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Insights

Inflation & Unrest

About the Authors

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Richard advises clients on their exposure to terrorism and political violence. With his deep analytical capability, Richard brings together a macro and micro lens. Prior to joining CHC Global, Richard spent 13 years at the Ministry of Defence and the Foreign and Commonwealth Office. He focused on national security issues including geopolitical developments and strategic threats, such as terrorism, nuclear proliferation and the actions of hostile nation states.

Overview

The prospect of high inflation has always alarmed central bankers and politicians in developed markets, due to its economic impact and the difficult policy choices that follow.

For emerging markets, however, high and persistent inflation can represent a far more damaging threat to both societies and governments, as imported goods begin to run short and the social contract between ruling parties and populations comes under intolerable strain.

Globally, countries are currently facing a fearsome mix of economic, operational, and geopolitical pressures that show no sign of abating. In this context it is worth considering the possible implications for stability, political violence and social unrest, and what might be done to mitigate these risks.

Inflation and Associated Problems

The recent sharp increase in global energy prices and associated inflation can largely be attributed to the war in Ukraine and subsequent issues with energy supplies. The impact of a reduced supply of gas has been felt most immediately in countries across Europe and has posed significant challenges for their respective energy ministries. Restrictions on Russian and Ukrainian commodities also created a growing food crisis around the globe, as grain exports plummeted and the price of fertiliser shot up by nearly 200%

Many broader pressures, however, pre-dated Russia's invasion and these served to only exacerbate the impact of the conflict. The reduction in Russian energy exports and wider supply chain disruption coincided with a post-COVID recovery of consumer appetite, adding strain to a system that was already struggling to come out of hibernation. Geopolitically, the return of great power competition, and seemingly zero-sum attitude towards meaningful cooperation, meant that any hope of a finding a multi-lateral solution to shield the most exposed countries was unrealistic.

The combined impact of these pressures has been felt most keenly in emerging markets. Increasing interest rates, particularly in the US, have served to suck foreign direct investment out of developing economies and back into safe havens such as US Treasuries – albeit not at a pace and scale seen in previous years. At the same time, a strengthening US Dollar has weakened the value of many other currencies, making imports of food and energy more expensive through foreign exchange costs. Export restrictions, such as on wheat from India, only served to exacerbate shortages and push prices up further, laying bare the inherent risks in extended supply chains that rely on the genuinely free movement of goods.

Security Implications

Although much of the debate about inflation is inevitably wrapped up with economic policy, there are important security implications of the current global crisis which could lead to a rise in political violence and social unrest. There are a number of factors which could determine how resilient specific countries may be in the face of rising inflation and a challenging economic environment.

Levers of Power

Most states would like to insulate their populations from inflationary pressures and declining living standards, but few have the necessary tools left at their disposal. The German government's energy support package is predicted to cost 200 billion euros (approximately 5% of GDP), which is not an option available to most countries even at the best of times. Government support programmes following the 2008 financial crisis and COVID-19 have depleted most states' financial reserves, while the cost of borrowing in international markets has only increased. This has left governments with few easy policy choices and has already forced countries such as Egypt to reduce imports and Turkey to guarantee Lira deposits (converted from other currencies) against depreciation, in an attempt to encourage saving and reduce capital flight.

Deprivation and Unrest

For lower and middle-income nations, reducing subsidies for staple foods or fuel would help to free government budgets from unsustainable commitments, but this remains politically fraught. In many cases this has been tried before, either as an independent government initiative or following cajoling by the International Monetary Fund (IMF), but had led to rioting, such as in Egypt, Tunisia, Sri Lanka and Iran.

Many governments will be acutely aware that the 'Arab Spring' was driven by economic deprivation, a lack of opportunities, and a belief that the ruling parties were more focused on self-enrichment than finding solutions. As people struggle to feed their families, while also feeling they have no intrinsic stake in the maintenance of the state, it becomes increasingly likely that social unrest will follow. To date, price controls have shielded people from the full increased cost of living, but this is unlikely to last.

Eroded Informal Support Structures

In those countries where the state has failed to provide a reliable safety net, informal support structures have often played a crucial, if politically motivated, role. The Muslim Brotherhood in Egypt and Hezbollah in Lebanon have both had outsized parts to play in assisting specific elements of their respective societies. However, ruling governments and external actors have spent the last 10 years or more seeking to weaken these organisations, meaning they may now struggle to offer a meaningful level of support to local communities, thus increasing reliance on an already overburdened state.

National Risk Profiles

The global nature of the current spike in inflation and supply chain friction means that all countries will be impacted in some way. Assessing which states will prove resilient and which might suffer significant instability and unrest is a nuanced judgement. To help narrow the list, we suggest three factors that are likely to indicate states at greater risk of instability:

- **A high percentage of food or energy is imported,** especially where the local currency has depreciated against the US Dollar.
- **The long-term provision of government subsidies** on food and fuel is part of the social contract between the people and government.
- **Rulers who lack legitimacy,** rule on behalf of a minority and/or fail to offer people a stake in the growth of the country.

