Geopolitics, Trade Conflicts, and Industrial Policy: Strategies for Small, Open Economies

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Abstract

Geopolitical rivalry, trade restrictions and industrial policy are reshaping the global economy. These developments confront all countries, but they do not provide all countries with the same strategic options. Major countries can draw on large domestic markets, fiscal scale and geopolitical leverage. Small, open economies cannot replicate those strategies at comparable cost or effect. This discussion paper develops a two-model comparison between major countries and small, open economies such as Switzerland. It argues that the appropriate response for Switzerland is not scaled-down power politics, but a strategy built on openness, diversification, international cooperation and adaptability. The objective is resilience without self-sufficiency and competitiveness without uncontrolled subsidy races.

Executive summary

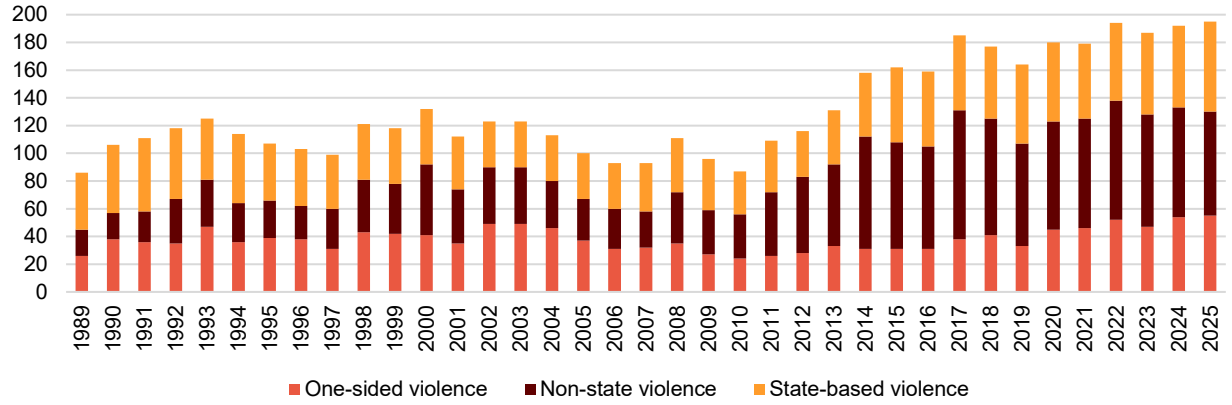
- **A more fragmented international environment**
  Armed conflict, trade-policy uncertainty and interventionist industrial policy have all become more prominent. These three trends reinforce one another and reduce predictability for internationally active firms.
- **Different structural conditions create different strategic options**
  Major countries can use domestic market size, fiscal resources, regulation, subsidies and security instruments to influence external actors. Small economies face higher relative costs and have less unilateral leverage.
- **The same instrument produces different effects**
  For a major country, tariffs may raise costs but can also provide bargaining leverage in trade negotiations. In a small economy, by contrast, tariffs primarily increase input costs for businesses and prices for consumers. Similarly, large-scale subsidy programs may exploit domestic scale effects, whereas comparable programs in a small economy often entail substantial opportunity costs.
- **Switzerland should respond by building on its own strengths**
  Its strategy should enlarge the economic space available to firms, reduce strategic dependencies, pool influence through cooperation and preserve the capacity to adapt quickly. Given Switzerland's close integration into European value chains, stronger Swiss competitiveness and resilience also contribute to more robust European supply chains.

1 The New Reality

1.1 Geopolitical conflict and strategic rivalry

The international economic order is increasingly shaped by security considerations. The Uppsala Conflict Data Program (UCDP)[1] documents a marked rise in state-based and non-state conflicts since 2010. Conflict counts do not measure severity, economic spillovers or latent tensions, but they capture a broader deterioration in the geopolitical environment. For firms, the consequences go beyond physical disruption. Sanctions, export controls, investment restrictions and sudden changes in political relations can alter access to markets, technology and finance.

