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## **The 2030 Most Likely Best Case Scenario**

Two weeks ago we started looking at the 2030 alternative world development scenarios as laid out by the National Intelligence Council (NIC). The NIC forecasts the likely paths that are either currently underway or are forecast to occur in the future. In its most recent report, the NIC projects four possible global political and economic states based on these expected trends. Last time, we presented the most likely worst case scenario. This week, we will explore the most likely best case scenario.

We will first turn our attention to the NIC report, exploring the methodology that the report utilizes, briefly describing the megatrends in place and then give a list of the four most likely outcomes. We will then analyze the most likely best case scenario in-depth and present our own view on the direction and likelihood of these conditions. We will focus on the U.S. role and how the country and its global partners might react to the changing economic and geopolitical environment. As always, we will conclude with the long-term impact on the financial markets.

### **The 2030 Report**

The NIC is the analytic arm of the Director of National Intelligence office. It provides data and analysis for all the intelligence agencies and operates as the Intelligence Council's main source for long-term strategic analysis. The NIC is represented

by all 16 civilian and military intelligence agencies and also taps experts from academia and the private sector. The organization is designed to serve as an unbiased source of information for policy design, whether it conforms to the current foreign policy or not. In the most recent global long-term outlook report, the NIC has provided four alternate states of the world for 2030 which could result based on the interplay of council-defined megatrends, smaller trends and "known unknown" game-changers. We note that these should not be seen as predictions for the future, but potential possibilities that are likely to happen given the set of current circumstances. The NIC report is designed to make the intelligence agencies and policymakers aware of a wide range of possible outcomes. We believe that our readership would benefit by understanding the possible scenarios that the government judges to be likely. The NIC reports often affect U.S. foreign policy in the long-run and thus we deem it useful in analyzing global geopolitical and economic trends.

In addition to the input from the aforementioned government intelligence agencies, the NIC has sought out the views of international leaders and think tanks, leading academics and corporate players to determine the current and emerging trends. It ranks the trends according to their expected probability and impact. The NIC forecasts that there are developments in play that are likely to happen under any scenario, and that there are possible game-changers that, although are less likely to happen, would change geopolitics significantly if they occurred. Game-changers should be

perceived as low probability, high impact events.

### **Review of the Megatrends**

Four megatrends were distinguished to be underway or emerging over the next couple of decades. These trends are best described as highly probable. The first is individual empowerment, including poverty reduction, better accessibility to education and widening of the global middle class. Basically, an increasing number of people will improve their living standards. The second megatrend is the slow loss of an obvious global superpower. Under this scenario, networks and coalitions are important in balancing the resulting multipolar world. Geopolitical uncertainty will increase with this trend. The third megatrend is the global demographic shift that will affect economic growth, slowing growth in the “aging” countries and boosting it in the “young” countries. The fourth megatrend is the significant growth in demand for natural resources, including food, water and energy, as the global population surges. This trend would also increase international and regional tensions.

The NIC also points out a handful of smaller and less certain trends; we will not list all of them, instead we will name a few that we deem more important. Global economic growth continues to be slow and crisis-prone. The NIC expects global growth to moderate, with the developed world slowing the most due to demographic changes. Even Chinese growth is expected to slow to an approximate 3% rate from the current 8%. Another interesting game-changer is the increasing governance gap. As countries within unions and even regions within countries have different fiscal situations and divergent objectives, the local governments and non-state actors will fight for more autonomy and consequently play an

increasing role in the decision making process. International agencies, such as the U.N., the IMF and the World Bank, will be reshaped to reflect the changing economic growth contribution. More countries will also move from autocracy to democracy and this environment is notoriously unstable. Changing technologies will also aid the emerging state and non-state agencies to better reach their audiences and distribute their message. Increasing technology use can also grant governments an unprecedented ability to monitor their citizens.

A side effect of this regional power struggle is increasing regional instability. The Middle East and South Asia are two conflict zones. The NIC predicts that the Middle East will slowly move toward democracy, but the path will be a volatile one. At the same time, an increasingly multi-polar Asia is likely to see rising political, social and religious tensions, as the security framework and international relations are shaped in the region.

