Geopolitical Rivalry and Business: 10 Recommendations for Policy Design

WHITE PAPER

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Contents

Preface	3
Executive summary	4
Introduction	5
1 What's at stake? Benefits from cross-border commercial operations	7
2 "Geopolitics" means different things to different firms	9
3 Recommendations for design and conduct of public policy	12
4 Steps businesses can take to better manage geopolitics	14
Conclusion	16
Annexe	17
Contributors	19
Endnotes	20

Preface

Navigating geopolitical tensions is becoming more important for globally engaged businesses than ever before.

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The case for free trade is under unprecedented pressure. Rising geopolitical tensions combined with global health and climate shocks, and concerns over the social and environmental costs of free trade, call into question the fundamentals of the global trading system that have brought the world tremendous prosperity and relative peace during the past half century.

Against this background, the World Economic Forum convened the workstream on trade shocks and geopolitical tensions. The purpose was to help businesses and governments navigate trade shocks and geopolitical tensions as well as to contribute to a balanced narrative on the risks of economic decoupling while acknowledging the associated climate, health, social, environmental and national security concerns.

The work benefitted from the participation of members of the Global Future Council on Trade and Investment, the Global Future Council on Geopolitics, and others. The World Economic Forum's network of Global Future Councils is a multistakeholder and interdisciplinary knowledge community dedicated to promoting innovative thinking to shape a more resilient, inclusive and sustainable future.

This white paper draws on discussions among members of the workstream, comments by Boston Consulting Group and interviews with companies during the latter half of 2023.

Executive summary

Policy interventions for achieving geopolitical objectives must be designed to cause the least harm to international trade.

Based on the evidence gathered, this white paper identifies several recommendations for better policy design.

Existing analyses of the potential for geopolitics to further fragment the world economy do not consider the impact of policy intervention on how firms create value from their international operations or on corporate performance. Nor do they consider the numerous ways internationally active firms can respond to geopolitics.

The purpose of this white paper is to bridge this knowledge gap. It draws upon 13 expert interviews with senior executives from international businesses selected to cover a range of manufacturing and service sectors.

By laying out how international business perceives evolving geopolitical dynamics and reacts to it, the overall goal of this study is to provide officials with a deeper understanding of associated commercial choices, so that they can better advise governments on how to manage cross-border commercial ties.

The executives interviewed noted several different options for responding to globalization-related tensions. Associated with each option are benefits that are at risk should geopolitical considerations force firms to loosen their ties with other economies. The benefits at risk are in four broad categories and relate to existing revenue streams, cost control, scale of operation and advantages arising from certain organizational forms and innovation.

The intensified rivalry between China and the United States (US) was the most commonly mentioned geopolitical tension. But many other state measures were mentioned too. Because some governments seek to influence corporate deliberations about their international footprint, it is critical how policy-makers communicate their geopolitical priorities and how corporate executives understand those messages.

The companies interviewed said they were responding to growing geopolitical rivalry in different ways. For example, executives of North American firms put more emphasis than others on production repatriation to their region. Since firms choose between alternative locations, any state encouragement to relocate production must be complemented with steps to address talent shortages, infrastructure gaps and other deficiencies in national business environments.

Companies have agency too. If policy intervention results in a decline in a company's expected sales growth in a geopolitical hotspot, then the response is often to find new markets or to find under-served market segments in other nations. Policy measures that weaken certain cross-border commercial ties create incentives for firms to develop other ties, creating new goods and service offerings along the way. If anything, choice is likely to expand for those buyers in the many nations whose governments refuse to take sides in the current geopolitical demarche. In this manner, globalization evolves – rather than retrenches – in response to geopolitics.

Based on the evidence gathered, this white paper identifies several recommendations for better policy design. The North Star of geopolitically motivated policy design should be to pick sensible objectives that take due account of the many commercial options that firms have, and to attain geopolitical goals through means that do the least harm to cross-border commerce. Doing so requires a stronger understanding of the options and strategies available to the private sector. This paper outlines recommendations towards that end.

Introduction

Geopolitical rivalry is increasingly driving business decisions and producing a diverging set of corporate responses.

Geopolitical rivalry is the competition for economic, military and technological dominance between nations or blocs of nations. It has come back with a vengeance during the past 15 years.

