LM05 · ECONOMICS · CFA LEVEL I

Introduction to Geopolitics

How interactions among state and non-state actors shape trade, capital flows, and investment risk

What This Reading Covers

Geopolitics is the study of how geography affects political and international relations. Analysts study the **actors** — individuals, organizations, companies, and national governments — and how they interact across a spectrum from **cooperation to competition** and **globalization to nationalism**.

Learning Outcome Statements

LOS a	Describe geopolitics from a cooperation versus competition perspective
LOS b	Describe geopolitics and its relationship with globalization
LOS c	Describe functions and objectives of the international organizations that facilitate trade, including the World Bank, the IMF, and the WTO
LOS d	Describe geopolitical risk
LOS e	Describe tools of geopolitics and their impact on regions and economies
LOS f	Describe the impact of geopolitical risk on investments

Why Investors Care

Geopolitical risk affects **economic growth, interest rates, access to key resources, supply channels, and access to markets**. These in turn drive **risk premiums, asset allocation,** and **geographic exposure** in a portfolio.

Exam Tip: LM05 is qualitative — there are no calculations. Focus on **definitions, classifications** (archetypes, risk types, tools), and the **functions of the IMF, World Bank, and WTO**.

LOS A · NATION-STATE, ACTORS, SOVEREIGNTY

Nation-State, Actors, and Sovereignty

A **nation-state** is a political entity whose population shares a **national identity** and whose government exercises **sovereignty** — authority over national security and domestic resources.

Two Categories of Actors

STATE ACTORS

National governments, political organizations, and country leaders that exert authority over a country's national security and resources.

E.g., governments, ruling parties, heads of state, central banks.

NON-STATE ACTORS

Do **not** directly control national security or country resources.

E.g., NGOs, multinational companies, charities, influential individuals. **Globalization is primarily carried out by non-state actors.**

The Cooperation–Competition Spectrum

Political cooperation is the extent to which countries work toward agreements on **rules and standardization** for their activities and interactions. Countries lie on a spectrum — cooperation and non-cooperation exist in degrees, not as a binary.

Non-Cooperation	Partial	Mixed	Cooperation
arbitrary rules	selective engagement	some alignment	rule standardization

Cooperative country

Engages and reciprocates in **rule standardization**, **tariff harmonization**, international agreements on trade, immigration, or regulation, and allows free flow of information including technology transfer.

Non-cooperative country

Inconsistent and even **arbitrary rules**, restricted movement of goods, services, people, and capital across borders, retaliation, and limited technology exchange.

LOS A · FACTORS DRIVING COOPERATION

What Drives Countries to Cooperate?

Cooperation is more likely when national interests **align**, when **power is symmetric**, and when **institutions** on both sides are strong and durable.

Motivations for Cooperation

1 · NATIONAL SECURITY / MILITARY

Shared defense interests — alliances to deter or respond to a common threat.

2 · ECONOMIC INTEREST

Access to **key resources** and the ability of domestic firms to operate on a **global scale**.

Resource Endowment and Standardization

Unequal distribution of resources across countries creates the **need (or desire)** for cooperation — but may also create **power imbalances**, both inter- and intra-country.

Standardization — the process of creating protocols for the production, sale, transport, or use of products/services — provides the "rules of engagement":

Regulatory	Basel Committee on Banking Supervision
Process	SWIFT (cross-border payment messaging)
Operational	Containerization (shipping)

Soft Power, Culture, and Institutions

Soft Power

A means of influence **without force or coercion**.

Cultural Considerations

Cultural similarities and immigration patterns support cooperation.

Institutions

Formal structures (rule of law, property rights, human rights) *or* customs/behavioral patterns.

Institutional Quality Matters

Strong institutions contribute to more stable internal and external political forces. They provide more opportunity to develop cooperative relationships — and those relationships tend to be **more durable**.

Hierarchy of Interests — Costs of Cooperation

National interests (a country's goals/ambitions) may *conflict with* or *support* cooperation. Classic tensions:

US vs. China

US promotes democracy & human rights *but* wants access to cheap labor.

West vs. Russia

West wants to spread democracy and extend NATO *but* needs Russian energy supplies.

The **power of the decision-maker** matters: a political party (Congress/Parliament) faces short political cycles and changing priorities; an autocrat/dictator adds individual psychology and possible non-predictability.

