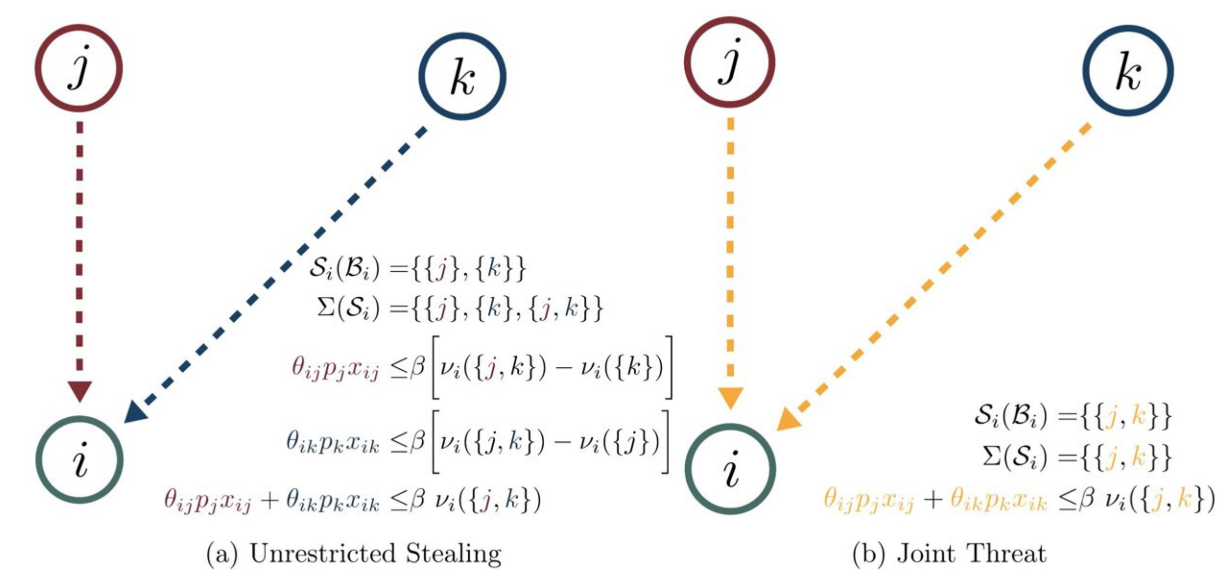
# Q&A: 'Geoeconomics' makes sense of a turbulent world

March 6 2024, by Krysten Crawford




Stealing, Action Sets, and Joint Threats. Notes: Panels focus on a firm in sector i with suppliers in sectors j and k. The action sets, and related incentive constraints are from the perspective of firm I under different configurations. Panel (a) illustrates the case in which suppliers in sectors j and k have individual triggers only. Panel (b) illustrates the case in which suppliers in sectors j and k have a joint trigger, that is a joint threat. Credit: *A Framework for Geoeconomics* (2024)

A new paper by Stanford economist Matteo Maggiori offers policymakers a framework for understanding how economic power is used to achieve geopolitical goals.

For thousands of years, powerful countries have used economic tools as carrots and sticks to get others to do what they want. The Romans, Medicis, French, and British all did it during their respective rules. Today, the United States and China are using economic coercion on multiple fronts—including the U.S.-led sanctions against Russia over its war on Ukraine and China's massive funding of power plants, airports, and other infrastructure projects around the world.

As global tensions rise, one scholar shedding new light on the phenomenon known as "geoeconomics" is Matteo Maggiori, the Moghadam Family Professor of Finance at the Stanford Graduate School of Business, a senior fellow at the Stanford Institute for Economic Policy Research (SIEPR), and co-founder of The Global Capital Allocation Project.

In a new paper, Maggiori maps out how countries wield geoeconomic power to achieve their goals, details the impact of this power on the world at large, and applies these results to current policies in the U.S. and China. Here, Maggiori talks about his insights and how they can help policymakers, business leaders, and the general public to understand 21st century geoeconomics better.

## Geoeconomics has been described as an emerging area within economics, and yet the concept is not new. What's going on?

We define geoeconomic power as the ability of governments to use their countries' economic strength from existing financial and trade relationships to achieve geopolitical and economic goals. After World War II, given the importance of geoeconomic power in reshaping the world economy, this was a big focus among economists.