The game-changers are very low-probability events, but the Council still believes that policymakers should be aware of these trends. We will list them, as it is constructive to see the possible extreme cases that the government would be willing to put in print. Most of these could have far reaching negative impacts on global stability, but some are deemed positive for geopolitics. First, a severe pandemic could develop that would kill more than 1% of its victims. Second, an unforeseen and rapid change in climate could disrupt already stretched natural resources. Third, the collapse of the Eurozone and/or the EU in its entirety could cause a disruption to the financial markets eight times as large as the Lehman Brothers collapse. Fourth, China could either become democratic or collapse

entirely, adding to uncertainty. Fifth, Iran could reform and become more liberal as it suffers under current sanctions. Sixth, a sudden U.S. disengagement in international security would cause an extended period of disorder. The final game-changers include a nuclear or WMD attack and an increasing trend of solar geomagnetic storms.

### **The Alternative Worlds**

This week we will look at the most plausible best case scenario, the case of Fusion, as the NIC calls it. Under this scenario, the U.S., China and the Eurozone cooperate on a multitude of issues after jointly diffusing a geopolitical situation in South Asia. Economic growth is likely to increase globally and the general geopolitical stability is likely to improve. Two weeks ago we explored the most likely worst case scenario, the Stalled Engines, under which conflicts are forecast to rise as the U.S. moves slowly out of the global super power role. Over the next couple of weeks, we will look at the remaining two possible outcomes. The third scenario, the “Gini-out-of-the-bottle,” sees instability rising due to increasing inequalities both internationally and within countries. The fourth possible outcome, the Non-state World, is the scenario in which non-state actors aided by emerging technologies take control of the global geopolitical dynamics.

### **The Most Likely Best Case Scenario**

Under the NIC’s most likely best case scenario the U.S., China and Europe would work together on a multitude of economic, political and military fronts. The increasing conflicts in South Asia would bring the three global powers together as they realize that cooperation would be in the best interests of all parties involved. This scenario assumes an orderly political movement to democracy in China, as the country’s leaders will have to make an active, and possibly unpopular,

decision to collaborate with other international powers. Overall, the outcome really depends on the actions of the international political leadership as the politicians have to overcome the more cautious and protectionist factions within their own countries.

Under this best case scenario, the size of the global economy would double by 2030. Both developed and developing markets would benefit substantially. Emerging economies, in particular, will witness a fast pace of economic growth. With a steep and rapid accumulation of wealth comes a growing demand for natural resources. Although emerging technologies are likely to aid in solving some of the resource shortages, the world will see increasing social tensions within countries and additional conflicts between countries as they compete for energy, food and water rights.

Although the democratic process is likely to spread globally, a number of countries are still likely to suffer from a democratic deficit, whereby the country’s developmental level is more advanced than its level of governance. For example, China is set to cross the \$15,000 per capita purchasing power parity in the next five years, which is oftentimes considered the democratization threshold. If China democratizes, it is likely to lead to a domino-effect reform in many other countries.

On the security front, more responsibility is likely to be shared as the U.S. is looking to only become actively involved in conflicts that directly affect America’s interests. In other conflicts, the U.S. may provide a supporting role but leave the active fighting to others. We are likely to see regional hegemony and consequently open conflicts

are likely to moderate. Major armed conflicts are likely to become rare. Indeed, major armed conflicts have declined since the end of the Cold War, mostly due to the fact that such conflicts would simply be too costly. The U.S. served as a global security provider; however, China is likely to take over some of the areas that the U.S. is currently controlling.

As China grows in economic and political importance, the country and the U.S. are expected to share most of the responsibilities, with the Eurozone still projecting some influence in Central Asia. Although the U.S. is still forecast to maintain its strong political and economic allegiances and keep its effective “soft power” dominance, both the U.S. and its allies are likely to go through a realignment of power. The U.S. by itself will move out of the uni-polar position, while its allies, the developed countries, in general, will also give up their influence.

The U.S. position will also depend on how successful it will be in managing developing international crises. The U.S. has been the default global negotiator since the end of the Cold War, but it seems that it is moving away from the global security provider position. The U.S.’s unwillingness or inability to resolve ensuing global conflicts will indicate to the world its waning dominance and a myriad of actors will attempt to project their power in that power vacuum. Although the NIC believes that China and other countries will take over more international responsibilities without taking advantage of the weakening American power, we doubt it will be quite as courteous.

We believe that the process of the U.S. withdrawing its international powers will be slow and riddled with uncertainty for the

U.S. and the world. As one power becomes less active on the international scene, other players will surely look to strategically increase their influence. As the U.S. turns inward, the most likely candidate to take on more responsibilities would be China. Indeed, the report suggests that China will take over as the world’s largest economy several years before 2030.