LOS B · GLOBALIZATION VS. NATIONALISM

Globalization and Its Relationship with Cooperation

Globalization is the process of interaction and integration among people, companies, and governments worldwide — *mainly economic and financial, but with cultural spillovers.*

It is marked by **economic and financial cooperation** carried out **mainly by non-state actors**: trade in goods/services, capital flows, currency exchange, and cultural & information exchange.

Globalization and Cooperation are Correlated

Countries that are highly globalized also tend to be highly cooperative. **Nationalism** is the opposite: domestic economic and financial activity dominant to the exclusion of the interests of other nations.

Motivations for Globalization

1 · Increasing Profits

New markets (possibly via foreign direct investment); lower costs — cheaper labor, lower-tax operating environments, supply-chain efficiencies.

2 · Access to Resources & Markets

Talent or raw materials unavailable domestically.

3 · Intrinsic Gains

Information exchange and knowledge spillovers.

Costs of Globalization & Threats of Rollback

COST	DESCRIPTION
Unequal accrual of gains	Winners and losers — may reduce political cooperation
Lower ESG standards	Production moves to countries with lower environmental, social, and governance standards
Political consequences	Loser countries experience net job losses, out-migration, capital outflows
Interdependence	Over-reliance on resources — or a key resource — from another, potentially non-cooperative, country

Globalization Headwinds

Financial contagion · **Nationalism** (domestic interests first) · **Supply-channel risk**.

Vulnerabilities, once exposed, may trigger **reshoring essential production**, **country-sourcing diversification**, or **owning foreign production** directly.

LOS B · POLITICAL COOPERATION CLASSIFICATIONS

Archetypes: Four Classifications of Country Behavior

Geopolitical actors can be classified on **two axes**: *political cooperation vs. non-cooperation* and *globalization vs. nationalism*. Four archetypes result — each with its own costs, benefits, and tradeoffs.

ARCHETYPES MATRIX

← NATIONALISM | GLOBALIZATION →

↓ NON-COOPERATION | COOPERATION ↑

BILATERALISM

Nationalism + Cooperation

Cooperation between 2 countries (may have many such relationships, but no multi-country arrangements)

trade between 2 countries

MULTILATERALISM

Globalization + Cooperation

Extensive rules harmonization; broad international trade; many cooperative arrangements across the globe

broad multi-country cooperation

AUTARKY

Nationalism + Non-Cooperation

Self-sufficiency, limited trade — can result from isolation; trade may be limited to key national-security concerns (food, water, energy)

HEGEMONY

Globalization + Non-Cooperation

Political, economic, military domination — regional/global leaders influence other countries without necessarily cooperating

Summary Table

ARCHETYPE	COOPERATION	GLOBALIZATION	DEFINING FEATURE
Autarky	Non-cooperation	Nationalism	National self-reliance; often state-dominated society
Hegemony	Non-cooperation	Globalization	Open to globalization but influences other countries without cooperating
Bilateralism	Cooperation	Nationalism	Cooperation between two countries at a time
Multilateralism	Cooperation	Globalization	Extensive international trade and multi-country cooperation

Regionalism — A Variant of Multilateralism

Some countries exhibit **regionalism** — cooperating multilaterally with **nearby countries** (a regional bloc such as the EU, ASEAN, Mercosur) but less so with the world at large. It is *mutually beneficial trade among a group*.

Exam Tip: Memorize the 2x2: **Autarky** = self-reliant & isolated. **Hegemony** = dominant & global but uncooperative. **Bilateralism** = paired cooperation. **Multilateralism** = global cooperation. Regionalism is multilateralism with nearby countries only.

LOS E · TOOLS OF GEOPOLITICS

Tools of Geopolitics

Tools can be used to **improve cooperation** or to **escalate conflict**. The more tools of collaboration a country uses, the **less likely** it is to initiate conflict or to use non-cooperative tools. Tools may be **actively used** or **merely threatened**.

Three Categories of Tools

NATIONAL SECURITY TOOLS

Used to **influence/coerce** a state actor through direct or indirect impact on the country's **resources, people, or borders**.

E.g., armed conflict, espionage, bilateral/multilateral security agreements and alliances.

ECONOMIC TOOLS

Reinforce cooperative or non-cooperative stances via economic means.

Cooperative: free-trade areas, common markets, economic/monetary unions, standardization, tariff harmonization.

Non-cooperative: domestic content requirements, voluntary export restraints, nationalization.

FINANCIAL TOOLS

Reinforce cooperative or non-cooperative stances via financial mechanisms.

E.g., free exchange of currencies across borders, foreign direct investment, **sanctions**.

