

Global Agenda Councils

Geo-economics

Seven Challenges to Globalization

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Geopolitics vs Globalization: How Companies and States Can Become Winners in the Age of Geo-economics

Written by Mark Leonard

Geopolitical competition is reshaping the global economy and unravelling global power relationships and governance. As tensions between great powers rage, the global businesses that once saw themselves as masters of the universe now feel like pawns in a game over which they have little control.

Before the global financial crisis, geopolitics mainly played out locally, but today the biggest conflicts are between the world's greatest powers. Ukraine is at the epicentre of a crisis of European order that has seen the Russian Federation and the West use financial markets, energy and the control of the internet to advance their respective causes. In Asia, the competition between a rising China and its neighbours has spawned naval disputes, the use of sanctions and restrictions on access to natural resources. In the Middle East, the rise of ISIS is playing into a wider sectarian conflict led by Iran and Saudi Arabia. In every region of the world, new powers and restive populations are rising, and an increasingly introverted America is recalibrating its role in a scattershot manner that leaves allies guessing.

Although wars rage from Damascus to Donbas, the main battlefield is economic rather than military; sanctions are taking the place of military strikes, competing trade regimes are replacing military alliances, currency wars are more common than the occupation of territory, and the manipulation of the price of resources such as oil is more consequential than conventional arms races. The world is witnessing what Edward Luttwak called the rise of geo-economics, a contest defined by the "grammar of commerce but the logic of war".

Geo-economics is both the antithesis and the greatest triumph of economic globalization. It is the overwhelming dependence of all countries on the global economy, which makes the threat of shutting them out so effective. And after two decades of coming together, many countries are focusing on the challenges of interdependence as well as on its benefits. The United States craves energy independence, China wants to stimulate domestic consumption, Germany wants to protect itself from the economic decisions of its neighbours, and Russia is trying to hedge against Western markets and the US-led dominated financial system. This paper attempts to map out the challenge of geo-economics for companies, governments and campaign groups. It highlights the powerful trends reshaping the

world, which are changing the rules for competition between countries and even the arenas in which these frictions play out. It shows a world where:

- The pursuit of power is as important as the pursuit of profit, with increasing state presence in economies
- Economic warfare is undermining economic integration
- Multilateral regimes are becoming regional rather than global
- Oil prices are lower and more volatile, and the main competition is for markets rather than resources

In each story, the aim is to identify the winners and the losers in this new world. The biggest winners are states that are able to shape their own future – China, the United States, the European Union (EU). The biggest losers are international institutions and companies that cannot rely on the support of large states or the autonomy to hedge between them. In this brave new geo-economic world, the institutions developed for an era of win-win cooperation are increasingly in disarray. In the absence of global leadership, the erosion of global norms and standards and the ensuing shift towards a multipolar, regionalized power dynamic are apparent. This places acute pressure on leaders around the world, challenging their effectiveness and legitimacy.



Challenge One: Economic warfare

The United States, Europe and other developed economies, faced with challenging fiscal postures and weak domestic political support for engagement, are increasingly unwilling to pursue foreign policy objectives through the projection of military force. To compensate, these powers continue to seek to project power through their influence over the global economy (including the dollar and euro) and through their control over multinational corporations (MNCs) domiciled in their countries.

Recent Western sanctions against Russia signalled the beginning of the first great-power conflict since the end of the Cold War. Their stated goal is to change Russia's policies, though Moscow is convinced that the sanctions are aimed at replacing the existing Russian political regime and holding the country down. The world has also seen the emergence of Western trade controls in recent years aimed at Iran, Myanmar and Venezuela. Indeed, the US and EU in recent months have come up with new forms of sanctions (e.g. the Treasury Department's Sectoral Sanctions Identifications or "SSI" list). Increasingly, Washington policy-makers see sanctions as the drones of the future – highly targeted weapons that can be deployed to devastating effect.

