



ZURICH®

Borders vs. Barriers

Navigating uncertainty in the US business environment

Executive summary

 Atlantic Council

SCOWCROFT CENTER
FOR STRATEGY AND SECURITY



Building a better working world

Executive summary

For the first time since the global financial crisis, every major economy in the world is projected to grow, and President Trump says the US is “open for business.” As of early 2018, business leaders have been generally buoyant. The Global CFO Survey conducted for this report found CFOs to be optimistic about the economic outlook for the US; 61% of respondents indicated they are confident or extremely confident about investing in the US, and 71% expect continued improvement in the US business environment in the next one to three years. Business leaders are bullish on the near-term US outlook, according to the survey; deregulation and the passage of landmark US tax reform has boosted business confidence, with 68% of CFOs reporting that they expect the passage of the US tax reform to have a positive impact on their company’s financial performance in the next one to three years.

Get beyond those exclamation points, though, and you start to see the question marks and concerns – about global shifts in power, a potential wave of protectionism, and warnings that business leaders and policymakers should be “on guard” for the next recession and that global growth may be masking systemic financial, social and geographical risks. Economic volatility and policy uncertainty in the first quarter of 2018 have only increased those concerns.

In this age of transformation and transition, the US has questioned long-standing trade agreements, transformed the tax and regulatory system, and challenged traditional defense treaties. In 2017, the US Congress passed the most significant changes to its tax code in 30 years and the Trump administration opened renegotiations on the 25-year-old North America Free Trade Agreement (NAFTA). The impact of these changing policy choices has yet to be fully realized, and our research suggests the impact on business may differ significantly over the short and long term. The alterations to the tax code present reasons to be optimistic in the near term, but longer-term effects have yet to be seen.

Conversely, although NAFTA renegotiations raise concerns and risk disruption to existing operations, they also present an opportunity to modernize the agreement. According to the Global CFO Survey, business leaders are most concerned about policies that would restrict the flow of goods, capital and people; 68% of CFOs surveyed expect growth of US protectionism in the next one to three years, and 46% fear this growth will negatively impact investment.

Geopolitical trends and shock events can disrupt, but they can also create opportunity. Given the potential impact, businesses must act to dissipate a potential storm and create


upsides, for their customers, shareholders and employees. Leading organizations must increasingly consider geopolitics in their business strategy; explore contingent scenarios; make preparations; engage with stakeholders and policymakers on local and national levels; and potentially shift operations to seize opportunity and mitigate risks, whether financial, locational, political or social.

Key takeaways

- In our Global CFO Survey, which comprised 500 CFOs in 30 countries, we found that CFOs were bullish on doing business in the US, mainly due to a positive economic outlook and the passage of landmark tax reform.
- However, the survey results indicated that CFOs are concerned about US policies that would restrict the flow of goods, capital, and people, as these could negatively impact the current positive business environment.
- The improved outlook for the US economy is generating optimism about growth among CFOs, yet at the same time, there are high levels of concern with unconventional or inward policy shifts from the US. This raises the question of how companies are approaching the difficult task of integrating this uncertainty into their business planning and whether they can be prepared for any potential adverse and longer-term impact of geopolitical events.
- In our modeling of three potential geopolitical scenarios for the US, the Isolationist scenario was defined as the most inward-looking, characterized by protectionist trade policies. Our models reflected that over a five year period, Isolationism was associated with significantly lower US GDP – a cumulative loss of \$2 trillion – and higher unemployment – 1.7 million US job losses – as compared with an open-market Internationalist scenario.
- To minimize risk and take full advantage of opportunities, companies need to develop a more strategic approach to understanding geopolitical change. This involves defining a holistic “geostrategy”, including bold scenario planning, to successfully navigate through periods of geopolitical uncertainty. Organizations have a choice – manage geopolitical risks or be managed by them.

Scenario analysis

Given the level of uncertainty around the future of the US business environment, we have explored three geopolitical scenarios and their impact on strategy and operations. In addition, US policy decisions will have very real impacts on the US economy, and by extension the global economy. For example, modeling of these scenarios shows a potential difference of \$2 trillion in cumulative US GDP and 1.7 million US jobs for the period of 2017 to 2022 between the Internationalist and the Isolationist scenarios.



Internationalism

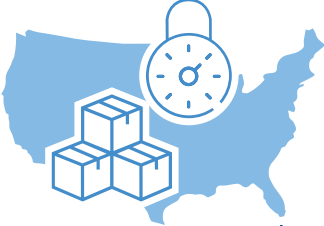
- Globalism
- Free and open trade
- Global cooperation

| GDP | Unemployment | Trade |
|-----|--------------|-------|
| | | +10% |

- Supply Chain** – Increase transparency, global standards, increase security, block chain opportunity, increased collaboration
- Investment** – Increased global competition, increased US investment, CFIUS scrutiny moderated
- Reputation** – Human rights, data privacy focus, international cooperation/consistent global regulation, increase in US aid reduces risk
- Policy** – Education investment, tax incentives in technology, advanced manufacturing, and engineering, ESG focus

Note – As constructed, the US trading relationship with the rest of the world contributes to defining each scenario. In the Isolationist and Atlanticist scenarios, increased tariffs and border adjustment taxes drive the value of US trade with the rest of the world lower (modeled at 30% and 10%, respectively). In the Internationalist scenario, the further opening of markets through new trade agreements increases the value of US trade (modeled at 10%).

Each scenario carries implications for overall US policy (including economic, regulatory, military and immigration), global supply chains, investment behavior and reputation. To assess these scenarios, business must consider the interconnectedness of the operating environment and the short- and long-term impacts of varying policy choices and geopolitical events.

