

Political risk

Text of speech by Sir Mark Boleat at IRM risk leaders conference, London, 15 November 2018

Over the past 40 or so the years UK has gone from being the “sick man of Europe” to a highly successful economy, and London has been transformed from a large national capital into the world’s leading global city. The finance industry is probably the best manifestation of this. London is the world’s major international financial centre. This transformation of the UK generally, and “the City” in particular, was not the result of a conscious plan, but rather resulted from a combination of factors. Some of these were UK’s long-standing advantages including political stability, the English language, the rule of law, a strong university network, a favourable and predictable business environment, and a welcoming environment for outsiders. But there were some helpful policy decisions, in particular in respect of tax and regulation, and also some “own goals” by other jurisdictions, notably France and United States.

But we are now in a very different environment. Brexit is dominating discussion not only in the Westminster hothouse but also in businesses throughout the country and in some businesses in other parts of the world. We all know what the political discussion is about because it dominates the media. Business issues are very different. There is now an uncertain business environment to the extent that we do not know what the nature of our trading relationship will be with our biggest trading partner in just five months’ time. Arguably, this is a symptom of a larger issue as indeed the referendum vote was a symptom of a larger issue, that is growing disaffection with the existing political structures leading to a rise in populism such that evidence is now much less important in the political decision-taking process and personalities more important. This paper discusses the growing importance of political risk to business.

Political risk has not been a factor in the past

Businesses operating in Britain have generally been able to ignore political risk. They could operate without running any significant risk in respect of-

- Expropriation of assets or retrospective taxation.
- Significant adverse tax or regulatory changes imposed at short notice.
- Discrimination against businesses that are British or against executives or workers who are not British.
- Being required to pay bribes in order to establish a business or to win contracts.
- Being subject the consequences of trade wars between Britain and other jurisdictions.

Even general elections did not pose a political risk as in practice the policies of the major parties were largely aligned. The transitions from Thatcher to Major to Blair to Brown to Cameron were almost seamless and had no significant effect on the business environment.

It is difficult to overstate the importance of these factors, which we have tended to take for granted in Britain. Businesses operating in other jurisdictions will realise just how significant these risks can be.

Brexit has changed everything

When the second decade at the 21st century becomes more a matter for historians than for commentators the 2016 referendum may well be seen to be one of the most damaging things that any country has managed to do to itself, and I stress here that it is the referendum itself that was damaging rather than the result. Britain's membership of the European Union was not until then a matter of great concern to the British public. It certainly was not a major talking point nor was it capable of dividing communities and families. Rather, it was a matter of great concern to a small number of political activists in the Conservative Party. The referendum elevated the issue into one of the defining issues of our time. People were almost obliged to take sides and to defend their side regardless of the facts. The issue became tribal, with people being labelled as "leavers" or "remainers", interpreting issues in accordance with the tribal view. An analogy from America illustrates this point neatly. Views on whether or not Brett Kavanaugh should have been appointed to the Supreme Court depended primarily on party affiliation not on his qualities as a judge; in one poll 63% of Democrats opposed his nomination and 73% of Republicans supported it. And in respect of the allegation of sexual misconduct a majority of men believed him, a majority of women did not. I have no doubt that a poll in Britain would show that a high proportion of those who voted leave think the current Brexit mess is the fault of the EU while a high proportion of those who voted Remain think it is because this was inevitable. It is rather like a disputed penalty at a football match. People's views depend not on the facts but rather on which team they support.

The political world and the nature of political decision-taking has never been very attractive. That is the nature of politics. In principle, nobody can object to the concept of evidence-based policy-making in the same way that no business would take important investment or other decisions without having the necessary evidence. But in politics this has never been the case. Alistair Campbell commented that in the early years of the Blair government it was more into policy-based evidence-seeking than evidence-based policy-making. But there is no doubt that the referendum has significantly worsened the position. People were able to choose their own facts even if they were demonstrably incorrect, such as the argument that Turkey was about to join the European Union and that if Britain left there would be an additional £350 million to spend on the NHS. Membership of the European Union never lent itself to a referendum because the issues were so complex even for those who had spent many years studying them, and the referendum was constructed in such a way that the official Leave campaign could say whatever it wanted safe in the knowledge that implementation would be a matter for someone else. It really was an abdication by government and Parliament of responsibilities that properly belonged to them. And, if Parliament lets the people decide it should not be greatly surprised if that decision is not based on hard evidence but rather on emotions and on factors that had little to do with the subject, such as declining real wages and incorrect perceptions about immigration.

The debate also contributed to the strengthening of personality-politics, exemplified by Nigel Farage, one of the most effective political leaders of our time, which is quite an achievement for someone who has never held public office of any kind in the United Kingdom let alone being a Member of Parliament or government minister. This was compounded by media coverage of the referendum, particularly by the BBC which at times seem to regard the concept of balance as having one person talking with expertise and experience followed by another person speaking with no expertise or experience and saying the precise opposite, leaving the listener or the viewer thoroughly confused.

Business found itself in a very different difficult position in the referendum debate. Its views tended to be discounted, not helped by various business scandals over the last few years. Businesses find the political environment a very difficult one, as is so alien to the environment within which they normally work. There are very few business leaders capable of making a meaningful contribution to political discussion, and it is partly for this reason that the political decision-making process now takes little account the views of business. I should add the business has only itself to blame this. As you know in your own businesses, if there is perceived to be a significant new risk, for example the threat of a cyber-attack, you devote the necessary resources to countering that threat. That logic seems not to have applied to political threats.

