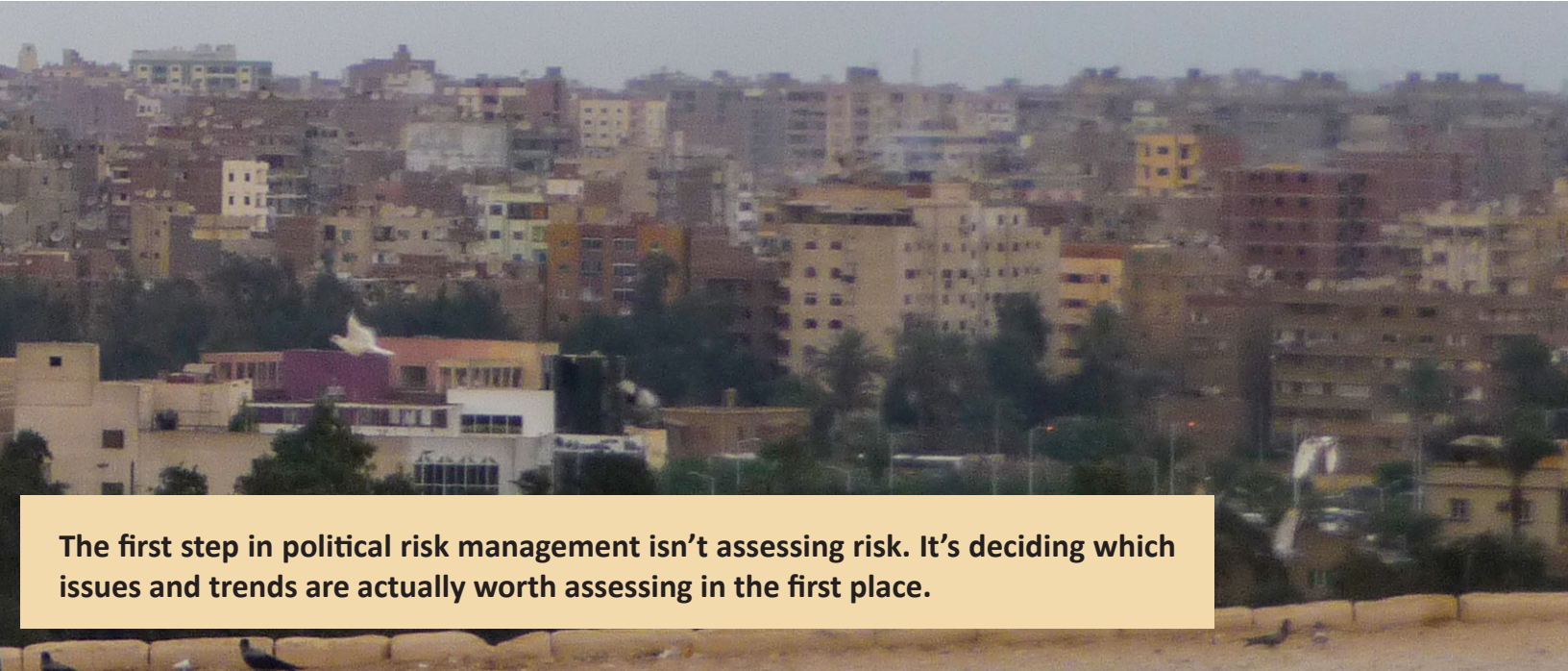


# INTERNATIONAL POLITICAL RISK: SEPARATING NOISE FROM WHAT MATTERS

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**The first step in political risk management isn't assessing risk. It's deciding which issues and trends are actually worth assessing in the first place.**

Every day we are confronted with a stream of headlines competing for our attention—tariffs, trade disputes, wars, elections, sanctions, shipping disruptions, energy markets, China, artificial intelligence, and countless other developments. Some may ultimately shape markets, trade and investment. Others will fade almost as quickly as they appeared. The challenge isn't simply staying informed. It's deciding what actually matters.

This is one of the first questions political risk professionals ask themselves. If we don't focus on issues that matter, we can waste time and energy worrying about things that don't.

The process is often called targeting —separating the developments that deserve closer attention from those that simply warrant monitoring, and

those that are little more than background noise. The result is clear targets for subsequent assessment and planning, as well as an initial sense of priorities.