On the economic front, the loss of the dollar as the global reserve currency will be one of the strongest signals of the U.S. stepping back. However, this will likely be an extremely slow process as there are no other players able or willing to take over the role of providing the fiat currency. There are really two key decisions tied in with the reserve currency role.

First, the reserve currency role requires that the currency cannot be controlled and needs to be able to fluctuate based on global economic and political developments. At the moment, it seems unlikely that countries with a large enough currency base would be willing to allow their currency to appreciate. China has been very reluctant to allow for free foreign exchange movements as an undervalued yuan has allowed Chinese exports to remain relatively cheaper for the rest of the world, therefore boosting export growth.

This leads us to the second point, the global reserve currency country will also have to become the global importer of last resort. The U.S., for most of the post-war period, was willing to distort its economy to allow for the absorption of foreign exports. Many U.S. manufacturing industries have suffered to ensure international peace. On the flip side, the most successful emerging economies have adopted export promotion as a development strategy. Though successful, the program is dependent upon

external consumers. For the post-war period, that has been the U.S. consumer. China has built up its economic machine based on investments and has actively suppressed consumption. Consumption had to be maintained at a low level to provide sufficient funds for the government to invest in further export boosting projects. The Politburo is concerned about the period of volatility during the transition from an investment-led economy to a consumption-led economy. Eventually, the country will have to make the move, but we are not certain that it will happen in the short or medium term. Also, for China, increasing consumption may lead to the population demanding more political freedoms, which worries the current government.

Although some countries are somewhat resentful of American-led international order, they also recognize the global benefit of U.S. dominance. The perception is that the U.S. has projected its own will on its international partners, especially the developing world. However, the U.S. has pledged to keep international sea lanes safe, supplementing the ability of its trade partners to continue exporting. Additionally, the U.S. has maintained its demand for exports, which has allowed many developing countries to build their economies. Given that the U.S. is looking to rebalance out of the importer of last resort role, whichever country takes over this position is likely to cause changes to the economic models of emerging market countries. We do not see a backlash against the U.S.'s withdrawal from the developing world since although the emerging countries combined are large and growing in importance, they are unlikely to compete with the U.S. directly due to the fact that the developing markets are very fragmented and not likely to unify. These markets realize that rather than contesting the global

powers, they are better off competing for regional control.

This scenario offers some very interesting insights into the government's view of the best possible outcome. For ease of analysis we can divide the scenario into three trends: increasing cooperation, wealth accumulation and resource shortage. We do not believe that collaboration is likely to increase. Instead, geopolitics are likely to become more volatile as the U.S. becomes more isolationist and allows the world to remilitarize. Although U.S. involvement is important short-term because of the need for security, in the long-term if the U.S. decides to withdraw as the superpower, then the power vacuum will allow a multitude of regional economic, political and religious power struggles to re-emerge. The second trend, the accumulation of wealth, is likely in general; however, we believe that global inequality will increase. The third trend, resource shortage, is near certain to happen even in the absence of the other two trends. The most likely chain of events is that rapid population growth and urbanization will lead to increasing tensions over natural resources. As natural resources become stretched, countries are more likely to turn protectionist and reignite conflicts over disputed resource rights.

### **Ramifications**

The most important item to take away from this report is the question of U.S. dominance being raised by a government agency. This indicates that the U.S.'s exit from the global center stage is a real possibility and is under active discussion within government intelligence circles. We believe that the U.S. will remain a major power, but that it is becoming more willing to remove itself from non-strategic battles and focus on domestic issues. If so, the global economy is likely to become more volatile and

geopolitics unstable in this global power vacuum.

China is likely to continue as an important global power, both economically and politically. China has certainly indicated its interest in having more influence in its near abroad, and we believe that the country will continue to challenge its neighbors, especially over natural resource rights. However, contrary to the NIC report, we do not believe that this will be entirely diplomatic. The recent South China Sea island dispute demonstrates the country's willingness to engage in conflict and throw its weight around. We believe that China

will need to resolve several issues, including more efficient capital allocation mechanisms and more effective social programs, to ensure its continued growth. In general, this scenario is correctly described as the best case outcome. However, we fear it is much less probable than what we discussed a fortnight ago.

In this environment, long-term investors can add an allocation to commodities and developing countries in their diversified equity and fixed income portfolios.

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