose fiscal adjustments and inflation reduction measures. In Mexico, President Andres Manuel Lopez Obrador's popularity will remain high, and his ruling Morena party will maintain a majority in the lower house, allowing him to keep control of a policy agenda that will undermine the business environment.

High levels of social discontent will weaken incumbents and open the door for populist candidates, especially in countries holding presidential elections. That risk is highest in Ecuador, where moderate candidate Guillermo Lasso will face an uphill battle, jeopardizing the country's IMF program and economic stability. In Peru, rising discontent opens the door to an outsider candidate and a policy reversal away from the orthodox, investor-friendly policies that have been the norm for decades. In Chile, the electoral cycle coincides with constitutional reform in an environment of widespread discontent, with more violent protests likely. A leftist candidate who threatens to reverse the current policy direction would be competitive.

The Middle East is the obvious big coronavirus crisis loser among the world's regions. But Latin America is a clear second.

The Middle East is the obvious big coronavirus crisis loser among the world's regions; but Latin America is a clear second

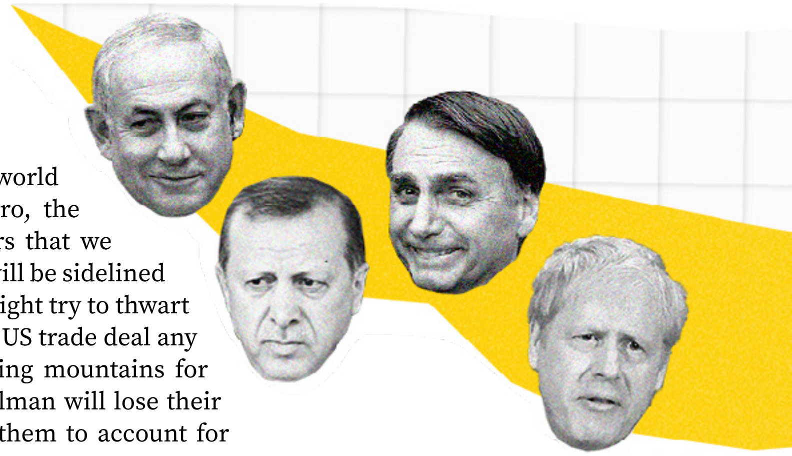
Latin America elections



Sources: Cedatos, Ipsos, Cadem, Invamer Gallup, CID Gallup, Datanalisis, Poliarquia, El Financiero, CNI/Ibope

Red Herrings

Trump's friends in trouble



You might expect that Trump's fellow travelers among world leaders—a group comprising Erdogan, Brazil's Jair Bolsonaro, the UK's Boris Johnson, Israel's Binyamin Netanyahu, and others that we labeled the "Coalition of the Unwilling" in *Top Risks for 2019*—will be sidelined as Biden moves into the White House. Or that these leaders might try to thwart Biden foreign-policy plans. It's true that Johnson won't get his US trade deal any time soon, Netanyahu won't see the new US president moving mountains for him as Trump has, and that Erdogan and Mohammad bin Salman will lose their protectors within a Washington establishment eager to call them to account for various transgressions.

But to view these leaders as doomed to four years of pain from Washington underestimates both the Biden administration's willingness to engage their governments on matters of shared interest and the capacity of these leaders to adjust to new realities.

Johnson booted Brexit hardliner Dominic Cummings from 10 Downing Street soon after the US election and then pivoted aggressively to a green agenda that will be further boosted by the UK's hosting of the UN climate conference in 2021.

These are bridges toward common ground with Biden's White House. Erdogan intends to pursue a reset of US-Turkey relations and made subtle moves late last year to clear the way for this strategy. Netanyahu has made a point of highlighting Biden's pro-Israel record and his personal history with the president-elect (plus, there's a good chance he doesn't last long). Mohammad bin Salman will be ready to appease a Saudi-skeptic White House, possibly with a deal with Qatar to end the Gulf Cooperation Council embargo, further steps toward normalization of relations with Israel, and clean energy cooperation with the US. Bolsonaro will bristle at US pressure on climate issues, but he can still find common cause with Biden on China and Venezuela.

The incoming Biden administration will be willing to engage on matters of shared interest

While these leaders enjoyed a personal affinity with Trump that they won't share with Biden, they weren't counting on another Trump term, and Biden's White House will look past personalities toward foreign-policy pragmatism. Not all attempts to curry favor will be successful—we have particular doubts on Turkey, as described in Top Risk #7—but a coordinated axis of troublemakers with shared grievances is one thing Trump won't be leaving behind.