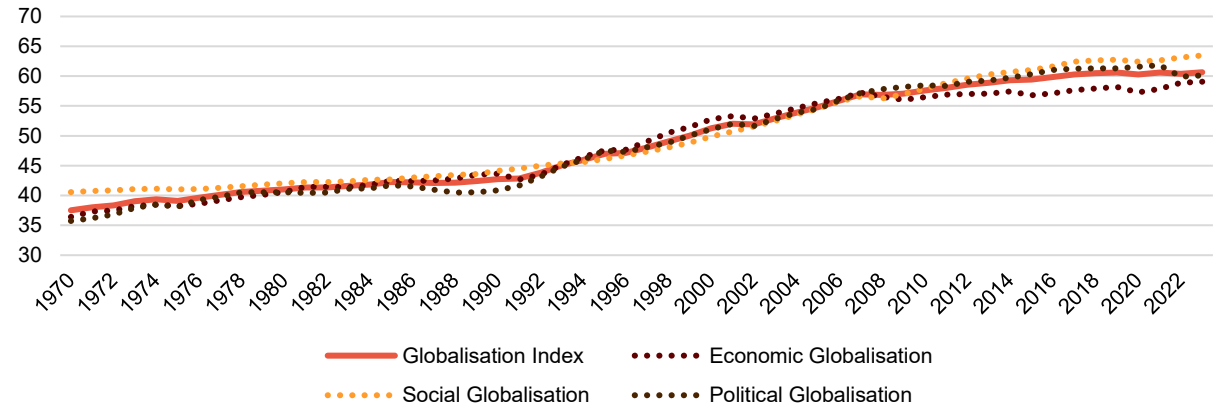
Figure 1: Number of Conflicts



1.2 International trade under pressure

Globalization has not gone into reverse, but economic integration has lost momentum. The KOF Globalization Index[2] indicates that economic globalization rose sharply from the 1990s onwards and has largely plateaued since the global financial crisis. More recently, trade-policy uncertainty has become a major source of instability. Uncertainty matters even when no restriction is ultimately imposed: companies may postpone investment, hold additional inventories or redesign supply chains because the rules governing cross-border activity have become less predictable. All of this raises costs for exporters and importers. If globalization stagnates or even declines, companies and countries alike will be less able to reap the full benefits of specialization.

Figure 2: Globalization Index

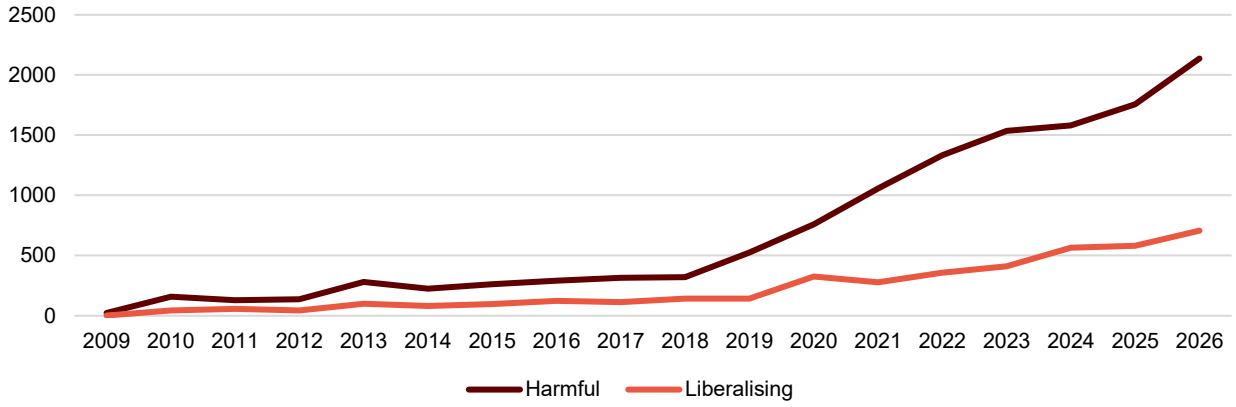


[1] UCDP - Uppsala Conflict Data Program
[2] KOF Globalisation Index – KOF Swiss Economic Institute | ETH Zurich

