5 Correlated Trade and Geopolitics Driving a Fractured World Order

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5.1 Introduction

In the 2020s, public discourse, international relations scholarship, and global policymakers have all noted that geopolitical rivalries are worsening global fragmentation. The friend-shoring, de-risking, and decoupling emerging from US-China geopolitical rivalry have caused trade barriers to increase everywhere. From 2019 to 2022—coincident with the COVID-19 pandemic that also exacerbated geopolitical tensions—international trade restrictions rose three-fold (Georgieva, 2023). From this, a considerable loss in global well-being is possible; indeed, fragmentation over the long term could reduce global gross domestic product (GDP) by up to 7% (USD7.4 trillion), equivalent to the combined GDPs of France and Germany and more than three times the size of the entire sub-Saharan African economy (Georgieva, 2023).

A leading international relations scholar, Joseph Nye, noted of US decoupling that ‘it would be foolish to think [that] we can separate our economy completely from China without enormous costs’ (Nye, 2021). These enormous costs can be viewed as the price of fragmentation, but when the price is sufficiently high, rational agents will not undertake actions that incur those costs. Accordingly, International Monetary Fund (IMF) Managing Director Kristalina Georgieva wrote a 2023 *Foreign Affairs* article entitled, ‘The Price of Fragmentation’ (Georgieva, 2023). IMF Deputy Managing Director Gita Gopinath used the same reasoning to argue that if geopolitical-driven fragmentation produces individual gains, when set against real costs, those gains are illusory. Individual gains from fragmentation are, at best, only relative in that ‘even those who benefit from fragmentation could be left with a larger slice of a much smaller pie . . . . [E]veryone could lose’ (Gopinath, 2024).

This chapter investigates the relationship between geopolitics and economics as forces jointly driving world order. Have geopolitics and economics always driven world order in opposite directions, one splintering and the other coalescing? How accurate is the IMF (and indeed conventional) belief that geopolitical rivalries are fragmenting the world, but economics holds the global economy—and thus world order—together? This chapter argues that conventional wisdom is at odds with the global experience of the last 5 decades. The last 50 years can be divided

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into two periods: (i) the centripetal era of 1980–2010, when both geopolitics and economics drove world order to ever-greater coalescence; and (ii) centrifugal era, from 2011, when both geopolitics and economics drove world order to ever-greater fragmentation.

If the current era is indeed centrifugal and economic ties are splintering world order, then seeking to develop greater economic interconnectedness—without recalibrating underlying fundamentals—is doomed to fail. Increasing trade ties will produce only perverse results, further fracturing the world. Instead, more effective and better-targeted policies are needed. This chapter suggests drawing on mechanisms that target repairing fragmentation beyond just strengthening trade ties. Such policies are (i) seek inadvertent cooperation; (ii) identify and shelve zero-sum propositions with prisoner's dilemma or epic fail outcomes (Armstrong and Quah, 2023; Quah, 2024b); and (iii) build systems around plurilateral principles or pathfinder multilateralism, and when first-best multilateralism is unavailable, seek second-best solutions in restricted problem domains.

This chapter is organised as follows. Section 5.2 documents how convergence due to geopolitical and economic forces in the early part of the last half-century produced the centripetal era and coalesced world order. Section 5.3 describes how after the centripetal era, both geopolitical and economic forces reversed direction so that the two drove fragmentation in the international system. It also examines reasons for the parallel reversal in both geopolitical and economic forces.[1] Section 5.4 advances three proposals to mitigate further global fracture, given that trade—the large, already extant natural glue to the international system—may no longer be effective. Section 5.5 provides a brief conclusion.

5.2 Convergence

In the 1980s, conceptualisation of world order and the global economy were powered by three critical ideas—political convergence, economic efficiency, and comparative advantage. These drove the coalescence of world order in this period of the centripetal era.

Political convergence refers to the hypothesis that as incomes rise and economic development progresses, societies tend naturally to become more democratic (Lipset, 1959). This provided an easy resolution to the challenge noted by US President John F. Kennedy of the 'long twilight struggle' between democracy and freedom, and totalitarianism and tyranny.

Economic efficiency does not entail high productivity or advanced technology. Instead, it refers to an imperative to seek efficiency in the sense that economists understand, Pareto optimality. Outcomes have to be, rationally, win-win. Coupled with the idea of political convergence, every victory on economic efficiency during this time also meant a further advance in the march to democracy worldwide.