But while the study of geoeconomic power remained active in political science and international relations, it soon became dormant in economic research, partly due to the lack of theoretical tools to properly characterize the complexities involved.

Today, competition between the U.S. and China has made geoeconomics once again very salient. And we, as economists, now have more tools to take a serious crack at understanding what geoeconomic power is, where it comes from, and what are the likely impacts of wielding it.

We're able to combine elements from economic theory, macroeconomics, and the literature on networks, industrial policy, and trade to provide more clarity for policymakers and business leaders trying to understand the dynamics at hand.

## How do you, along with your co-authors Jesse Schreger at Columbia and Chris Clayton at Yale, help shed light on this phenomenon?

We've developed a framework that explains how geoeconomic power arises from the ability of countries like China and the United States to induce behaviors by other governments or firms when legal contracts are incomplete, and the high costs of a military operation aren't justified.

Countries with geoeconomic power are able to leverage their multiple economic relationships—arising, for example, from lending or access to manufacturing resources—in their favor. They can pressure governments and firms to undertake costly actions—actions that frequently take the form of tariffs, markups of goods, surcharges on loans, or import-export-related restrictions on industry sectors or countries.

They can also threaten retaliatory moves—either directly or indirectly—against a deviating entity, thereby increasing their power to compel other governments or firms to honor their contractual obligations or do something that benefits the powerful country. We provide a theory of the joint optimal use of these strategic instruments.

## Where have we recently seen geoeconomic maneuvers?

Our paper describes in detail two examples of modern geoeconomic power. One is China's flagship Belt and Road Initiative. China provides emerging market countries with package deals of lending, infrastructure, and manufacturing support in exchange for, among other things, political concessions, such as closer alignment over the recognition of Taiwan.

The other example is the U.S. demand to European countries to stop using 5G technology supplied by China's Huawei because of national security concerns. We explain why and how the U.S., by exerting pressure on a subset of Huawei customers, was able to indirectly get countries and firms it couldn't influence directly also to stop using the company's technology.

Both examples illustrate the underlying mechanism: The implicit or explicit threats used by geo-economic powers like China and the U.S. work because each country has control over multiple resources that others need but can't easily access elsewhere. By controlling the supply of various goods and services, powerful countries can manipulate the world economy in their favor.

## Is having geoeconomics power good or bad for the world in general?

In our framework, geoeconomic power can have an overall positive effect. China and the U.S. are able to generate more economic activity in a world where contract enforceability can be a real challenge.

Think, for instance, of the construction of mines or airports in developing nations. However, geoeconomic powers also extract a lot of surplus—or economic benefits—from that increased activity, and how much of that surplus they take for themselves versus how much is left for everybody else is an open question.

## Your paper also addresses the limits of geoeconomic power.

There are limits whenever there are alternative buyers and sellers of the goods or services that a country is using as a threat. The U.S.-led refusal to buy oil and gas from Russia once it invaded Ukraine would have had a bigger impact if China and India had been part of the coalition; instead, its effect was more limited because Russia still had alternative markets to sell its energy products.

Another example is the global financial system. The US controls a large part of the world's financial payment and settlement systems. Threats to shut off access to these systems can be very powerful because there currently are limited alternatives. However, these threats also create incentives for other countries to create alternative systems. China, for example, has been attempting to create its own payment system with an eye to decreasing the US power in this dimension.

There is also a natural limit to what you can ask for before people will no longer want to deal with you. Countries like the U.S. and China can only wield their power if other entities find their demands worthwhile to comply with.

## What do you hope your framework inspires?

More research that helps improve policy on geoeconomics. I think we are at the beginning of a process similar to what happened during and subsequent to the financial crisis of 2008 and 2009 when policy debates around how to respond focused on extremes initially. Only over time were we able to make serious progress in terms of developing financial stability tools and understanding related trade-offs.

Today, the conversation around international economic policy often features polarized views: some advocate for completely unregulated trade and financial systems, while others would like the U.S. (or China) government to use its power for frequent and large interventions.

My goal is to move people toward a middle ground where we converge on a set of rationales that can guide governments in wielding their geo-economic power. Frameworks like ours can lead to more specific policy tools and criteria for limited and beneficial intervention. I hope that our work is a step in that direction.

**More information:** Paper: drive.google.com/file/d/1iTJIV … rq1T_mmsiyhvZH8/view

Provided by Stanford University

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