

# The Arc of Geopolitical Risk

Revision state: *Published*

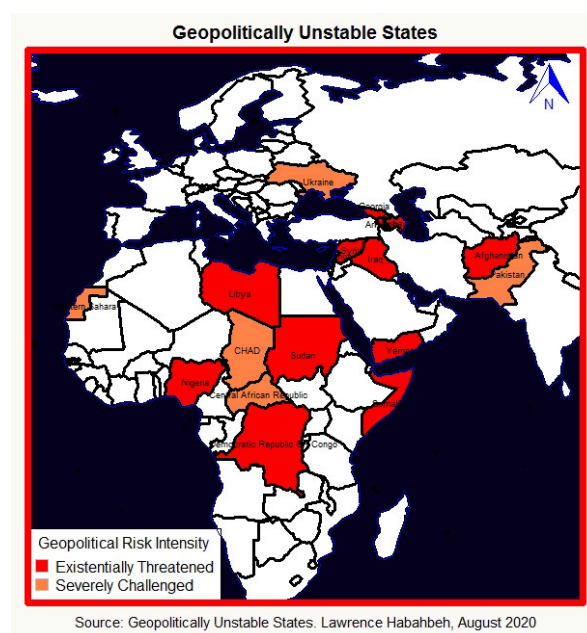
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12 August 2020

*Lawrence Hababbeh, Chair of the [Sustainable Development Goals MIG](#), discusses the differences between government instability and hard core geopolitical risk and the leading risk factors driving geopolitical instability.*

Understanding the major drivers of [geopolitical risk](#) is becoming more important in a world that is undergoing a state of transition in the framework that organises, structures and regulates relations between countries in a particular epoch of history, through the collection of organisations, institutions, treaties, rules, norms, values, and practises, termed “[World Order](#)”. The world order is being subjected to various stresses, rejected by certain State, and non-State actors as a result of the return to great power competition between major world players. Geopolitics is defined as the role geography plays in a State’s geographic character, which dictates its strategic value, the shape of its participation in international affairs and overall relationship to the rest of the world. Further, according to this author he defines [geopolitical analysis](#) as the interaction between geographic, demographic, cultural, economic and strategic factors, alongside their relevant impacts on tensions, conflicts, trends and foreign policy decisions. Indeed geopolitical risk analysis should also take into consideration strategic factors that drive foreign policy decisions and relations between countries such as competition for natural resources, climate change factors, and mass migration movements among others. In a globalized and densely connected world, geopolitical risk should be a factor in the strategic vision of all investors faced with meeting the challenges of the strategic future. For this reason, every investor should take risk into account when building and maintaining a portfolio and that is why it is wise to have at least a basic familiarity with the major dynamics driving geopolitical instability and the current geopolitical issue areas around the globe.



The big five classical experts on geopolitics are the father of contemporary geopolitics the Swedish [Rudolph Kjellen](#) who coined the term “Geopolitics” in 1916. American naval officer [Rear Admiral Alfred Thayer Mayhan](#), who wrote the “The Influence of Sea Power Among History”. British geographer, [Halfrod J. Mackinder](#), who in 1904 introduced the concept of the geographical pivot of history, and later between 1918-19, he developed this concept into a [heartland theory](#). German general and officer of World War I [Karl Haushofer](#), whose ideas of the State as a living organism and the inclusion of [organic](#) state theory, informed by [social Darwinism](#) lead to developing the School of Haushofer. Haushofer believed that Germany’s living space “[Lebensraum](#)” should contain not only Eastern Europe, but

Scandinavia, Asia Minor, part of Iraq and portion of Africa. Finally, American college professor, [Nicholas John Spykman](#), who wrote "On American's Strategy in World Politics". Spykman noted that peaceful world could exist assuming a strategic balance of power in Eurasia and the cooperation of the United States, the Soviet Union, and Great Britain. He also believed that the Mediterranean basin, the European Peninsula, and the Asiatic Coastline were of greater strength and power than the heartland.

According to the [Joint Forum On Actuarial Regulation \(JFAR\)](#) June 2020 Risk Perspective report, page 49, the report noted: "From a financial projection point of view, it is unclear the scale of impact which these geopolitical tensions would have on global trade or even whether it would throw doubt on the ability of the structure of the nation states to remain intact. The meeting noted that implications of these risk scenarios are very troubling." Likewise, in the latest Bank of England (BOE) [systemic risk survey](#), geopolitical risk is cited as the third risk with the greatest impact on the UK financial system and in the top seven risks hard to manage by firms. Furthermore; according to the [World Economic Forum 2020 Global Risk Report](#), geopolitical risks are among the top ten risks in terms of likelihood and Impact. This rise in the importance of geopolitical risk is a significant development and it marks a shift away from the focus on economic risks that prevailed over the past decade due to the global financial crisis of 2007-2009.