The West's use of economic levers mirrors the tactics of emerging powers with less powerful militaries. Russia has introduced sanctions towards Georgia, Moldova and Ukraine to prevent their drift to the West, while China has used sanctions against Japan and the Philippines over maritime issues.

Economic sanctions and restrictions are a prime tool of geo-economics and can span from stricter sanitary controls to a full-blown economic blockade. What matters is the size and capacity of the country being sanctioned, and the power of the sanctioning country or international coalition. These tools stand alongside economic incentives such as trade regimes, the use of export credits, tied aid and other forms of sovereign-backed finance.

Economic sanctions are usually a double-edged sword. The country applying sanctions hurts its own businesses that trade with or invest in the target country. US companies have had to stay away from Iran, German machine-builders have had to reduce their exports to Russia, and French shipyards have suffered through the freezing and potential cancellation of the sale of Mistral ships to Russia. Sanctions can also provoke counter-sanctions. In 2014, Russia retaliated against Western measures by banning food imports from the countries that had joined sanctions against Moscow.

The consequences of this trend are evolving, but they potentially include companies' "de-globalization". That is, as companies are increasingly forced to think of themselves as tied to their home governments, they will think twice before investing in certain markets abroad. Other consequences

include changes in traditional foreign trade patterns in line with new geopolitical alignments. Faced in 2006 with the Russian wine embargo, Georgia had to look for new markets in the West, where it was headed politically. When in 2014 Russia faced Western sanctions, it accelerated its rapprochement with China, the one major power that refused to condemn its actions and shared Moscow's opposition to US global dominance.

The outcome of these geo-economic campaigns is not a zero-sum game. The stronger economy backed by other forms of power can incur more damage on the target country than it will sustain in return, but it does not always alter the political behaviour of the government to be "punished". Sometimes sanctions can make that behaviour even more problematic. Ironically, the true winner may be a third party that jumps into the opening: European countries in the initial phases of US-Iran sanctions; China in the case of current Western sanctions against Russia; Russia in the case of the post-Tiananmen Western weapons ban on China; Turkey in the situation when EU pressure made Russia abandon its South Stream gas pipeline project.

Politically, sanctions are most effective against friends and allies; in the case of adversaries, they can stiffen their resolve – at least in the short term. The sanctions imposed on Russia in 2014 during the crisis over Ukraine have contributed not just to a surge in Vladimir Putin's popularity but, more importantly, to the growth of Russian patriotism and nationalism. In moments of bravado, the Kremlin even hopes that a long period of sanctions can guarantee political stability in the country for many years (although the downturn in the Russian economy might have the opposite effect).

Whether or not they achieve their objectives, sanctions have great economic impact on target countries: their technological development slows down and their populations grow poorer. This breeds popular resentment, to be sure, but "regime change" is not always the outcome. More liberal regimes, like Slobodan Milosevic's in Serbia, may be swept away, but the harsher ones, like Saddam Hussein's in Iraq, cannot be toppled from the inside. Western-headquartered multinational corporations, even the presumably stronger ones, lose their markets.

The (relative) "winners" of this development are the US/EU (as long as they maintain sufficient leverage over the global economy to be able to make sanctions "bite"), and China (whose companies are often turned to, when Western firms are barred, and that is most active in supporting its companies in global markets). The "losers" are targets of Western sanctions, such as Russia and Iran, and Western-headquartered MNCs that are relatively disadvantaged, as well as, above all, the multilateral institutions designed to safeguard the free flow of trade and investment, such as the World Trade Organization (WTO), that lose credibility by appearing irrelevant.

Challenge Two: The geopoliticization of trade talk

A surge of trade talks has taken place across the world with a burgeoning number of negotiations – some pan-regional, some regional and others country-by-country. In theory, new activism could fill the void of new WTO deals and bring about much needed growth. In reality, major regional talks are likely to accelerate the multipolarization of the world or even competition among regional blocs far beyond trade.

