

Global Essay Competition 2025

Title: Shielding Markets: National Insurance for Geoeconomic Risks in a Divided World

Essay:

Geoeconomics, or economic statecraft, strategically uses economic tools to achieve geopolitical objectives, accelerating global fragmentation and disrupting supply chain efficiency. Tactics such as supply chain disruptions, export controls, and industrial policies weaponize economic interdependence, pushing businesses and states toward reshoring or friend-shoring to mitigate risks. This retreat into economic blocs fosters inefficiencies and discrimination, as countries prioritize “in-group” partners over economically optimal ones. By severing vital economic ties, particularly for developing nations, fragmentation threatens to undo globalization's benefits and curb growth. This paper examines the costs of global fragmentation due to geoeconomic risks and proposes strategies, including national insurance mechanisms, to protect economic activities, sustain trade, and uphold market principles amid geopolitical volatility.

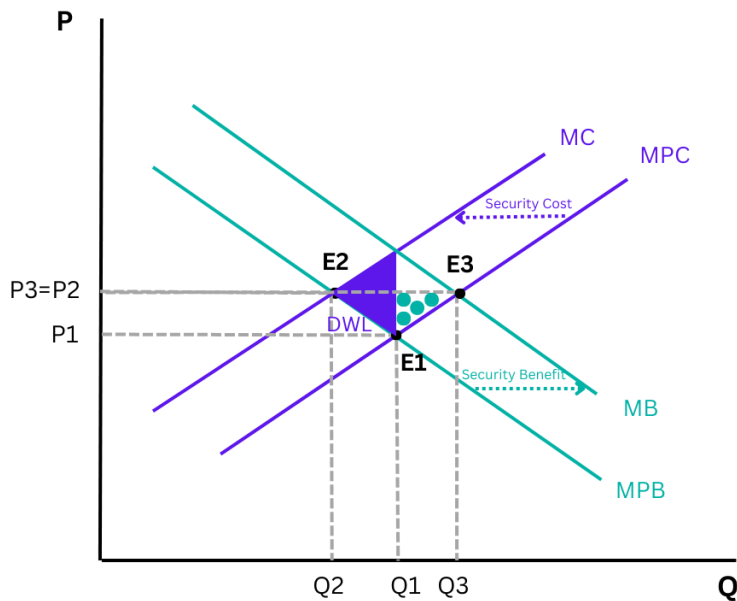
Geoeconomic Risks, Security Externalities and Economic Disequilibrium

Geoeconomic risks are the security risks associated with economic activities. For example, when countries and businesses engage in economic exchanges, these risks include potential supply chain disruptions due to regulatory changes or protectionist measures imposed by partner countries¹. The greater the geoeconomic risk, the more likely businesses are to diverge from engaging with those partner countries altogether. Geoeconomic risk is a key driver of economic fragmentation because countries and businesses, in an effort to de-risk, tend to transact with friendlier and therefore less risky partners².

When realized, geoeconomic risk manifests as an additional transaction cost of economic exchange, making it a form of market failure. This is because it increases the cost of conducting business beyond the production costs alone. Political economists have coined the term “security externality” to describe such risks. Specifically, Norris (2016) defines geoeconomic risk as an externality of transactions, where the security costs or benefits of a transaction extend beyond the two parties involved to impact a third party – namely, national security. These externalities can lead to overconsumption or underproduction of goods, as the social cost or benefit exceeds the private cost or benefit. In other words, the global economy has witnessed disequibrated transactions of goods that are of critical security importance. The graph below illustrates market disequilibria in the case of a positive security externality for the state, showing how the cost of risk affects private firms.

¹ Nguyen-Vo (2024)

² Pisani-Ferry, Weder and Zettelmeyer (2024)



Source: The author

In a market free from geoeconomic risk (or where the security cost, $SC = 0$), the market reaches equilibrium at E_1 , trading quantity Q_1 at a price P_1 . However, when geoeconomic risks are introduced – such as firms fearing potential supply chain disruptions due to regulatory changes – the security cost SC shifts the supply curve inward from MPC (marginal production cost) to MC (marginal cost). As a result, customers now pay a higher price ($P_2 > P_1$) for a reduced quantity of goods ($Q_2 < Q_1$), creating a deadweight loss (DWL), represented by the purple area in the graph. The size of this DWL depends on the magnitude of the SC ; the higher the SC , the greater the DWL . In scenarios where SC remains an unrealized fear (e.g., disruption does not materialize), the DWL may approach zero. However, because geoeconomic risks always exist, there will always be some loss in market efficiency due to geoeconomic competition and global fragmentation.

