

A Fragmenting World Order: The Dynamic Effects of Aggregate Economic and Geopolitical Shocks

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Thu 12 Jun 2025

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“Geopolitics is the dustbin of bad economics”

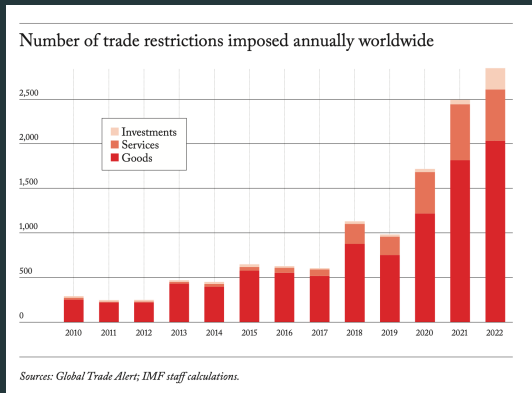


Figure 1: Trade restrictions worldwide tripled between 2019 and 2022, and have been rising even faster since due to geopolitical tensions and advanced-economy industrial policy (not yet incorporated in Figure above from Georgieva 2023).

and more...

- Intensifying geopolitical rivalries
- Declining effectiveness of international organizations
- Rising unilateral action and violation of treaties, and international law
- Falling trust across nations
- Declining cooperation and other public goods provision
- Increasing deviation from global standards

NIPO

Instrument		Occurrence
import barriers	Developing countries 40%	
subsidies	China 89%, EU 73%, US 46%	
export subsidies	Japan 45%, ROK 28%	

Table 1: Trade and industrial policy across nations (Evenett and Martin, 2024).

Official reason	USD bn
Strategic competitiveness	545
Climate change	318
Supply resilience	167
National security; geopolitics	102
Digital transformation	9
Other	...
Total	1720

Table 2: Industrial policy and national security (n = 24,000). Announced subsidies 2024 by official reason, across all economies. Rows don't include all records; some announcements give multiple reasons. From NIPO, Global Trade Alert.

Abstract

Many observers have noted the international system being progressively characterized by declining globalization and fragmenting world order. In the economics literature, the implications of these developments are well-studied: a more-protectionist, higher-frictioned global economy is poorer and less efficient. But even beyond that, the fragmentation of world order means a withdrawal of multilateralism, implying that international cooperation is less likely and the provision of global public goods more restrained. Less analyzed, however, are the drivers of these changes. This paper models the immediate causes of deglobalization and order fragmentation in terms of two large disturbances to the international system: a China Shock and a US Shock. For the global economy, the China Shock is a supply disturbance; the US Shock, demand. Both shocks undermine the multilateral rules-based order. This paper traces the deeper causes of the two disturbances to the interaction between longer-run geopolitical and economic dynamics. The paper develops a MIMIC (Multiple Indicators, Multiple Causes) model for the stochastic dynamics of world order, and thus provides a quantitative measure of aggregate changes in the global economy.

Conclusion

Fragmenting world order: Consequences

- Trade, efficiency, growth. Uncertainty
- Withdrawal of multilateralism and rules-based order: Level playing field. Peaceful dispute resolution.
- Cooperation and global public goods provision

Two-shock model

- The China Shock. The US Shock. Supply and demand
- Undermining the rules-based order
- Collinear economics and geopolitics

Measuring world order: Multiple indicators, multiple causes

- World order is unobservable
- Unilateralism. Violation of international law
- Protectionism and industrial policy

Two-Shock Model for the International Economic System

Whatever else it might or might not do, trade disrupts price ratios

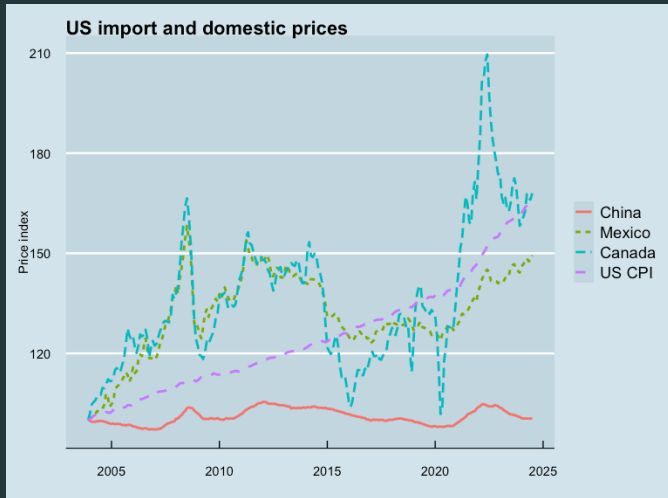


Figure 2: US import and domestic prices. The graph shows, from 2003 to 2024, prices of imports into the US from China, Mexico, and Canada, alongside the US Consumer Price Index.

A Two Shock Model for the International Economic System

China Shock

- “stealing our jobs, hollowing out our industry, turning into ghost towns what were once thriving middle-class communities”
- Not inconsistent with comparative advantage
- Over-capacity
- Industrial policy within WTO rules

US Shock

- Liberation Day Tariffs
- “Markets don’t always do the right thing. Not all growth is good growth. Not every trade deal is a good deal.”
- “Advocating industrial policy was once considered embarrassing—now it should be considered something close to obvious.”
Trigger words: national security
- Advanced-economy Industrial Policy: CHIPS and Science Act, IRA
- Foreign investment and national security. CFIUS: Nippon Steel 2025. Broadcom 2008. Dubai Ports World 2006.

Collinear Economics and Geopolitics

Geopolitics is autonomous

- JFK's "long twilight struggle"
- Colby "hostile hegemonic power", whatever its political complexion, would severely constrain US freedom of actions and future prospects
- Mearsheimer "Beijing and Washington are following the same playbook". This is not about political ideology.

Economics and geopolitics are collinear

- Cold War: Economic efficiency; comparative advantage; political convergence. 'A vital expanding economy in the free world is a strong counter to the threat of the world Communist movement.'
- Not Cold War: Economic security. "Stealing our jobs". Critical minerals, AI, technologies of the future. EVs and tanks

National security

- US needs to “prevent a hostile hegemonic power from gaining ascendancy over the Asia-Pacific region”, as this would sharply restrict America’s freedom of actions and future prospects
- China’s “... ambitions to create an enhanced sphere of influence in the Indo-Pacific and to become the world’s leading power” (NSS, 2022)
- US leading the West in a campaign of “containment, encirclement, and suppression” (Xi, NPC 2023)



Figure 3: China’s FOBS allows nuclear warhead launch from hypersonic glide vehicles in orbit, 2021.

A hostile hegemonic power, restricting America's prospects and freedom of actions? Or a liberal democracy, security partner, and treaty ally?

- “(...) should not expect to find a big American market because they don't make the things we want. They must find markets elsewhere for the goods they export”
- “largely a land of rule-bound rote learners”, whereas “advances in information technology could only be made in free societies by free thinkers”
- “a locked and closed civilization that reciprocates our hushed fear with veiled contempt”
- “(...) the most serious, most somber, most challenging? It is that they are very, very good, better at some things than Americans. They are brilliant, efficient, aggressive people who prize education as much or more than Americans — and have learned to use it.”

World Order: Multiple Indicators, Multiple Causes

Estimating the Dynamics of World Order

$$Y = X\beta + \epsilon$$

1. The right explanatory variables X ?

Causality, instruments. Multiple causes

2. The right dependent variable Y ?

3. $Y_i = \gamma Z + \eta_i$, $i = 1, \dots, M$. Multiple indicators

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(Incomplete)

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Appendix
