Viewpoint

Emerging Fault Lines: 2019 and Beyond

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What key themes are likely to impact socio-political and economic developments?

The year 2018 was a maieutical one. It led to the better recognition of emerging global fault lines in politics, the world order and the economy.

Indeed, as we move into 2019, the chasms opening up within traditional politics versus populism, the United States versus China and workers versus robots, are becoming ever clearer.

Traditional Politics and Populism

Over the last 25 years, the global consensus has revolved around what politics should look like and what policies should be. Free-market-oriented policies, combined with an open attitude to the way society should be structured, constituted the tenets of the post-Cold War world.

This view broadly comprised some economic elements of the centre right, along with social and cultural elements of the centre left. This "Third Way" captured the l'esprit du temps for a long period - not only in industrialised economies, but widely across emerging and developed nations. Each country, in its turn, applied the consensus in its own way - some tilted towards the right, some more towards the left.

This consensus was underpinned by a set methodology where policies should be 'evidence-based', i.e. driven by data, facts. Technocrats ruled.

Over the few last years however, and more progressively in the last year, this approach has been challenged by 'populism'.

Populism has a different paradigm. It dictates that politics should not necessarily be driven by data and evidence, but by what people think is right. As a result, we have witnessed a strong wave of anti-elitist sentiment move across the Western world and beyond.

Identity politics and sovereignism, together with the will to address the frustrations and insecurities within society, have become mainstream policies in several countries.

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Fabrizio joined Muzinich in June 2018. Prior to that he was in the public sector where he has held a number of roles including most recently Head of the Office of Italy's Minister of Finance, responsible for developing policies targeting macroeconomics, tax, finance and banking. Before that he served as G20 Sherpa and Senior Economic Counsellor to the Italian prime minister. Previously, during his time at the OECD in Paris, he also held the role of Chief of the Sherpa Office and Special Counsellor to the Secretary General in Paris, responsible for coordinating the OECD's contributions to the G20 and G8 during and after the financial crisis. He holds a degree in International Affairs from the Scuola S. Anna in Pisa and a Masters in International and European Law from the European University Institute.

Against this backdrop, in 2019 the European elections are likely to become the epicentre of this fault line. For the first time in European history, European elections matter.

As the May elections approach, there will be a serious discussion about Europe and what kind of Europe the electorate wants.

It will also be a time for populist parties and movements to develop some concrete ideas and policies about what kind of Europe they want, and for traditional parties to find compelling arguments to defend existing and further continental integration.

United States versus China

In geopolitical terms 2018 was also revealing. President Trump's decision to impose a range of trade tariffs on China's exports highlighted a growing broad-based competition between an incumbent superpower and a rising one.

Pandora's box has been opened. In the US, 'wake up to China' is not only a Trump/Pence administration sensibility, it is being shared more widely by the political and economic establishment and within public opinion.

At the same time, China is developing a more assertive foreign policy with the US and the world as we come to the end of China's "hide and bide" attitude, as defined by Den Xiaoping in the 1980s.

Indeed, China is increasingly becoming a strategic partner and ally for many countries, not just in Asia, but along the 'belt and road' as the country's most ambitious trade route takes shape, and also for some African and Latin American nations. China now constitutes an 'alternative' in a world which is progressively less unipolar.

The current trade disputes are the tip of the iceberg and the rivalry runs much deeper: macro imbalances, investment, innovation, intellectual property, state-owned-entities and cybersecurity issues, leaving aside military and hard security. These are long-term trends, secular by nature and destined to dominate global politics for decades.

However, this "Technology Cold War", as it has sometimes been characterised, is likely to see a good mix of competition and cooperation. The two economies are too integrated to be disentangled. In 2018 for example, notwithstanding the trade row, the number of Chinese company IPOs in New York hit an eight-year high.[1] On the other hand the value of products made and sold within China by US companies was around US$250bn in 2018.[2]

In the coming years, we believe the two largest economies will take rounds of antagonistic measures vis-á-vis each other: tariffs, export bans, tax measures, investment restrictions, regulatory and judicial actions. However, we believe the ongoing further economic and financial integration is unlikely to stop.

Overall it is likely to be more a case of small-scale steps rather than larger, brash moves.

Workers versus Robots

In production we are witnessing the powerful convergence of different technologies, new materials and new processes. At the centre of these changes lays the transformation of means of production through robots and artificial intelligence. "Artificial intelligence already underpins over 50% of global financial transactions."[3] Here the veil has not been fully pierced; we do not have a full understanding of the depth of these changes and of their consequences on productivity, labour markets and the whole of society.

Policymakers have started to notice. OECD studies outline these issues - about 14% of jobs are highly automatable and another 32% could soon face major transformation.[4] It has also started to come to the attention of political leaders. The "future of work" was a key topic of Argentina's G20 Presidency agenda.[5]

Technological disruptions have always been a part of mankind's evolutionary landscape, from the invention of the wheel to the internal combustion engine through to the production line revolution. There is nothing new in saying that technology can replace people and their traditional working roles.

However, there are a few elements that seem new this time around. Two in particular make the current revolution stand out. One is the ethical and policy challenges that artificial intelligence poses, the other is the sheer size and global nature of the potential disruption.

Smart machines need smart policies to help them develop and also perhaps to rein them. New technology has the potential to swing public opinion in a continuous pendulum between excitement and fear. We believe policymakers will be called, eventually, to regulate these progresses.

In the past, disruptions happened almost exclusively in a few industrialised countries. Today the rise of artificial intelligence and robotics is likely to be felt worldwide. Leaving aside the depth of the disruption, it may affect hundreds of millions of people. In the 2000s, US manufacturing employment fell by one third.[6] Similar effects on China and other Asian countries could be dramatic. Adjustment policies may have to be conceived and implemented on a scale never experienced before.

Conclusions

While the obvious question is how will markets react to these trends, perhaps it is more pertinent to ask whether markets, with their short-termism, will react to the emergence of these long-term fault lines?

It is a common-held view that the European elections will be very much at the centre of the market's concerns in the coming months. An outright victory of populist parties seems at the moment unlikely in our view, but a very strong score will still be able to change the political balance in European politics.

Within traditional parties, pro-European positions are losing ground and the formation of a Eurosceptic European Parliament is a concrete possibility. Oxymoron is becoming common in contemporary politics. We expect volatility, at least until 26th May.

China-US trade confrontation has already highlighted its potential to unsettle markets. The wild ride is likely to continue; developments could be temporary, inconclusive and contradictory for months and years to come. Eventually markets should become accustomed to the new normal of the US/China antagonistic cooperation, but it may take some time.

The most disruptive societal and economic developments may come from technology, but they may be too long term for markets' appreciation.

In any case, no-one can fully predict the future.

1. https://www.ft.com/content/36e15a18-07a1-11e9-9fe8-acdb36967cfc
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