MARKO PAPIC

Geopolitical Alpha

AN INVESTMENT FRAMEWORK FOR PREDICTING THE FUTURE

Foreword by
Steven Drobny

WILEY

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This book is dedicated to the country that no longer exists.
Pjevaj nek te čuju, ko ne sluša pjesmu slušaće oluju!

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Foreword

Montreal. February 2017.

A cold, dark, and ice-stormy night.

I met Marko Papic for the first time over dinner at a spot he enthusiastically called "the coolest restaurant in town." Upon entering, I found a dark and empty restaurant save for a bartender, a waiter, a *mâitre d',* and a lone customer sitting in the back corner. I started strategizing a polite early exit. But the food and drinks were incredible, and we proceeded to have an excellent, wide-ranging conversation. We stayed late and got totally blasted. It was the first of many times I would observe Marko make a correct, out-of-consensus call.

Within minutes of meeting Marko, I knew he was unique. My singular skill is sniffing out quality from crap and gathering the good ones around me – be it finding new money managers to run capital for our institutional clients, bringing together smart investors on a deal, backing founders of new financial technology companies, or convening the most interesting people in the world at an event in some far-flung location. I also seek out those with unique skills and try to persuade them to join the Clocktower Group team.

By the time I met Marko, I'd been looking for a chief strategist for a while. I needed someone to act like a basketball center, a big man in the middle to gel the team. I was looking for a beautiful mind to sit on top of our unique and exclusive information flow, then channel it into a coherent form for our clients. At first, I looked for the typical economist. Over the past 40 years, bond markets, central bankers, and finance ministers drove markets – and the world. It was the Lords of Finance and the Committees to Save the World who pulled the puppet strings, and the *alpha* lay in correctly forecasting their next move.

Enter 2016.

The passing of the Brexit referendum and the election of Donald Trump marked a sea change in the macro game. Populist movements in developed countries drove home the point that the era of the economist and the interest rate soothsayer was over. In the post-Trump, post-Brexit era, geopolitics are all that counts. With interest rates pegged to the zero lower bound for the foreseeable future, the Lords of Finance and Committees to Save the World have run out of ammo.

As such, Clocktower's chief strategist needed not be an Ivy-trained economist with a perfect résumé coupled with a PhD, CFA, MBA, and other meaningless acronyms. We needed someone not locked on the movements of the Fed & Co., but focused on international and domestic politics. The battles and power players of today (and tomorrow) are Trump versus Xi, the UK versus Europe, Putin versus world, MBS, Macri, Bolsanaro, etc.

Enter Marko Papic: a geopolitical expert who grew up getting chased by packs of wild dogs in collapsing Yugoslavia; who subsequently moved to Iraq, Jordan, Switzerland and Texas; and who married a *Tejana* and settled in Canada. Whispers of an unorthodox geopolitical thinker with out-of-consensus market views drifted from clients and prospects. A strategist out of Montreal who more often than not, turned out to be right. For many, Marko, the nihilist Serbian, was their favorite strategist. I realized he was just the stateless, unbiased, enthusiastic, unique idea generator that the team in Santa Monica needed to fill out our global macro squad.

After following Marko's calls for a year and test-driving him at a few client events, I spent the better part of 2018 convincing him that the beaches of Southern California are a better place than the slopes of Mont-Tremblant. In December 2018, Marko signed on to join Clocktower Group as our chief strategist. In 2019, he crushed it. In January 2020, I said, "Marko, that was great, but now it is time to take the training wheels off," and made him write this book. I've written two books about global macro and was halfway through writing my third: the final installment in my trilogy. Contract was signed, chapters were in the can, and an advance was paid. Halfway through, the world changed. It was time to pass the ball to the big man in the middle.

Marko took the pass and ran with it. Like his childhood hero Kobe Bryant (RIP), he approached this book with insane focus. He wrote chapters faster than I could read them. He did this all while producing reports and talking to clients, seeds, founders, and partners on top of a torn ACL/meniscus (which he ignored), working from home and homeschooling his three kids due to COVID-19. Mamba-style.

