

***In 2014, it will be the interaction of politics and economics that matter. Politics – domestic and international – is back.***

The world's focus over the past few years has been on managing the economic fallout from the global financial crisis, particularly in the US and the Eurozone. Although events in Syria and Egypt, and jostling in Asia, have also captured attention, the primary focus of developed country governments, markets, and companies over the past few years has been on macro-economic policy and financial issues.

But to an increasing extent in 2014, it will be the interaction of politics and economics that matters. The way in which governments and political processes deal with emerging structural issues - from inequality and jobs, to a changing international order - will increasingly be the major driver of events. Governments, companies, and investors should recalibrate their focus accordingly.

The economic projections made at the start of 2014 by the IMF, World Bank, and others have been consistently positive. Although many economic challenges remain, growth is picking up in the developed world and the likelihood of another crisis is declining.

However, even as economic and financial tail risks diminish in intensity, there is a growing array of political risks requiring attention. The tectonic forces caused by globalisation are reshaping countries as well as the international system. Political responses are required to address the structural impact of globalisation on national economies – the effect on labour markets, income distribution, and social cohesion – as well as on the functioning of the

international economic, political and security system.

Indeed, as the world moves from crisis management to structural questions in 2014, the political process becomes more important. These issues require a political settlement, not just a technical response. The central actors will be politicians and governments, not celebrity central bankers. Politics – and geopolitics – are back, and will be in the foreground of 2014. Political decisions and policy choices will generate the key opportunities, challenges, and risks for countries, companies, and markets.

National governments in countries across the developed world, from the US, to France and the UK, will face pressure to refashion economic and social models to address issues such as economic growth, unemployment, and income inequality. And they will have to do this in the context of sluggish global growth and intense competition and technological change.

For some, this will require policy changes of a similar scale to those seen in response to previous disruptions in the 1930s and 1970s. Expect spirited policy debates on tax, social insurance, economic strategy, as well as on issues such as trade and immigration, as countries seek to respond to emerging realities in a politically and economically sustainable way. We already see such debates in Northern European countries like Sweden and the Netherlands.

As political issues move to the foreground, the quality of national political decision-making on these structural issues will be a dominant driver of national outcomes. For example, decisions will be made on key European leadership positions (including European Parliamentary elections in May), and the UK has the Scottish independence referendum and a possible vote on EU membership. The outcomes of these processes will have a significant impact.

Countries are differently exposed to these structural challenges, and also differ in their ability to respond in an appropriate way. Many small advanced economies, such as the Nordics and Singapore for example, are heavily exposed to globalisation but have also been effective in responding to its impact.

In terms of the international environment, globalisation may not reverse but we should expect changes in the way nations respond to it. There are emerging signs, for example, that key countries are less committed to an open, global system at a time of growing domestic political pressures. Consider the recent failure of the US Congress to support the IMF reform measures and ongoing protectionist measures by G20 members. And the multilateral system is weakening in a world with many new large stakeholders with different interests and preferences. Increasingly, regional solutions are preferred.

Hyper-globalisation is out, managed globalisation is in. How this process is handled - in areas such as trade agreements, capital controls, and international policy coordination - will have significant implications for small, open economies.

In addition, there are growing international security tensions, particularly with competing national interests in East Asia, an unsettled Middle East, and a more inward-looking US. This creates a more worrying security outlook. This year it is perhaps too easy to reach for 1914 analogies - but neither should they be dismissed out of hand. The experience of 1914 should be a warning against complacency, poor decision-making, and unintended consequences.

This perspective leads to a different outlook on 2014 than one based primarily on economics and markets. There are indeed grounds for guarded optimism regarding global economic prospects. But there are also grounds for concern about the stability of some governments and their ability to make decisions, the extent to which countries will engage constructively with the global economy, and the possibility of increased international tensions. And in an inter-connected world, such political events can quickly have economic effects.

These challenges place a premium on national and international political leadership. The various challenges can be met with creative, careful, sustained political effort. Or they may not be. Indeed, there are worrying signs of populism and nationalism, and declining trust in government in part a reaction to the impact of globalisation and the performance of elites.

The prospects for countries and the global system in 2014 (and beyond) depend in large measure on the quality of political decision-making. To better understand the possibilities in the year ahead, we should be thinking much more about the interaction of structural, global forces with political processes - and less about central bank minutes. And because these

political issues are often complex, controversial, and with no easy answers, we should expect 2014 to be a turbulent year.

So there is a broad distribution of possible outcomes. Plausible negative stories can be told about the potential for domestic political dysfunction in various countries and international conflict. On the other hand, there are historical periods, such as the late 1940s, when new political settlements were achieved. If complacency is not warranted, neither is fatalism.

The avoidance of fatalism is particularly important for small countries, like Singapore, which are highly exposed to global dynamics. In addition to the ongoing task of domestic policy adaptation, small countries should be looking to contribute to the ongoing health and functioning of the international economic and political system. Even small countries can make an important contribution to addressing these emerging challenges.

A slightly condensed version of this piece was published in the Review pages of Singapore's Straits Times on 31 January 2014.

## About the author

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## About Landfall Strategy Group

Landfall Strategy Group is a Singapore-based research and advisory firm that provides advice on strategic issues to governments and companies, particularly in small advanced economies. We provide distinctive perspectives on emerging global trends, working with decision-makers to understand key global changes and how governments and companies should respond and position themselves in the emerging global economic and political environment.

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