To illustrate how this works in practice, let's imagine that I'm the strategic planner for a large forest products company. We sell lumber from Canada mainly to the US but also to Asia, we have some mills in the southern US, we sell a considerable amount of pulp to China, and we sell a moderate amount of pulp and paper products to a few other regional markets. We already know the domestic Canadian situation very well, and we have routine discussions with a range of Canadian and provincial political stakeholders. I don't have the same familiarity with the international arena, and it's hard to develop it because things never stay still. I want a

clear sense of the global issues we need to think about. There are waves of news that make everything sound really important. We can't focus on everything, and I suspect that we don't need to. So what do I do?

Before looking at what's going on in the world, I'm going to get a sense of the company's exposures, or what it depends on for performance. This will give me something against which to assess global issues – what matters is what could affect exposures. I consider supply and value chains, access to key markets, and what could affect demand, for example global economic stability, market confidence, and energy prices. The specifics would vary by company but this suffices for illustration.

## Global scan

Now I want to see what's going on in the world so I have a menu of possible things worth worrying about. Just to help keep this to the barebones logic, we can assume that I'm not particularly experienced in this kind of exercise and don't have a pile of relevant reports on hand. So, I'm going to go through some international newspapers and just jot down headline issues that I think could matter, and I'll ask a few colleagues to do the same thing. From this, I get my initial grab bag of potential dynamics, which, in no particular order, consists of:

- US trade policy and protectionism;
- Canadian trade policy and evolving foreign relations;
- US-China trade friction;
- The Iran War;
- The Ukraine War;
- A swathe of countries in Latin America taking the nationalist populist route;
- Far-right pressure on the political centre in Europe;
- India-Pakistan tensions;
- The continued threat of jihadist terrorism;
- Cybercrime;
- The Sudan War and its connection to regional tensions in northeast Africa;
- The China-Taiwan problem and the threat of a Chinese invasion; and
- China's economic resilience.

This list could be a lot longer but it's a decent start. There are also some broader questions, like what will emerge from the rubble of the old world order, but we'll come back to those later.

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## Global issues against our exposures

Now I'm going to test each of the issues against our exposures to see which ones could affect us. As I proceed, I'm going to have to do some basic research, since a simple headline doesn't give me enough to make a preliminary judgement.

First, what I can safely shelve or discard? The political shift in Latin America is significant but it's not really touching our business and it probably won't have a very noticeable impact on global demand or costs. We'll shelve that one for now. India-Pakistan tensions might, if they manifested in a serious war, disrupt our minor India sales and affect global demand, but a major conflagration doesn't seem likely and so far the issue has had little effect. It also gets put into the storage bin. Jihadist terrorism is still in the news and Islamic State and Al Qaeda aren't gone, but even in its heydays, at least after 9-11, it caused more smoke than fire and hasn't noticeably affected business. We can shelve that too. Cybercrime is hyped but it's hardly uncertain. It's a routine problem these days and like anyone else we've already been beefing up our IT security.

My gut reaction is that the Sudan issue is also remote from our exposures and I'm about to shelve that too. Then I look at a map. When the Houthis in Yemen made Red Sea transit a risky prospect, it forced shippers to go around Africa and that added time and costs. What if the rivals in Sudan put the squeeze on the Red Sea to try to hurt each other? We can at least assess it and see how much attention it's worth.

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### China-Taiwan example

Let's try everyone's bugbear, a potential Chinese invasion of Taiwan. How could that touch us? Its direct effects would be limited. However, its knock-on effects would be serious. Sanctions on China and an amping up of tensions with the West, including with Canada, could see China effectively cut off at least for a while. Our access to the Chinese market would close, and so too would our access to Chinese chemicals and industrial components. We don't know for how long, but it would be long enough to damage our business. A conflict would also upend market confidence and weaken overall demand. The total effect would be severe.

But is an attempted invasion likely enough to justify major changes to our networks and markets? China's not particularly confident about its military's readiness (if you've heard about wargames that showed China winning, be aware that any wargame that used classified intelligence had China losing if the US got involved; regular purges of experienced military leaders also hinder, and indicate, a lack of readiness). China has no idea how the US and its allies would respond. Its economy is fragile and the Party's trying to avoid unnecessary trade friction. Add this up, and an invasion any time soon looks implausible regardless of the rhetoric and hype around the issue. Plus, there'd be plenty of warning signs – the US and its Asian allies keep a very close eye on the situation. It's a highly important issue, but for now it only warrants monitoring and initial contingency plans.