Marko has a lot to say about this brave new world that revolves around politics and geopolitics. People deserve to hear it – not just Clocktower clients and friends but anyone who wants their eyes opened to the invisible barriers that dictate the future. In *Geopolitical Alpha*, Marko models how to make well-researched, actionable forecasts using his constraint-based framework. Along the way, he gifts you, the reader, with funny stories, anecdotes, and historical examples coupled with invaluable insights on relevant geopolitical trends: the state of US–China tensions, the future of Europe, the implications of the COVID-19 pandemic, US elections, and other schisms that will drive world markets. I hope you learn and enjoy. You're welcome.

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Author of *Inside the House of Money* and *The Invisible Hands*.
March 2020
Currently under "Shelter-in-place"
order in Malibu, Claifornia

Introduction

"The German president just resigned. We are selling everything. This is it."

It is May 31, 2010, and Horst Köhler, the president of Germany, has resigned.

I saw the news flash across my inbox in one of the hundreds of news items that I skimmed every morning, but I ignored it. I had triaged it, along with most articles that day, for the sake of sanity; I thought it was irrelevant.

Several hours later, I stare at the Polycom in the middle of the boardroom at Stratfor, the Austin, Texas–based geopolitical analysis firm that gave me my first job. My decision to ignore this one news item is about to cost me that first job. The knot in my stomach has knots.

The saleswoman whose client – a large Connecticut-based hedge fund – is on the line bores a hole in the side of my head with her gaze. I almost hear her thinking, *Oh my God … this foreign kid is out of his depth.*

I have no idea why the German president resigned or why it is market-relevant to a hedge fund (I have only a vague idea of what a hedge fund is in the first place). I have no idea who the German president even is!

* * * * *

By May 2010, the Euro Area sovereign debt crisis was already in full swing. The 2008 Great Recession had come and gone without the collapse of Western civilization, but things were still touch-and-go. People were on the lookout for the next shoe to drop. In October, 2009, incoming Greek Prime Minister George Papandreou revealed that the previous government had massively underreported the budget deficit. Instead of 6.7%, the figure was 12.7% (later revised to 15.4%!). The shoe *dropped*. By December 2009, the greatest economic crisis in the developed world since the Great Depression was afoot.

Nobody at my firm really cared. It was not the fault of the folks running the place; the firm was simply not designed to care about financial markets. For most of the past three decades, the investment and geopolitical communities rarely communicated, in part because they struggled to understand each other. They had become over-professionalized, erecting barriers to entry largely for job security, like medieval guilds.

When the Euro Area crisis hit, my marching orders at the firm were not to spend too much energy on it. I was told to focus on US ballistic missile defense in Europe and some other geopolitical matters that nobody outside the Beltway cared about. We had no edge in covering capital markets – few of the firm's analysts understood their own credit card statements. But as the firm's Europe analyst, it was impossible to ignore the evolving imbroglio. Not only did it flood my inbox with scary headlines and client emails, but I also sensed that this was the career opportunity of a lifetime.

By early 2010, my own career had stalled before it had even really begun. I was on leave from a PhD program at the University of Texas at Austin. Political science coursework and research ware easy, but not interesting. I would have coasted for the rest of my life teaching Poli Sci 101, but the oversupplied labor market in social science PhDs meant that I had to take whatever job was available, even if it deposited me and my family in some academic colony in the middle of nowhere.

I took the job at Stratfor because it was based in Austin. I got lucky. The place was fast-paced, young, and brutal. It taught me not to waffle, to digest information quickly, and to create knowledge shortcuts. But I was still missing the sense that I was making a difference in anybody's life.

My feeling of inadequacy was, in large part, a product of my job description. At the start of the decade, Europe had not produced geopolitical risks for a quarter of a century. The fall of the Berlin Wall, the dissolution of the Soviet Union, and the rise of the world's largest trading bloc were all epic events, but they were all tailwinds in the sails of the global economy. There was a sense that history had ended in Europe and that Jean-Claude Juncker was its Last Man.

At the same time, I was expressly hired to be the firm's Europe analyst. Given Stratfor's roots in "Great Power geopolitics," my position was the equivalent of being the admiral of the Swiss Navy. Most of the all-hands meetings were about Tomahawks, car bombs, and *jihad*. I usually got to fight with the Africa analyst for the scraps left over by the Middle East, counterterrorism, and East Asia analysts.