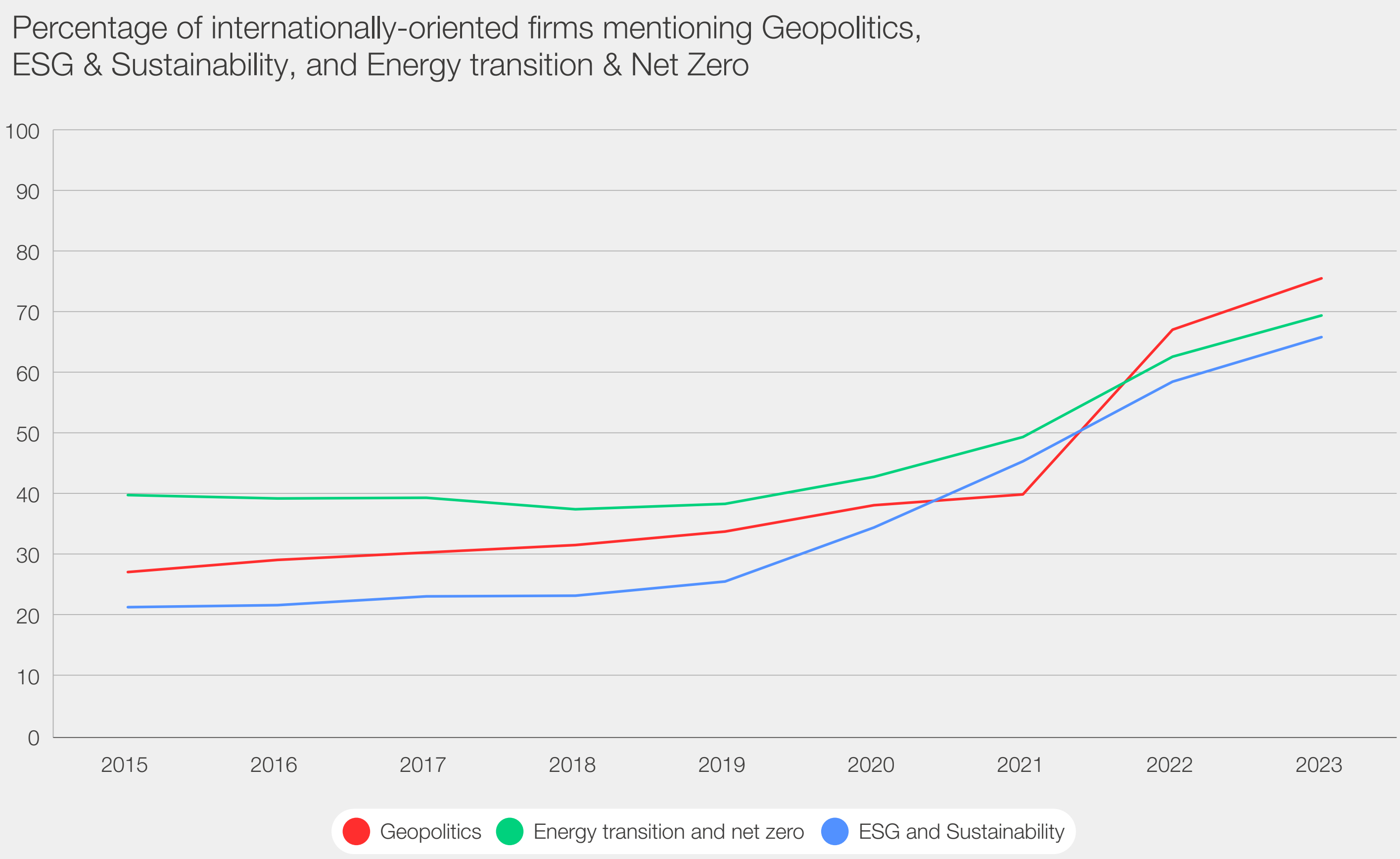
While there is no accepted start date for the latest bout of geopolitical rivalry, the narrative has markedly shifted when compared to the years following the fall of the Berlin Wall. That shift is significant because many internationally active firms developed their global commercial footprints during calmer times. Now that geopolitical rivalry has intensified, how is international business responding?

There can be no doubt that corporate boards and senior executives now confront the reality of geopolitical rivalry. Export bans, screening of inward and outward investment plans on national security grounds, subsidies to induce the repatriation of production and greenfield sites, as well as import tariff hikes have become part of the geopolitical armoury in a multipolar global economy.

According to corporate filings to the US Securities and Exchange Commission (SEC), for the first time in 2022, more internationally active firms mentioned geopolitical factors as driving business decisions or influencing risk assessments than terms relating to environmental, social and governance (ESG) matters, sustainability or climate change.

In 2015, just 27% of firms had mentioned geopolitical factors. By 2022, that had risen to 67%. SEC filings during 2023 revealed that 75% of internationally active firms noted the importance of geopolitical considerations (see Figure 1 below).

FIGURE 1 **From 2022 on geopolitical terms were mentioned in the SEC reports of internationally active firms more often than ESG, sustainability, and climate change.**



Source: Corporate filings to the US SEC.

Concerns that geopolitically driven policy measures might weaken cross-border commercial ties have not gone unnoticed. Since 2021, we have identified a total of 16 macroeconomic studies that have sought to estimate the costs of decoupling. The losses vary depending on the scenario defined, but some of the real income losses predicted are as high as double digits in percentage terms for certain countries and regions. However, these findings typically have limited resonance beyond technocratic stakeholders well-versed in economics.

Also, the studies do not explicitly consider the impact of geopolitically motivated commercial policy interventions on how firms seek to create value from their international operations, or on corporate performance. Nor do they consider the numerous ways internationally active firms can respond to geopolitics.

The executives selected for interviews for this paper, work in international businesses that operate across a range of manufacturing and service sectors and are headquartered in China, Europe, the Middle East and North America. By laying out how international business perceives evolving geopolitical dynamics and reacts to it, this study aims to provide officials with a deeper understanding of associated commercial choices to be able to better advise governments on how to manage cross-border commercial ties going forward.

The interviews indicate that the international business community is not aligned on what geopolitics is in the first place. This means officials and businesses risk talking past each other, with the associated risk that geopolitics gets conflated with other policy dynamics.

Corporate responses therefore also differ, which again has implications for how to better design and execute commercial policy initiatives motivated by geopolitics, security of supply and national security considerations.

1 What's at stake? Benefits from cross-border commercial operations

Businesses must safeguard these in the interest of improving revenues, reducing costs, strengthening innovation and achieving scale.

After the fall of the Berlin Wall and China's opening up to the world accelerated globalization, companies sought to strengthen cross-border ties. In many cases this involved extending commercial operations into nations that had previously been geopolitical foes or had been relatively closed to international business. Falling costs of communication and transportation facilitated the unbundling of manufacturing processes and eased the delivery of cross-border business services. The result was that certain corporate practices, such as offshoring, became widespread.

Deliberate steps were taken to integrate emerging economies into global markets. This was done through a combination of unilateral reforms (often taken with an eye to wooing foreign investors), signing bilateral investment treaties and regional trade agreements, and joining multilateral trade-facilitation organizations (in particular, the World Trade Organization). This created options for companies to venture beyond their countries' borders.

More recently, an era where a hegemon guided the world economy has given way to one where multiple poles of economic activity vie for influence. The return of geopolitical rivalry in recent years confronts a world where different types of strong cross-border commercial ties are in place. The contrast with the start of the Cold War era during the years of reconstruction after World War II could not be starker.

To verify what is at stake from intensifying geopolitical rivalry, the trade and investment team at the World Economic Forum, in collaboration with experts from the global trade team of Boston Consulting Group, interviewed senior executives from 13 internationally active companies during the third quarter of 2023.