The geoeconomic risk is quantified as $p \times SC$, where p is the probability of the geoeconomic risk materializing, and SC is the magnitude of its impact on businesses. Similarly, societal welfare loss is calculated as $p \times DWL$, where p remains the probability of the risk materializing, and DWL is the size of the societal welfare loss when $p = 1$.

Thus, given that $0 < p < 1$:

- The firm's risk lies within $0 < \text{firm risk} < SC$,
- The societal welfare loss lies within $0 < \text{societal welfare loss} < DWL$.

This shows how even the mere probability of geoeconomic risk imposes costs on markets, with greater risks leading to higher inefficiencies and welfare losses for society as a whole.

Current Strategies to Manage Geoeconomic Risks

Indeed, many companies are addressing geoeconomic risks through four main strategies. First, in low-risk scenarios with minimal SC , businesses adopt *retention*, continuing operations while monitoring risks closely. For example, during the Trump administration's tariff threats against Vietnam, firms chose to observe the situation rather than relocate, as the perceived risk was low compared to relocation costs³. Second, in high-risk scenarios with significant and persistent geoeconomic risks, firms often *exit*. In politically unstable or war-torn regions like Iran, Syria, and Russia, sanctions and

³ Cave and Pham (2024)

instability have forced businesses to withdraw, isolating these markets from global economic flows⁴. While sanctions often aim for targeted, immediate policy changes, they can inadvertently harm societal welfare by driving markets away altogether.

In intermediate scenarios, where risks are tangible but not severe, firms minimize security costs through diversification and insurance⁵. Diversification, a priority for multinational corporations (MNCs) and states, balances risks by developing alternative supply chains. For instance, Japan and the EU encourage a "China Plus" strategy to reduce dependency on China amid regulatory shifts and U.S. tariffs. Meanwhile, businesses incorporate security costs into operations and purchase private insurance to cover risks like currency convertibility and expropriation. However, high premiums and exclusions in high-risk regions, leave inefficiencies and deadweight loss unresolved⁶.

These risk-driven strategies hinder economic cooperation and exacerbate inefficiencies by duplicating resources across geopolitical blocs. In the semiconductor industry, for example, both China and the U.S. are investing heavily in independent production capacities, while middle powers like Southeast Asia and Europe are building alternatives to reduce reliance on Taiwan. Taiwan Semiconductor Manufacturing Company (TSMC), under U.S. pressure, has expanded to the U.S. and Europe, raising concerns about global oversupply. Increasingly, geoeconomic risks drive business decisions based on security externalities and geostrategic competition, further undermining global market efficiency.

Solution: A National Insurance against Geoeconomic Risks

Why Public, Not Private Insurance?

Private insurance premiums reflect losses passed onto consumers and insurers as higher prices, rather than addressing market disequilibria. The MC in the graph does not shift outward because private insurance only covers losses after disruptions occur, without preemptively reducing systemic risks. Private insurers also avoid systemic risks or regions with elevated geopolitical uncertainties. Premiums can be prohibitively high, further limiting accessibility for SMEs or businesses in critical supply chains, leaving significant gaps in coverage.

In contrast, only systematic intervention by the government can address market failures and fix inefficiencies at scale. National insurance against security risks tackles the root cause of inefficiencies by universally reducing SC , minimizing DWL , and enhancing market efficiency. Beyond this, the public benefits from businesses operating in their territory – whether domestic or foreign. For example, an American company operating in China can serve as a “security asset” for the Beijing, especially when conducting strategic activities like managing data centers. In the graph, these firms also generate “positive security benefits” for the state, which shifts the demand curve outward (MPB to MB). By pooling these “security benefits,” the state can offer safeguard premiums to foreign firms operating in high-risk sectors, sharing their security costs and encouraging market participation. From the graph, the equilibrium moves to E_3 , where $Q_3 > Q_1 > Q_2$, with the price $P_3 = P_2$. While DWL is not entirely eliminated, the additional welfare gained in the dotted area can be redistributed to finance the insurance scheme. This reduces inefficiencies and moves the market closer to the efficient equilibrium E_1 .

Another reason for the state to provide insurance is to reduce its reliance on geoeconomic tactics for coercion in foreign policy. State-provided security insurance diminishes the strategic utility of such measures. By assuming responsibility for mitigating economic consequences, the government reduces pressure to use sanctions or trade restrictions for political objectives. This shift in financial burden from businesses to the state makes aggressive tactics less appealing due to their direct fiscal cost. Additionally, state insurance undermines the ability to exploit foreign businesses’ vulnerabilities, depoliticizing economic activities and promoting non-coercive, rules-based interactions.