"But … the Lisbon Treaty … " I could feel the sneers before I finished my sentences – sneers from the "real analysts" who subsidized my EU-watching.

Thankfully for my career – and sadly for 400 million European citizens – the Euro Area crisis hit with a vengeance. Even though I couldn't navigate my credit card statement either, I knew that this was my moment to add value.

That said, all this was not clear on the morning of May 31, 2010. I was ushered into the conference room by the salesperson who handled the firm's financial relationships. I tangentially knew what these clients did for a living. Most were passive in their use of the firm's services. They read the analyses we posted online. They gave little feedback. Most of the time I didn't know if anyone cared what I was writing. But over the course of the next 12 months, I would have the most professionally intense period of my life. I realized *a lot* of people who *definitely* understood how interest rates worked were reading my research.

* * * * *

> "The German president just resigned. We are selling everything. This is it."

I look at the Polycom. I have a choice to make. Do I waffle my way out of the conversation, or do I bite the bullet?

Something about the accent on the other end of the line instills fear. I think it is a Long Island accent. I cannot tell precisely, as I'm a Serb living my fourth year in the US. Before arriving, all I really understood about America came from movies and *The Simpsons*. My gut tells me not to waffle "Long Island"; *he will know*. So, I take a deep breath and 'fess up.

"Guys, I don't know who the German president is."

Silence. Uncomfortably long. I glance at my colleague; she is revising her résumé in real time. I imagine my boss decapitating me on the same boardroom table at the next all-hands meeting.

"What do you mean? Aren't you the Europe guy at this shop?!"

Ok, here we go. Long Island is angry. The man pays for a service and is not getting it. I respect that. But the Serb in me now starts to come out. I get irrationally confident for no good reason.

"No … sorry, I apologize. You misunderstood me … yes, I am *the* Europe guy. And if *I* don't know who the German president is … " Silence on the other line … *time to go on the offensive.*

> " … Then it is not a significant piece of news. The president of Germany is the equivalent of Queen Elizabeth; he cuts ribbons, kisses babies, and shakes hands at the airport. I don't know why he resigned, but this event has zero relevance."[1]

* * * * *

This was a risky move. The resignation *could* have been related to the Euro Area crisis.

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[1] German President Horst Köhler resigned because, in 2010, it was still not acceptable for a German statesman to say that Berlin would use its military to protect its economic interests – such as to keep trade routes open. He was widely respected and a popular, nonpolitical leader. Ironically, his successor (who also resigned) later said much the same thing with little fanfare and no pressure to resign, showing how quickly the world was evolving in the early part of the 2010s.

The conventional view at the time was that Germany would not bail out the EU member states. Germans were obsessed with fiscal austerity, risks of inflation, and that "the Swabian housewife saved every *pfennig*." Maybe the president was a "hard-money" zealot who objected to bailing out profligate Euro Area peers like Greece. Maybe he thought that the crisis was an opportunity to "liquidate everything" – in the words of former US Treasury Secretary Andrew Mellon, who almost single-handedly turned a severe recession into the Great Depression.

And yet … I had a reason for dismissing this news. I had a *framework,* and it had taught me to push hard against the Eurosceptic narrative for months. This view on Europe would become a successful investment theme, and the proto framework that I had developed would become my profession and passion over the ensuing decade.

This framework – which focuses on the material constraints policymakers face – is what this book is about.

The framework boils down to this: Niccolò Machiavelli was wrong. No amount of *Virtù* will help the Prince overcome *Fortuna*. So don't study the Prince. Study his constraints.

* * * * *

Back in 2010, I take a gamble because "Long Island" pushed my buttons. It is an educated gamble. Long Island's singular focus on relevance – the "so what?" – forces me to make a call. Not to waffle, not to talk about "on the one hand" and "on the other hand," not to split hairs about "hard-to-estimate probabilities," but to give him an investment-relevant view in three sentences. *The resignation of the German president does not matter. Go back to making money.*

"Oh … got it. Thank you. We'll talk later."

Click.

Exhale.

I straighten up and turn to my colleague, chest flexed, a "What's up?" look on my face while maintaining an air of "I had this the entire time." (I did not.)