First, each executive was asked to explain how their company had benefited from globalization – that is, in what ways did open markets underpin their fundamental corporate strategy choices? Twelve distinct and sophisticated answers were provided to this question, as summarized in Table 1.

TABLE 1 **How firms take advantage of global market integration and the benefits at risk from deglobalization**

Option created by globalization	Corporate benefits at risk from deglobalization	
	Explanation	**Impact category**
1 Trade and investment reforms open markets, enabling sales to new foreign customers or to existing customers that are expanding internationally.	– New or increased revenue streams open up. – Dependency on home market sales and attendant risks to the viability of business models are reduced.	Revenues
2 This improves access to markets abroad with faster growth rates than the home market.	– A firm's prospects are no longer tied to slower-growing home market or region.	
3 Enhanced proximity to foreign customers facilitates tailoring of goods and services to their needs.	– Higher prices can be charged, creating the potential for higher profit margins. – In addition, gains can accrue from economies of scope.	
4 Cross-border temporary movement of personnel allows for talent to be sourced from more labour markets.	– Skilled employees can be deployed from more labour markets at faster speed and lower cost.	
5 Certain stages of commercial activity (not just production) can be moved to locations with more favourable cost/efficiency outcomes or potential. 6 Businesses can source parts, components and materials more readily, reliably or cheaply abroad.	– Cost control improves. – New or better ways to deploy a firm's core competencies become possible. – Excessive dependence on suppliers in the home market is reduced.	Costs
7 Access to foreign capital markets has improved.	– The cost of capital is reduced. – Access to innovative financing methods improves. – Dependency on principal financing mechanisms in home markets reduces.	
8 Greater foreign sales combined with economies of scale in production allow for lower prices to be offered to customers.	– Value propositions improve for customers at home and abroad, longer production runs become possible.	Scale of operations
9 Access to regional and global markets facilitates operations at sufficient scale to make certain business models viable.	– Can spread major R&D, other set-up costs and fixed costs across a larger number of customers, creating greater profit potential.	
10 Access to foreign technology and knowhow enables firms to faster reach and then stay close to the technological frontier, sometimes through the creation of R&D centres abroad. 11 Access to foreign talent enables firms to faster reach and then stay close to the technological frontier.	– The capacity to innovate higher value-added and margin goods and services is enhanced. – The ability to offer more attractive careers to national and foreign team members results in better hiring and retention of talent.	Organizational transformation and innovation
12 Mergers with or acquisitions of foreign firms become possible.	– Synergies (not only cost-related) and other complementarities can be utilized. – Revenue streams are diversified. – Exposure or dependencies on certain sectors or geographies, including home market, are reduced.	

The executives interviewed pointed to a wide range of commercial options created by the integration of national markets into the world economy. The availability of these options helps avoid the downside of sourcing from, operating in and relying entirely on growth in home markets. Without the option of organizing some activities in foreign locations, the alternative for certain companies would have been to move all of their operations abroad.

If geopolitical considerations force firms to loosen ties with economies abroad, they stand to lose benefits related to existing revenue streams, cost control, scale of operation and advantages arising from certain organizational forms and innovation.

The interviews also highlighted the stake that international businesses, their employees and their customers have in current cross-border commercial arrangements, in the domestic policies and international architecture that underpins them, and in a manner in which geopolitical rivalry between governments unfolds.

When assessing different means to attaining a geopolitical end, governments should take into account any likely impairment to corporate performance and national competitiveness caused by curtailing cross-border commerce. Even better would be to quantify in broad terms what is at stake from competing policy options.

2 "Geopolitics" means different things to different firms

Since companies understand and respond differently to "geopolitics", policy-makers must communicate their priorities and objectives with utmost clarity.

Because firms operate in different lines of business and in different geographies, and have made different legacy decisions, the understanding of the term "geopolitics" and of geopolitical rivalry diverged significantly among the executives interviewed (summarized in Table 2).

TABLE 2 **"Geopolitics" is understood very differently by various firms with international operations**

What interviewees associate with the term "geopolitics"	Contemporary manifestations of this form of geopolitics as mentioned by interviewees	Potential future examples mentioned by interviewees
1 Intensified rivalry between China and the United States.	– Tariffs imposed during the Trump administration. – Export controls on certain technologies. – Foreign investment screening on national security grounds, inbound and outbound. – Decoupling, de-risking narratives.	Potential sanctions on China, should conflict erupt in the South China Sea.
2 Geopolitics as code for actions taken by the Chinese government against foreign firms.	– Harassment of foreign firms, threats to their operations. – Officials refuse to engage or advise foreign firms. – Discouragement of local talent from working for foreign firms.	
3 Sanctions against nations violating international law.	– Sanctions on Russia following invasion of Ukraine in 2014 and 2022. – Weaponization of wheat and energy flows by Russia, and its commercial fallout. – Unplanned sales of Russian subsidiaries.	Potential sanctions on China, should conflict erupt in the South China Sea.
4 Populism and nationalist sentiment in the West.	– BREXIT, resulting in certain cases in zealous application of restored regulatory powers. – "America-first" trade policy.	Re-election of Donald Trump.
5 Fragmentation of the world economy.	– Fault-lines between countries on willingness to sanction Russia. – Reinforcement of North American and Western European economic blocs. – Biden administration's Indo-Pacific Economic Framework (IPEF) initiative. – Regional Comprehensive Economic Partnership and Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). – China's Belt and Road Initiative. – Scramble for critical raw materials.	Fragmentation into distinct blocs with high walls.
6 Concerns about undue reliance on foreign suppliers of essential goods arising from the COVID-19 pandemic.	– Attempts to reduce excessive dependencies on certain countries with subsidies to encourage local production or to repatriate factories. – The friend-shoring narrative. – Pressures from customers to diversify production locations and to have more production facilities closer to buyers.	Mandating or incentivizing production relocation, even reshoring.
7 Availability of critical raw materials.	– Export restrictions and bans by extracting countries. – Pre-emptive investments to secure supplies by firms and governments, including foreign direct investments involving potential offtake agreements.	Potential deals such as the Organization of Petroleum Exporting Countries (OPEC) between suppliers of critical raw materials.