Other Tools That Shape Geopolitical Relationships

TOOL	HOW IT WORKS
International trade	Active trade of goods and services, often via tariff harmonization and trade agreements
Financial flows	Capital flows, currency exchange, foreign investment
Standards	Regulatory (Basel), process (SWIFT), operational (containerization)
Migration	Movement of people across borders — source of labor, talent, and cultural exchange; also a long-term thematic force
Culture & information	Soft power, language, shared values, free flow of information and technology transfer

Cooperative vs. Non-Cooperative Use

Every tool can be deployed either way. Tariff harmonization is cooperative; tariff escalation is non-cooperative. A free currency exchange is cooperative; capital controls and sanctions are non-cooperative.

QUIZ 1 · CHECKPOINT

Test Your Understanding: Actors, Cooperation & Archetypes

Q1. Which of the following is *best* classified as a **non-state actor** in geopolitics?

Q2. A country that is open to globalization but influences other countries without necessarily cooperating with them is *best* described as exhibiting:

Q3. Which factor is *most likely* to increase the likelihood and durability of political cooperation between two countries?

Q4. Cooperation between two countries, where a country may have many such relationships but does not participate in broader multi-country arrangements, is *best* described as:

Q5. Which of the following is *most likely* a **cooperative** use of an **economic tool** of geopolitics?

LOS C · IMF · WORLD BANK · WTO

International Organizations Facilitating Trade

Three institutions coordinate global trade and finance: the **IMF** (monetary cooperation), the **World Bank** (development finance), and the **WTO** (trade rules and dispute resolution).

International Monetary Fund (IMF)

IMF

- Promotes **international monetary cooperation** and **exchange rate stability**
- Oversees fixed exchange rate agreements between countries; helps governments manage their exchange rates
- Assists in setting up **international payment systems**
- Lends foreign currencies to member states in times of significant external deficits — provides **short-term capital to aid balance of payments** (preventing the spread of crises)
- Forum for cooperation on international monetary problems

World Bank

WORLD BANK

Helps **developing countries fight poverty** and enhance **environmentally sound economic growth**. A *not-for-profit supranational organization*. Two components:

IBRD — International Bank for Reconstruction & Development
Borrows at AAA rates and lends to member countries.

IDA — International Development Association
Provides low-/no-interest loans and grants to countries with few or no other options.

Also provides resources, knowledge, and helps form public/private partnerships with the overall goal of fighting poverty.

World Trade Organization (WTO)

WTO

- Ensures that **trade flows freely** and works smoothly
- **Regulates cross-border trade relationships globally** — reviews/monitors trade policies
- Implements, administers, and operates individual multilateral trade agreements

- **Settles disputes** between trading nations
- Main focus: instituting, interpreting, and enforcing multilateral trade agreements that set global trade policies for a large majority of the world's trading nations

THREE PILLARS OF INTERNATIONAL TRADE COORDINATION

IMF	WORLD BANK	WTO
Monetary cooperation Exchange rate stability Balance-of-payments loans	Fight poverty Developing countries Low-interest loans, grants	Trade flows freely Enforces agreements Settles trade disputes
short-term capital	*long-term development*	*global trade rules*

Exam Tip: Memorize the **one-line function** for each: **IMF** = exchange-rate stability & balance-of-payments lending · **World Bank** = fight poverty in developing countries with loans/grants · **WTO** = regulate and enforce global trade agreements; settle disputes.

LOS D · TYPES OF GEOPOLITICAL RISK

Three Basic Types of Geopolitical Risk

Geopolitical risk is the risk associated with tensions or actions between actors (individuals, organizations, companies, national governments) that affect the normal and peaceful course of international relations.

1 · EVENT RISK

Date-specific — timing is known in advance, outcome is not.

E.g., elections, new legislation, scheduled referenda.

2 · EXOGENOUS RISK

Sudden or unanticipated risk that impacts either a country's cooperative stance, the ability of non-state actors to globalize, or both.

E.g., invasions, natural disasters, outbreaks of war ("black swan" events).