China and Russia are examples of new powers challenging the Western-led post-war economic and political order through developing “trade” zones and strengthening their influence over their respective neighbourhoods.

China is strongly pushing for the Regional Comprehensive Economic Partnership, against the US-led Trans-Pacific Partnership. Quite a few Asia-Pacific nations have been placed in the awkward position of working out how to reconcile the two competing frameworks. Each discusses different rules on flows of goods, money and intellectual property in line with the respective interests and principles favoured by the United States and China. The turf battle mirrors the rivalry between the world’s two largest economies in far broader arenas, including military prowess.

Russia’s efforts to create a Eurasian Economic Union (EEU), involving Belarus, Kazakhstan and Armenia, are aligned with Moscow’s geopolitical strategy to hold its ground against EU/NATO in the West (overtly) and China in the East (implicitly). Interestingly, the EEU has signalled the intention to leverage the Eurasian Development Bank to help develop the infrastructure of the participating nations, which is reminiscent of China’s advocacy of the Asian Infrastructure Investment Bank over the more Western-influenced Asian Development Bank.

It will be interesting to see in the next few years how Moscow and Beijing manage to harmonize their respective projects of the EEU and the Silk Road Development Area, and how the Central Asian countries manage to play one big neighbour off the other.

Challenges are not limited to the traditional Western-led institutions. Brazil has been the core economic power of the Latin American region, and exerted strong influence over Mercosur along with Argentina. Now four emerging stars – Mexico, Colombia, Chile and Peru – are trying to provide an alternative to Mercosur through the development of the Pacific Alliance. The new framework emphasizes the inclusion of Asian economic powers into Latin American development, and could change the political and economic landscape of the region.

Again, all these moves might benefit the progress of freer trade in the world. Yet, trade and economies cannot exist outside the geopolitical context. At the same time as these regional trade talks advance, the world is moving from Pax Americana to a multipolar system that balances different powers. If geopolitical rivalry among major powers influenced the nature of trade deals to make them mutually competitive both politically and economically, global consumers and businesses would become clear losers. Countries in the periphery of major regional powers would be under their strong influence and lose out too.





Challenge Three: State capitalism 2.0

The re-emergence of state capitalism after the financial crisis is turbo-charging the competition between governments for power and influence.

Although the US continues to dominate financial markets, increasingly, countries that do not share the US belief in limited state intervention play a lead role in the origin, destination and intermediation of capital via markets and real economic sectors. In their models, the state attempts to play a leveling role in markets, to ensure that booms and busts are limited and that unbridled capitalism is tempered by the interests of the state and other stakeholders.

In some ways this is not new - for many years governments have used their ownership of companies and financial institutions to further their strategic goals - but today they are extending their influence in powerful new ways.

Politicized Central Banks

Firstly, through increasingly politicized central banks that use 'unconventional' tools to advance national policy interests with significant cross border and, in some cases, global impact. As fiscal authorities have become increasingly paralyzed and politically constrained, post-crisis responses have fallen to central banks via monetary policy. Central bankers have, by choice or otherwise, become owners of enormous swathes of securities, with enormous influence as a result. In addition, central banking supervisory authority has been enhanced by post-crisis legislative efforts to manage financial system stability. Emerging market central banks are increasingly caught between domestic political pressures and alleged monetary policy and supervisory independence. The risk of states using central banks to advance interests beyond those explicitly consistent with their mandates is on the rise.

Setting Standards to help National Champions

Governments are using standard-setting, legal and policy reforms to advance national interests/national champions by changing the rules of the road for crucial sectors and industries regionally and globally.

The establishment of regional and/or international norms for strategic sectors is now more likely to play a role in advancing national interests via economic and regulatory tools. The establishment of cross-border norms for financial market instruments, banking, technology, energy and trade has always been inherently political, while ostensibly technical. Now, we can add strategic as well, with market, legislative, regulatory and other policy tools increasingly being used to try to strengthen state-owned enterprises (SOE's) and national champions.