### *Iran conflict example*

Here's one that's still making daily headlines, the Iran War and its effects on the Strait of Hormuz. As a conduit for regional oil and gas exports, its status is a major variable in energy prices. And energy prices affect not just our own operating and logistics costs, but our customer's costs, global economic stability and market confidence. It ultimately has a significant effect on demand. This is a weird one because we've already seen the effects and the economic impact hasn't exactly been a disaster. One would think it would've been, but China's energy resilience and US measures to prop up supplies helped to blunt the effect. But it's not over yet.

I and others who examined the situation in its early days postulated a baseline scenario in which Trump miscalculated, and he'd seek to stabilise the situation because of the effect on his approval ratings and the potential effect on the US midterm elections. Israel would be upset but it would have to play ball, since it couldn't handle Iran alone. That pretty much played out, but there are a number of uncertainties.



The main one, which is uncertain because it's so hard to see, is the Iranian government's thinking. The war killed off more mature, indeed somewhat sclerotic leaders who were replaced by a younger, more energetic cadre which is just as hardline. The regime seems to be seeking an honourable peace, but its idea of honour is pretty stringent. It won't want to look like it caved in on major issues, and despite being hammered for months it still has plenty of weapons left over. If it's too intransigent, the US might agree with Israel that it's time to finish the job. Then the Strait would be a no-go zone for another few months. We can just about squeak by right now without serious economic disruption, but if the war kicked off into a new phase, energy prices wouldn't just get higher because of nervous markets – they'd get higher because strategic reserves are actually running out. So, this is an issue that warrants both ongoing attention, and some near-term planning to try to mitigate potential effects.

## *US political trends example*

We'll try one more, an obvious one for most Canadian businesses and particularly for lumber: US trade policy and relevant political dynamics. Remember, we're an integrated company and while our product diversification gives us a bit of breathing space, we still ship a lot of wood to the US. We have some mills there and some of our value chains are cross-border. All in all, we have very high exposure.

I'm not going to get into the nuts and bolts of US policy contortions and where things might stand in a given month. That's very fast-moving stuff and best left to industry analysts, plus immediate pressures don't present hard choices, they're more a matter of damage limitation. Rather, again wearing my strategic planner hat, I'm going to look beyond the here and now and ask, is this just a phase, or is the US going to be an unreliable market for a long time to come? The answer is critically important. If it's a phase associated with Trump, then after his term, or perhaps even after the midterms if he becomes something of a lame duck, things might get back to normal, and we can afford another few years on the damage limitation treadmill. If it's not just a Trump problem but a fundamental shift in the US, then every day we try to wait it out we're actually wasting time.

If we can't bet on a return to normal we'll have to diversify both in products and geographies, and the sooner we do that, the better our chances of survival. This is a tricky question for a planner. If we're too sanguine, the company would come under serious pressure if we're wrong. If we're too insistent that the US has become fundamentally unreliable and then things at least partly go back to normal, then the strategic shakeup we triggered would be waste of time, focus and resources.

Given our exposure and the stakes of getting it wrong, the US warrants very high attention. It's not enough, though, just to look at what's going on with trade policy. We need to get a deep sense of where US politics is headed. That means looking at socio-political trends, the sentiment of ordinary Americans, the evolution of ideological tendencies, and the health of US democracy, specifically whether or not elections remain free and fair. Building a picture of a potential post-Trump America is a far more complex undertaking than just watching policy changes and political commentary. But again, given the stakes, it's worth the effort.

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## *Our finalists – issues that matter*

Let's say that my team has done the above back-of-the-envelope assessment for each trend or issue that we identified in our scan. I come up with the following five priorities. Note that I did some aggregating to trim down the list.