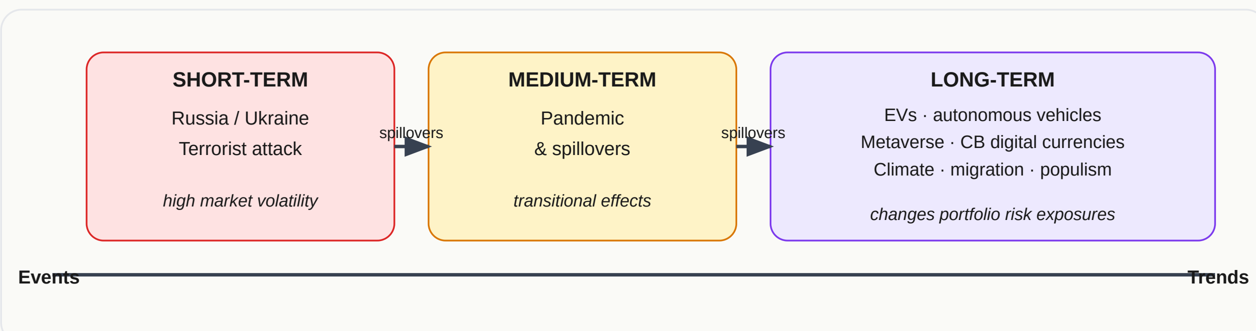
3 · THEMATIC RISK

Known factors that evolve and expand over a **long period**.

E.g., climate change, immigration patterns, populism, demographic shifts.

Time-Horizon Map

SHORT, MEDIUM, AND LONG-TERM GEOPOLITICAL RISKS



A Useful Heuristic

Event risk = known timing, unknown outcome. **Exogenous** risk = unknown timing, usually major impact. **Thematic** risk = known factor, long-term gradual impact.

LOS D & F · ASSESSING GEOPOLITICAL THREATS

Assessing Geopolitical Risk: Three Dimensions

To assess geopolitical threats, an investor considers risk across three dimensions. Because geopolitical risks rarely evolve in a linear fashion, a **single-point forecast** is rarely useful.

LIKELIHOOD

The **probability** that the risk will occur. Mostly **subjective**.

VELOCITY

The **pace** at which the risk impacts an investor's portfolio — how quickly investment values reflect its effects.

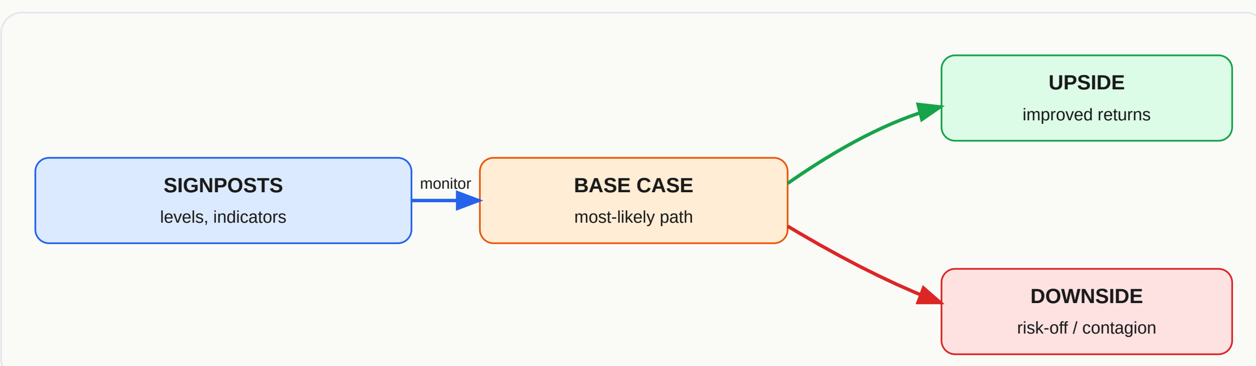
IMPACT (SIZE & NATURE)

Magnitude and breadth. **High or low**, **discrete or broad** — company/sector vs. economy/market. Investors generally focus on high-impact risks.

Scenario Building and Signposting

Instead of a single-point forecast, investors build **scenarios** around a base case — upside and downside — and identify **signposts** (levels, indicators) that would signal a move from the base case toward one of the alternative scenarios.

BASE CASE, SCENARIOS, AND SIGNPOSTS



Market Spikes as a Risk Signal

In the **short term**, geopolitical events (Russia/Ukraine, terrorist attacks) produce **high market volatility** — sudden **market spikes**. These spikes are themselves a signal: they identify moments when the market is re-pricing the risk premium.

Velocity distinguishes different impacts:

Short-term	Event and exogenous risks: sudden volatility, rapid price moves
Medium-term	Spillovers (e.g., pandemic aftermath) that gradually propagate
Long-term	Thematic trends — change portfolio risk exposures over years

Geopolitical Risk and the Risk Premium

Geopolitical risk affects the **risk premium** investors require to hold assets in a country or region. Countries that are more cooperative and globalized tend to have *less* likelihood of some geopolitical risks (such as war) — but they may have *greater* likelihood of others (such as supply-chain disruptions).