For example, there are competing visions and standards for applying anti-monopoly tools to advance national interests in the name of market competition. In many instances, the guise of "leveling the playing field" is used as justification for strategically important economic outcomes.

Regional and global standards are increasingly being set (or impeded) by those countries whose national champions dominate or challenge incumbents in strategic industries and sectors. In particular, the US, China and the European Union grapple with standard setting and regulatory frameworks in strategic sectors including finance, energy and technology. The impact of each sector extends far beyond economic interests and impacts the role of countries, companies and regions in terms of economic independence and political security and stability.

And they are blurring commercial and strategic lines for sectors like technology and finance, where implications of advancing national agendas have global implications. Technology is of increasingly strategic concern, with major powers assessing a landscape of economic and security concerns emanating from the opportunities and risks posed by the interlinkages and deep dependence on technology as the foundation of global economic, military and political security. As the US and China, for example, discuss technological and intellectual property concerns, NATO grapples with its potential response function to intrusions under its mutual defense obligations. Recent “hacking” into Sony Pictures and disclosure and theft of its private files and films has sparked speculation of government related catalysts and retaliation. How will future security and technology concerns be addressed and agreed upon? Who will set the rules and who will seek to ensure that they are enforced?

Who are the winners and losers?

For Central banks, the US - as the dominant global reserve currency - stands out as the biggest winner. Central banks of other major economic and financial actors, including the European Central Bank, Bank of Japan and Bank of England whose policy choices have extensive strategic policy influence beyond their borders. China’s People’s Bank of China, whose ascendance is both strategically important and necessary for the optimal functioning of the global economic system, is also winner, albeit one with an uncertain direction.

Countries with large national champions are likely to be winners. Conversely, the US, which has traditionally used its influence without actual ownership or control of the tools of its economic influence, is a loser, should the world evolve into a more SOE-centric model.

Existing national champions and dominant market actors are winners if they benefit from continued support by their governments, allowing them to accept or even reject internationally agreed upon standards/outcomes. Under this framework, global norms are less likely to be agreed upon than are regional ones and regional ones are more likely to result in regulatory agreements that favor incumbents.

US technology companies are both major winners and potential losers. The increasing role of technology on the global strategic landscape means companies with a dominant role are likely to be winners. The regulatory and legal backlash and protectionist agendas of some countries, however, makes these same companies and sectors potentially vulnerable to challenge both by national competitors and government backlash, to the point where their dominance makes them particularly at risk.

Sadly perhaps, the biggest losers in these scenarios are the international institutions whose mandates are global, but where their limited abilities, resources and practical implementation issues mean that regional and national efforts will fill gaps created by their inability to solve global problems.

Challenge Four: Competition for gated markets, not natural resources

The competition between states in the geo-economic era will increasingly be driven by a quest for markets rather than national resources. This is a major development.

During colonial times, competition revolved around direct control over land and sea, both for extracting resources and for promoting long-distance trade with colonies on preferential terms. As colonies became independent, an ideological rather than economic contest took its place. Once the Cold War ended, oil emerged as the big driver of competition, creating strange new alliances and drawing the United States into the security of the Middle East.

Today, as the world economy suffers from the after-effects of the financial crisis and many previously stable economies are reeling under the pressure of slow or no growth, the nature of strategic competition is changing again – due to two major factors.

First, resources are becoming cheaper, due to the shale gas and oil revolution, and other technological advancements that are reducing dependence on traditional suppliers (see Challenge Seven). Second, the economic and demographic growth – as well as human capital development – in emerging markets makes them an important source of global aggregate demand and of relatively cheap qualified labour.

The interests of modern multinational corporations underpin the shift from the strategic competition for access to resources to the competition for inroads into new markets. Due to the breakthroughs in information and communication technologies – as well as more efficient transportation and logistics – these corporations have become truly global, able to invest and allocate the production of goods, services and even individual production tasks across continents.

