

Economic Diplomacy: Align, Acquiesce, Mitigate. Third-Nation Strategies for a Disrupted World Order

by
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What is optimal economic statecraft for Third Nations—those states not frontline in geopolitical rivalry? International actions undertaken by the Trump administration have escalated a US Shock as profound and disruptive as any China Shock. The rules-based order has breached, with its architect and principal provider now seeking advantage from a forced rewrite of the international system. Globalisation and multilateralism have frayed, so that nations around the world are, appropriately, re-examining options on trade and strategic engagement. In the face of geopolitical rivalry, no nation wants to be collateral damage in someone else's conflict.

Economic statecraft is, in logic, the practice of using economic instruments to advance a nation's geopolitical goals. The word "statecraft" indicates simply the directed management of state affairs to achieve national objectives, and so is a terminology used by both large and small nations. However, the terminology "economic statecraft" is more often identified, in the US say, as a "means of working the US's geopolitical will in the world". To emphasise that this is not what small states or indeed most other nations do, I use the term "economic diplomacy" instead.

Economic diplomacy: Economic statecraft for small states

In regions such as ASEAN, alignment has long been a strategic option. This was made plain during the Cold War, but especially so from the 2000s on when America presented Singapore and the rest of ASEAN with choice between it and China. Alignment means bundling trade and investment, technology and innovation, and economics and security all together—and therefore alignment is not so much choice as taking sides in a binary setting.

Given these origins, alignment refers to how a nation would answer the question posed it by a major power, "We are going to war. Are you with us?" This is obviously extreme but it suggestively conveys the background landscape when discussion occurs on the topic of alignment.

While stark, in a world of national autonomy, alignment remains still within the agency of a small state. Moreover, conditions exist under which alignment is an optimal strategy. The Table indicates, e.g., that if the international system is truly zero-sum, then alignment potentially represents the right approach. For the analysis here, especially for distinguishing them from acquiescence and mitigation, the richer strategies of balancing, hedging, and bandwagoning can all be put together with pure alignment as

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instances of a “generalized alignment”. Mathematically, all these strategies can be represented simply as points in the convex hull defined by the major powers.

Acquiescence can be viewed as appeasement. This too might be optimal, depending on circumstances. For instance, a major power might have unclear objectives, but a visibly thin-skinned leader. Actions—whether cheap-talk signalling or more substantive efforts—that get at the psychological mindset of that leader can be acceptable that nation’s foreign policy initiatives, without its actually committing to aligning with the major power’s foreign policy objectives.

Mitigation represents a third class of strategies. Since they represent a more novel approach to small-state behaviour, they are considered in the following section.

Mitigation as mechanism design

If we visualize alignment as locating alongside one Great Power or another, or taking up a position somewhere on the straight line that connects the Great Powers, then mitigation can be viewed as stepping off that straight line altogether.

Mitigation properly-construed comes with adaptation. In this article, for brevity, I group the two together and label the joint collection just “mitigation”. Adaptation and mitigation parallel strategies for the global climate crisis. Adaptation describes strategies that seek to minimize the **effects** of external shocks. Mitigation seeks to reshape the **causes** of external shocks, not just react to them. In the global climate crisis, adaptation means protecting one’s people, perhaps moving them to higher ground as sea levels rise or providing more resilient living structures. Mitigation, on the other hand, refers to carbon sequestration, lowering the nation’s plastics and carbon footprint, and accelerating the green transition by shifting to renewables, away from hydrocarbon sources of energy.

“Mitigation”—adaptation and mitigation proper taken together—suggests how Third Nations can exercise agency and influence in addressing proactively the external shocks inflicted on them by major powers. This contrasts with more conventional ways of thinking: For example, although importantly different from each other, Thucydides-Waltz realism and Kindleberger Hegemonic Stability Theory both align in instructing small nations to remain price-takers. The first says Great powers do what they will, small nations suffer what they must. The second says that if the stability and performance of the international system are to be optimized, it will come down primarily to what the hegemon does, and little on what small states do. Both ways of thinking condition on size and power as the sufficient statistics for world order.

Mitigation, on the other hand, helps guide small nations away from price-taker behaviour and instead emphasises interests, not size and power, as the driver for relations between nations. It employs tools of agility and networking. Mitigation is, therefore, a shift away from the Thucydides-Waltz-Kindleberger fixation on power hierarchy.

Consider rules-based trade. This does not, as a matter of logic, require major power underwriting, only the understanding that all sides gain from the proper implemen-

tation of an international system of exchange. Obviously, the enforcement of rules does follow more easily if a benevolent hegemon is minded to carry out that enforcement: But such efficiency due to economies of scale applies to all rules enforcement and is not specific to international trade. The alternative to brute-force, major power rules-enforcement is to build coalitions that are incentive-compatible, i.e., where no member of the group sees unilateral incentive to deviate from the rules of the game. Call this a coalition of the willing. Partners in the coalition should not have to agree on everything; they only need be (sufficiently) like-minded on issues of trade. Making rules-based trade work would then provide an example of successful coalition-building. Such an incentive-compatible multilateralism would not just reap gains from trade but also lower risk and instability in the group. Recourse to major power leadership to enforce rules—as Kindleberger might suggest—would then reflect not a logical necessity, but only a defect in mechanism design.