QUIZ 2 · CHECKPOINT

Test Your Understanding: Trade Orgs & Risk

Q6. The international organization whose main role is to institute, interpret, and enforce multilateral trade agreements and settle trade disputes is the:

Q7. A member country experiencing a sudden balance-of-payments crisis and in need of short-term foreign currency funding would most likely turn to the:

Q8. A scheduled national election in a large economy is *best* characterized as:

Q9. A sudden outbreak of armed conflict that disrupts a country's ability to cooperate with trading partners is *best* described as:

Q10. The *velocity* of a geopolitical risk refers *most directly* to:

LOS F · RISKS TO INVESTORS

Specific Risks to Investors

Geopolitical events translate into portfolio risk through **two channels**: non-cooperative **tools of exchange** (tariffs, sanctions, capital controls) and disruptions to cooperative **tools of cooperation** (regulatory harmonization).

Tools of Exchange — Non-Cooperative Uses

TOOL	EFFECT ON INVESTORS
Tariffs	Taxes on imported goods. Raise domestic prices, reduce importer margins, benefit domestic producers; create retaliation risk that can cascade into trade wars.
Sanctions	Financial restrictions targeting a country, entity, or individual. Can block asset access, freeze accounts, or prohibit transactions — rapid, severe impact on exposures in the sanctioned region.
Capital controls	Restrictions on flow of financial capital across borders — prohibitions on foreign investment, taxes on repatriated earnings, or outright bans on repatriation. Can trap capital and create severe liquidity risk.
Nationalization	Seizure of foreign-owned assets by a state. Potentially total loss of invested capital.
Domestic content / export restraints	Force foreign firms to source locally or restrict export volumes — reduce margins and supply-chain flexibility.

Tools of Cooperation — When Harmonization Breaks Down

Regulatory harmonization (Basel banking rules, SWIFT, containerization standards) lowers cross-border friction and the cost of capital. When harmonization is **rolled back or fragmented**, costs rise, liquidity declines, and supply chains become more expensive and fragile.

Regulatory Harmonization — Cooperative Side

When countries harmonize regulations, investors benefit from **lower compliance costs**, **deeper liquidity**, and **more predictable cross-border treatment**. Breakdown of harmonization — re-regulation, divergent rules — reduces the efficiency of globalized capital markets.

Political Risk vs. National Security Risk

POLITICAL RISK

Risk from changes in the **domestic political environment** — elections, new legislation, changes in ruling party, regulatory shifts. Affects investor rules but is usually within the normal political cycle.

Typical exposure: sectors sensitive to taxation, subsidies, licensing, or regulation.

NATIONAL SECURITY RISK

Risk from threats to a country's **resources, people, or borders** — armed conflict, espionage, alliances that reinforce or prevent conflict. Can materialize abruptly and alter an entire country's investability.

Typical exposure: defense, energy, strategic minerals, infrastructure in/near affected regions.

Key Insight

National security tools — often invisible or only threatened — can be activated quickly and drive **high-velocity, high-impact** outcomes. Political risk tends to evolve on the electoral cycle; national security risk can reprice markets in a single headline.

LOS F · PORTFOLIO IMPLICATIONS

Portfolio Implications of Geopolitical Risk

Geopolitical risk directly affects **risk premiums**, **asset allocation**, and **geographic exposure** — three levers investors adjust as the geopolitical landscape changes.

Three Portfolio Channels

RISK PREMIUMS

Rising geopolitical risk raises the discount rate investors require to hold assets in the affected country or region. Valuations compress; equity and credit spreads widen.

ASSET ALLOCATION

Shift between asset classes — e.g., into defensive assets (gold, Treasuries, safe-haven currencies) when risk rises; into growth-sensitive assets when it falls.

GEOGRAPHIC EXPOSURE

Adjust country and regional weights. Reduce exposure to sanctioned, nationalizing, or non-cooperative regions; increase exposure to stable, cooperative multilateral partners.

What Flows Through to Portfolios

CHANNEL	MECHANISM
Economic growth	Trade restrictions and supply-chain disruptions reduce global output; sector earnings re-rate
Interest rates	Central banks respond to shocks; safe-haven bond yields fall while risky-country yields rise
Access to key resources	Energy, metals, food supply — key exposures can become stranded or repriced
Supply channels	Reshoring, country-sourcing diversification, owning foreign production — each reshapes corporate margins
Access to markets	Tariffs, sanctions, or capital controls cut off revenue streams for affected firms

Practical Investor Response

Investors use **scenario building and signposting** rather than single-point forecasts. Key actions: monitor signposts (policy announcements, election polls, trade-flow data, sanctions lists), maintain liquidity in positions exposed to high-velocity risks, and diversify across archetypes and regions.