In a slow, staccato voice, she says, "These guys don't know what they are doing."

Boom. There it is. My Jerry Maguire moment. If we were in a cartoon, a lightbulb would have pulsated above my head and burst. I reply:

> "They're not stupid. That guy could literally … buy me … to tutor his kids for the rest of my life. These guys are not stupid. They are just … busy."

* * * * *

And human. And over-professionalized. To become an investment professional in 2010, one had to be confident in a lot of subjects, but a basic grounding in political science was not among them. This failing is not because investors suddenly became ignorant of global affairs and history but because those skill sets had not mattered for most investors since at least 1985.[2]

That moment led to a career-altering decision for me. I decided that I wanted to devise a framework for geopolitical forecasting rooted in the real world. Not based on conversations with "wise men in smoke-filled rooms" or on a narrow, inflexible view that geography and history predetermine outcomes, but on actual research and fundamentals. A framework that was not only easy to use but that was replicable by others who sought insights into the future.

There were two reasons I felt confident to declare that the resignation of the German president was irrelevant, both rooted in material constraints. First, the president was constrained by Germany's constitutional irrelevance. Second, I already had a framework for what German policymakers and voters would be forced to accept in the Euro Area crisis. Even if I had been wrong about this particular news item, I had a structural, macro view of what would happen next in the Euro Area crisis, one that was unlikely to unravel due to a single resignation. As I explain in

[2] Most does not mean all investors. Many of the greatest macro hedge fund minds of the past three decades made smart calls based on correct geopolitical insights. For example, George Soros "broke" the Bank of England in 1992 by understanding that the Bundesbank may burn deutschmarks defending the lira and the peseta, but not the pound. Aside from the occasional story of an astute geopolitical insight leading to fame and fortune, most professional investors have not had to care about geopolitics in their daily lives for a very long time.

Chapters 4 and 5, the Euro Area crisis illustrates how material constraints impact not only policymakers but also voters. European integration is not only going to continue, it will accelerate over the next decade due to these epochal constraints.

After downloading the constraint-based framework, the reader will be able to stop relying on the news flow for analysis. Much as an anchor keeps a ship from being blown out to sea, constraints anchor the smart investor to a subjective probability grounded in material reality.

I take one chapter to describe this framework. The punchline: investors (and anyone interested in forecasting politics) should focus on material constraints, not policymaker preferences.

Preferences are optional and subject to constraints, whereas constraints are neither optional nor subject to preferences.

The era of geopolitical ignorance is over. The days when investors and corporate decision-makers could be successful without much understanding of politics will be a footnote in the annals of history. In the first chapter, I go over these paradigm shifts rather quickly because, at the time of this writing, the idea that "we're not in Kansas anymore" is obvious.

At the same time, not everyone needs to rush to enroll in political science courses. The constraint framework has worked well for me by providing the tools sufficient to make sense of politics. As such, I hope to offer professionals who must take politics seriously a shortcut – not a foolproof, scientific method – to forecasting geopolitics.

The focus of the rest of the book is on the framework itself. While I initially built the constraint framework to help investors make sense of geopolitics – and make money in the process – the C-suite can also use it to make long-term investment decisions. Journalists can use it to find the right buttons to push in an interview, and voters to become more politically informed.[3]

Chapter 2 describes the inspiration for the constraint-based framework. It is a mix of political science, political theory, intelligence analysis, and social psychology – as well as voodoo and trial and error.

Why read beyond the first part that describes the framework? It is one thing to hear the framework described; it is another to see it in action.

[3] By the way, if you have *that* relative at every family gathering, this is a perfect book to get them for the holidays!

It would be like telling a budding skier that skiing comes down to balance and reading the terrain. Sounds awesome. Now plunge yourself down a double black slope. I therefore take the framework for a spin, using recent geopolitical and political events as the racetrack. The book concludes by operationalizing the framework in a process that gives us the title: *Geopolitical Alpha*. Alpha, in the context of this book, refers to a return on an investment against a benchmark, in finance-speak, rather than the leader of a pack or someone spending too much time in a gym.

There are three things this book does *not* aim to do.

