

Economics Cannot Be Relied On To Bring About Peace. Look Instead To The Incentives Driving Small States

by
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Summary: This essay argues that economics cannot be relied on to make for peace between nations. However, understanding those limitations can help nations strategically and peacefully navigate today's increasingly ruptured geopolitical landscape. Because it is incentive, rather than power, that will be pivotal, it will be smaller states, not Great Powers, that will be best placed to advance the case against further global fracture and to strengthen the forces that can keep our world at peace.

For decades, a reassuring belief has shaped international politics: economic interdependence makes war costly. When capital flows freely and supply chains crisscross borders, nations should reject conflict because disruption would damage themselves and others.

The logic is elegant but fails to be uniformly supported by evidence.

Economic integration has not dissolved geopolitical rivalry. Instead, in significant instances, rivalry has intensified with integration. America's experience of the "China Shock" well illustrates this. US trade with China generated enormous aggregate benefits to the US. But it also displaced American workers, hollowed out US industries, and deepened resentment in American communities sidelined by globalization. Comparative advantage raised overall well-being but concentrated loss in specific parts of the population. Concentrated loss became sharp political anger.

That anger has reshaped politics not just in the US but across many advanced economies. Populist movements have turned economic grievance into nationalism, protectionism, and hostility toward foreign competitors. The result has been not simply domestic polarization but international rupture—led by the world hegemon.

The United States, long the architect of the rules-based open global economy, is now actively dismantling the world order it built. The hegemon that warned the world against the rising revisionism from bad-actor states has turned

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revisionist itself. Tariffs, sanctions, industrial policy, and technology restrictions have become central instruments of US international strategy. If the China Shock was an inadvertent supply-side disruption, today's "US Shock" is a deliberate geopolitical demand shock. As Adam Posen noted, the United States has transmogrified from global insurer to profit extractor.

The consequences are profound. The rules-based order the US built after 1945 rested on three principles: economic competition on a level playing field, peaceful dispute resolution, and cooperation on common challenges. None was ever perfectly upheld. Great Powers regularly bent the rules they claimed to defend. But, in the main, the system nonetheless integrated the world economy and dampened great-power conflict.

Thus, today, geopolitics and economics no longer jointly drive greater integration. They are working together to pull the world apart.

Yet this fracture reveals an overlooked strategic reality: the decisive variable is not power alone but incentives.

Great Powers, because of their sheer size, can imagine going it alone. They can absorb higher costs, coerce others, and reshape institutions to suit their interests. Their incentive to preserve an open multilateral system has weakened.

For small states, however, the opposite is true.

Small states are the ones most exposed when rules collapse, the ones most vulnerable when coercion replaces diplomacy, and the ones least able to bear the costs of disruption. A world governed by raw power rather than stable rules is not merely awkward for small states; it is an existential challenge. Small state vulnerability creates a powerful incentive to preserve cooperation, resist further fracture, and restore sufficient multilateralism to sustain peace.

Importantly, "small" here does not refer to territory or population. In economics, a firm is small not because of an arbitrary size threshold but when it chooses to be a price-taker. A firm is not small if, instead, it behaves in a manner that reshapes the entire market. Likewise, in international politics, a state is small when it cannot unilaterally determine the terms of engagement.

To be effective, therefore, small states need to deploy a different strategic logic. Small states cannot rely on domination or coercion. Nor do they benefit from confrontation with great powers. Their strengths lie elsewhere: small states can exercise agency and influence through working with institutions, organising coalitions, and aligning on incentives. Under the right circumstances, small states can confer legitimacy and make multilateral an action that might otherwise come across as just great power unilateralism.

For small states to advance their well-being and, in the process, strengthen conditions for world peace, three priorities matter.

First, small states should abandon nostalgia for the postwar order without compromising its core principles. The goal is not to restore an idealized past.

It is to preserve enough multilateralism to allow international engagement and security. The relevant question is not whether the world can still be a full Liberal International Order. It is whether world order can remain multilateral-enough.

Such a project does not require universal consensus. Smaller states should move incrementally, beginning with organising practical cooperation among countries that share an interest in keeping markets open, reducing coercion, and maintaining predictable rules. Today more than 70

Second, small states should resist reducing every geopolitical fracture to U.S.-China rivalry or a new Cold War. Framing current events as a single-dimensional struggle between democracy and autocracy, say, obscures more than it clarifies. In the Cold War, citizens on both sides understood how victory by the opposing bloc would fundamentally transform their societies. Today's geostrategic rivalry carries no such ideological divide. In the language of economics, there are no separating hyperplanes. The binary rhetoric persists, but mostly among narrow, if high-profile, political elites and strategic commentators.

More helpful is to acknowledge that the world faces a confluence of shocks: the China Shock, the US Shock, and the Multilateralism Shock—the broader erosion of multilateralism as economic statecraft increasingly weaponizes economic interdependencies. Recognizing this complexity creates strategic space. Smaller states need not define themselves through alignment with one camp or another. They can focus instead on the deeper threat: the erosion of rules and diplomacy, and the collapse of cooperative norms.

Third, small states should build coalitions that are incentive-compatible rather than universalist. Simply as a matter of logic, durable cooperation does not require sweeping treaties or grand institutional redesigns. Those might be sufficient but they are not necessary. Flexible and overlapping arrangements are often more resilient than formal structures that great powers abandon once interests diverge. When the WTO Appellate Body became inquorate and thus non-functioning with the US blocking appointments, a subset of WTO members created the Multi-Party Interim Appeal Arbitration Arrangement (MPIA) as an alternative mechanism for dispute settlement. Provided they agreed to follow MPIA rules, others were welcomed to join but under no compulsion to do so. In five years, MPIA membership more than tripled.

In many cases, inadvertent cooperation matters more than formal agreement. States often move in parallel not because they share values or sign binding contracts, but because their incentives align. In today's increasingly fragmented "G-minus" world, small states will need strategies of selective alignment, calibrated acquiescence, and adaptation and mitigation. Recognising that the perfect should not be the enemy of the good, the objective is not to eliminate rivalry. It is just to build incentive-compatible coalitions of the willing.

The decades after 1945 were historically unusual. For a time, economic inte-

gration and geopolitical strategy appeared mutually reinforcing. That convergence has ended. The same economic interdependence once expected to guarantee peace now fuels resentment, coercion, and rivalry among major powers.

But incentives have not disappeared. They have shifted location.

Today, it is small states, not Great Powers, that have the strongest incentive to defend cooperation, constrain predation, and preserve peace. Small states cannot dictate outcomes. But they can alter the odds. In today's increasingly fractured international system, incentives—not power—and small states—not Great Powers—represent the best available bet for keeping the world at peace.

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