TABLE 2 | **"Geopolitics" is understood very differently by various firms with international operations** (continued)

What interviewees associate with the term "geopolitics"	Contemporary manifestations of this form of geopolitics as mentioned by interviewees	Potential future examples mentioned by interviewees
8 Attempts to induce relocation of factories away from geopolitical rivals or back home ("reshoring")	– Combination of high US tariffs on imported goods from China and negotiation of US-Mexico-Canada trade agreement. – Japanese government scheme to incentivize relocation of factories from China to home soil or to Association of Southeast Asian Nations (ASEAN).	
9 Industrial policy in strategically important sectors.	– Initiatives to encourage semiconductor production in Group of 20 (G20) countries and to ban certain sales of upstream technologies. – Restrictions on foreign investment in national energy infrastructures. – Localization requirements, not only in digital sectors.	
10 Greater favouritism towards home commercial interests, overt or subtle protectionism.	– Resort to non-transparent non-tariff barriers, sometimes in the form of regulation. – Reduced adherence to multilateral norms. – Bailouts and subsidies for favoured local firms. – Expropriation of foreign investors. – Bans on foreign firms selling products to public-sector buyers.	
11 Export controls on critical technologies.	– Bans or onerous approval requirements on export of certain commercially or militarily sensitive technologies, not confined to semiconductors. – Dual-use regulations.	
12 Singling out of individual foreign firms for denial of market access.	– Measures taken against Huawei and TikTok.	

For some executives, geopolitics was associated with a particular state action or sequences of actions (e.g. a trade war). For others, geopolitics was associated with a cause, a consequence and even a rationale.

For some, the growing rivalry between China and the US was the dominant geopolitical theme. Potentially linked with this theme were certain industrial policies (in increasingly sensitive sectors such as semiconductors and critical raw materials) as well as initiatives to encourage the relocation of production away from geopolitical foes and sometimes towards home.

For others, geopolitics was associated with the world economy breaking into distinct blocs of nations, a process that some felt has been accelerated by sanctions against those nations – such as Russia – that are said to have violated established international norms. In turn, in the view of some interviewees, this fragmentation of the world economy has been reinforced by growing populism and nationalism in Western economies. The legacy of COVID-19, in which security of supply considerations for medical goods and vaccines were paramount for some time, was seen by some as relevant to understanding contemporary geopolitical dynamics as well.

Some interviewees associated the term geopolitics with particular actions taken against specific foreign firms. Some executives associated geopolitics with protectionism, and provided examples of cases where they thought geopolitics had driven protectionist measures.

Given that corporate executives interpret official statements about geopolitics differently, and some governments seek to influence corporate deliberations about their international footprint, policy-makers must communicate their geopolitical priorities with utmost clarity.

Officials opining on geopolitical matters might draw inspiration from the extraordinary lengths that their counterparts in central banks go to when providing forward guidance to the private sector. Like officials tasked with managing geopolitical risks, central bankers consciously seek to shape private sector expectations and behaviour.

Corporate responses to geopolitical tensions

The companies interviewed said they were responding to growing geopolitical rivalry in different ways, which can be summed up in five broad classes. They repeatedly emphasized the financial ramifications of these responses and put them into context in an era of higher costs of capital following the end of quantitative easing in recent years.

Whether diversity of corporate response matters to officials depends on the outcomes sought from policy, assuming they have been identified in the first place. This may not be the case where the outcome sought is simply to decouple from a given market as soon as possible.

The main responses were:

1. **Reconfiguration of cross-border supply chains**. This was seen as an increasingly attractive approach, in the wake of the COVID-19 fallout which came on top of the ongoing geopolitical changes. Executives from firms headquartered in North America, in particular, emphasized the degree to which sourcing has been repatriated to their region which, critically, includes Mexico. They confirmed that firms have many options when rewiring supply chains – reshoring is not the only one. As to why some firms are prepared to accept higher risks from continuing to source from geopolitical hotspots, interviewees specifically mentioned the reluctance to give up proven economies of scale and reliable suppliers, and to incur investment costs on establishing new production facilities.

2. **Reassessment of corporate exposure to China and other potential geopolitical hotspots**. Sometimes the trigger was changes in Chinese policy towards business, in other cases it was US export controls that raised question marks in the eyes of Chinese buyers on the reliability of Western suppliers. Interviewees mentioned a wide range of options, including: developing explicit China-for-China strategies; creating separate corporate structures for Chinese operations; and scaling back activity including a partial exit, reducing employment of expatriate staff and, at the extreme, completely abandoning the Chinese market. Overall, there appeared little corporate appetite for complete decoupling from the Chinese market.

3. **Relocation of research and development (R&D) facilities when talent is available**. Repatriation to a firm's home economy is contingent on the availability of relevant qualified personnel and infrastructure to support cutting-edge R&D. In terms of talent management, certain sanctions frustrate nationality-blind employment of talent and have resulted in reduced career opportunities for nationals from countries imposing those rules. A number of executives interviewed seemed resigned to the development of a world economy with bifurcated technological and digital domains. Whether it is the semiconductor sector or data localization measures, public policy in the largest economies is fragmenting global markets, the interviewees said. In turn, this compromises business models based on common technological platforms that seek to attain global scale.

4. **Market-by-market assessment of the merits of accommodating local policies**. Executives of one technology service provider favoured this approach over reflexively exiting markets. Since many such firms have multiple revenue streams, they can use calibrated responses such as continuing commercial operations in some business lines and not others. In cases where multiple means of attaining public policy ends are available, executives favoured engagement with officials to make the case for the least trade-distorting and disruptive policy measures.

5. **Development of new revenue streams**. Firms targeted by sanctions realize they must enhance their value propositions to customers by significant investments in R&D. Emerging markets whose governments are not taking sides in current geopolitical rivalries were cited as important sources of new business. Some interviewees also emphasized that the targets of sanctions have agency and may well have enough resources to be able to overcome restrictions on where they can, for instance, source cutting-edge technology from. Firms face make vs. buy decisions, and sanctions may shift some decisions towards the former. That potentially reinforces existing tendencies towards geographical bifurcation of certain leading-edge technologies, some interviewees said.