Examples already exist of incentive-compatible cross-national groupings, maintained not by Great Power hegemony but by smart mechanism design that encourages incentive compatibility. Consider just two leading examples.

ASEAN is a collection of Southeast Asian nations that promotes rules-based trade and supply-chain integration. Initiated in 1967, it now comprises 11 nations representing 670mn people and generating GDP of USD3.6tn. Thus ASEAN is the world's fifth-largest economy, and with only China and India more populous. It forms a central platform for building out extensions to like-minded partner nations in what's called "ASEAN+" frameworks, i.e., ASEAN carries out pathfinder functions for expanding a multilateral-like coalition. ASEAN decision-making is by consensus and leverages common interest in "ASEAN Centrality", i.e., the proposition that it is ASEAN itself that determines ASEAN outcomes, not any external hegemonic power.

In 2017 then newly-installed US President Donald Trump withdrew the US from the Trans Pacific Partnership (TPP). The next year, however, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) formed, reconstructed from the original TPP and obviously without US leadership. CPTPP does not include China but its 12 member nations represent 500mn people and generate a GDP of USD14tn. Membership is not closed, but as with any grouping, induction is deliberate and measured.

But however ASEAN and CPTPP re-constitute and grow, can their trade aspirations form the beginnings of a global economy without the US, should that be necessary? Today the US imports 11% of what the world exports. This is a large fraction. It means, however, that the world trades with itself eight times more than it does with the US. ASEAN+3 (one of the "ASEAN+" groupings, bringing on China, Japan, South Korea) is a larger market than the US. In numbers alone, should the US decide to become an autarky—surrounded only friends and fish—the global economy would be poorer, but it would continue to grow. The resulting global economy—a G-minus world—would have its stability and performance determined by incentive-compatible groupings such as ASEAN and CPTPP, not by a Kindleberger hegemon. A G-minus world is not aspirational. But it might be a necessity.

Both ASEAN and CPTPP consider themselves operating, broadly, within WTO-based rules of multilateralism. They focus on narrower issues than would be covered more broadly by generalized global multilateralism. While each of ASEAN and CPTPP contains members that might be considered Middle Powers, there is no leadership or hegemonic significance to that categorization as compared to the other obviously small-state members in the group. The key feature in both is the emphasis on rules-based trade without obvious power-driven leadership. Agility and networking, convergence of interests and incentive compatibility, and decentralized governance matter more than mere size and power.

However such groups evolve or new ones emerge in the future, the reality for them now is mitigation against both the US shock (unpredictability, “Might Makes Right” and “America First” tactic) and the China shock (economic overdependence). Through emphasising rules-based operations and interest alignment, they have emerged to be resilient and robust, and capable of mitigation

Conclusion

This article has described how Third Nations—whether small states or Middle Powers—can navigate a world order disrupted by shocks. Strategies fall in three categories: align, acquiesce, or mitigate. When different strategies are optimal depends on external circumstances.

Mitigation gives Third Nations greater scope in agency and influence to reshape proactively disruptive shocks to the international system. The community of nations has already begun to build mitigation responses to increase their resilience.

Technical appendix

This section tabulates several key characteristics of the align, acquiesce, mitigate strategies described in the text.

Strategy	Details	Optimal
Align	Choose a side; or lean one way or another. For the analysis here, the essence of aligning is to locate at a point either coincident with one major power or the other, or somewhere between them. That last, which can be viewed as balancing, hedging, or bandwagoning is, mathematically, just an interior form of alignment, and thus can be put in a category of "generalized alignment" to be distinguished from acquiescence or mitigation.	The international environment is objectively zero-sum, not just perceived so: A Prisoners Dilemma situation, for instance, is not a zero-sum environment.
Acquiesce	Appease major powers through cheap-talk signalling or more substantive actions, but without actually aligning. For instance, a nation might choose to award a high-visibility (but ultimately meaningless) prize to the leader of a major power, or build a golf course in their name, on the understanding that such actions elicit an elastic positive response. The nation does so, however, without an agreement to commit further.	The international environment displays high uncertainty but certain features are more pronounced and reliable.
Mitigate	Actively reshape the external forces, not just react taking those forces exogenous and inelastic. Unlike alignment, mitigation steps outside the convex hull defined by major powers. Mitigation targets the causes of disruptive external forces. A closely related strategy—adaptation—seeks to minimise the impact of those forces.	The international environment shows specific dimensions of elasticity but could be otherwise restricted and inflexible.