Finally, comparative advantage references another key concept in economics, that all nations—no matter how differentially resourced and under-developed—would gain in some manner from participating in the global system of trade and capital flows. Globalisation—the construct that sought to make anything produced anywhere available to everyone everywhere—was therefore the appropriate objective for the emerging international system.

These three ideas formed a self-reinforcing, globally consistent, virtuous cycle of policy and practice, driving both prosperity and democracy.[2] The system did not promise that everyone would achieve the same levels of well-being, only that the norm would be win-win outcomes and a tendency towards democracy. The imperatives of economic efficiency and comparative advantage drove more intense and widespread globalisation, so that cross-country flows of trade and foreign direct investment rose.

In retrospect, the 1980s and 1990s appear to confirm success in a coalescent international system, at least along particular dimensions. Economically, the big success was the rise of China and East Asia. These are obviously outside of the usual Transatlantic locus of economic success; that they both became richer meant there was convergence for the world. Moreover, there were significant poor parts of the world that converged upwards to become richer, and modernity arrived in these places where previously it had been absent.

However, convergence failed in several significant dimensions. For instance, many studies of cross-country income dynamics revealed persistent income disparities (e.g. Pritchett, 1997); a middle-income trap (e.g. ADB, 2011) in that poor countries remained bounded away from reaching the same levels of economic achievement as rich countries; and even twin-peakedness in the cross-country distribution of incomes (e.g. Quah, 1996, 1997), where distinct clusters of convergence emerged, with at least one grouping of countries stagnating at lower income levels.

All of these studies, however, were of per capita incomes, treating each nation as a distinct data point. This meant that China, with over 1 billion people, was treated on equal basis with, for example, Haiti, which has under 10 million people. Data at a more disaggregated level provided more insight on economic convergence. Quah (2011) calculated the world's economic centre of gravity based on urban cities and rural centres and used dynamics of that centre of gravity to map out a dramatic change in the world's economic landscape since the 1980s. The key finding was that the rapid rise of incomes outside of the Transatlantic region had, by 2008, pulled the world's economic centre of gravity 5,000 kilometres east from its traditional 20th-century resting point in the Atlantic Ocean (i.e. midway between the United States and Western Europe). Over this same period, China's economic growth lifted nearly 700 million out of extreme poverty (Chen and Ravallion, 2010). Thus, as a narrative of individual incomes and economic well-being in the 3 decades after 1980, the overarching story was, indeed, convergence.

In parallel with these technical findings, a narrative on political convergence appeared. Fukuyama (1992) reported two key conclusions: (i) a 'consensus on the legitimacy of liberal democracy as a system of government emerged throughout the world'; and (ii) market mechanisms targeting economic efficiency and leveraging comparative advantage had produced 'unprecedented levels of prosperity in developed countries and in countries that had been, at the close of World War II, part of the impoverished Third World'.

US President Bill Clinton (2000) provided one of the most vivid and memorable depictions of confidence in political convergence during this centripetal era. He spoke on how China might try to buck the trend on political convergence by seeking to contain the flow of information on the internet: 'Good luck! That's sort of like trying to nail Jell-O to the wall'. He also made clear the prevailing thinking on economic and geopolitical alignment:

> China is not simply agreeing to import more of our products. It is agreeing to import one of democracy's most cherished values, economic freedom. The more China liberalizes its economy, the more fully it will liberate the potential of its people—their initiative, their imagination, their remarkable spirit of enterprise. And when individuals have the power, not just to dream, but to realize their dreams, they will demand a greater say.
>
> (Clinton, 2000)

Alongside these global successes in world order, one nation—the United States—emerged as the key player in the international system. It had become the de facto leader in a unipolar world order. An economic historian, Charles Kindleberger, described this kind of international leadership on the basis of the hegemonic stability theory. This is the idea that the international system—like any macroeconomy—naturally undergoes bouts of instability, for which a sufficiently large agent must be the consumer and lender of last resort or, more generally, provide the global public good of international policy-making (Kindleberger, 1996, 2013). Indeed, even beyond Keynesian countercyclical stabilisation, a hegemon is needed to provide security, maintain the rules of world order, and support global institutions that monitor and correct deviations. This allows the emergence of equitable openness in international trade and gives rise to the idea of multilateralism—a rules-based order, a level playing field in economic engagement, commitment to peaceful resolution of disputes, cooperation in problem-solving, and equal treatment of nations. At the time, the United States was the only economy powerful and rich enough to provide these global public goods (Kindleberger, 2013). As some political scientists described so vividly, US unipolarity produced world order (Ikenberry, 2005).