This has shifted the strategic space of the natural resources competition to a competition for markets. The United States’ outreach in recent years to India, the evolving relationship between the US and China, China’s infrastructure investments in Africa, and Russia’s attempts to penetrate oil-rich Venezuela are all signs of the same phenomenon.

The main law of the new race is access to large markets, which often have large, young populations as well as a burgeoning middle class that enjoys increasing purchasing power.

The need for this access is twofold. Those who want to win in the new world should invest in skills. Those who want to provide incentives for human capital accumulation should assure access to a large (preferably global) market. Thus, accessing markets to make production more competitive by possible outsourcing to cheaper skill centres and having large middle class markets to sell products in are driving this new trend.

The winners of this new strategic competition are primarily the countries with growing per capita incomes and large and growing populations – mainly China, India and several large countries in Sub-Saharan Africa. The highly skilled citizens of the developed world are to gain as well as they become more productive in managing larger corporations and creating new technologies for larger markets. Countries and corporations that are adept at building inroads into new markets through their control over social, economic and communication networks will stand to benefit from these growing markets.

At the same time, the producers of natural resources are likely to see their power eclipsing, so oil rich countries such as Saudi Arabia, Russia and Iran stand to lose. And so are the medium-skilled workers in the Organisation for Economic Co-operation and Development (OECD) countries who now face competition from the cheaper-qualified labour in emerging markets. Countries that are unable to provide security and stability for economic enterprise and foreign investments will also be marginalized from this new wave of globalization. All China could do during the 2011 conflict in Libya was to evacuate its thousands of workers from the country. The low-skilled workers in developed countries are still protected from this competition, as their jobs are not yet outsourceable. However, technical progress may threaten them through automation.

Challenge Five: The survival of the biggest and hollowing out of the periphery

Many people hope that the gridlock of global governance will lead to a world of orderly regions rather than a world of chaos. As the conventional thinking goes, neighbourhood heavyweights will step in, in a largely agreeable way, to set the rules of the road for trade, investment and security – much as the post-World War II United States and its like-minded allies did globally for decades. Many visions of regionalism resemble a harmonious EU-style integration.

But these assumptions are not playing out. While it is true that a breakdown at the global level is strengthening many “core” countries and empowering them in their respective regions, these countries’ leaders are not trying first and foremost to leverage their growing clout into creating fair regional standards. Instead, they are creating new core-periphery relationships that benefit the core, often at the expense of periphery states. Looking forward, could these asymmetric bilateral relationships strengthen the core regional powers and “hollow out” the periphery?

Three major examples of this hollowing out around the world can be seen today. It is most obvious in Russia’s relationship with its “near abroad”. But it also extends to Germany’s role in Europe, as well as a rising China’s disruptive posture in the East and South China Seas (and beyond).

In all three cases, this hollowing is playing out both diplomatically and economically. Take the Asian Infrastructure Investment Bank and other new organizations that China has spearheaded to challenge the global alternatives. These new bodies are not really meant to be global in their own right, nor are they truly multilateral. They are aligned more with Beijing’s interests than with the

interests of the region as a whole. China has a geopolitical interest in making its neighbours more economically reliant on it. In Europe, the stresses of German-enforced austerity on the EU periphery manifest themselves in political gains by Eurosceptic parties and rising social discontent. Russia, for its part, has used both carrots and sticks – both aplenty – in a failed effort to include Ukraine in the Eurasian Union project. Now that Kyiv has decided in favour of an association with the European Union, Ukraine’s trade and other economic links with Russia are being sharply reduced.

