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## **The 2030 Increasing Inequality Scenario**

Last month 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 expected trends. Last time, we presented the most likely best case scenario. This week, we will explore the third scenario, under which the world gets wealthier as a whole, but inequalities increase.

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 increasing inequality scenario in-depth and present our 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 that 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, 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**

The NIC singles out four major trends that are either currently underway or emerging. These four megatrends are highly likely to shape the future. The first trend is individual empowerment, including poverty reduction, widening of the global middle class and better accessibility to education and healthcare. The global middle class is forecast to become the leading segment of the population in most countries, economically and socially. This is the most important megatrend, since it is either a source or a consequence of most other trends. The expanding global economy, rapid growth of emerging economies and increasing use of technologies will all be closely related to the development of the middle class. Geopolitical balance of power improves as the world gets wealthier, but if this wealth is not evenly distributed then it will lead to geopolitical uncertainty.

The second megatrend is the slow loss of an obvious global superpower. The diffusion of power will take place on multiple levels. America has fulfilled the primary security provider role as well as maintained the reserve currency. As the developing world grows, regions are likely to become increasingly important on the global political and military scale. It is uncertain whether any specific country would become the leading superpower, but many powers will vie for more regional power. China, India and Brazil will all take on more regional responsibilities. Some smaller, yet still important, regional powers will include Colombia, Indonesia, Nigeria, South Africa and Turkey. At the same time, the role of governments versus the importance of non-state actors also becomes important. Under this trend, networks and coalitions are

important in balancing the resulting multipolar world. Countries with the highest GDP and population size will also have to work with the networks and interest groups, and will not be able to simply use their weight to gain power. Geopolitical uncertainty will increase with this trend.

The third megatrend is the global demographic shift. Economic growth will be faster in the “younger” developing countries and will slow in the “aging” developed countries. In addition to the organic population growth, migration and growing urbanization will also affect not only the economy but could also put a strain on resources. The global population is expected to reach about 8.3 billion by 2030, up from the current 7.1 billion. This rapid growth combined with the expected spike in urbanization rates will push the volume of urbanization up enough for the new urban construction volume to equal the volume of urban construction that has taken place in all of history. This trend could, at least initially, increase social tensions.

The fourth megatrend is the significant growth in demand for natural resources as the global population surges, including food, water and energy. The first megatrend, the increase in the global middle class, will worsen the scarcity of resources as new wealth creates more demand for resources. The U.S. could reach energy independence in the time frame, as advances in new technologies expand domestic production possibilities. The increasing scarcity of resources could 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. First, global economic growth continues to be slow and

crisis-prone. Even Chinese growth is expected to slow to an approximate 3% rate from the current 8%. This economic instability is likely to lead to a wider scope of regional tensions. Second, the Middle East and South Asia remain hotspots for socio-political friction. As new technologies provide new sources of oil, the Middle East has to diversify its economy away from oil production. Given the rigidity of the regional political process, the course really depends on the governments' decisions. 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 multipolar Asia is likely to see rising political, social and religious tensions as the security framework and international relations are shaped in the region. Inequality, lack of infrastructure, inadequate security systems and educational deficiencies will remain problems for South Asia. In general, an increasingly multipolar Asia would be one of the largest geopolitical threats. Many Asian countries are worried about rising Chinese nationalism, a fear which has recently been re-ignited by the Japanese-Chinese island disputes.

The game-changers are very low-probability events, but the Council still believes that policymakers should be aware of these trends. We will list some of 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, China could either become democratic or collapse entirely, adding to uncertainty. Third, Iran could reform and become more liberal as it suffers under current sanctions. Fourth, a sudden U.S.

disengagement in international security would cause an extended period of disorder.

### **The Alternative Worlds**

We first looked at 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 superpower role. Two weeks ago we explored the most plausible best case scenario, the case of Fusion. 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. This scenario is likely to raise economic growth, and general geopolitical stability is likely to improve. 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.

This week we will look at the third of the four possible alternative world scenarios, the “Gini-out-of-the-bottle.” “Gini” in this case refers to the Gini coefficient, a commonly used measure of inequality. The coefficient varies between zero and one; zero indicates complete equality, with every citizen having an equal amount of wealth, and one indicates complete inequality, with one individual having all the country's wealth. This scenario is a world of extremes. Although the total global wealth will increase in this scenario, so do inequalities and socio-economic tensions.

### **The Inequalities**

The world will grow wealthier under the increasing inequality scenario as the gap between the poor and the rich will widen. This will happen between countries as well as within countries. Internationally, the countries that are globally competitive and have a diversified export exposure are forecast to grow their prosperity. However, countries with rigid labor markets and

narrowly focused trade will lag behind. The U.S.'s increasing energy self-reliance will also affect the developing countries that have built their economies around oil exports to America.