Big tech will be saved by the political complexities of the problems it poses

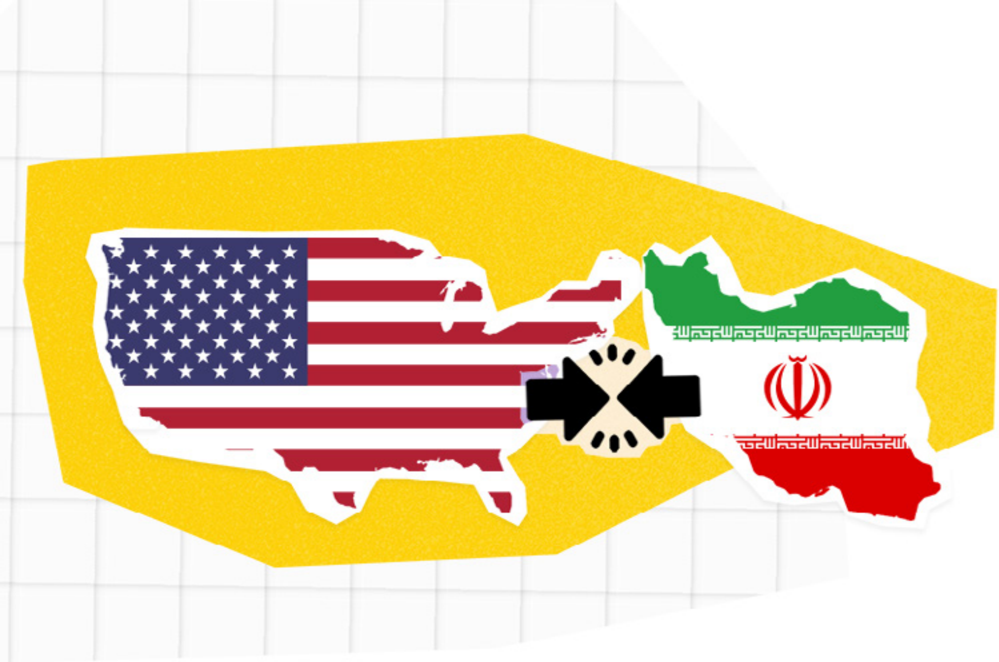
Techlash in the US

Silicon Valley companies and their shareholders have profited handsomely from an accumulation of market power and political influence in the last decade. And as the coronavirus hit with full force last year, the shares of the world's biggest internet companies strongly outperformed, with lockdowns forcing millions of people to work, learn, entertain themselves, and shop from home, while gutting the brick-and-mortar economy. Today, shares of the world's biggest tech platforms—worth about $6 trillion (twice the GDP of France)—trade at an eye-popping 35 times future earnings. And that is to say nothing of the increasingly critical role these platforms play in the political process.

All of this makes them enormous targets, and some expect 2021 to be the year that the global backlash against US big tech—the techlash—really bites.

Instead, big tech will be saved by the political complexities of the problems it poses. Europe wants to impose new fees on US tech champions, but the US government will fight to defend these firms and the tax base they represent. Within US borders, there is plenty of animosity toward tech companies, but complaints differ across the political spectrum. Republicans are upset over an alleged anti-conservative bias in tech firms' efforts to police content, while Democrats complain about their monopoly power and *lack* of content regulation. Meanwhile, both parties fear the rising prominence of China's own tech champions, and neither has a clear sense of whether backing US alternatives means abandoning their own regulatory impulses.

And with tech serving as an engine of post-Covid recovery, lawmakers will think twice about strangling the golden goose, even if they could agree on how it should be done. US big tech will have plenty of challenges to navigate this year (see Top Risks #5 and #6), but a "meet your maker" moment will not materialize. On balance, US big tech is positioned to reach the end of 2021 in a stronger position than at the beginning.



Iran-US confrontation

Ties between the two countries will be neither as productive nor as dangerous as many observers expect. Rather than war or peace, US-Iran relations will muddle through.

Bilateral diplomacy between the two governments won't be straightforward. During his election campaign, Biden pledged to return to the 2015 nuclear agreement as a platform for broader negotiations to "strengthen and lengthen" the deal and address Iran's regional meddling, human rights violations, and missile program. For its part, Iran is eager for sanctions relief but has little interest in these broader conversations.

Both sides will be wary about moving quickly. For Biden, re-entering the nuclear agreement is legally easy but politically costly. Given the need to battle the pandemic and restart the economy, foreign affairs will take a backseat early in the administration. Biden has to pick his battles—and Iran is a political loser. The challenge is greater in Tehran. While President Hassan Rouhani wants a deal immediately, he is politically weak and at the end of his final term. Supreme Leader Ali Khamenei is wary that the US may be setting a trap that would require negotiations on Iran's regional or missile policy—a red line for his regime. US-Iran talks could start early, and the two sides may reach some kind of interim agreement to lower tensions. But Tehran will probably wait until after both the June presidential election and the new president's inauguration in August to consider seriously returning to the nuclear deal.

There is also growing concern that Iran's nuclear advancements could trigger conflict. Israel was blamed for an explosion at a sensitive nuclear site in July and the assassination of a top nuclear scientist in November. Iran has pledged to retaliate for both. Meanwhile, Iran has ramped up its nuclear program, announcing it intends to enrich to levels close to weapons grade. The country has already started moving more key nuclear infrastructure underground, making it harder to attack. As Iran advances and Biden considers negotiating, Israel will escalate its rhetoric about the danger posed by Iran. But don't expect a blowup. Israel is aggressive in covert operations; that's not the same as being willing to start a war. Biden will hold back Israel by using the Obama playbook—a mixture of assistance and security cooperation. Absent a clear dash to a bomb, the risk of war is low.

Absent a clear dash to a bomb, the risk of war is low

As we start off this New Year, it's impossible to close the door on the pain and suffering we all experienced, together and alone, in 2020. Our world failed us in ways that were terribly plain to see, and that failure stirred anger, hurt, and blame. We've never been so saddened by the failings of our political leaders and institutions as we have been this past year, but also never so aware of the hope in the possibilities before us. And as we have sometimes learned from the worst of our mistakes in history, keeping the pain of 2020 alive also offers promise for the future.

Our thanks to you for your support. We're all connected, some of us more dysfunctionally than we'd like. But we care for each other nonetheless. We'd like to take this moment to express our appreciation; it's one thing from this last year we think worth dwelling on.

With very best to you and yours,

Ian and Cliff