First, it cannot teach you about the world. To wield the constraint-based framework competently, you must know a lot. For instance, that the German president = Queen Elizabeth. If you don't know, speak to experts. That potential absence of a knowledge base is why I include a chapter on how to use expert judgment.

Second, this book will not tell you the future. This is a methods book. I offer up my framework because many investment professionals have found it useful. But I am not a prophet, nor will focusing on constraints make anyone else a prophet. This book is simply my attempt to share what has worked for me. There are other frameworks out there that work for other investment strategists.

Third, this book will not tell you what I think *should* happen.

I don't care. Not in this book, not in my field. I am a professional nihilist. And if you analyze politics for a living – especially if you have a fiduciary duty to your investors – you should be the same! To competently use my framework, meditate on your biases and bathe yourself in indifference. If you are not up to it, you should not be in the forecasting business, let alone finance.

Part One

SCAFFOLDING

Chapter 1

We're Not in Kansas Anymore

The world is undergoing paradigm shifts on multiple fronts: political, geopolitical, generational, and technological. What these changes are and their implications for the future are beyond the scope of this book. Instead, I present a framework that has helped me make sense of the world over the past decade. I hope it will prove helpful to navigate the paradigm shifts to come.

I use the term "framework" because it is less deterministic than a theory and not as prescriptive as a method. It is messy, full of contradictions, and much more art than science. It fits with forecasting geopolitics and politics because forecasting is similarly messy. There is nothing parsimonious about the constraint framework I present.

In the past 25 years, geopolitics and politics have switched from being tailwinds to the global economy and markets to being headwinds. For many in business and finance, it feels like a rug has been pulled out from under them. I know the feeling; I saw it happen to my family firsthand when I was eight years old.

Cut off from the Yellow Brick Road

In 1986, my 36-year-old dad joined General Export (Genex), the *crème de la crème* of Yugoslavia's corporate world. For my dad, it was the equivalent of landing a job at IBM in the 1950s-era United States.

Dad had *made* it. His life – and by extension my life – was going to be pure *kajmak*.[1] Step one: a four-year stint in the London office ("so you and your sister can learn English"). Steps two and beyond: an upgrade to our 505-square-foot "condo," then maybe a car with more than two cylinders, a house on the Dalmatian coast, a year at a foreign university … culminating in an entrée into the upper echelons of socialist society.[2]

What was so great about Genex? At the end of 1989, the conglomerate controlled 12–13% of Yugoslav foreign trade and nearly a third of Serbian trade with the rest of the world.[3]

What did it manufacture? What services did it export?

Nothing and none. What Genex "manufactured" was pure geopolitical *alpha*.

The Soviets did not believe in running a trade deficit. So, every year, the USSR would produce a list of goods that it was interested in exchanging for barter. Because Yugoslavia was a promiscuous communist country – it played both sides of the Cold War – a company like Genex would sell Yugoslav and foreign goods to the Soviets in exchange for what the USSR was willing to export (mainly commodities). Genex would then sell the Soviet commodities in the global market, pocketing a hefty profit in hard currency.

Unfortunately for Genex, but fortunately for almost everyone else on the planet, the Berlin Wall fell on November 9, 1989. Two years later, the Soviet Union disintegrated. The geopolitical gravy train ended and Genex's edge with it. The firm's entire corporate strategy was leveraged to the geopolitical status quo. In fact, my homeland was basically living off the Cold War. When the geopolitical winds shifted, the end was nigh for both Genex and Yugoslavia.

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[1] Like "gravy," but cheese … and *much* worse for your cardiovascular system, if you can believe it.

[2] From which there is no sliding back into the proletariat!

[3] "Rise and Fall of Genex: To Have and Not to Have," *Transitions Online*, April 25, 1998.

Thanks to the combination of a massive geopolitical paradigm shift and epic mismanagement, Yugoslavia in the 1990s was worthy of a chapter in Jared Diamond's *Collapse*. The near-first-world life that my family built in Belgrade descended into hell in weeks.