Terrorism, based on inflamed socio-economic inequality but also religion and ethnicity, will continue growing. The countries with large youth bulges and high unemployment rates will see increasing rioting and calls for the government to change social orders. The changes that will be made are not likely to equalize incomes and wealth levels, but will give in to calls for religious and ethnic divisions by redrawing national borders. The recent adjustments made in the developing world, like the secession of Eritrea from Ethiopia and South Sudan from Sudan, are likely to be the first of many. It should be noted that many country borders were drawn by colonial powers to purposefully bind conflicting groups in order for the external power to dominate over the country and eliminate a functioning local opposition. A good example of this is how Stalin organized the southern part of Eastern Europe in a way that forced ethnic factions to focus on domestic divisions, allowing Stalin to easily control the region. The British did the same in Iraq. In the shorter term, this is likely to increase geopolitical pressures, but in the longer term it could prove to be a positive. Additionally, as the U.S. withdraws from the world police role, the power vacuum will lead to an increasing number of failed states. African nations are the most likely to see increasing instability and border adjustments, although similar shifts could affect the Middle East as well.

Population growth and urbanization are likely to remain key trends globally, leading to fissures within countries. Over the 20 year time frame, 65 million people are added

to the world's urban population every year. This is equivalent to adding seven cities the size of Chicago annually. The global urbanization rate is forecast to surge to 60% from the current 50%. Promises of better pay and improved living standards will attract numerous rural workers to cities, but the greatest inequalities will remain between the rural dwellers and the urbanites. This influx of new labor will, at least initially, increase the number of people living in slums. Progress in improving quality of life will be highly dependent on global economic growth.

China, in particular, could see wealth levels diverge between cities, with the cities on the coasts continuing to thrive due to their advanced international commercial links and richer populations. The Politburo will have an increasingly difficult time governing the divergent objectives and could revert back to nationalistic fervor. The conflicting interests could also lead to a split in the governing party. More generally, as the developing world becomes richer the push for democracy becomes unstoppable. Traditionally, the \$15,000 per capita income level has been considered the democracy threshold, above which the population demands more political freedom. Democracies do not usually revert back to autocracies past this point.

Today about one billion people globally are living in extreme poverty, earning less than \$1.25 a day, and one billion are undernourished. The absolute number of impoverished people has remained pretty stable for a long time, but the proportion of impoverished has declined with population growth. The number of people living in absolute poverty is projected to fall significantly by 2030. The greatest advances are forecast to take place in East Asia, especially China, South Asia, the

Middle East and North Africa. Sub-Saharan Africa is forecast to maintain its very high level of impoverishment.

We note that as living standards improve globally, the expectation of steady improvement will also rise. These expectations, if not met, could lead to political instability. Historically, the growing middle class, when let down, has pressured governments for change, especially in the countries that lack a free political arena. 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.

Another important element of the inequality problem is the power that technology will give the poor. The ability of hackers to undermine the financial and economic infrastructure will grow and create an "arms race" of sorts between the technological insurgents and security firms. The rise of a technological non-state "proletariat" could become a serious problem; if this trend develops, expect that hackers will become as notorious as terrorist figures are today.

### **Ramifications**

The increasing inequality scenario projects that prosperity will grow for the world as a whole, but that the socio-economic inequalities will be tremendous. Inequalities will flourish between and within countries, leading to political and social uncertainty.

Many of the developments dealing with the wealth gap and the resulting social tensions will depend on the reactions of state governments and multi-national organizations. The differing wealth levels and thus the divergent political objectives are likely to lead to dissent. Although an all-out war is unlikely, local conflicts are

likely to rise over a multitude of issues, including economic disparity, politics and religion.

This new international system will likely not be rules-based but interests-based, with the international security providers only getting involved in situations that threaten their own interests. The decrease in international cohesion also means that the poorer countries will be caught in a vicious cycle, whereby declining wealth means less influence.

The world has faced similar periods of great wealth and income divergences. In earlier periods, these situations were diffused by income transfers, unionization and expansion of suffrage. Beth Simmons notes in her book "Who Adjusts"<sup>1</sup> that the gold standard worked prior to WWI because, in most developed nations, suffrage did not extend to the working classes. Since the upper classes across all the developed nations, who were mostly creditors, benefited from the low inflation (and sometimes deflation) brought by a stable money supply, they implemented policies which supported the gold standard. As voting extended to the working classes after the war, the ability of governments to remain on the gold standard eroded, as the policies necessary to maintain the standard were generally unpopular with the working classes, who were usually debtors.

In yesterday's world, wealth and the wealthy were mostly tied to the nation state. Countries were more easily able to raise progressive taxes on the wealthy to support social programs. However, in today's world, wealth is more easily transferable. France's follies with its 75% tax rate and the

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<sup>1</sup> Simmons, Beth, *Who Adjusts? Domestic Sources of Foreign Economic Policy During the War Years*, Princeton University Press, 1994, page 21.

flight of its wealthy to more favorable tax venues is a good example of the differences between today's situation and earlier conditions. Thus, not only is there a chance of a growing non-state technological proletariat; there is also evidence of a stateless wealthy class as well.

In this environment, long-term investors will spend much of their time trying to protect their wealth from confiscatory tax regimes and hackers. Technology firms that supply security software and states that offer low tax regimes should flourish.

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