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Neoliberalism is dead, long live national security

Geopolitical competition is reshaping the global economy, forcing countries to rethink their development strategies amid growing fragmentation

If direct hot wars between great powers can be avoided, the primary battlegrounds for geopolitical competition will be the economy and technology. Today, all major world powers have begun using protectionist measures that were rare during the era of globalisation.

The Biden administration has continued and intensified the export controls and investment barriers initiated by the Trump administration. The 'small yard, high fence' strategy aims to slow China's advancement to the technological frontier in sectors where the United States feels most vulnerable to its main competitor. American allies in Asia and Europe are cautious of the devastating effects of complete economic de-coupling from China but have aligned themselves with a de-risking strategy to reduce one-sided dependencies. In response, China has imposed export restrictions on rare earths, utilised import bans to penalise non-conforming states and generally made operating conditions more challenging for Western corporations in its market.

The trend is clear: geopolitical competition is driving geo-economic disruptions.

Following the Russian invasion of Ukraine, Europe and Russia have largely de-coupled their economies. The West has utilised its financial sector dominance to impose sanctions on Russia and threatens secondary sanctions on anyone who does not comply. In response, Russia has turned to China and other supportive countries to bypass Western export bans. The BRICS bloc intensified the use of local currencies for bilateral trade to sanction-proof their economies.

Shaken by sudden disruptions during the pandemic and empowered by increased productivity through digital automation, industrial economies

have begun emphasising resilience, leading to the re- and near-shoring of supply chains. Now, geopolitical competition is accelerating these trends and fostering 'friend-shoring' with like-minded 'value partners'.

The list goes on, but the trend is clear: geopolitical competition is driving geo-economic disruptions. Taken together, these trends are altering the workings of the world economy. The paradigm is shifting from efficiency to resilience. Globalisation has peaked and is now reversing. The result may not be full de-globalisation but rather regionalisation, potentially punctuated by emerging trading blocs. Market interests no longer reign supreme; after a brief hiatus, the primacy of national security interests has returned. The state, long relegated to the side-lines, is reasserting control. Corporations are hastily adapting to this new environment. The neoliberal model is officially dead.

Adapting current development models

Beyond piecemeal and tit-for-tat measures, the largest economic powers have begun shifting their development models. China, aware of geopolitical headwinds in Western markets, is attempting to pivot to a dual circulation economy. However, the shock over strict Covid-19 measures and uncertainty about the future have led to reduced consumer spending. Sluggish domestic demand has made existing issues worse in the manufacturing sector and real estate market, contributing to a slow-moving banking crisis. Efforts by local governments to manage this situation could further worsen the debt problems faced by both private companies and the state, and could eventually lead to the same kind of stagflation Japan experienced.

Against better judgment, China is under pressure to focus more on exports to deal with excess production. This could lead to trade barriers from major economies like those in the G7, potentially sparking a new round in the trade war. China's strategy to sanction proof the economy by becoming self-sufficient in technology could unintentionally worsen its overcapacity issue. If China can't boost consumer confidence through better welfare and healthcare, its plan to balance export growth with increased domestic consumption may fail. This would leave China's development vulnerable to the head-winds of geopolitical competition. Transitioning from a model focused on rapid GDP growth through state-driven industrial and infrastructure projects to a more balanced economy is challenging, especially when current incentives are motivated by the political imperative of retaining control of the private sector.

Similarly, the Inflation Reduction Act signals the return of industrial policy to the United States. Like all major economies, the US suffers

from sluggish consumer demand. Regardless of who occupies the White House next year, scepticism towards free trade and the goal of revitalising jobs in the American heartlands will prevail. Similarly, security interests have taken a front seat in the economic outlook of all OECD economies.

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This shift alters the opportunity structures for development worldwide. Naturally, the impact of geo-economic disruptions will vary depending on geographic location, geopolitical vulnerabilities and position in the global value chain. For some commodity exporters, market politicisation may prove beneficial. Others aim to capitalise on the windfall of geopolitical competition and leverage friend-shoring opportunities.