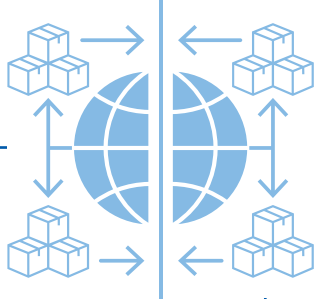


Isolationism

- Protectionism
- Economic restrictions
- Domestic focus

| GDP | Unemployment | Trade |
|-----|--------------|-------|
| | | -30% |

- Supply Chain** – Localize operations, domestic sourcing/local content, export focus
- Investment** – Focus on US productive capacity, increased CFIUS challenges and cross-border M&A scrutiny
- Reputation** – Focus on local investment/contribution, provide “American” credentials
- Policy** – Immigration restrictions, tax incentives, tariffs/border adjustment taxes



Atlanticism

- Elements of Isolationism/ Internationalism
- Focus on European/Americas relationships

| GDP | Unemployment | Trade |
|-----|--------------|-------|
| | | -10% |

- Supply Chain** – Focus on the bloc, “picking sides”, restrictions on non-bloc locations
- Investment** – Intra-bloc production & activity incentivized, non-bloc activity scrutinized, including CFIUS challenges
- Reputation** – Cyber, government social risks in the operating cross-blocs; pressure to contribute to US economic development
- Policy** – Tariffs/taxes: bloc and non-bloc

Organizations have a choice – manage geopolitics or be managed by them

With so many potential and unknown factors, it may seem daunting to even attempt to manage geopolitical risk and uncertainty. The first step is relatively straightforward: assess your global footprint and consider your strategic goals within that context. Second, invest in knowledge and networks. Internal knowledge and practices can be supplemented by needed external expertise. In the age of constant news and information, dispassionate, experienced geopolitical perspective is critical, especially amid the increasing likelihood of misinformation campaigns around the world. Third, organizations must act. To thrive in a world being transformed by geopolitics, businesses need to be flexible and resilient, monitor risks proactively, and constantly challenge their corporate cultures. Advanced planning and business continuity assessments can build an organization’s resiliency in times of crisis.



Adaptation in an age of transformation

As highlighted in the World Economic Forum’s 2018 Global Risk Report, the world’s increasing interconnectedness reminds us that geopolitics cannot be viewed in a silo. As political, economic, social and geographic issues shape our world, shifts of a similar magnitude are occurring in information technology, automation and robotics, demographics, and the future of work. While three discrete scenarios are presented, the future US business environment is likely to be more fluid, reflecting various characteristics of each scenario at different times, and taking into account reciprocal or retaliatory action by other nations. To the extent the environment tilts in one direction or another, playing out the implications developed as part of these scenarios can contribute to planning and adaptation.

After nearly a decade of slow growth, the improved economic outlook appears to be prompting CFOs to be overwhelmingly optimistic. However, they may be overlooking the implications that possible policy changes may have on the US economy and on their business strategy directly. This raises the question of whether companies are truly prepared for the impact of potentially negative geopolitical events, which could be further exacerbated by an economic downturn. In the words of IMF Managing Director Christine Lagarde, this is the “perfect opportunity . . . to repair the roof.” We believe now is the time for action – the time to consider the future and prepare your business to navigate and thrive through uncertainty in the US business environment.



Zurich

1299 Zurich Way, Schaumburg, IL 60196-1056

800 982 5964 www.zurichna.com

© 2018 Zurich American Insurance Company and Ernst & Young LLP.

All rights reserved.

Disclaimer

This publication has been prepared by Zurich Insurance Group Ltd, the Atlantic Council and Ernst & Young LLP. The opinions expressed therein are those of Zurich Insurance Group Ltd, the Atlantic Council and Ernst & Young as of the date of writing, and are subject to change without notice.

This publication has been produced solely for informational purposes. The analysis contained and opinions expressed herein are based on numerous assumptions. Different assumptions could result in materially different conclusions. All information contained in this publication has been compiled and obtained from sources believed to be reliable and credible, but no representation or warranty, express or implied, is made by Zurich Insurance Group Ltd or any of its subsidiaries (the "Zurich Group") or the Atlantic Council or Ernst & Young as to their accuracy or completeness.

This publication is not intended to be legal, underwriting, financial, investment, or any other type of professional advice. Persons requiring advice should consult an independent adviser. The Zurich Group, the Atlantic Council and Ernst & Young disclaim any and all liability whatsoever resulting from the use of or reliance upon this publication.

Certain statements in this publication are forward-looking statements, including, but not limited to, statements that are predictions of or indicate future events, trends, plans, developments, or objectives. Undue reliance should not be placed on such statements because, by their nature, they are subject to known and unknown risks and uncertainties and can be affected by other factors that could cause actual results, developments, plans, and objectives to differ materially from those expressed or implied in the forward-looking statements. The subject matter of this publication is also not tied to any specific insurance product, nor will it ensure coverage under any insurance policy.

This publication may not be reproduced either in whole, or in part, without prior written permission of Zurich Insurance Group Ltd, Mythenquai 2, 8002 Zurich, Switzerland, the Atlantic Council, 1030 15th Street, NW, 12th Floor, Washington, DC 20005 and Ernst & Young, 5 Times Square, New York, NY 10036.

Zurich Insurance Group Ltd, The Atlantic Council and Ernst & Young expressly prohibit the distribution of this report by or to third parties for any reason. Neither the Zurich Group nor The Atlantic Council and Ernst & Young accept liability for any loss arising from the use or distribution of this presentation. This report is for distribution only under such circumstances as may be permitted by applicable law and regulations. This report does not constitute an offer or an invitation for the sale or purchase of securities in any jurisdiction.

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

SCORE No. 02459-181US

1802-2583718

ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax or other professional advice. Please refer to your advisors for specific advice.

ey.com