- The direction of trade policy in the US, near to long term with a major question around whether or not the US has fundamentally changed as a market and trading partner. This is where we have the highest and most direct business exposure, and the US' future is highly uncertain.
- Nearly anything to do with China, because it's a pillar of global economic stability, our main source of industrial components and a significant market. There are a number of China-related issues, such as the prospect of an invasion of Taiwan or another trade blowout with the US. These are relevant in themselves, but they're linked to China's wider fortunes and hence to global market performance.
- The Iran War and other conflicts around the Gulf and Red Sea, not just because of our direct energy costs and the effects on logistics, but also because of the indirect but still powerful link to global confidence and demand.
- Canadian trade and industrial policy, which are strongly linked to the evolution of Canadian foreign relations as Canada seeks to reduce dependence on an eccentric US. We're a Canadian company. We'd benefit from initiatives aimed at growing Canadian exports and foreign investment, and potentially from easier foreign market access that might come from closer political relations, for example with China and India.
- The Ukraine War is relevant. We've survived the effects so far, but it remains unfinished. Its progress and aftermath hold significant risk of major global economic disruption, not least through potential Russian aggression in Europe. More directly, for several years now Russia has been cut off from any major market except China. If the war came to a reasonably tidy finish, Russia could be a global lumber and pulp competitor again, but at the same time it might not get preferential treatment in China anymore, opening up more of the market for Canadian firms.

In addition to these specific issues, there would be a few broader questions that we'd need to monitor and clarify as they evolve. One, as noted earlier, is the shape of the international system after the rules-based order. How the system evolves, especially with respect to trade blocs and norms, will have a significant effect on all international firms, Canadian wood products companies included.

Another broad question is the evolution of climate change policies and initiatives. On the one hand, the US' withdrawal from climate action initiatives has affected overall momentum and cohesion. On the other, the effects of climate change are staring many countries in the face and there's considerable urgency to address it. The Iran War has also made it clear that hydrocarbons dependence is a vulnerability and it's given impetus to the green transition. There's still momentum then, but it's going to be uneven. There's likely going to be a patchwork of different initiatives, each with new constraints and opportunities for wood products.

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Finally, while several of our selected issues impinge on global economic stability, it's a wider but highly relevant question because of the potential effect on demand. There's a dangerous bubble forming around AI and data centres in the US. If the bubble burst, its effects would be global. Public and private debt is high and increasing in many lynchpin countries. Inflation has been persistent around the world since the twin shocks of covid and the Ukraine War, and interest rates aren't having the intended effect. China's

economy is still export-dependent and the Party is hesitant to undertake the necessary reforms to boost domestic activity. In some analyses, China is practically a house of cards. That's seems pessimistic, but China's certainly fragile and its fate matters to the global economy. We'd keep an eye on these broader questions, as well as their links to our five priority issues.

As for the rest of the things in our initial grab bag, we wouldn't discard them, because they could evolve and become relevant, and they could affect other issues we're looking at. But we wouldn't dedicate much time and resources to tracking them. Our priorities, on the other hand, warrant deeper assessments, regular monitoring and contingency planning. Indeed for some priorities, planning should have already given way to action.

### *Behind the curtain – the underlying thinking*

The strategic planner didn't select issues in a formulaic manner, but instead tacitly considered several angles as they formed a judgement. One was timelines and potential urgency – is it worth worrying about anytime soon? Uncertainty was important – the less confident we feel about the occurrence or magnitude of a change, the more it could take us by surprise if we weren't paying attention to it. The intersection of probability and impact was a subtext in some cases. Looking for knock-on effects helped to extrapolate an issue's potential, eventual effect on demand. Finally, the planner looked ahead, using quick, back-of-the-envelope scenario thinking to explore potential future pathways. These weren't part of a single process, just thought tools for sense-making.

## Summary

While our illustrative exercise wasn't the kind of assessment we'd base hard planning on, it was enough to help us separate noise from what matters. We're under constant pressure from a breathless news cycle and "geopolitical risk" commentators to take everything seriously ("geopolitical risk" is a fashionable way of saying political risk at the global level – the term can be handy but it's way overused). It's not good to miss something that could matter, but it's just as bad to treat everything like it does. We end up chasing shadows while the real problems don't get enough attention. The next time you hear about some big thing going on in the world, before you put it on your mental radar at work, ask if and how it might touch the company. If it's unlikely to significantly affect exposures in the foreseeable future, it can go on the shelf so you can focus your effort where it makes a difference.

To learn more about political risk intelligence and management, readers can visit [Harmattan Risk](#), where there are a number of educational papers.

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