What Are the Top Five Risks the World Faces in 2014?

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Extreme weather events. Climate change. Cyber-attacks. Mounting rates of unemployment and under-employment. Growing income disparities. More than ever before, corporations and governments all around the globe are deeply concerned about enacting strategies that address and mitigate the sorts of occurrences that can cause significant negative impact for countries and industries for as long as ten years.

To address their concerns, the World Economic Forum (WEF), based in Davos, Switzerland, issued its "Global Risks 2014" report this week. Two of the report's contributors — Howard Kunreuther, Wharton operations and information management professor and co-director of the school's Risk Management and Decision Processes Center, and Erwann Michel-Kerjan, the center's managing director — offered Knowledge@Wharton their assessments of the report's major takeaways and the challenges that lie ahead for global risk managers.

Both Kunreuther and Michel-Kerjan are optimistic that the 2014 edition of the annually published report — titled, "Understanding Systemic Risks in a Changing Global Environment" — will contribute to a steadily growing understanding of global risks. "We have found that, because of a whole series of events that have happened in recent years, corporations are paying much more attention to issues of global risk and recognizing that risk management is something that they have to put on the table," Kunreuther says. "From that vantage point, this report is something that [executives] have found very useful because it highlights not only what they may be thinking, but also what a [number] of experts around the world are thinking" across various disciplines.

Perhaps not surprisingly, perceptions about what constitutes a major risk have transformed rapidly in recent years. For example, the top five global risks identified in the 2014 Report are entirely different from the top five risks identified by executives, researchers and other experts who were surveyed in 2007, Kunreuther and Michel-Kerjan note. This year, the most likely five risks, ranked in descending order, were income disparity, extreme weather events, unemployment and underemployment, climate change and cyber-attacks. In 2007, the five systemic risks rated most likely were, in descending order, the breakdown of official information infrastructure, followed by chronic disease in developed countries, oil price shock, China's economic hard landing and, finally, asset price collapse.

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When ranked in terms of their potential impact — rather than likelihood — the five highest-ranked risks for 2014 were also completely different from those identified by respondents in 2007. In 2014, the five most impactful risks were fiscal crises, followed by climate change, water crises, unemployment and under-employment, and critical information infrastructure breakdown. Not one of these five risks was ranked as having the most potential impact in 2007. The 2007 top-five list began with asset price collapse, followed by retrenchment from globalization, interstate and civil wars, pandemics and, finally, oil price shock.

According to Kunreuther, the disparity is "extremely interesting" because "it highlights one of the major challenges one faces as one begins to look at the likelihood and consequences" of various risks. On the likelihood side, there is the "broader challenge of short-term thinking and myopia" whenever a threatening event occurs, he says. At the time such events occur, there may be good reason to believe they will continue to have an impact, such as the prominence of an oil and gas price spike on the lists in 2008 and 2009. "It may be right that attention has to be paid [to these challenging events when they happen], but … over a period of time, as with asset price deflation, that [event] may not emerge as [a major risk] from the point of view of likelihood or even consequences."

Other kinds of risks that may not always appear in the top-five lists are nevertheless widely recognized as "going to be around for a while" by experts despite their absence, Kunreuther adds. In 2011, climate change was ranked fifth for likelihood and second for impact, but dropped off the list entirely until 2014, when it re-emerged — in part because of the destructive power of Hurricane Sandy. "Climate change is recognized, in general, as a long-term problem, but it did not have a lot of salience in 2007 and 2010" in the absence of dramatic news events, he notes.

Connecting the Dots

The 2014 report also highlights the critical issue of global interdependency. It includes a "Global Risks 2014 Interconnections Map," which demonstrates that "the numerous and complex interconnections between [risks] can create consequences that are disproportionate and difficult to predict." The map attempts to connect the dots by identifying and visualizing the underlying patterns between various risks and effects. The goal is to understand the impact of systemic risks in order to mitigate them "by identifying the transmission channels between risks and potential second- and third-order effects." Importantly, Kunreuther and Michel-Kerjan point out, these interconnections "do not represent direct casualty," but are likely to represent indirect impact or mitigation trade-offs.

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The report also distinguishes between the way male and female respondents view various risks. Studies show "that women are more likely to be concerned about environmental issues," the report notes, while adding that "some argue this reflects a tendency for women to think more [about] the long term than men, and to have a more network-focused rather than linear approach to problem-solving." Moreover, the report adds, "the younger generation" – identified as aged 30 or below – "is more concerned about the potential impact of global risks, while perceptions of likelihood show no such consistent deviation." Younger individuals also responded that an oil-price shock, the loss of biodiversity and collapse of the ecosystem, and the occurrence of various natural catastrophes were "more likely" than did those respondents who were over 30 years of age. Younger individuals also considered such events "more impactful" if they were to occur.

For his part, Kunreuther notes that "interdependency and the challenges that we face with interdependency" are a major theme of the 2014 report. For example, he says, "climate change is a global risk – everyone has to pull their weight. [Addressing it] requires the global community to try to take some steps, but [we] also have some real challenges with respect to doing that."

Michel-Kerjan points out that in the case of systemic risks, such as asset price collapses, "whether it started in the U.S. or in Asia, everyone will be interconnected." He adds that the 2014 report is hardly the first to stress that "risks should not be considered in silos…. Just because you are an environmental [specialist], that doesn't mean you should be unconcerned about fiscal issues." However, he concedes that such behavior requires a significant change in mindset. Numerous other reports have called for people not to "think in silos, but that is hard to do. People love boxes," he says.

Diverse Strategies

Every corporation has its own set of agendas, depending on what kinds of challenges it faces, notes Kunreuther. "They are going to treat this report differently because they focus on the things that are of concern to them. A company that might be involved in supply chain problems will think about interdependency in a very different way from a company that is more self-sufficient. There are companies associated with issues of carbon emissions, climate change and greenhouse gas reduction, for example, that are taking a leadership role in terms of [what] we should do" to address those risks.

Kunreuther adds that the 2014 report doesn't "talk about exactly what these companies should be doing [to mitigate risks]…. It is not designed to be prescriptive." Instead, it provides a high-level list of some of the strategies that companies have been pursuing, "guided by [the] firm's risk appetite [and] the level of risk an organization is prepared to accept to achieve its objectives, such as profitability and safety goals," according to the report.

According to the report, income inequality is "most likely to cause serious damage globally in the coming decade." Kunreuther points out that the problem can't be isolated: Developed as well as developing economies will need to take steps to deal with issues of income inequality and affordability. Because of the interconnected nature of the potential risks the report highlights, "firms are trying to take a much more forward-looking approach – and to develop long-term strategies for dealing with them, which they had not necessarily been doing five years ago," Kunreuther says. "And so, we are more optimistic on two levels. First, we are hearing more about firms doing this. Second, we are also recognizing that – from other studies – firms want to be given some benchmarks as to how they could go forward."