In conclusion, the 3 decades following 1980 saw remarkable success in political convergence, economic efficiency, and comparative advantage driving a coalescent, converging world order. The centrifugal era was, overall, a success, establishing with ever-greater firmness an integrated global economy. There were, of course, notable exceptions to this view in the literature (e.g. Rodrik, 2006). It is not that geopolitics no longer mattered (e.g. Luce, 2023), but geopolitical and economic forces aligned to produce convergence in the international system.

5.3 Shifts

By the late 2010s, it had become obvious that China was demonstrating no democratic tendencies even as it modernised, grew rich, and developed advanced technologies. This was not just a data point inconsistent with an academic hypothesis (Fukuyama, 1992; Lipset, 1959). Instead, this failure of convergence grew to become a driving force in modern Great Power rivalry. Because of its sheer size, China's political non-convergence presented, in some policymakers' views, an unacceptable threat and ideological challenge to the incumbent hegemonic Great Power, the United States. The United States' policy towards China thus shifted from engagement—increasing trade and investment and people-to-people ties—to balancing or undertaking actions to protect itself against China's present and future capabilities.

Under a regime of geopolitical engagement, China's actions might have been viewed as innocent or ambiguous. However, in the new atmosphere of balancing, they elevated concerns. Such markers included China's emplacement construction and heightened territorial claims in the South China Sea, aggressive wolf warrior diplomacy, concerns over the 'two Xs' (i.e. Xinjiang Uygur Autonomous Region, representative of China's 'ethnic management' policies, and President Xi Jinping for his centralisation of political power, including Xi's assumed association with Document No. 9, which warned of seven 'dangerous' Western values [Buckley, 2013]), restrictions on information flow during the COVID-19 pandemic, and China's dramatically rising military power. Obviously, comparable actions are seen elsewhere—including in the United States itself—but in China's case, these attracted elevated scrutiny because they appeared to represent a change in China's geopolitical stance. Taken with the fear that China's stubborn political non-convergence represented a statement of international intent, these markers reinforced the new vicious cycle of suspicion of China.[3]

By 2018, the US position on China had concretised into policy statements such as those by the US Secretary of Defense James Mattis, who stated, 'Great Power competition, not terrorism, is now the primary focus of US national security' (DOD, 2018). On China, he stated that the United States and the West

> face growing threats from revisionist powers . . . that . . . seek to create a world consistent with their authoritarian models, pursuing veto authority over other nations' economic, diplomacy, and security decisions . . . . [China persists] in taking outlaw actions that threaten regional and even global stability. Oppressing their own people and shredding their own people's dignity and human rights, they push their warped views outward.
>
> (DOD, 2018)

Such views are much more jarring in comparison to Clinton's 2000 'Jell-O to the wall' understanding of the disruptive or commanding power of states such as China. These views also stand in stark contrast to earlier positions held by US leadership in the centripetal era and earlier, which strove to bring China into the international system. US President Richard M. Nixon, for instance, wrote in 1967 that the United States

> cannot afford to leave China forever outside the family of nations, there to nurture its fantasies, cherish its hates and threaten its neighbors . . . . [t]here

> is no place on this small planet for a billion of its potentially most able people to live in angry isolation.
>
> (Nixon, 1967)

Circumstances had thus reversed the train of argument in political convergence, and geopolitics had turned into a force for fragmentation rather than coalescence.

All nations are, of course, increasingly empowered by technology to be able to undertake 'outlaw actions that threaten regional and even global instability' (DOD, 2018). Yet what are the incentives of different nations to do so? When Nixon wrote the passage cited, China was indeed a dangerous country. The nation was in the throes of the Cultural Revolution that caused over 1 million deaths and the arbitrary persecution of millions; it was feared to be actively exporting a Communist revolution around the globe. Today's China does none of these things; it is known for bringing 700 million out of poverty and helping the world reach Sustainable Development Goals. China's most notable exports are still feared—but for their competitiveness and economic impact on other nation's industries, not for their incompatible ideology.

In this reversal from coalescence to fragmentation, China's role is not just a counterexample to political convergence. China has also become the source—for the United States and other Western economies—of 'China shock', or the idea that one's trading partner is stealing one's jobs, dismantling one's industry, and turning one's thriving middle-class communities into ghost towns. How can trade do all this when it is supposed to bring mutual benefits?