However, for those relying on the historically successful flying geese model of cheap labour, export-led catch-up industrialisation, the race to development may become significantly tougher. The substitution of human labour with robots, algorithms and Artificial Intelligence in developed economies is eroding the comparative advantage of cheap labour. At the same time, a drop in consumer demand and increasing protectionism are raising the stakes for access to export markets. Moreover, the weaponisation of technology transfer and supply chains jeopardises the ability of developing countries to climb the ladder toward industrialization. The dumping of China's excess production into local markets could lead to deindustrialisation, where domestic industries struggle to compete and may even collapse.

Navigating a global economy that's fragile, fragmented and prone to shocks disrupts development paths and makes debt crises even worse. Cheap-labour, export-led catch-up industrialisation will be difficult in a world ridden with geo-economic disruptions. This means there is an urgent need to adapt development models accordingly.

To prepare for this necessary strategic debate, a thorough analysis of the likely impacts of geo-economic disruptions and the capacity of both state and private sectors to respond is required. Equally important, any realistic proposal for a new development model must consider the domestic political economy. Shifts in development paths create winners and losers; thus, resistance to change from those who stand to lose is to be expected. Given the influential position of many status quo forces in the political economy, this resistance can derail efforts to adapt to the new economic environment. This explains why countries where elites have captured the state for their own benefit often lag in the development race. Therefore,

the search for a new development model must not be a purely academic exercise but must also account for the balance of social forces.

Guiding principles

Accordingly, there is no one-size-fits-all solution, and each country will need to develop a customised approach that aligns with its specific conditions. Nevertheless, a few guiding principles can aid in these deliberations.

Geopolitical competition presents opportunities. The de-risking and diversification strategies of Western countries are bringing investments to nations perceived as friendly. Chinese private corporations' 'going out' strategy may also benefit local ecosystems. However, choosing a partner for infrastructure projects – whether in connectivity, telecommunications or energy – can influence investment opportunities, trade terms and market access from other countries. Leaning too heavily toward one side may also lead to being taken for granted. Therefore, most countries in the Indo-Pacific region, with a few notable exceptions, adopt balancing strategies to avoid taking sides.

Being open to business from all sides is not enough; countries must also be seen as reliably neutral to be considered safe options for resilient supply chains. Perception matters. Actions, even if driven purely by business interests, are now viewed through a geopolitical lens. Rhetoric aimed at a domestic audience resonates differently with international investors. Countries need to carefully calibrate their posture and fine-tune their rhetoric to manage these perceptions.

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The crucial question is whether structural trends might force countries to choose sides against their own interests. Geopolitical events can significantly impact economic development paths, and conversely, geoeconomic disruptions may push countries into geopolitical alignments. In the event of a major conflict in the region, there could be intense pressure to align. Even countries not directly involved in territorial disputes or military conflicts would face disruptions in their supply chains and other indirect consequences.

In a Cold War scenario, technological bifurcation could lead to significant costs and create path dependencies, pushing countries to restrict their supply chains and infrastructure to align with one

technological world over another. For many developing countries burdened with debt, the need for bailouts or restructuring could lead to political pressures to align. Nations with a clear consensus on their foreign policy will be better positioned to avoid external interference and navigate the complexities of geopolitical competition.

The emerging world order is unlikely to be as clear-cut as during the previous Cold War. Today's major economies are deeply interconnected and interdependent. Unless a major hot war occurs, the costs of complete economic decoupling would be prohibitive. For example, if a future US administration continues the 'small yard, high fences' strategy, large parts of the global economy will remain interconnected. Additionally, de-risking strategies that rely on digital automation at home and supply chain diversification abroad will be limited by the costs of shifting from cheap labour. The anticipated impacts of long-term strategies like de-dollarisation might also be overstated. Still, the new world economy may become more fragmented and regionalised, with increased vulnerability to crises and shocks.

Countries should focus on strengthening their resilience and swiftly adapting to this evolving landscape. Achieving a better balance between supply and demand-side economics will help adapt to geoeconomic disruptions, while a mutual understanding among all domestic stakeholders will ease navigation through geopolitical competition.



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