⁴ Laub (2015), Heydemann (2025)

⁵ These are also the scenarios where most firms find themselves in, as listed by WEF’s Global Risk Report 2025

⁶ See LaCroix (2024) on different private insurance schemes and policies against political risks

National Insurance Program for Geoeconomic Risks: A Design

Under this scheme, the government, rather than private insurers, provides security risk insurance to both foreign and domestic businesses, covering a wide range of geoeconomic disruptions such as trade restrictions, sanctions, expropriations, and political instability. Similar to private insurance models, businesses purchase this insurance when trading in specific countries, with premiums adjusted according to assessed risk levels – the lower the risk, the lower the premium. In the event of a disruption, the government compensates affected businesses, ensuring continuity of operations and mitigating economic losses. By transferring the burden of risk from individual businesses to a national insurance scheme, companies can focus their resources on innovation and operational efficiency rather than redundant and costly risk mitigation strategies. Moreover, national insurance schemes can complement broader economic policies to promote sustainable and diversified trade. Governments can leverage these tools to align risk-sharing mechanisms with strategic objectives, such as enhancing regional economic stability and reducing overdependence on specific supply chains.

To ensure the effectiveness of the scheme, several key elements need to be incorporated:

- **Universal risk coverage:** The scheme must include high-risk sectors and regions, ensuring comprehensive coverage and reducing *SC* for all participants. This fosters confidence and engagement in sectors that might otherwise be avoided due to geopolitical concerns, and left out by private scheme.
- **Subsidized premiums:** To ensure accessibility, especially for small and medium enterprises (SMEs) and critical industries, premiums should be subsidized, preventing market fragmentation and maintaining optimal trade levels in vulnerable sectors. The subsidies can be financed by redistributed the state’s “security benefit.”
- **Policy coordination:**
 - **Integration with economic and foreign policy:** National insurance can be aligned with broader economic and foreign policy goals to stabilize global value chains and incentivize cooperative economic behavior, such as diversifying supply chains, de-risking trade routes, encourage foreign investment in critical sectors.
 - **Public-private collaboration:** Governments can collaborate with private insurers to share risks in areas already offered, improve operational efficiency, and leverage private sector expertise in risk management.
 - **Global coordination:** Partnering with international organizations, such as the WTO and existing free trade agreement (FTA), to establish multilateral insurance pools and incorporate risk-sharing scheme into FTA clauses. Such coordination strengthens global economic stability while encouraging shared responsibility in addressing geoeconomic uncertainties.

Existing Mechanism and Empirical Examples

While national insurance for geoeconomic risks may be a novel concept, there are precedents that aspire to achieve similar objectives – most notably the investor-state dispute settlement (ISDS) mechanism and Europe’s risk-pooling initiatives. ISDS, embedded in agreements like the the North America FTA (NAFTA) and Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), provides a legal framework to protect foreign investors against risks such as expropriation, discriminatory regulations, or abrupt policy changes⁷. By offering binding arbitration and ensuring compensation for damages, ISDS reduces uncertainty and encourages foreign investment, particularly in high-risk regions. Although ISDS primarily focuses on legal and regulatory risks for investors, it shares the same goal as a national insurance scheme: mitigating security risks to stabilize trade and investment flows.

Similarly, Europe’s approach to pooling risks through collaborative mechanisms has proven effective in reducing welfare losses and bolstering resilience in trade relationships⁸. For instance, the EU has implemented frameworks to stabilize trade and protect against external shocks, ensuring economic

⁷ See chapter 9 of the CPTPP, and chapter 11 of NAFTA

⁸ Especially in public health governance post-Covid pandemic. See de Ruijter, Hervey and Prainsack (2024)

continuity even during geopolitical crises. These initiatives demonstrate how coordinated efforts to share risks and mitigate uncertainties can foster economic stability and protect cross-border trade. A national insurance scheme could build on these precedents by providing a comprehensive safety net against a broader range of disruptions, extending coverage to both domestic and foreign businesses. This would enhance economic resilience, promote investors' confidence, and reduce inefficiencies caused by fragmented risk management.

Limitations and Conclusion

National insurance for geoeconomic risks provides a pragmatic approach to stabilizing trade, fostering investor confidence, and mitigating deadweight loss in a fragmented global economy. By reducing uncertainties and depoliticizing economic activities, such schemes can help preserve the benefits of globalization even amid geopolitical rivalries and economic statecraft. Drawing from frameworks like ISDS and Europe's risk-pooling initiatives, national insurance mechanisms can enhance resilience through policy coordination and shared risk management. However, challenges persist, including potential fiscal strain during large-scale disruptions, moral hazard from over-reliance on compensation, and enforcement difficulties in loosely regulated regimes. Despite these obstacles, with strategic design and proper safeguards, national insurance offers a path to uphold healthy economic interdependence, sustain global trade relationships, and reduce inefficiencies in a fractured world.

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