The new political risks

So, what now are the political risks that businesses need to consider. There is the very general one of political instability within the main political parties as well as nationally. There has been a little-understood change in the way we select our political leaders in this country. In the past we voted for a party and the elected representatives we voted for, MPs, chose their leader. Generally, although not always, this ensured that the leaders commanded widespread political support. Both main parties have now changed the method of electing their leader, and therefore the Prime Minister, such that the leader is in effect chosen by extremists. So, in the Labour Party people joined the party specifically to elect Jeremy Corbyn and he is firmly ensconced as leader of the Party notwithstanding some three quarters of Labour MPs having no confidence in him. In the Conservative Party the leader is chosen by the party members, who are not characterised particularly by extreme views given their demographic profile, but who are characterised by old-age. It is no longer a question of parties ditching leaders that they don't like knowing that another competent leader can soon be appointed, but rather much of the discussion is about the damaging consequences of a lengthy leadership election and the very uncertain outcome, leaving the incumbents in a strong position. In one sense this means stability but to coin a phrase, it is an unstable stability.

Nationally, we are all well aware of the current political instability with the government having a tiny majority and being reliant on a small party from Northern Ireland, and with significant dissidents in its own ranks. The government could well be defeated in a meaningful vote on what has been negotiated with the European Union, although it may well come back for a second meaningful vote. What was agreed by the Cabinet yesterday is at best fragile and we are in for a period of extreme political excitement, which will be damaging to business.

It may be that Britain will leave the European Union in March, with a smooth transition to a new trading relationship, but this is wishful thinking. If we do leave the Brexit negotiations will continue for years and years. A damaging consequence of this is the lack of resource to deal with the other significant issues that we need to address in the country, including those that contributed to the referendum result such as alienation felt by many people particularly those outside London, and by failure to address issues such as social mobility, poverty and poor educational standards in many parts of the country.

In the business context the main risk now is that we do not know what in five months' time will be the nature of our trading relationship with the European Union and indeed with those many countries with which the European Union has trade deals. The most likely outcome is that the deal that the Prime Minister has negotiated will be approved by Parliament and the European Parliament and the EU 27 and will come into operation such that Britain leave the European Union on 29 March but with a transition period where everything remains the same until the end of 2020 and with the likelihood of being in the Customs Union, although not the Single Market, for an extended period thereafter. However, there is a not insignificant risk that there will not be an agreed deal and that Britain will crash out at the European Union on 29 March. Equally, there is a not insignificant chance that there will be a peoples' vote, something which itself will be very divisive and which may or may not lead to Britain remaining in the European Union. It is significant that last night for the first time the Prime Minister talked about one of the consequences of rejecting the deal was "no Brexit" as well as "no deal". However, even many of those who think that leaving the European Union is bad are strongly opposed to a second referendum because of the damage they think it will do.

How can businesses mitigate political risk?

I imagine it is a fair assumption that in many businesses political risk is simply not considered adequately if at all and does not feature prominently on risk registers. Regardless of the end-game in respect of Britain's membership of the European Union any business operating in United Kingdom is now subject to much greater political risk than was the case in the past. It follows the risk managers, as well the senior management and boards of directors, have a responsibility to factor in political risk to their decision taking processes.

The first requirement in this respect is to understand the nature of political risk, something very few businesses manage to do. I can recall many years ago when I was running the Association of British Insurers, one of the prominent members saying to me "The trouble is that the politicians don't understand business" to which my response was "the trouble is that business people do not understand politics". In running trade association much of my effort was not in representing the views of the industry to politicians but rather in explaining political realities to the members. My first words to the staff of the ABI on taking up my role in 1993 was "we are not here to represent the views of our members, that would make us a laughing stock. We are here to represent their interests and as far as possible to seek to ensure that their views and their interests coincide." It is really not difficult to understand how political decisions are taken, what drives the politicians and what is going on in the political world. There are any number of books that adequately explain what

politics is really like. I would particularly commend Tim Shipman's two recent books, one on the referendum campaign properly entitled "All-out war" and the second on what has happened subsequently entitled "Fall out – a year of political mayhem". The third book should be even more interesting. And in respect of understanding current political developments, simply reading *The Economist* every week would be a great help.

But business also needs access to people who understand politics. This can include executives, board members and if this is not adequate then the use of consultants. Political consultants have a bad image with many people, seen to be associated with lobbying. But much of the best work of political consultants is simply informing companies about the political decision-taking process, how politicians view what they are doing and how they can best secure the policy outcomes that they want.

Businesses sensibly also need to take account of political risk in making location decisions. Sir Howard Davis, now the chairman of RBS and someone with huge political and business experience in Britain, has commented: "Brexit will alter the picture, whatever the outcome of the negotiations. Foreign-owned firms have concluded that keeping all of their eggs in a British basket being shaken vigorously by changeable political winds is risky." This is already affecting location decisions taken by businesses from outside Britain and it should properly influence businesses in Britain. One way of mitigating political risk in Britain is to have the ability to switch business to other locations and there are some other jurisdictions that seem very keen to attract business at present.

Businesses also need to be more involved in the political world, not by tub thumping and making grand statements, but at least by engaging with the local politicians, both councillors and Members of Parliament, to ensure that there is an understanding of what it is they are doing and what the consequences of certain political decisions might be. And more national business leaders need to speak up on Brexit and other major issues. Many businesses are scared of doing this. They should not be. If business does not engage adequately with politics it can hardly be surprised if the political system makes decisions that it does not like.

But this is not easy. The media are far more interested in what politicians have to say about business than what business has to say about business. I can usefully end with a little anecdote on this. Two nights ago, I was invited to go on Newsnight to speak about why business seems so reluctant to put its head above the parapet in the current debate on Brexit. However, shortly before my appearance I was bumped off as the BBC decided that it was far more sensible to have a politician, Jacob Rees Mogg, on the programme rather than me.