As inflation persists, prices of staple goods rise, and some governments are perceived to be disinterested or impotent, the risk of civil unrest, political violence and even terrorism in the longer term will likely increase.

Rise in Criminality & Coercive Threats

Of those left struggling with higher prices and little support, some may inevitably turn towards criminality or more extreme narratives to help confront their situation. Deprivation, driven by events outside people's control, could act as a powerful recruiting narrative for extremist groups, whilst the threat of kidnap for ransom and detention scenarios against western travellers may also rise. States themselves may seek to extract rents from multi-nationals, ranging from higher fees to transit the Suez Canal through to sudden tax demands and law changes that verge on extortion. Businesses and travellers will need to be prepared for increased volatility and uncertainty.

Debt ownership

The ability of some emerging economies to mitigate the impact of rising costs and pressures may ultimately be decided in Beijing. In Asia and parts of Africa an increasing portion of debt is owned by China as part of its 'Belt and Road' investments. Even in better times this caused concerns about debt traps, with the 2018 transfer of Hambantota Port in Sri Lanka to a Chinese operator being the most widely quoted example[1]. How China approaches debt restructuring is not well understood and may well lack the relative flexibility of the largely western-dominated 'Club of Paris' group of creditors. In short, the more governments are required to spend on servicing debt, the less they will have to spend on supporting their population. If China does offer debt relief, it remains to be seen on what terms and at what geopolitical price.

1. In 2018, Hambantota Port was signed over to Beijing on a 99-year lease after Sri Lanka struggled to repay Chinese state bank loans it had received to fund the construction

Building Resilience

Companies and CEOs often recognise the importance of geopolitics but can feel the scale of the issue at hand is unmanageable against what they can control. This is unsurprising since such macro issues can seem overwhelming, complex and impervious to influence, except for by the largest multi-nationals. Nevertheless, there are steps that can be taken to help mitigate some of the risks to staff and operations.

Assess Your Exposure

The scale of great power competition, inflation and unrest may be global, but will not affect every company in the same way. By virtue of sector, supply chain design, or national market, some companies may be largely unaffected, while others will sit on the liveliest fault lines. Leaders should devote the time to understand the macro environment but then focus on the 'so what' for their operations, people, assets and reputation.

Existing business continuity management processes or enterprise risk management can provide a good basis on which to expand. With this focus, a company can then pursue a process of information gathering, monitoring, futures forecasting and scenario development as a precursor to building greater operational resilience.

Travel Risk Management

Companies and individuals should review how they manage 'safe travel' and ensure they have fully assessed the risks and have in place suitable insurance and support. As well as the threat of crime, civil unrest, detention, and kidnap for ransom, thought should be given to the risk of malicious detention by a state.

Most countries have concluded that economic strength is a key component of national security, especially in the crucial and fast-growing markets of AI, semi-conductors and biotechnology, amongst others. For those operating in these sectors, the detention of staff and seizure of the IT they carry when travelling offer an opportunity to apply pressure to an opposing government, whilst simultaneously stealing valuable IP.

When visiting certain jurisdictions, individual staff risk assessments may be required, including considering nationality, seniority, access to crucial IP and even social media posts to identify those who could fall foul of arbitrary and malicious detention.

Insurance

The Insurance market has, of course, been buffeted by many of the issues highlighted. From the highly visible issue of destruction of property and business in Ukraine as a result of the war, through to the less visible pain of inflationary pressure on claims impacted by rising prices of materials. However, the insurance market also remains a form of safe haven for those looking to manage and transfer risks associated with the great security challenges of the day.

Enterprise risk management and other forms of proactive risk management remain critical but ultimately, when a crisis hits, insurance is still fundamental to helping put the policyholder back on an even keel. This is often through a combination of crisis response services and financial protection. Kidnap for ransom policies are pre-eminent in this approach, but increasingly other classes are adopting a greater focus on crisis response services, such as political violence and cyber insurance.

> "There are steps that can be taken to help mitigate some of the risks."

Conclusion

The war in Ukraine, following so quickly behind the COVID pandemic, has placed extraordinary pressure on governments, economies, and societies.

The second and third order effects of these events are still developing, but the consequences are unlikely to be evenly distributed across the globe. For some emerging markets financial stress will likely give way to political violence and civil unrest.

In such a turbulent environment it is crucial that businesses maintain a close eye on the threats to their people, operations and assets and seek appropriate support to mitigate and transfer the risks.

About Samphire Risk

Samphire Risk was formed in 2021 and is a world-leading independent Managing General Agent (MGA) focused on insuring people and companies against hostile and malicious risks. Through an expert team and exceptional technology, Samphire aims to create world-class products that insure against extortive crime, hostage-taking and kidnap; terrorism in all its guises; travel into, and within, insecure countries and locations.

To find out more about Samphire please visit our website www.samphirerisk.com or follow us on LinkedIn.

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