These corporate responses all point to the adverse implications of growing geopolitical tensions for companies' financial performance. To the extent that higher operating costs are broad-based and can be passed on to customers, they add to inflationary pressures. To the extent that cost pass-through is limited or impossible, profitability is impaired, putting at risk firms' ability to raise funds internally for R&D and other investments. This, in turn, threatens competitiveness and jobs over the medium term. Ultimately, much hinges on how competitive the markets are in which a firm operates, and whether domestic state support for investments is available.

Relocating commercial activities requires additional outlays (such as building new plants) which, in turn, impairs cash flow. Coming at a time when investment and working capital are more expensive to finance, this places further pressure on business models that have been stretched by higher energy prices. It is unclear whether governments are taking into account the cumulative effect of these pressures on companies when formulating policy towards geopolitical rivals.

In sum, international businesses are reacting to geopolitical tensions in five discernible ways. In each, companies have numerous options to choose from. This ought to temper any expectations of uniform responses, such as blanket withdrawal from geopolitical hotspots. Risk appetites and competitive pressures facing firms differ. These differences are compounded by different societal and governmental pressures to retrench in geopolitical rival countries and by the extent to which alternative locations can substitute for the advantages that attracted a firm to invest in the rival country in the first place.

Whether diversity of corporate response matters to officials depends on the outcomes sought from policy, assuming they have been identified in the first place. This may not be the case where the outcome sought is simply to decouple from a given market as soon as possible.

3

Recommendations for design and conduct of public policy

Policy interventions must preserve the benefits of globalization to the greatest extent possible.

During the latest wave of globalization, companies with international operations invested trillions of dollars in foreign markets and continue to spend funds sourcing goods and services from foreign suppliers. There is no way that policy interventions seeking to trim commercial ties between geopolitical rivals can do so without disrupting corporate operations, impairing financial performance and, in some cases, stranding assets.

In turbulent times, policy-makers and businesspeople are on sharp learning curves. Based on the interviews conducted for this white paper, on discussions with executives and officials attending the 2024 Annual Meeting of the World Economic Forum, and on desk research into the ways in which firms have reacted to unfolding geopolitical rivalry, here are 10 recommendations for better design of government policy initiatives. These recommendations suggest how governments can attain geopolitical objectives with the least foregoing of the benefits of globalization.

1. **Policy formulation processes should be designed to identify the least commercially disruptive state means to reach geopolitical goals**. As a matter of course, multiple options for attaining a given goal must be explicitly identified and systematically compared. These options should be identified through a process informed by the relevant choices of other governments, now and in the past.

2. **Policies must be grounded in a deeper understanding of corporate practices and strategic options, both domestic and cross-border**. Such understanding will help officials to properly diagnose geopolitical risks as well as the risks from domestic commercial operations. It will help them better understand the options available to business, and to recognize the harm done and uncertainty fostered by poorly designed policy interventions. Such harm includes additional operational costs, greater investment outlays, impaired cash flows, unnecessary delays and heightened uncertainty. Uncertainty, an enemy of corporate investment, is particularly pernicious and tends to be higher when policy changes sharply or frequently.

3. **More effective communication of policies to avoid disappointing private-sector responses**. Given the multifaceted nature of geopolitics and its potential conflation and interaction with profound global shocks, such as the COVID-19 pandemic, it is unsurprising that, when business hears the term geopolitics, it is interpreted in different ways. A failure to understand precisely what is meant by phrases such as “de-risking” may lead businesses to postpone the very changes or investments that governments seek to promote. Ineffective communication that results in business and government operating in parallel universes is a recipe for mounting frustration.

4. **The links between intended geopolitical goals, decisions and actions taken, and their rationale should be spelt out by officials as clearly as is practically possible**. This would help the private sector to better judge what corporate practices are now deemed acceptable/unacceptable, desirable/undesirable, etc. Depending on the context, it may well be that, as states advance and communicate their geopolitical goals, many of the ways in which firms capitalize on globalization will continue to remain open so that more commercially damaging disruptions can be avoided.

5. **Steps to encourage reshoring must be paired with measures to improve the supply side of national economies**. Some governments have sought to discourage firms from availing themselves of certain foreign locations, data, talent and technologies. Encouraging firms to repatriate commercial activity is likely to encounter greater opposition if the deficiencies in the home business environment are glaring. Corporate subsidies should not be awarded to mask fixable deficiencies in national business environments.

❝ The literature on the effectiveness of trade and investment sanctions during the era of American hegemony is sobering enough. Now such sanctions tend to be even easier to circumvent and less effective as a result.

6. **A venture capital mindset to industrial policy is preferable to lavishing subsidies**. Such a mindset involves focus on resolving bottlenecks for firms and industries seeking to scale up and addressing coordination failures along supply chains. Subsidies can make a valuable contribution but only as part of a comprehensive approach grounded in a thorough understanding of relevant business dynamics.

   Given the length of many firms' investment horizons, with payback periods often stretching into decades, short-term subsidy interventions are less likely to influence business decision-making than a credible commitment to long-term improvements to the relevant sectoral and national business environment. An interviewee pointedly remarked that the vast subsidies being awarded in the semiconductor industry would ultimately shift the location of new production sites but would not necessarily increase the total number of such facilities.

7. **Repurpose guidelines for responsible business conduct (RBC) in geopolitical hotspots**. Existing guidelines by the Organisation for Economic Co-operation and Development (OECD) and the United Nations (UN) for RBC need to be revised. To the extent that current guidelines relate to conflict zones, they do not appear to contemplate the eventuality where a conflict may have been instigated by a geopolitical foe. This exposes firms with operations in a rival country to accusations of "trading with the enemy", even if the investments were made in less fractious times.

   Moreover, geopolitical rivals can introduce countermeasures that reduce the profitability and likelihood of disposing of corporate assets. In turn, this creates the potential for multinationals' subsidiaries to get trapped. Sensible norms for RBC need to be articulated for these subsidiaries. These norms should be formulated through a multistakeholder dialogue in which business executives with operational experience in geopolitical hotspots should be involved.