The country's currency, the dinar, was devalued 18 times in seven years, with 22 zeros erased from its value.[4] The monthly rate of inflation peaked at 313,000,000% in January 1994 – at the time the second-highest recorded rate of inflation.[5] Between February 1992 and January 1994, the price level in Yugoslavia rose by a factor of 3.6×10^{22}.[6] I have an academic footnote to prove it.[7]

My hometown of Belgrade came fourth in the 1986 vote for the 1992 Summer Olympics. But by 1992, it had descended into an episode of *The Walking Dead*. In May 1994, my family left Belgrade with two suitcases. Destination? Amman, Jordan.[8]

Thankfully, my dad saw it coming, so he quit Genex a few years before the deluge. He got a job in a direct sales company selling cooking pots. He went from faux IBM to essentially Tupperware.

Many years later, whenever I fretted about my grades or school in general, he told me, "Relax. Why are you stressed? Do you know what Marx and Engels have to say about direct sales? Nothing. All my university exams and work experience are useless for the damn job I do today."

If you are a CIO of an institutional investment fund, a portfolio manager in an asset management firm, or a C-suit executive, you also face geopolitical paradigm shifts that will, at best, make your work more challenging. At worst, they will collapse your civilization like they collapsed my father's. In this book, my intention is to offer you a framework with which to prepare yourself for the former possibility. For the latter, I've got nothing.

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[4] Steve H. Hanke, "The World's Greatest Unreported Hyperinflation," *Cato Institute*, May 7, 2007, https://www.cato.org/publications/commentary/worlds-greatest-unreported-hyperinflation.

[5] Only behind the Hungarian record from 1945–1946, until – to my somewhat perverted disappointment – Zimbabwe beat out both countries in 2008.

[6] What does that even *mean*!?

[7] Pavle Petrović, et al., "The Yugoslav Hyperinflation of 1992–1994: Causes, Dynamics, and Money Supply Process," *Journal of Comparative Economics*, July 31, 2013.

[8] Yes, you read that right. We ran away from war by going *to* the Middle East.

Investors are all in the same predicament that my dad faced at age 36. The training, certifications, and experience of the past 35 years have woefully underprepared the West's financial and corporate communities for the paradigm shifts that are occurring.

The End of the Goldilocks Era

Politics and geopolitics have shaped investment and business decisions for centuries. In his seminal work, *The House of Rothschild*, Niall Ferguson describes how the Rothschild family – well-versed in geopolitical analysis – became the richest and most powerful family of the nineteenth century. Adam Smith named the bible of economics *An Inquiry into the Nature and Causes of the Wealth of Nations*. Not people, not companies, nor corporations, but *nations*. And while John Maynard Keynes is most renowned for *The General Theory of Employment, Interest and Money*, he showed the range of his genius in *The Economic Consequences of the Peace* (1919), where he correctly forecasted the rise of the populist right, the Second World War, and even the European Union.[9]

For centuries, success in business and investing required the skills of both long division and sensitivity to political and geopolitical change. Yet today the curricula of most MBA programs – *and* the CFA curriculum in its *entirety* – ignore the latter.

For the better part of a quarter-century, between 1985 and 2008, election results in most large markets made little difference to the price of assets or company earnings.[10] For the vast majority of investors, politics and geopolitics were worthy of a one-hour meeting at the start of the year or, at most, a small expense on the research/consulting budget.

Politics and geopolitics still played a role, but in the background, working as a tailwind in the sails of investors. Events and paradigm shifts played out into the hands of the multinational corporate and

[9] John Maynard Keynes, *The Economic Consequences of the Peace* (New York: Harcourt, Brace, and Company, 1922).

[10] I would argue that the last election of any relevance to the financial markets in a major developed market economy in the 1980–2010 stretch was the 1981 French election, in which socialist François Mitterrand won an upset over the center-right Valéry Giscard d'Estaing. I am open to a debate on this question.

financial communities. As a result, a new crop of investors emerged out of this Goldilocks Era who were overquantified, while the gray-hairs and their cautionary tales receded into neglect.

Since the collapse of the Soviet Union, American hegemony meant that wars either occurred in investment-irrelevant countries – Rwanda, Armenia, Azerbaijan, Moldova, Somalia, Bosnia and Herzegovina, Lebanon, etc. – or were finished quickly, such as the First Gulf War or the 1999 North Atlantic Treaty Organization (NATO) air war against Serbia.