1.3 The return of industrial policy

Industrial policy has returned to the center of economic policy. Data from Global Trade Alert[3] show that the number of harmful industrial policy measures has risen sharply in recent years. An in-depth analysis (New Industrial Policy Observatory) concludes that "the recent wave of new industrial policy activity is primarily driven by advanced economies and that subsidies are the most employed instrument"[4]. Advanced economies increasingly use subsidies, tax incentives, public procurement, local-content requirements and targeted finance to promote selected technologies and production capacities. Measures are often justified on the grounds of climate policy, national security, resilience and technological competition. Prominent examples include semiconductor, clean-technology and critical-material programs in the United States, the European Union and China. This expansion of industrial policy also has a fiscal dimension. Subsidy competition ties up public resources over long periods and creates additional commitments at a time when many governments face competing expenditure pressures. The resulting fiscal costs can narrow the fiscal space for productivity-enhancing investment and make economies more vulnerable to future shocks.

Figure 3: Number of Interventions



1.4 A vicious cycle

Geopolitical conflict, protectionism and industrial policy are closely intertwined. Geopolitical rivalry encourages governments to reduce dependencies. Trade restrictions and subsidies then shift investment and production, prompting trading partners to respond. The result can be a cumulative cycle of intervention, retaliation and uncertainty. The costs include fiscal burdens, distorted competition, duplicated capacity and weaker international specialization. Governments may nonetheless accept these costs when they expect strategic influence, domestic political benefits or greater control over critical capabilities. Policy responses often fail to distinguish between ordinary economic interdependence and genuinely critical dependencies. Dependence becomes strategically relevant only where supply is highly concentrated, substitution is difficult and disruption would impose substantial economic or security costs. Treating every import dependence as a strategic vulnerability risks prompting disproportionate interventions that weaken competition, specialization and resilience over time.

2 Two Strategic Models

The current challenges do not affect all countries equally. Their strategic options depend on the size of their domestic market, their absolute economic and fiscal resources, and their geopolitical influence. This paper therefore compares two analytical ideal types: major countries and small, open economies. The distinction is deliberately stylized and analytical rather than categorical: countries differ not only in size but also in fiscal capacity, economic structure and geographic location. These characteristics vary along a continuum. Furthermore, regional integration can allow a small member state to draw on the collective weight of a larger bloc. The comparison nevertheless clarifies why identical policy instruments can produce very different costs and benefits.

[3] Global Trade Alert - Monitoring Policy Changes That Affect Global Trade
[4] Evenett, S., Jakubik, A., Martín, F., & Ruta, M. (2024). The return of industrial policy in data. The World Economy, 47, 2762–2788.

2.1 Defining small, open economies

In this paper, small, open economies are understood as countries with limited absolute domestic market size, a high degree of integration into international trade and investment, and comparatively limited unilateral influence over foreign governments and firms. The category therefore refers not simply to population or territory, but to a combination of economic scale, external dependence and bargaining power. Small does not mean economically weak: several small economies achieve high levels of productivity, innovation and prosperity. Their structural constraint is that firms depend more heavily on access to foreign customers, suppliers, technologies, capital and talent, while the state has less leverage to shape the conditions governing that access.

2.2 Major countries can translate economic scale into leverage

Large domestic markets. Access to a large market is commercially valuable to both domestic and foreign firms. Major countries can therefore impose conditions on market access without necessarily causing foreign firms to withdraw. Their domestic demand may also support production at a scale that is difficult to achieve in smaller economies.

Fiscal scale. Large economies can spread the fixed cost of defense, infrastructure and technology programs across a broader tax base. Their absolute financing capacity allows them to support several strategic priorities simultaneously.

Geopolitical and economic leverage. Major countries can combine trade, finance, technology, regulation and security policy. Their decisions can change incentives for companies and governments beyond their borders.

Bargaining and standard-setting power. When foreign actors place a high value on access to a market, its government has greater scope to set conditions in negotiations and to influence technical or regulatory standards.