8. **Reassess the effectiveness of punitive, geopolitically motivated state measures**. In a world with multiple poles of economic activity, tools such as trade sanctions may be considerably less effective than in the past. The surge in exports from some Western countries to the economies bordering Russia witnessed since the February 2022 invasion of Ukraine attests to this. So does the resilience of the Russian economy over the past two years.

   The literature on the effectiveness of trade and investment sanctions during the era of American hegemony is sobering enough. Now such sanctions tend to be even easier to circumvent and less effective as a result.

   Moreover, companies with long payback periods and whose home markets have matured and offer slower growth may resist pressures to exit geopolitical rival countries. An executive from a leading chemicals manufacturer said they could not conceive of a future where their company abandoned the Chinese market. That few Western companies actually exited the Russian market following the invasion of Ukraine should raise a red flag to those officials expecting to browbeat companies from the much larger Chinese market.

9. **Credible threats of counter-sanctions should influence the calculus for imposing sanctions**. That calculus ought to give greater weight to the potential fallout from counter-sanctions by targeted governments and to the options available to sanctioned firms. Tit-for-tat sanctions add to risk premia and can boomerang on those involved. Moreover, a multipolar world affords sanctioned firms the opportunity to develop revenue streams in underserved markets and to source needed components, materials and technologies from third parties.

10. **Incoherent sanction regimes impose unnecessary costs and uncertainty on international business**. Governments tend to ratchet up sanctions over time. The more objectives a sanctions regime has, the higher the likelihood that it contains measures that cut against each other. For example, a presumably unintended consequence of European bans on professional services firms contracting with Western subsidiaries operating in Russia is that the exits of the latter have been delayed, and more costly.

    Sometimes objectives clash too: pressure on Western firms to leave Russia may cut against the goal of depriving the Kremlin of revenues to maintain its military operations in Ukraine. This could be, for example, when subsidiaries from sanctioning Western countries are forced to pay sizeable "voluntary contributions" to the Russian government to expedite their departure from the Russian market. Sanctions regimes ought to be reviewed periodically to ensure that they are coherent and sufficiently effective.

4

Steps businesses can take to better manage geopolitics

These eight steps can help leaders take better decisions amid increasing geopolitical rivalry.

As part of the effort to gain a deeper understanding of the ways in which international companies are reacting to unfolding geopolitical dynamics, eight implications for deliberation and decision-making by corporate executives and board members can be drawn from the interviews conducted.

1. **Management and boards are right to give greater consideration to the implications of intensifying geopolitical rivalry**. This should result in greater appreciation of the many ways in which contemporary business relies on cross-border ties as a means to enhance revenues, keep costs under control, tap the benefits of scale, manage risks and accelerate innovation. If anything, intensifying geopolitical rivalry has highlighted why so many businesses – including those that may regard themselves as largely domestic in orientation – have a stake in the open global trading system.

2. **Managements and boards need to strengthen their understanding of geopolitical dynamics**. That geopolitics is associated with so many different potential factors affecting business implies that corporate executives need to ask how they can best learn about the various forms of geopolitical rivalry that most affect their business. Such learning needs to happen in operational business units as well as at senior executive and board levels. As geopolitical rivalry can implicate technological, military and foreign policy, as well as trade, investment and industrial policy matters, companies need to tap a wide range of expertise. This almost certainly requires going beyond having a former official or two sitting on a company's board.

3. **Siloed functional responses must be avoided**. Given that geopolitical factors are likely to have cross-cutting implications for the operations and strategy of a company, no single unit with the company should have sole responsibility for tracking and responding to these developments. Government affairs units may well have been one of the first to spot unfolding geopolitical developments, but responsibility for managing their fallout should not rest there. Likewise, geopolitically motivated sanctions regimes may implicate chief legal and compliance officers. However, responsibility for devising a coherent company-wide response is probably best done in a strategy unit or a unit close to the company's chairperson or chief executive.

4. **Putting geopolitical downside risks in perspective is vital**. Even when significant, geopolitical disruption is typically localized and is never the only factor influencing international commercial opportunities. At present, while many officials on both sides of the North Atlantic tend to see the (geopolitical) glass as half empty, it is worth recalling that in other regions of the world economy – such as Southeast Asia and Africa – many policy-makers are keen to strengthen cross-border commercial ties. Companies that find their growth plans disrupted in countries that their home governments designate geopolitical foes are searching for new markets and underserved market segments, often in countries not strongly aligned with any camp. The commercial opportunities from globalization are evolving, not ending. Governments alone do not determine the strength of cross-border commercial ties.

5. **Take steps to future-proof current and planned operations and investments**. Plausible if unwelcome contingencies, such as the re-election of Donald Trump and other potential sources of disruption, should be the subject of scenario planning exercises that draw upon expertise throughout the company. These exercises and the recommendations drawn from them should not be confined to senior management and board members.

6. **Levels of geopolitical risk appetite need to be explicit**. Some companies had considered the many options available to them and their attendant costs and risks and concluded that

❝ As geopolitical rivalry can implicate technological, military and foreign policy, as well as trade, investment and industrial policy matters, companies need to tap a wide range of expertise. This almost certainly requires going beyond having a former official or two sitting on a company's board.

current exposure to geopolitical risks was acceptable. This type of decision can only be properly taken if levels of risk appetite and their consequences have been discussed explicitly. As is often the case, risk reduction rather than risk elimination makes better commercial sense.

7. **Engage with officials early in policy formulation**. For many officials, geopolitical factors are still novel. Since commercially relevant policy intervention is mediated through firms and markets, corporate executives typically have an informational advantage over officials in their understanding of the consequences of different policy or regulatory choices. Active engagement during consultation processes with officials can pay important dividends. This is especially true when options are presented to officials that can attain sought-after goals at less cost, disruption and potential for uncertainty.