By the time I entered the financial industry in 2011, few if any of my clients and colleagues had ever had to make an investment decision based on geopolitics. The world's premier political risk consultancy – Eurasia Group – announced in its very name that its focus was on the fringes of the corporate world. By "Eurasia," Ian Bremmer – the firm's founder and a visionary in the field of political risk analysis – meant the frontier markets of the former Soviet Union. In 1998, Bremmer's vision was that political risk analysis would matter for "the Stans" and few others.

Why?

The answer lies in Mikhail Gorbachev's 1985 "Leningrad speech" – the one where he lambasted the Soviet leadership and launched *perestroika* ("restructuring").[11]

By the late 1970s, the Soviet Union was in the midst of a deep economic malaise. Living standards had stopped improving throughout the decade, and the Soviet Union fell far behind the US in terms of technological advancement. Gorbachev threw in the proverbial towel in the contest between a statist-planned economy and a free-market one.

By conceding the defeat of communism in the Soviet Union, Gorbachev undermined it in the rest of the world. The consequence of this ideological capitulation was the Third Wave of democratization and the adoption of free-market policies across the globe. Within a decade of Gorbachev's speech in Leningrad, free-market capitalism became "the only game in town," and within two decades, 90% of the global population was living in capitalism (Figure 1.1).

[11] Bruce Steinberg, "Reforming the Soviet Economy," *Fortune*, November 25, 1985, https://archive.fortune.com/magazines/fortune/fortune_archive/1985/11/25/66654/index.htm.

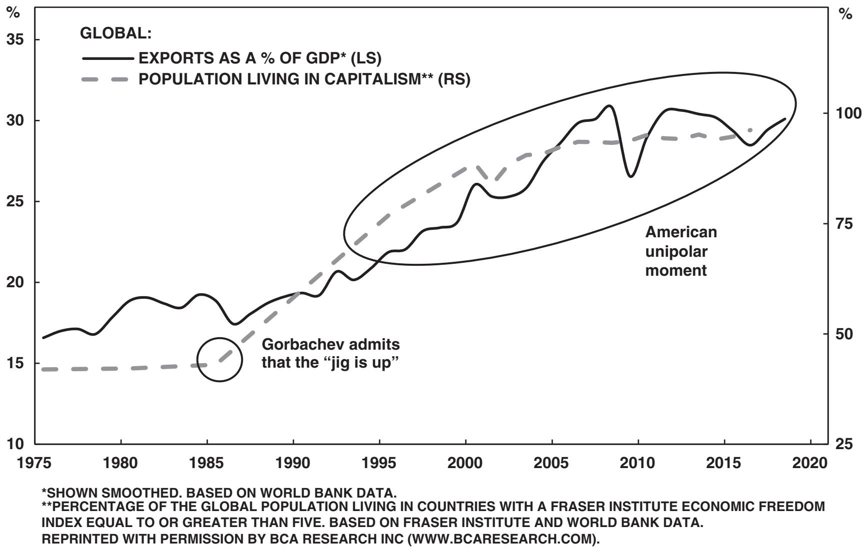

Figure 1.1 *Perestroika* launched the largest supply-side revolution.

The strategic victory of the US over the Soviet Union complemented the ideological victory of the free market. With the dissolution of the Soviet Union, the US became the sole superpower capable of enforcing norms of state behavior on a global scale.

The US did so by challenging revanchist regimes that were willing to challenge the new status quo, such as Saddam Hussein's Iraq and Slobodan Milošević's Yugoslavia/Serbia.[12] It also supported the new capitalist orthodoxy by encouraging international economic institutions to promote macroeconomic reforms, dubbed the "Washington Consensus."

The defeat of demand-side policies in the Thatcher–Reagan revolution of the 1980s occurred alongside the Soviet defeat. Profligate fiscal policy, politicized monetary policy, and an inflexible regulatory regime had saddled developed markets throughout the 1960s and 1970s, culminating in dramatic inflation that was only exacerbated by the "oil shock" following the 1973 Yom Kippur War.[13]

[12] As a child, I had the "pleasure" of living under both regimes!