The hollowing out of the periphery – to the benefit of the core – is also happening in the realm of security. The erosion of US global leadership gives Moscow and Beijing freer rein in their backyards – and their weaker neighbours see their options reduced. In Europe, the security component is more nuanced, but still apparent. Germany’s growing clout drives an increasingly German-centric perspective on foreign policy issues throughout the EU; after all, Germany feels very differently about matters like NATO and the recent National Security Agency scandals than Britain and France, the traditional architects of the European Union’s security policy.

Most of all, what many countries in the periphery fear losing is their “pivot state” status – that is, their ability to hedge between major powers to maintain their freedom of action. A country like Singapore can pivot with ease: it maintains its ability to diversify on account of its status as a trade hub with plenty of major economic partners and no overdependence on any one. Ukraine, by contrast, long wanted nothing more than a chance to pivot effectively between Europe and Russia, but now it has clearly opted for the western direction. But it is too tricky to do that painlessly: it is attached to the Russian economy. An increasingly multipolar world could create more Ukraines and fewer Singapores.

The key issue is that “regionalism” clearly makes global issues harder to tackle – but many presume it could at least lead to benefits at the regional level. But what if those benefits do not trickle down beyond the major sovereign? The winners and losers are a one-two punch. As global



leadership breaks down, regional hegemons are empowered and, in turn, are better equipped to box in countries in their peripheries. Thus, not only does the periphery's dependence on the core not necessarily grant it stability or sustainability, it also tarnishes the silver lining of increased autonomy in a world with less global leadership.

So where does this trend go from here? How it applies to Brazil and its Latin American periphery and Nigeria and its West African neighbours will demand close attention in the years to come. The rate of this hollowing out and the second-order impacts remain to be seen. What is happening now is only the early stage.

Challenge Six: China's infrastructure-driven alliances

China's infrastructure projects could be as important to the 21st century as America's protection of sea lanes was in the 20th century. Infrastructure finance has thus become a tool of foreign policy, particularly for China, which has surpassed traditional multilateral lenders in its loans, grants, joint ventures and other underwriting of infrastructure projects in developing countries, both in Asia and worldwide.

China is (re-)building the physical transportation and other infrastructure in key markets where it seeks to either access raw materials or make its export flows into those markets more efficient. These are axes of complementarity or "infrastructure alliances" rather than genuine geopolitical affinities.

This trend is manifesting itself in several ways. First, China has massively increased its foreign direct investment and loans to countries where it seeks to enhance access to commodities, particularly by investing in infrastructure, such as mineral deposits, roads, railways, pipelines and ports. This is happening on China's periphery (e.g. Mongolia, Myanmar, Kazakhstan, Russia), in the Indian Ocean (e.g. Sri Lanka, Pakistan), in Africa (especially the eastern coast, e.g. Kenya and Sudan) and Latin America (e.g. Panama,

Ecuador, Venezuela). China increasingly takes ownership stakes in such assets through joint ventures in order to hedge against payment default or political dispute.

Significantly, China has launched a series of new multilateral institutions to expand infrastructure finance activities, such as the BRICS Bank (currently located in China with plans to rotate the chairmanship to India), the Asian Infrastructure Investment Bank, the Silk Road Economic Belt, and other regional and inter-regional instruments with initial capitalization ranging from \$50-100 billion. Each of these is also aimed at improving infrastructure and removing customs barriers and commercial bottlenecks that will benefit Chinese resource inflows and export outflows.

So who will the winners and losers be? China stands to benefit immensely from improved infrastructure connectivity to markets in Asia and worldwide. Exporting countries will also benefit from higher quality infrastructure.

Several downside scenarios exist. The first is anti-Chinese backlash (already noticeable in Myanmar and several African countries) against China's importing of foreign workers and insufficient local management training and technology transfer.

The second is heavy indebtedness to China, resulting in defaults and political tension and expropriation practices, particularly as commodity prices are low and thus rents diminished for resource economies.

On the other side, local countries could feel pressure to stand up to China and engage in resource nationalism through contract termination or the nationalization of jointly owned infrastructure assets, resulting in political tension. China's stationing of private military personnel in Sudan, Algeria and other countries could be a crucial issue in this regard.