8. **Joint action by business to encourage de-escalation of tensions will be needed from time to time**. Instability and turmoil threaten not only existing commercial operations but also lead to postponement of investments and corporate plans. International business has a strong stake in guardrails being developed that keep geopolitical competition within tolerable limits. There is only so much any one international business can do to encourage governments to de-escalate tensions and to reset relations after fraught periods. National, regional and pan-regional business associations can play their part in encouraging governments to get to the negotiating table and devise ways to curb any excesses in geopolitical rivalry. After the First World War, the phrase "merchants for peace" was coined to characterize the collective efforts of the international business community. A similar initiative is called for today.

Conclusion

This report was motivated by the desire to inform officials of the realities international business executives are facing as they grapple with unfolding contemporary geopolitical dynamics. We conducted a series of semi-structured interviews with executive officers from a diverse group of international businesses. These revealed that firms have sought to capitalize on globalization in various ways, indicating just how intertwined economies around the world have become. The firms interviewed understood the term “geopolitics” in very different ways – a finding that calls for very careful messaging by states when communicating with the private sector.

Unlike monetary policy, say, which has a widely accepted set of objectives and a distinct tool-box, geopolitics is associated with a range of goals not easy to measure and track. Moreover, governments advance geopolitical objectives with tools typically used for commercial policy purposes. This blending of trade and national security objectives and policy requires careful, transparent management by the state if the private sector is to draw the right inferences from policy action. The recommendations outlined above for policy-making are devised with these considerations in mind.

Companies too should take the opportunity to reflect on how they understand and act in response to unfolding geopolitical dynamics, their likely future trajectory, and what is at stake for their current operations and strategy. There is no reason why every firm must tackle geopolitical challenges in the same way. Nevertheless, the interviews conducted for this study revealed differences in how well-prepared firms were and the degree to which geopolitical considerations were being factored in at different decision-making levels. The recommendations for business provided above are for those who wish to up their game.

The “can do” spirit of many private-sector executives – also on display at the 2024 Annual Meetings of the World Economic Forum – came through in the interviews. If policy intervention results in a decline in a company’s expected sales growth in a geopolitical hotspot, then the response is often to find new markets or to find underserved market segments in other countries. Policy measures that thin certain cross-border commercial ties create incentives for firms to develop other ties, creating new goods and service offerings along the way. If anything, choice is likely to expand for buyers in countries whose governments refuse to take sides in the current geopolitical demarche. In this manner, globalization evolves in response to geopolitics rather than retrenches. This serves as a reminder that the downside from geopolitical rivalry should not be overstated.

Looking forward, how this rivalry is perceived and how it unfolds in the coming years will depend on electoral outcomes in several of the 60 or so countries going to the ballot in 2024. Given the competing and conflicting narratives on the issues of trade and security, some officials, particularly those seeking re-election, may make sharp adjustments to cross-border commercial ties. This will affect how businesses deploy capital, intellectual property and talent around the world. Businesses must remain agile and keep avenues of communication open with the policy-makers and regulators who have the greatest potential to wreak havoc on even the best-laid plans.

Annexe

TABLE 3 **Estimates of GDP losses from decoupling scenarios in 16 recent studies**

Study	Scenario	Headline GDP losses
McKinsey Global Institute (2024)[1]	Using the Global Trade Analysis Project (GTAP) general equilibrium model, two scenarios for the world economy through to 2035 were considered. Votes at the UN General Assembly between 2005 and 2022 were used to sort countries into three groups: a so-called Western group, an Eastern group, and a mid-aligned group. In one fragmentation scenario, 60% tariffs were imposed on trade in critical goods between Eastern and Western groups and 20% import tariffs on other goods. Tariffs imposed on trade with mid-aligned groups were lower. A second scenario modelled the consequences of diversification by firms so as to cap levels of geographic import concentration.	In the fragmentation scenario, long-run global GDP is found to be 1.5% lower relative to expectations for 2035. Some economies see their GDP fall by up to 6%. In the diversification scenario, global GDP falls by only 0.5% and China's GDP falls by 1%.
Hakobyan, Meleshchuk and Zymek (2023)[2]	Using a measure of geopolitical affinity based on treaty ties, three blocs are created (Eastern, Western and non-aligned). Three scenarios are defined: 1. increasing treaty ties within blocs, 2. doubled trade policy sensitivity to geopolitical affinity, and 3. the combination of 1 and 2. A dynamic trade model is used to simulate these three scenarios.	The median national GDP loss under scenario 1 is 0.2%. Under this scenario a quarter of all nations see GDP gains, largely resulting from enhanced trade within blocs. Latin American and Caribbean nations gain the most under this scenario. The median national GDP loss under scenario 2 is 1%, with the biggest losses seen in emerging Asia (0.7%) and the Middle East and Central Asia (1.5%). Scenario 3 sees median national GDP losses of 1.3%. Losses in the latter two mentioned regions increase markedly over scenario 2.
International Monetary Fund (2023b)[3]	Examines impact on Latin America and the Caribbean of three scenarios: 1. Cessation of trade between Russia and the European Union and the US, 2. countries are assigned to blocs based on intensity of current bilateral trade and, 3. countries are assigned to blocs based on a measure of geopolitical affinity. Trade between blocs in 2 and 3 ceases. A trade model with input-output linkages was used to simulate the outcomes.	Scenario 1 sees Latin America and the Caribbean marginally better off (largely on account of benefiting from trade diversion), while average losses elsewhere in the world are between 0.5% and 1% of GDP. Scenarios 2 and 3, the more serious fragmentation scenarios, result in GDP losses in the range of 2-4% of GDP in Latin America and the Caribbean, with losses higher under 3.
Clancy, Valenta and Smith (2023)[4]	A dynamic general equilibrium model is used to model a three-bloc world economy where localization policies are used to encourage sourcing from home or from allies. Simulates a 1% fall in import content of exports.	Euro area GDP losses can be as high as 0.5% if local firm productivity is impaired by reshoring or if local firm mark-ups go up. Friend-shoring scenarios yield losses of no more than 0.04%.
Bolhuis, Chen and Kett (2023)[5]	Uses a multi-sector, multi-country general equilibrium model to simulate the effects of two fragmentation scenarios on commodity markets with the latest available pre-pandemic data. The mild scenario has no trade between Russia and the EU and US and no technology trade between the US and China. More severe scenarios see world economy split into two blocs, one centred around the EU and the US and the other around China and Russia.	Global GDP loss in mild scenario is 0.3%. In severe scenario the headline global GDP loss is 2.3% but, depending on modeling assumptions, can range from 1.9% to 7%. In the more severe scenario, low-income nations face GDP losses of 4.3%.
Campos, Estefania-Flores, Furceri and Timini (2023)[6]	Simulates world economy splitting into three blocs based on UN General Assembly votes on Russia's membership of the Human Rights Council. Second scenario goes further and sees the "Eastern bloc" leave the WTO.	Three-bloc scenario sees national welfare changes ranging from +0.9% to -8.3%. Exit of the Eastern bloc widens the range of national welfare outcomes to +0.9% to -18%.
Attinasi, Boeckelmann and Muenier (2023)[7]	Simulates four decoupling scenarios for trade in intermediate goods, the most severe of which involves no trade between Eastern and Western blocs. Again, bloc membership is determined by UN voting records. Deploys a model based on 2017 input-output tables for 73 jurisdictions.	With flexible prices and substitution practices, long-term welfare losses are around 2%. With less flexibility, welfare losses rise to 5%. The most severe decoupling scenarios generate welfare losses that range from -3.1% to -15.2%.

