Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

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The global economy is retreating into the borders drawn by geopolitics

There is probably no better place than the annual World Economic Forum, which starts today in Davos, to discuss one of the principal disruptive global trends - the fragmentation of the global market, that is, the impact of geopolitics on the global economy.

Political leaders, heads of the largest companies, gurus of globalisation, and sceptics, even opponents, will all be in one place. They will arrive with the idea of greasing the wheels of world trade, business, political cooperation and technological connectivity.

But despite this, there is little hope that they could slow the trend of economics and exchange increasingly following lines of geopolitical division, even polarisation. Simply put, most of them participated in creating this phenomenon. It is unlikely that, at least for now, they have a recipe for overcoming it.

Global business is less immune to the borders drawn by politics and security. Until a decade ago, business led the game, expanding across the borders of political interests without much regard for them.

The COVID-19 pandemic made economies turn more to their internal potential rather than cross-border operations, followed by crises that set new barriers to doing business.

Permanent cutting of ties between the West and Russia

Russia's aggression against Ukraine led to an almost complete cutting off of economic flows on the "line of fire" between the 2 previously closely linked entities - Russia and the EU.

The EU has since cut its reliance on Russian gas from close to 50% before the aggression against Ukraine to around 13% (combining LNG and pipeline gas) of its needs last year (S&P).

The block has been working on legislation that would allow reducing the import of Russian gas to zero without significant consequences for the market.

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Cutting the energy link with Russia went even faster regarding oil, given that the EU reduced imports by 90% in just one year after the start of the Russian invasion of Ukraine.

Russia has probably permanently, and definitely in the long term, lost its most significant market for oil and gas exports.

Political decisions based on security estimates will determine whether or not these ties will ever be repaired, given that the EU has already served its economic interests by rapidly shifting to stable and alternative energy suppliers.

Unclear boundaries between blocks

Russia has been trying to compensate for losing its largest market by increasing exports to the East. China and India welcomed it using the advantage (again geopolitical) that forced Russia to sell oil to them at a significant discount.

The crisis in the Middle East, after the terrorist attacks by Hamas on Israel followed by the Israeli operation in Gaza, has reinforced the trend of recomposing economic flows within the borders of the blocs based on politics and security.

Through the violent actions of its proxies in the Middle East, Iran seeks to disrupt the economic, primarily transport, channels for the economy of Israel and its allies.

A World Trade Organisation study from last December confirmed that trade between the (hypothetical) blocs of East and West has been decreasing due to political tensions.

Inter-bloc trade has been increasing 4% slower than intra-bloc trade, primarily due to the war in Ukraine. This trend only intensified the already existing trade tensions between the 2 largest economies - the US and China - which have existed since 2018 and the mutual introduction of economic restrictions at that time.

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The trend of withdrawal of economic flows within the boundaries of geopolitical blocs, hypothetical or actual, was confirmed earlier by Bloomberg's analysis, according to which FDI (Foreign Direct Investment) almost completely stopped crossing the inter-bloc border.

Taking as a criterion which countries in the UN condemned Russia's aggression against Ukraine and those that did not, the research concluded that out of a total of $1.2 trillion FDI in 2022, only $180 billion (or 15%) crossed the border of this division.

The geopolitical blocs are not clearly and firmly divided along the east-west or north-south lines. The positions of some of the largest economies, such as India and China, which still maintain strong economic ties with Russia but still have significant partners in the West, make that border blurred.

They are even more unclear when placed in the context of the crisis in the Middle East, in where India gives strong support to Israel, just like the countries of the Western "bloc", but remains one of the principal economic partners of Iran, particularly in the energy sector.

Isolation of rogue regimes remains in force

Sanctions of the world's largest economies against Russia significantly encourage shifting economic flows to the borders of allied and friendly groups. They just continued the practice that has been visible for years in the case of Iran.

Just before its annual meeting in Davos, the World Economic Forum estimated in the 2024 Global Risk Report that "Coordinated efforts to isolate ‘rogue’ states are likely to be increasingly futile".

There is a clear reference to the system of economic restrictions by Western actors (US, EU, UK, and G7) towards Russia and entities from the "friendly camp", which contribute to their abuse.

The WEF's assessment is well-founded, given a wide range of economies that allow circumvention of sanctions, including some of the largest.

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However, this does not imply that the instruments used to isolate the economy of those countries whose aggressive policies during the past 2 years have caused the global order to become more unstable than it has been since World War II will be abandoned.

Russia and Iran are certainly the centres that emit these global disturbances. They are supported in this by a series of friendly regimes that see this classification as an economic opportunity that rarely appears.

However, long-term trends indicate that politics and security will shape global trade significantly more than in the past, which does not benefit their short-term interests.