In the IMF view described previously, economic efficiency and comparative advantage give rise to outcomes that benefit all sides. This happens at the level of aggregate well-being; thus, they remain forces for coalescence through the perspective of international policy-making. The costs of decoupling are high. However, at the level of individual agents in the United States or other developed countries, the lived experience from trade differs from the positive effects at the aggregate level. Trade does not bring economic efficiency nor the welfare impact of comparative advantage; instead, it shifts price ratios. When trade occurs, relative prices change—otherwise, trade would have no effect. Yet any change in relative prices means some agent somewhere experiences reduced prices for what they produce and sell (Quah, 2024a). For affected individuals, this translates into perceptions of China shock—falling employment, shuttered industries, and displaced communities.

It is this price disturbance that matters—not the aggregate welfare improvement, income inequality, or aggregate bilateral trade deficits.[4] The relevant negative price shock can affect those at the top of income distribution as easily as it can those at the bottom. Thus, an effect on income inequality is neither necessary nor sufficient for political resistance to trade. Even if inequality falls, those at the top of income distribution can find cause to rally against trade. By the same reasoning, a negative price shock from trade can worsen the well-being of those affected, whether the trade balance is in surplus or deficit or a trade deficit is large or small. Such a price shock is, of course, not inconsistent with standard concerns over inequality and trade deficits, but it can take effect regardless of what happens to inequality and trade deficits. Neither inequality nor the trade deficit are sufficient statistics for understanding the impact of trade.

Research on prices and the political consequences of trade is not as widely available as that on inequality or trade balances. Figure 5.1 shows the dynamics of US import prices; imports from China, Mexico, and Canada; and the US Consumer Price Index.[5]

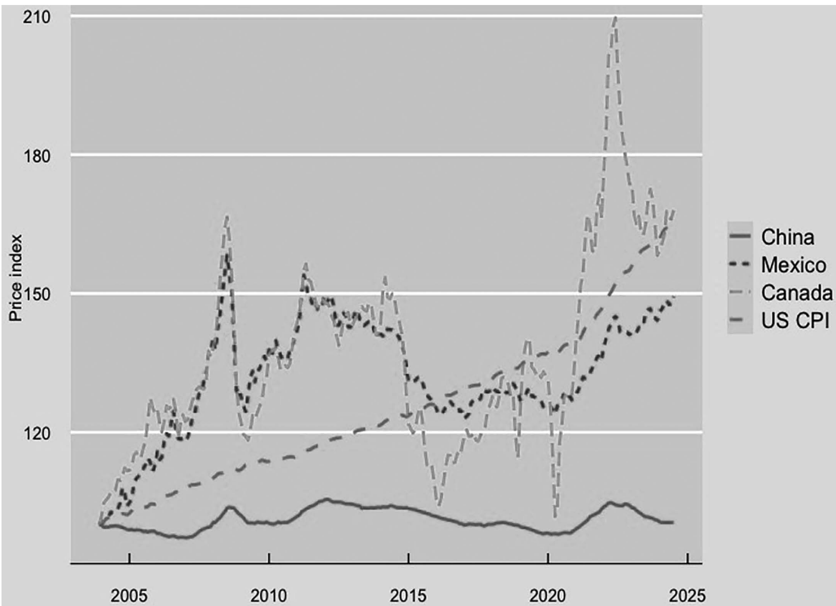

Figure 5.1 United States Import and Domestic Prices, 2003–2024

US CPI = United States Consumer Price Index.

Note: The graph shows, from 2003 to 2024, prices of imports into the United States from China, Mexico, and Canada, alongside the US CPI. In the 2 decades plotted, China's import prices into the United States have remained flat, only 0.5% higher at the end than at the beginning. In contrast, imports from Canada have seen price inflation higher even than in the US Consumer Price Index, ending the 2-decade period with prices 68% higher than at the beginning. Imports from Mexico, similarly but not as extreme, had prices ending 49% higher than at the start. The US CPI inflated 65% over this sample.

Source: United States Census Bureau, International Trade Data, https://www.census.gov/foreign-trade/data/index.html.

A first observation is that import prices do not uniformly remain low. In the figure, in the normalisation adopted, all price indexes begin at 100 in 2003. Both Mexico and Canada import prices show inflation rates higher than that in the US Consumer Price Index. This is not unexpected or unusual; compositions of import bundles change, and when those bundles shift into containing higher-technology products, import price inflation can be high. Indeed, over the entire time sample, import prices from Mexico and Canada have, separately, shown both acceleration and slowdown in cycles over time.