Challenge Seven: The decline in oil prices

After three years of unusual stability around \$100 a barrel, oil prices fell steeply in the second half of 2014, dropping from \$115 a barrel in June to around \$60 by December. With oil critical to national economies, international security and climate change, what does the apparent new world of oil mean?

Less is known about where oil prices are heading than confident forecasters have suggested. Oil prices plunged in 2014 despite only a small excess of world supply over demand. This is a reminder that Saudi Arabia no longer plays the same stabilizing role in oil markets that it once did. (Contrary to many headlines, this is not new: it has been the case for at least the last decade.) But this feature of oil markets works just as well in the other direction: a gain in demand relative to supply could push prices back up to their previous level – or, if the boost is big enough, even above it. The return of volatility, not the fall in prices, is the trend that can most confidently be expected to persist. That said, with oil supply growth stronger than it was expected to be only a few years ago, and demand growth weaker, the world should anticipate lower oil prices than it would otherwise have seen.

Oil price volatility is universally bad economic news. It stunts consumption and investment while often confounding economic policy-makers. When prices are falling, as they did in 2014, the biggest benefits accrue to major oil importers: even though US tight oil gets major credit for pushing prices down, the Chinese and European economies will reap bigger dividends. Among the G20 member states, only Russia and Saudi Arabia are clear losers (the Russian rouble, for instance, lost about 50% of its value vis-à-vis the major currencies in the second half of 2014), with Mexico and Brazil possibly ending up in that category too.

But the ultimate winners and losers will depend on how nimbly governments respond to changing oil prices. India, for example, has magnified its gains by using the opportunity created by falling prices to cut costly diesel subsidies – a move that has long been economically and strategically attractive but politically impossible. Brazil might yet reap a similar dividend if it uses the fall in prices to reform restrictive policies that have threatened to choke investment in its own oil resources. Russia finally has a chance to start to diversify its economy from the over-reliance on oil and gas. Decisions by consumers and producers will shape future oil production, consumption and trade, with economic and strategic consequences.

Beyond energy markets, lower prices – or at least periods of lower prices – impose pressure on Russia and Iran, two countries that have consistently been at the centre of geopolitical storms. Both countries' vulnerabilities can easily be overstated: with substantial cash reserves and some budgetary and exchange rate flexibility, neither is at significant risk of insolvency despite oil prices well below what the International Monetary Fund has estimated are necessary for their budgets to balance. And, for both, the geopolitical stakes involved in their ongoing conflicts are high, often outweighing economic concerns. But, all else being equal, falling oil prices might increase both countries' incentives to eliminate other sources of economic pain – and, for both, that means using various tactics to ease geopolitical conflicts, but hardly throwing in the towel.

Amid all this, it is essential to remember that oil prices are not actually low. Even at \$70 a barrel, oil prices are higher (in real terms) than in four out of five of the past 50 years and higher than they were 10 years ago. Much of the world's oil-using infrastructure – automobiles, buildings, industrial facilities – was built when oil was much cheaper than 2014 lows. Compelling economic, strategic and environmental reasons remain to respond by reducing global oil use, even as prices decline.



Conclusion: Five lessons for the world of geo-economics

In the absence of effective global leadership, global norms and standards are eroding – with an ensuing shift towards a multipolar world where great powers compete with each other through economic means and regional powers play a larger neighbourhood role.

Increasingly, multilateral institutions are seen as instruments of power projection and there is less interest in tackling shared problems from Ebola to climate change. Because the great powers are looking at issues through a more zero-sum lens, they only work together when their interests are very closely aligned. This is exacerbated by a widespread turn inwards as populism and nationalism rise, and governments try to establish measures to give them more control over their affairs.

