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The economic threat of undisciplined geopolitical primacy

Can rivalry and economic integration coexist and, if so, under which terms? The answer will determine the fate of the global economy

In recent weeks, there has been no shortage of speeches by prominent leaders discussing their countries' relationships with China and the potential economic fallout of geopolitical fragmentation. This is a welcome, if much-belated, discussion. But it must address a fundamental question: Can rivalry and economic integration coexist and, if so, under which terms? The answer will determine the fate of the global economy.

In February 2020, Jennifer Harris and Jake Sullivan published an article highlighting the need for a shift in economic thinking. When it came to managing globalisation, they noted, foreign-policy professionals have largely deferred to the 'small community of experts who run international economic affairs.' They urged national-security specialists to step up, recommended a proactive stance on public investment, and advocated a more guarded approach to trade opening.

Trade policy as a surrogate for foreign policy

Geopolitics and international economics have long operated under two distinct paradigms. Foreign-policy experts often see global politics as a zero-sum game in which one country's gain is another's loss. By contrast, economists tend to focus on the potential for mutual gains from multilateral cooperation and market-led integration. These contradictory paradigms were married to each other by the shared belief that trade and openness were in the best interest of the United States. America's hegemonic status had its drawbacks, but the benefits outweighed the costs.

Doubts began to surface even before Donald Trump was elected US president. But Trump's openly confrontational trade policy triggered a

more significant and enduring shift in perspective than initially anticipated.

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In 2021, Sullivan was appointed to US President Joe Biden's White House as national security adviser. Harris joined him as senior director for international economics (a position she left earlier this year). They quickly began to develop a geopolitically-oriented economic-policy agenda.

More than two years on, the consequences are visible. The Biden administration has largely kept Trump's trade tariffs and made reshoring and 'friend-shoring' a matter of national security. It revived industrial policy with the passage of the CHIPS and Science Act and the Inflation Reduction Act (IRA), designated China as a national-security threat and an economic rival, and tightened restrictions on exports and foreign investment.

Europe, where trade policy served for a long time as a surrogate for foreign policy, was initially unenthusiastic. But Russia's invasion of Ukraine was a watershed. It spurred European policymakers to overcome their reluctance to reassert the primacy of geopolitics over economic relations. While negotiations with China on a new Comprehensive Agreement on Investment (CAI) were completed in late 2020, European Commission President Ursula von der Leyen recently urged European governments to 'reassess the CAI in light of our wider China strategy.' The Commission recently unveiled two new draft bills aimed at boosting European manufacturing: the Net Zero Industry Act and the Critical Raw Materials Act.

Effects of long-term deglobalisation

Amid this flurry of activity, the potential economic costs of putting geopolitical goals first are often overlooked. The fact that disregarding supply-chain resilience and ignoring the increasingly aggressive character of Chinese industrial and trade policies was a costly mistake does not justify forgetting that economic interdependence spurs prosperity. As Adam Posen of the Peterson Institute for International Economics has pointed out, the Biden administration's 'Buy American' policies could harm the American economy and lead to job cuts.

While it is difficult to quantify the long-term costs of deglobalisation, the International Monetary Fund estimates that it would have a negative effect on foreign direct investment and financial stability. In a recent

speech, European Central Bank President Christine Lagarde warned that economic fragmentation could result in less trade, lower output, and higher inflation. She emphasised that central banks would act swiftly to avoid repeating the policy mistakes of the 1970s. Lagarde's message to politicians was clear: Do not attempt to pass the costs of protectionist policies onto the ECB.

The world 'is big enough' for China and the US, says Janet Yellen.

Three days later, US Treasury Secretary Janet Yellen issued a similar warning. While she maintained a tough stance on China and avoided any implicit criticism of the administration's policies, she cautioned that a full economic decoupling would have disastrous consequences for both the Chinese and US economies. The world 'is big enough' for both countries, she said, pointedly noting that this was also Biden's view.

Finally, in a recent speech, Sullivan spelled out the administration's views on international economic policy. His aim was evidently to calm things down, but also to formalise a doctrine and seek a new consensus on how to integrate domestic economic policy and foreign policy. He rejected decoupling and advocated instead for the de-risking of the economic relationship with China, an expression borrowed from von der Leyen. And he emphasised that friend-shoring was a sufficiently broad concept to encompass many more countries than just the West.

For too long, economists and economic policymakers assumed they could ignore geopolitical realities. They got burned and can blame only themselves for their lack of realism. A new conversation has started. They must participate in it, listen to security concerns, and accept that resilience is not just a fig leaf for protectionism. But they must also speak out and stand up for what they believe in, because they know something that their foreign-policy counterparts often overlook: that a world of undisciplined geopolitical interference in international economic relations would endanger growth and jobs.

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