[13] A popular misconception is that the 1973 oil shock caused the stagflationary environment of the 1970s. This is not true. Commodity prices ex-oil were already on the rise well before the Yom Kippur War, signifying that inflation was coming one way or another.

In response to this economic malaise, UK Prime Minister Margaret Thatcher instituted her neoliberal shock therapy. While the initial outcome was a recession and elevated unemployment, her policies eventually led to an economic recovery in the late 1980s. Thatcher's tax cuts, privatization, and deregulation became the pillars that would underpin the Washington Consensus – and *laissez-faire* economics in general – that countries would replicate across the developed and later the developing world.

One country that rejected the supply-side revolution was France. In 1981, in the midst of the rightward policy turn in the UK and the US, France elected socialist François Mitterrand. Mitterrand ran on an unabashedly left-wing policy package called the "110 Propositions for France." The package of reforms included price controls, reregulation of industries, minimum-wage increases, public works programs, a massive public-sector job program, nationalization of major industrial groups, reduction of the working time, a wealth tax, and an extension of trade union powers. Mitterrand's surprise electoral win led to two major runs on the franc in the year after his victory and the resulting near ignominy of contemplating aid from the International Monetary Fund (IMF).

In the battle of ideas, the Thatcher/Reagan supply-side – *laissez-faire* – won as decisive a victory over Mitterrand's demand-side – *dirigisme* – as one could imagine. Voters and policymakers across the developed world took note and adjusted behavior accordingly.[14]

By the mid-1980s, the twin tailwinds of *laissez-faire* economics and American geopolitical hegemony created the ultimate Goldilocks scenario for investors and C-suite executives alike.

On the geopolitical front, hegemonic stability – in the words of Charles Kindleberger – prevailed.[15] The George H.W. Bush and Bill

[14] The victory of supply-side policies in the early 1980s over demand-side was not absolute but rather contextual. With runaway inflation caused by excessive fiscal and monetary stimulus in the 1960s and 1970s, as well as capacity constraints built up through over-regulation, supply-side solutions were the correct suite of policies … for the era. This does not mean that adding more supply is always the correct solution. Policymakers have learned this the hard way in today's secular stagnation era, where arguably it is not supply, but rather demand, that is lacking.

[15] Charles Kindleberger, *The World in Depression* (Berkeley: University of California Press, 1975).

Clinton administrations enforced that stability when they engaged with the rest of the world.[16] The US foreign policy establishment, staffed mainly by foreign policy hawks who cut their teeth on the Cold War, favored an activist and engaged foreign policy, one that ensured the US would continue to provide the expensive global public goods necessary to grease the wheels of economic globalization.

The Tornado Hits Kansas: Geopolitical Paradigm Shifts

Hegemony sows the seeds for its own decline. America's policing freed up other countries to strengthen their own economic independence. By ushering in stability and globalization, the US allowed countries to set aside their challenges to US hegemony and focus on economic development. But those material gains ultimately allowed these challengers to get to the point where they could challenge the US for hegemony. This is the story of the rise and fall of empires; stability breeds collapse.[17]

In the wake of the Great Recession, a messy, multipolar world has replaced American hegemony.

Multipolarity is a concept from political science that describes a world in which no single entity (unipolarity) – and no two entities (bipolarity) – possess a preponderance of power with which to impose order in an otherwise anarchic system. Instead, multiple countries pursue their national interests independently, an arrangement that forecasters know – from history and political science theory – produces high geopolitical volatility (Figure 1.2).[18]

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[16] To this end, the decision by Bush Sr. to intervene in Somalia at the end of his term was an attempt to bind the incoming Clinton administration – seen as isolationist and domestically focused – to an internationalist foreign policy. A debate was raging in Washington among policymakers and academics over whether the US should remain engaged. Many Cold War warriors worried that the US may abandon a leadership role as it did after its previous unipolar moment: in the 1920s when it decided to turn its back on the League of Nations. This proved to be a misplaced fear, as Clinton's eight years in power definitely reinforced America's hegemonic role.

[17] Robert Gilpin, *War and Change in World Politics* (Cambridge: Cambridge University Press, 1995).

[18] John Mearsheimer, *The Tragedy of Great Power Politics* (New York: W. W. Norton & Company, Inc., 2001).