These advantages make tariffs, export controls, sanctions, procurement preferences and large subsidy programs strategically available. This does not guarantee that such policies are efficient or successful, but it does allow major countries to shift part of the cost onto foreign firms, consumers and governments.

2.3 Small, open economies face different constraints

Limited domestic scale. A small market cannot sustain efficient production in every strategically relevant activity. Companies need foreign customers to take advantage of economies of scale and reduce unit costs.

Higher relative costs. The fixed cost of a large subsidy, production or security program is borne by a smaller tax base and diverts resources from other priorities.

Limited unilateral leverage. Restrictions imposed by a small market may prompt foreign suppliers to scale back their presence while exerting little pressure on large trading partners.

Dependence on international exchange. Small economies rely more heavily on access to foreign markets, intermediate inputs, technology, capital, research networks and talent.

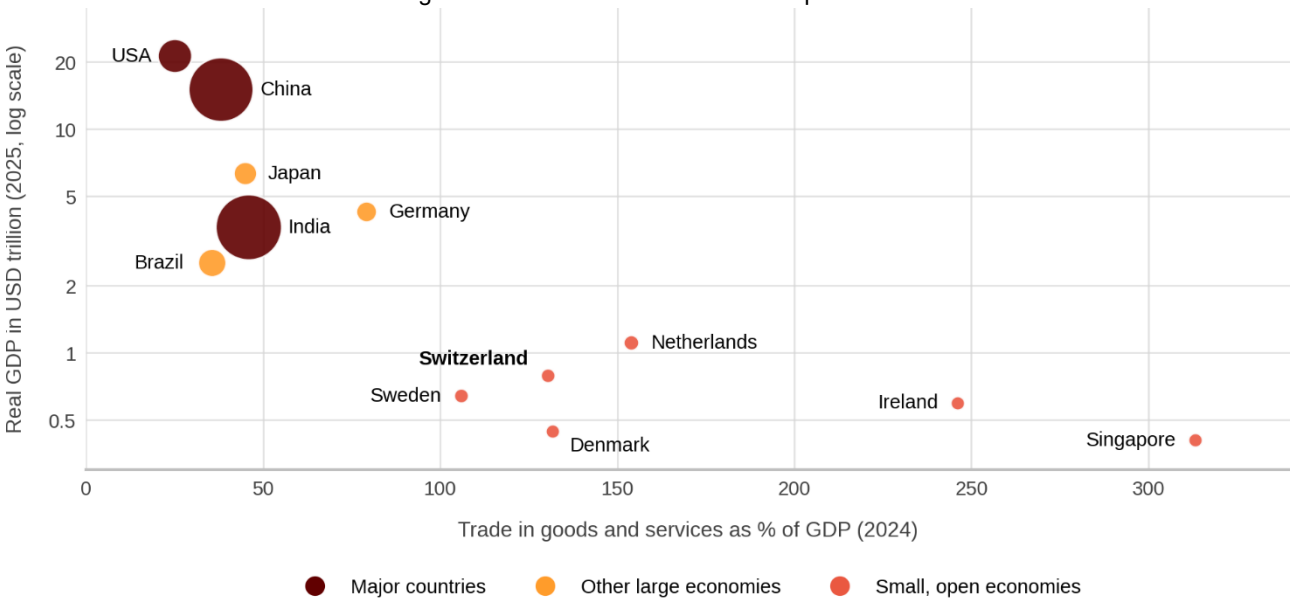
For small economies, the instruments used by major countries are not simply smaller versions of the same strategy. They usually impose higher domestic costs while offering less leverage to influence the behavior of external actors. This does not rule out targeted intervention in narrowly defined cases. Where it is used, however, intervention must target a clearly identified market or security failure, remain proportionate and be subject to regular review and evaluation.

2.4 Evidence and relevant differences

Figure 4 illustrates the structural asymmetry at the heart of this paper. Major countries combine large absolute economic scale with a relatively low dependence on international trade. Small, open economies operate under fundamentally different conditions: their domestic markets are limited, while cross-border trade represents a considerably larger share of economic activity.