Cooperative vs. Non-Cooperative Environments

MORE COOPERATIVE / GLOBALIZED

Lower likelihood of war and nationalization; **higher** likelihood of supply-chain disruption risk. Lower risk premia in normal times, but deeper interdependence means broader spillovers during shocks.

LESS COOPERATIVE / NATIONALIST

Higher likelihood of tariffs, capital controls, nationalization, and conflict. Higher risk premia; investors demand higher expected returns, often with shallower liquidity.

Exam Tip: Geopolitical risk impacts flow through to **risk premiums** → **asset allocation** → **geographic exposure**. For the exam, link any geopolitical trigger (e.g., new sanctions) to the channel it travels: access to markets, interest rates, supply chains, or the risk premium itself.

QUIZ 3 · CHECKPOINT

Test Your Understanding: Investor Impacts

Q11. Which of the following is *least likely* a **non-cooperative tool of exchange** that raises direct risk for investors with cross-border exposures?

Q12. Long-term climate change and shifting global migration patterns are *best* described as:

Q13. An investor concerned about a possible invasion uses scenario analysis with upside, base-case, and downside paths, and monitors specific indicators to detect movement between scenarios. These specific indicators are *best* described as:

Q14. Geopolitical risk affects investment portfolios *most directly* by changing:

MODULE COMPLETE

Your Scorecard

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LM05 Key Takeaways — Exam-Ready Cheat Sheet

Foundations

1. **Geopolitics** = how geography affects political and international relations. A **nation-state** shares national identity under government sovereignty.
2. **State actors** (governments, political orgs, leaders) control national security & resources. **Non-state actors** (MNCs, NGOs, individuals) do not — but they drive globalization.
3. Cooperation factors: **aligned interests · power symmetry · institutional quality**. Strong institutions make cooperation more durable.

Archetypes (2x2)

4. **Autarky** = nationalism + non-cooperation (self-reliance). **Hegemony** = globalization + non-cooperation (dominant). **Bilateralism** = nationalism + cooperation (paired). **Multilateralism** = globalization + cooperation (broad).
5. **Regionalism** = multilateralism within a regional bloc — nearby countries only.
6. Globalization is carried out mainly by **non-state actors**; it is correlated with cooperation.

Tools of Geopolitics

7. Three tool families: **National Security** (armed conflict, espionage, alliances) · **Economic** (trade areas, tariffs, content rules) · **Financial** (FX, FDI, sanctions).

8 Any tool can be **cooperative or non-cooperative** — harmonization vs. fragmentation. More cooperative tools = less conflict likelihood.

International Organizations

9 **IMF** — monetary cooperation, exchange-rate stability, short-term balance-of-payments lending.

10 **World Bank** — long-term development: low-interest loans & grants to fight poverty (IBRD + IDA).

11 **WTO** — regulates global trade, enforces multilateral agreements, settles disputes.

Risk & Investment Impact

12 Three risk types: **Event** (known date) · **Exogenous** (unanticipated) · **Thematic** (long-term known factor).

13 Three assessment dimensions: **Likelihood · Velocity · Impact**. Use **scenario building + signposts**, not single-point forecasts. **Market spikes** signal re-pricing of risk premia.

14 Investor risks: tools of exchange (**tariffs, sanctions, capital controls**), tools of cooperation (**regulatory harmonization** — and breakdowns of it), political vs. national-security risks.

15 Portfolio channels: **risk premiums · asset allocation · geographic exposure**.

Last-Minute Exam Checklist

Actors: state (governments) vs. non-state (MNCs, NGOs, individuals)

Archetypes (2x2): Autarky · Hegemony · Bilateralism · Multilateralism (+ Regionalism)

Tools: National Security · Economic · Financial — each cooperative or non-cooperative

Risk types: Event (known date) · Exogenous (surprise) · Thematic (long-term)

Assess by: Likelihood · Velocity · Impact — use scenarios & signposts

IMF = FX stability + balance of payments · **World Bank** = fight poverty · **WTO** = trade rules + disputes

Portfolio impact: risk premiums → asset allocation → geographic exposure

Step 1 of 15