TABLE 3 | **Estimates of GDP losses from decoupling scenarios in 16 recent studies** (continued)

Study	Scenario	Headline GDP losses
Felbermayr, Mahlkow and Sandkamp (2023)[8]	Uses GTAP model to double non-tariff barriers in five decoupling scenarios. Employs the Kiel Institute Trade Policy Evaluation (KITE) model.	Bilateral decoupling between China and the EU reduces their welfare by 0.92% and 0.78%, respectively. Decoupling of China from the US and its allies (including the EU) reduces Chinese welfare by 3.55% and US and ally welfare by 0.95%.
Goes and Bekkers (2023)[9]	Models a world divided into two blocs, based on evidence in the Foreign Policy Similarity Database. A full decoupling scenario—in which trade costs between blocs rise by around 160%--is simulated. A second scenario involving the imposition of 32% import tariffs between blocs is considered. The impact of these policy regimes on the transfer of technology/ ideas across borders was taken into account.	Median welfare losses for the Western bloc are 4% but range from 1% to 8%. Median welfare losses for the Eastern bloc are higher (10.5%) and range from 8% to 12%.
International Monetary Fund (2023a)[10]	Using data on bilateral flows of inputs into investment as a proxy for FDI, the IMF's multi-regional dynamic general equilibrium model is employed to simulate the effects of a 50% reduction in such trade between blocs of countries. The world is broken up into eight groups of countries and different scenarios relate to geopolitical alignment between various configurations of groups.	In the baseline geopolitical fragmentation scenarios, global GDP losses in the longer run could reach 2%. While the United States would experience a 0.5% GDP loss, European nations, China, and other high-income nations would lose around 2% of GDP. South East Asian nations would lose between 6% and 7% of GDP.
International Monetary Fund (2022)[11]	Uses a multi-country general equilibrium model to simulate effect of cutting trade in goods in high-tech manufacturing and in extractive industries. Word splits into blocs along lines given by votes at the UN.	Global annual GDP losses are 1.2%. GDP losses in the Asia-Pacific region estimated to be 1.5%. "Trade intensive" nations in the Asia-Pacific region see GDP losses of 3.3%.
Javorcik, Kitzmueller, Schweiger and Yildirium (2022)[12]	Models a world economy that splits into two blocs based on UN General Assembly votes on the conflict in Ukraine. Model takes account of input-output linkages across sectors and nations. Simulates imposition of 20% import tariffs or transport costs.	All countries lose 0.1-2.3% of GDP when 20% tariffs are imposed. Adding a further 20% of transport costs raises the GDP losses for nations to 0.6%-4.6%.
Sandkamp (2022)[13]	Simulates four scenarios each involving EU decoupling from different groups of nations or from all nations. Same approach taken as Felbermayr, Mahlkow and Sandkamp (2023).	Unilateral decoupling by the EU will reduce its welfare by 3.3%. Mutual decoupling reduces EU welfare by 5.3%. Under the latter scenario, German welfare falls 6.9%.
Eppinger, Felbermayr, Krebs and Kukharskyy (2021)[14]	To examine complete decoupling of trade in parts, components and other intermediate goods, sets the cost of shipping these goods at infinity.	Small highly integrated economies see massive GDP losses from global decoupling of input trade (Luxembourg's losses are estimated at 68%). Larger economies see smaller losses (US losses are estimated at 3.3% from global decoupling.) Bilateral decoupling results in much lower GDP losses and trade diversion to alternative suppliers.
Cerdiero, Eugster, Mano, Muir and Peiris (2021)[15]	Simulates technological decoupling around "hubs" of nations using a global dynamic macroeconomic model. Here technological decoupling involves imposition of non-tariff barriers that eliminates trade in high-tech goods. Considers effects of non-hub nations having preferential and non-preferential attachments to hubs.	Depending on the scenario, real GDP losses for China after 10 years can lie in the range of -2% to -10%. For the United States the range of GDP losses is -1% to -4%. For the European Union, the comparable range is 0 to -6%. For Japan and India, the comparable range is 0 to -4%. Technological decoupling limited to the US and China results in smaller GDP losses.
Economist Intelligence Unit (2021)[16]	Uses GTAP model to simulate consequences of imposing a 100% import tariff on trade between China and the so-called Five Eyes Countries (US, UK, Canada, Australia and New Zealand). However, in eight "strategically important sectors" trade is completely embargoed.	Estimate of cumulative loss over 2021-2030 amounts to 3.8% of world GDP. Cumulative losses for China are higher (-16.5%). Australia and Canada lose the most of the Five Eyes nations (-4.3% and 2.8%, respectively.) The cumulative loss for the US is -1.2% of its GDP.

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Endnotes

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