Moreover, according to an article published in the July 2020 in the Global Association of Risk Professionals (GARP) [What COVID-19 tells us about disruptive risks](#), and how chief risk officers can manage them, James Lam cautions against the "new normal", where a list of Disruptive risks of which geopolitical events are among them are no longer events that only happen once in a hundred years, such as technology (artificial intelligence, block-chain, and the Internet of Things), cyber-security, climate change and geopolitical events. An example of geopolitical risk is the ongoing conflict in [Nagorno-Karabakh](#) between Armenia and Azerbaijan, and the [annexation of Crimea](#) by Russia in 2014. Also, a flare-up of tensions between Saudi Arabia and Iran due to Iran's regional aspirations, which could result in a spike in the price of oil similar to the price shock of the 1990 that occurred in response to Iraq's invasion of [Kuwait](#).

Therefore, it is necessary to specify what exactly is meant by "geopolitical instability" and the major risk factors that drives geopolitical risk. In particular, we should differentiate a more superficial form of "*governmental instability*" from deeper "*geopolitical instability*". North Korea, for example, certainly has an unstable government, but its existence as a State with full control over its territory is not threatened. Similarly, Venezuela is both governmentally and economically unstable, but no groups are demanding its dissolution or threatening to annex large parts of its territory. The threats faced by such truly geopolitically unstable countries as Yemen, Syria, Iraq, Ukraine, and Libya, on the other hand, are much more extreme, as they are existential in nature. It is far from certain that Libya, let alone Yemen, will be reconstituted as a coherent functioning political unit.

A common theme in modern history is the repeated wars over territory. Political movements to unite the territory of an ethnic group with the territories of other countries, known as [irredentism](#), have caused some of the most significant conflicts of the 1990's. The call to re-unite "lost territories" and bring together ethnic kin has caused the wars for Greater Serbia and a Greater Croatia; a potential Kurdistan threatens Iran, Iraq, Syria and Turkey. Irredentist conflict in the Kashmir threatens a nuclear confrontation between India and Pakistan. Likewise, successful political movements asking for withdrawal of territory from part of an existing State to create a new state called [secessions](#) included Indonesia from the Netherlands, the Democratic Republic of Vietnam from France, and Guinea-Bissau from Portugal to name a few.

Consequently, the leading risk drivers of geopolitical instability, is the existence of active or dormant irredentist or secessionist movements in a country, as a result of historically evolved geopolitical risk factors driven by territorial issues, manifesting on the current global geopolitical configuration as "[geopolitical intersections](#)". Certainly, the presence of geopolitical intersections is at the core of geopolitical instability, ergo, geopolitical risk, and have been a prominent cause of armed conflict and war in the modern era that causes ethnic groups to seek independence [By appealing to the United Nations' principal (and accompanying right) [\[The Right To self-Determination\]](#), or unification with another State, to create a new, independent State [\[By Appealing to the Historic Right to a territory\]](#).

With this differentiation in mind, I have mapped a geographic zone of authentic geopolitical instability. The countries in red are deeply threatened and in some cases hardly exist as real geopolitical units. Lighter coloured countries are geopolitically challenged in one way or another, generally by serious separatist movements or from territorial encroachments by neighbouring States. The basic patterns of the map are clear, it shows that the distribution of

geopolitical risk events is concentrated across an arc of geopolitical instability stretching from Central Africa through North Africa and the Middle East and extending into the former Soviet region.

Finally, as actuaries, we have a natural ability to identify risks, and raise awareness of, and work on mitigating these risks to the public interest. We measure risks to a single financial transaction or to portfolios of financial transactions, using various approximation techniques and assumptions about both the statistical properties of the underlying risk factors driving the risk processes, and the sensitivity of changes in the value of financial transactions and portfolios to small moves in the underlying risk factors. Some actuaries will find a way to assess 'geopolitical risk' through constructing an analytic geopolitical risk model to forecast the socio-economic, and external natural risk factors that leads to the activation of secessionist or Irredentist movements that are the leading drivers of geopolitical instability, and incorporate the geopolitical risk model in the overall enterprise risk management framework. Others will be at ease in knowing that they were only one of numerous actuaries to utterly disregard geopolitics. But at least now, there are some central ideas about how to think about the dynamics of geopolitical instability and the major drivers of geopolitical risk. For if you are not aware of these risks and their momentum to disrupt markets then you could certainly be caught off-guard.

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