The most striking observation, however, is that concerning imports from China. China's move from low-tech to high-tech exports barely moved how much the United States had to pay for imports from China generally. Price inflation in China imports has been zero over the entire 2 decades in contrast to that in the US Consumer Price Index of 65%, Canada import prices of 68%, and Mexico import prices of 49%. China imports into the United States have remained dramatically cheap, although by 2024, almost half of that flow had become machinery and mechanical appliances, no longer low-quality toys and textiles. Keeping import prices low in this way is remarkable for the compositional change that must have occurred in this time. Towards the beginning of this time period, the view on China's production had been that with a per capita income at the same level as Guyana and the Philippines; most of the Chinese population did not have enough money to buy advanced technological products or have the resources to invent them (Allison et al., 2021).

Two concrete implications are notable. First, China's exports to the United States have strongly benefited US consumers, keeping prices low and the cost of living down. Second, however, by exactly the same observation, the China shock is significant for US workers in the same industries. These price dynamics are why those workers see jobs vanishing, industries being dismantled, and ghost towns emerging where middle-class communities once thrived.

The broader geo-economics dimension, too, turned in the late 2010s. The earlier themes of economic efficiency and comparative advantage were ones where every participant could find agreement with the outcome, as the exchange gave advantages to everyone (i.e. win-win). In the late 2010s, China grew rich; other countries did as well, spreading economic prosperity and thus increasing agency and capability to more parts of the world. The world thus became more multipolar, moving away from US unipolarity. This did not mean other parts of the world were growing to become direct rivals of the global hegemon; a decline in unipolarity does not mean automatically a rise in bipolarity. It meant that the distribution of power across the global landscape had become more diffuse. This growing multi-polarity—a shift in the distribution of economic and military capabilities towards a more uniform distribution rather than remaining single-peaked in only the United States—is, of course, another way to characterise economic convergence. There is lessening prominence of poles in the distribution of power.

Multilateralism—the idea that there is a level playing field and that all players obey the same set of rules—emerged from the principles of economic efficiency and comparative advantage. Multilateralism has allowed economic convergence to occur from the early 2010s and produce multi-polarity. Paradoxically, this combination of multilateralism and multi-polarity has generated a pull-back from further coalescence, however. Increasing multi-polarity means that the benefits advanced economies derive from supporting global public goods, such as international trade, are shared more with other countries (Gaspar, Hagan, Obstfeld, 2018). Turning away from continuing to support the provision of global public goods, like the international trading system, denotes a retreat from the globalisation and multilateralism that had been so powerful for coalescing the global economy. Maintaining multilateralism is difficult and especially challenging when others start to win as well.

5.4 Proposals

With both geopolitics and economics now centrifugal, the global challenge is no longer choosing the incorrect point on a trade-off locus. Instead, the danger is that nations end up in a prisoner's dilemma or epic fail gridlock. Armstrong and Quah (2023) and Quah (2024b) suggested that in such a situation, there are three policy options.

First, look for inadvertent cooperation. Obviously, in a prisoner's dilemma outcome, if all players decide to collaborate, equilibrium could shift to an outcome where all improve their well-being. A fragmented world order, however, is unlikely to be one where contractual obligations are trusted. The international community should thus seek cooperation without binding contracts; economists are familiar with such arrangements. Adam Smith characterised that 'it is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest'. An example of such unplanned cooperation occurred the 2020s in the South China Sea, where individual nations have overlapping territorial claims. Instead of giving in to an all-out rivalry, South-East Asian nations have been able to agree on a code of conduct for that body of water and continue to seek China's participation in that agreement.

Second is the possibility of navigating a fractured international system by looking to Third Nations—those that are not Great Powers in direct contention—to nudge Great Powers out of prisoner's dilemmas (Quah, 2024b). Through small side payments—that, in the cooperative outcome, may not be needed but whose availability is guaranteed—gridlock can be averted, and the usual prisoner's dilemma outcome removed as a possible equilibrium.

Third are options that recognise how a fragmented global economy makes it impossible to have universal multilateral solutions. Yet the spirit of multilateral problem-solving can be maintained in smaller subsets of the international community for restricted problem domains. These solutions can be thought of as providing pathfinder, plurilateral outcomes in the absence of full and complete multilateralism. An example of this is the World Trade Organization's Multi-Party Interim Appeal Arbitration Agreement (MPIA). In March 2020, with the World Trade Organization Appellate Body understaffed and non-functioning, 16 WTO members set up the MPIA to decide on cases between members of the group itself.