Switzerland, Denmark and Singapore are not small in terms of productivity, income or innovative capacity. Their constraint lies in the limited size of their domestic market and the resources available for unilateral action. Despite these nuances, the comparison shows why identical policy instruments can have different effects. For a major country, market size can create leverage. For a small, open economy, restricted access to international markets primarily reduces its own economic opportunities.

Figure 4: Economic scale and trade openness



Note: The figure presents selected economies as illustrative examples rather than as a complete classification. Economic size is measured by real GDP in USD on a logarithmic scale; trade openness is measured as trade in goods and services as a percentage of GDP. The size of each bubble indicates the country's population. The selection highlights differences in economic scale, market size, and dependence on cross-border exchange.

Small country, large bloc: Comparing Denmark and Switzerland

Switzerland and Denmark share many of the characteristics that define successful small, open economies. Both countries combine high levels of prosperity with strong institutions, highly skilled workforces and a remarkable capacity for innovation. They rank among the world's most competitive economies, invest heavily in research and development, and rely on international trade to sustain growth and living standards. Their economic success has been built on openness, adaptability and integration into global markets.

	Denmark	Switzerland
Population (Persons, World Bank, 2025)	6m	9m
Real GDP (International$ PPP, World Bank, 2025)	437bn	780bn
Real GDP per capita (International$ PPP, World Bank, 2025)	72,723	85,732
Real GDP per person employed (USD PPP, OECD, 2024)	126,519	130,996
Exports of goods and services (Percentage of GDP, OECD, 2025)	70%	78%
Real gross domestic expenditure on R&D (USD PPP, OECD, 2024)	12bn	22bn
PCT patent applications (Number of Patents, OECD, 2023)	1,564	3,079
World Competitiveness Ranking (Rank, IMD, 2026)	6	3

Yet on one decisive point the two countries differ: their institutional position in Europe. This difference shapes the strategies available to each of them in responding to geopolitical shifts and changes in trade policy.

As a member of the European Union, Denmark has transferred trade policy to the European level. It cannot conclude its own free trade agreements, but it acts as part of one of the world's largest trading blocs. Its strategy therefore works through the EU. Denmark helps shape common positions, builds alliances with like-minded member states and benefits from the collective bargaining power of the Single Market in negotiations with major countries.

Switzerland pursues an autonomous trade policy. Alongside its close ties with the EU through bilateral agreements, it can negotiate its own free trade agreements, often together with its EFTA partners. This allows it to open new markets flexibly and early. To this end, Switzerland relies on bilateral partnerships, plurilateral coalitions of like-minded countries and a strong commitment to a rules-based international order. In negotiating such agreements, however, it has considerably less bargaining power than a large bloc like the EU.

The comparison shows that small, open economies do not have a single blueprint for responding to a more fragmented world economy. Denmark gains influence through integration and collective weight. Switzerland gains room for maneuvre through autonomy and flexibility. Both approaches pursue the same goal: preserving open markets and reliable rules on which small economies depend.

2.5 Same instruments, different effects

The table below shows why policy instruments available to major countries cannot simply be replicated by small, open economies at comparable cost and effect.

Instrument	Major countries	Small, open economies
Trade barriers	May create bargaining leverage and attract local investment	Mainly raise input and consumer prices, with little leverage
Industrial subsidies	Backed by a large market and substantial fiscal resources	Impose high relative fiscal and opportunity costs
National capacity	Feasible in selected fields where market size allows sufficient scale	Constrained by limited scale; broad self-sufficiency is particularly costly
Economic coercion	Can materially affect access to markets, finance and technology	Mainly harms the domestic economy with little effect on others' behavior
Resilience	Can partly rest on domestic capacity and control	Rests mainly on diversification, cooperation and adaptability

2.6 Openness delivers better outcomes overall

Open and rules-based economic exchange benefits all countries, large and small. It raises aggregate welfare by enabling specialization, competition and innovation. Recent empirical research confirms that trade reforms raise economic growth on average, although the effects vary across countries.[5] Major countries are no exception. Even a large domestic market cannot replace the scale, the variety of inputs and the competitive pressure of the world market. The advantages of major countries described above should therefore not be read as evidence that power-based policies are economically superior. Market size and geopolitical leverage merely allow major countries to shift part of the costs abroad and to extract short-term strategic or political gains. Over time, protectionism weakens competition, productivity and

[5] Irwin, D. A. (2025). Does Trade Reform Promote Economic Growth? A Review of Recent Evidence. The World Bank Research Observer, 40(1), 147–184.

innovation in major countries as well. It also leaves the international economy as a whole less efficient, less predictable and ultimately less prosperous.