So what can the world's states do to prevent geopolitics from unravelling the globalization of the world economy and its systems of governance? What are the main risks to industry/business and what can they do to mitigate them? These are the questions that the Global Agenda Council on Geo-economics will be grappling with over the next two years. Here are five early thoughts.

1. **States must develop their rules of the road for economic warfare.** When governments use the infrastructure of the global economy to pursue political goals, they challenge the universality of the system and make it more likely that other powers will hedge against it. They could also provoke attacks in retaliation. In the same way that states have developed a series of agreements and conventions that govern the conduct of conventional wars between countries, these principles must be applied to the economic arena. Of course, this kind of coordination will prove elusive, given all the trends towards regionalization that are making economic warfare so attractive and more widespread in the first place. The United States still has the most to lose from other powers undermining the existing global economic system; thus, Washington should take the initiative to explain these principles, and it can encourage others to respond publicly. It will be difficult to achieve global consensus, but if major powers lay out their approaches, it could still protect against worst-case scenarios.
2. **States must find the right economic role and pursue new forms of engagement.** States need to find the right balance between “laissez-faire” and “intervention” to pursue strategic goals. After the financial crisis, it is clear that states will be more involved in setting the frameworks for economic activities. For example, Western countries could learn from China's infrastructure-first model, but adapt it to their strengths. China and other major emerging markets are providing an alternative source of capital and loans that make developing countries less willing

to adopt the stringent economic and political reforms that assistance from the Western-led International Monetary Fund is contingent on. Instead, the West could drive infrastructure investment in developing countries by leveraging the advantages of its private sector, such as access to high-end technology.

3. **Staying attuned to the “survival of the biggest” and the pooling of the weak.** When a small country becomes too reliant on the regional powerhouse, its ability to pivot and maintain options for itself – economically and strategically – becomes limited. To avoid being sidelined by regional hegemony, smaller states will need to do more to pool their resources and challenge local dominant powers in tandem. The common threat of a neighbourhood hegemon is a powerful impetus. Larger powers, for their part, should recognize the opportunity that small countries in other regions provide, as they look to deepen ties with large and stable outside powers that can give them breathing room. This is playing out to some extent in Asia-Pacific as China's neighbours hedge against Beijing's rapid rise by deepening their security relationships with Washington. That model could prove replicable around the world and make for unconventional alignments or alliances.
4. **Businesses can keep their eye on the global prize but play by new rules in the interim.** Business needs to pursue open globalization if it is to mitigate the risks posed by geo-economic competition and variables. It should be a strong advocate for trade liberalization and foreign investment, which deepens international bonds and diminishes protectionism and incentives for conflict. But even as multinational corporations strive for a more level and globalized marketplace, they need to brace for bumpier terrain. Businesses will need to think more about where they come from and how to be seen as local in different markets. The rise of state capitalism will complicate or even shut off many sectors that are viewed as strategic by home governments but, on the other hand, new areas of opportunity will open up. Authoritarian China may be very sensitive to foreign investment in the telecommunications sector but to combat rising pollution, it may welcome foreign expertise in renewable and alternative energies. Conversely, another country's energy sector may be strictly off-limits due to that government's strategic priorities, but it may want outside assistance in building up a viable smart grid and telecommunications infrastructure.
5. **A focus on key regional players and subglobal politics rather than worldwide institutions is necessary.** Civil society needs to be more pragmatic about where it looks for solutions to global problems. Rather than relying on the universal Bretton Woods

institutions, it is worth looking more carefully at regional and subregional layers of integration. The time for big global campaigns aimed solely at the G7 is over: amid waning global leadership and new emerging powers, the G7 is not a viable forum for global action. Such campaigns should be tailored to appeal to the strategic interests of the strongest states in a region that pertains to the initiative. Everyone has an interest in combating a world that is becoming a more dangerous, contested and ungovernable place by developing more political, regional and creative forms of collective action to fight the spirit of atomization that is increasingly defining the world.

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