5.5 Conclusion

When observers and policymakers acknowledge the risks of a fractured global economy and world order, it is often assumed that geopolitics is to blame. The typical accompanying hypothesis is that economics can hold world order together. IMF and many others believe in the view that economic exchange across nations makes mutual benefits to trade apparent and notes the tremendous costs of economic decoupling and deglobalisation.

This chapter has argued that large geopolitical and economic forces do, indeed, drive world order. However, their direction does not support the hypothesis that economics can provide a centripetal force for the international system. Between 1980 and 2010, both geopolitical and economic forces powered the coalescing of world order. However, after 2010, both forces reversed direction and contributed, instead, to the current fragmentation of the international system.

That economics can be a centrifugal force hinges on effects similar to two familiar ideas: (i) trade increases inequality and (ii) trade deficits attract political objections. In the United States and the developed West, such effects are commonly thought of as the China Shock, as China is a large trading economy that attracts the greatest political attention. The China Shock mechanism proposed in this chapter is centred on price change and is thus simpler and more direct than in narratives of inequality or trade deficits.

That economics no longer holds the global economy together means that fragmentation risks to the global economy cannot be mitigated by recalibrating trade patterns. The problem instead rests on how trade itself is perceived to be the problem. Three recommendations would help mitigate these problems of geopolitical and economic fracture: (i) inadvertent cooperation, (ii) Third Nations nudging the Great Powers away from gridlock, and (iii) pathfinder or plurilateral adjustments to multilateralism.

Notes

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1 World order—the international economic system, together with the norms and conventions determining relations across nations—is a point in a high-dimensional topological space. Over time, world order evolves as a function of its past values with a vector of driving variables, including geopolitical and economic forces. The latter may be exogenous or causally prior with respect to world order or, more typically, be jointly determined (i.e., world order with geopolitical and economic forces can be viewed as a vector autoregression in an appropriately defined topological space). This chapter describes the features of the propagation mechanism and impulses determining that vector autoregression, and hence the dynamics of world order.

2 Popular writing in the 1990s sometimes associated variants of this thinking with neoliberalism, the Washington Consensus, and other labels. Many of the central ideas in those, however, vary from those in the current chapter. This chapter considers outcomes but does not comment on the pathways to achieve those goals. There is, for instance, no suggestion in this chapter that free markets and fiscal discipline—key components of neoliberalism—are the only means to achieve efficiency and to leverage comparative advantage. Nor does it suggest that increasing democracy is a precondition needed to guarantee economic success. The Washington Consensus was not a plank for building world order; instead, it sought to provide concrete policy proposals for specific problems facing, mainly, Latin American economies. More detailed analyses are available that unpack the differences across neoliberalism, the Washington Consensus, and other similar labels, such as Naim (1999), Rodrik (2006), Spence (2021), and Williamson (2002).

3 An illustration of both the ambiguity and extreme risk lies in China's August 2021 demonstration of its Fractional Orbital Bombardment System (FOBS) capabilities. FOBS, initially developed by the Soviet Union in the 1960s, refers to the launch of a nuclear warhead off of a hypersonic glide vehicle in low earth orbit. China's approach to FOBS sacrifices accuracy for range, speed, and undetectability; this renders FOBS less suited

for first-strike actions but improves its second-strike retaliatory capability (Kaushal and Cranny-Evans, 2021). Indeed, China's own public announcements confirm this general perception of retaliation, in that FOBS allows 'using nuclear forces [so] US forces cannot crush China' and that 'when the Chinese people have this weapon . . . , nuclear blackmail toward the people of the world will be completely destroyed' (Fravel, 2019). China may be responding endogenously to US action and seeking only to achieve equilibrium, or China may be actively seeking primacy in a way that needs to be countered. The centrifugal era favours the second view.

4 This corresponds to Adão et al. (2022); Autor, Dorn, Hanson (2013); and others. However, it also emphasises price effects directly rather than the impact of trade working through inequality or aggregate trade balances.

5 United States Census Bureau. "International Trade Data." https://www.census.gov/foreign-trade/data/index.html. Import prices are monthly import price indexes by origin, all industries, for China, Mexico, and Canada, respectively, while the US Consumer Price Index is for all items less food and energy taken as the US city average for all urban consumers. The series are normalised to all begin at 100 in December 2003, the earliest date for which China and Mexico data are available.

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