For small economies, openness matters even more. Research shows that the economic benefits of country size depend on the degree of openness. Where trade barriers are high, political borders define the size of the market and large countries hold an advantage. Under open trade, this advantage largely disappears.[6] Large countries can therefore more easily afford to be closed, even though they lose from it as well. For small economies, closure would be far more costly.

2.7 Strategic implication

Structural conditions define the scope for policy action. Policies that are available to major countries cannot simply be copied by small economies. The question is not whether every intervention by a major country will succeed, but whether an instrument can be replicated at acceptable cost and delivers comparable influence. For Switzerland, the answer is often no.

Switzerland is not alone in this position. Denmark, Sweden, Ireland, Singapore and New Zealand are also examples of small, open economies with limited domestic markets and a high dependence on international exchange. Yet Switzerland differs from each of them in important respects. Like Denmark, Sweden and Ireland, it is closely integrated with the European economy, but unlike them, it is not an EU member. As outlined in the box above, it therefore pursues an autonomous trade policy rather than acting through a larger bloc. Unlike New Zealand, Switzerland relies only marginally on agricultural exports. Similar to Denmark, its export strength lies in pharmaceuticals and industry. Like Ireland, it hosts many multinational companies, but its economy also rests on a broad base of internationally active small and medium-sized enterprises. And while Singapore combines its role as a regional hub with an active state role in economic development, Switzerland relies primarily on favorable framework conditions. The result is a broadly diversified export economy that is deeply integrated into global value chains, yet politically positioned outside the major economic blocs.

Despite these differences, the underlying challenge for such countries is the same: limited domestic scale, high dependence on cross-border exchange and little unilateral leverage. The following chapter sets out a strategy for Switzerland. Many of its elements apply equally to other small, open economies. This also points to a shared interest: small, open economies have strong reasons to work together in defending open and rules-based trade.

3 A Strategy for Switzerland

Switzerland is prosperous and innovative, but small in absolute market and geopolitical terms. Its firms and institutions depend heavily on cross-border access to customers, suppliers, knowledge, capital and talent. The strategic objective should therefore be to maximize room for maneuver without sacrificing the gains from international specialization. This logic points to four mutually reinforcing pillars: openness, resilience, cooperation and sound framework conditions.

3.1 Openness as a substitute for size

- **Enlarge the economic space available to Swiss firms and institutions.**

Openness is not an ideological luxury for a small economy. It is a structural necessity. Switzerland cannot enlarge its domestic market, but it can widen the economic space in which its companies, researchers and workers operate. Market access, investment flows, research links, data flows and talent mobility enable a small country to tap opportunities far beyond its borders.

In a fragmented world, openness must be active rather than passive. It requires a broad portfolio of reliable economic relationships and rules that keep cross-border activity predictable. The aim is not to depend on a single partner but to secure access to as many partners as possible.

[6] Alesina, A., Spolaore, E. & Wacziarg, R. (2000). Economic Integration and Political Disintegration. American Economic Review, 90(5), 1276–1296.

POLICY DIRECTION

- Secure and further develop the bilateral path with the European Union, Switzerland's most important trading partner
- Extend and modernize free trade agreements, including rules for services, digital trade and non-tariff measures
- Preserve an attractive environment for domestic and foreign investment, including access to venture and growth capital for start-ups and scale-ups
- Invest in talent and maintain access to international research networks and highly qualified workers

3.2 Resilience without self-sufficiency

➢ **Reduce concentrated vulnerabilities through diversification.**

Resilience should not be confused with self-sufficiency. A country of Switzerland's size cannot produce every critical good or master every strategic technology domestically. Attempting to do so is not fiscally feasible and would weaken specialization, productivity and innovation.

A more realistic approach is to identify strategic dependencies and develop alternatives. As outlined above, a dependency becomes critical only where supply is highly concentrated, substitution is difficult and disruption would cause substantial economic or security costs. Multiple suppliers, markets, transport routes, technologies and sources of knowledge can reduce vulnerability while retaining the benefits of trade. Stockpiling and domestic capacity can play a role in narrowly defined cases, but they should complement rather than replace diversification. The state should facilitate and monitor this process, while firms remain primarily responsible for managing commercial supply-chain risks. Such measures involve trade-offs: greater security can reduce efficiency, while diversification and redundancy carry costs. The objective is therefore not to eliminate risk, but to manage it at proportionate cost.

POLICY DIRECTION

- Monitor critical dependencies using consistent criteria and stress tests
- Diversify procurement, export destinations, logistics routes and technology partnerships
- Use stocks or minimum-capacity requirements only where disruption costs justify them
- Review exceptional measures regularly and remove them when the underlying risk declines

3.3 Cooperation to pool influence

➢ **Create collective scale with reliable partners.**

Small countries have limited unilateral leverage, but they do not have to act alone. Cooperation can pool market access, information, purchasing power and diplomatic influence. It can also reduce the risk that national responses fragment markets or create incompatible standards.

For Switzerland, cooperation should include close economic relations with the European Union, the EFTA framework and targeted partnerships among open economies. The WTO remains the foundation of rules-based trade, but with reform stalled, plurilateral coalitions of like-minded economies are gaining importance. The Future of Investment and Trade Partnership[7] is one such initiative: it shows how smaller economies can defend open markets and practical cooperation without imitating power politics. To be effective, however, such initiatives must be filled with concrete content and followed by action. Beyond these coalitions, stable relations with the EU remain essential for Switzerland. A competitive and adaptable Swiss economy, in turn, strengthens the resilience and innovative capacity of the wider European economic area.

[7] Future of Investment and Trade (FIT) Partnership

POLICY DIRECTION

- Strengthen the WTO and work with like-minded economies to keep international rules predictable
- Use bilateral, regional and plurilateral partnerships to stabilize market access
- Promote mutual recognition, compatible standards and cross-border research cooperation
- Strengthen international cooperation in responding to economic coercion and disruptions to critical supply chains
- Use coalitions of open economies to support predictable international rules

3.4 Enabling winners instead of picking them

➢ **Strengthen adaptability and framework conditions.**

Industrial policy requires governments to identify sectors, technologies or firms that deserve preferential support. This task is particularly risky for small economies, where errors consume a larger share of available fiscal and human resources. Support can also lock resources into activities that are politically visible but economically unviable.

The alternative is not passivity. The state has a central role in creating conditions under which new winners can emerge: sound public finances, competitive taxation, efficient regulation, high-quality education and research, legal certainty, reliable infrastructure and openness to innovation. These framework conditions help firms adjust when technologies, supply chains and markets change.

POLICY DIRECTION

- Prioritize framework conditions that foster innovation and scaling-up across all sectors
- Reduce regulatory and administrative burdens
- Invest in education, research, infrastructure and institutional quality
- Where targeted support is unavoidable, define objectives, sunset clauses and evaluation criteria

4 Conclusion

Geopolitical rivalry, trade restrictions and industrial policy have changed the environment in which small, open economies operate. Switzerland should neither count on a rapid return to a less contested international economy nor imitate instruments that rest on the market size, fiscal scale and unilateral leverage of major countries. In the hands of a small economy, such policies generally impose higher domestic costs while yielding less influence abroad.

The Swiss response should therefore follow a different logic. Openness enlarges the effective market. Diversification limits concentrated dependencies. Cooperation creates collective scale. Adaptability enables companies and institutions to adjust as political and technological conditions change.

Openness provides the strongest foundation for prosperity and resilience, for large and small countries alike. Major countries may seek short-term gains through economic power; small economies can only succeed by remaining open, cooperative and adaptable.