Southeast Asia's crossfire shock: From multilateralism to strategic interdependence

*The region, a major beneficiary of the rules-based system, has a strong incentive to repair it*

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Asia's economic progress since the end of the Cold War has been nothing short of breathtaking. In little more than a generation, Asia's per capita GDP grew more than five-fold, its total GDP eight times. Extreme poverty—the fraction of the population living on less than one international dollar a day—fell from more than half to one-sixteenth. Life expectancy at birth rose a full decade. Adult literacy increased by 20 percentage points.

Such accomplishments have extended across diverse economies and populations, from giants like China and India to city-states like Singapore. The common denominator has been gainful engagement with a postwar rules-based multilateral world order that increased trade and openness and integrated the global economy.

And while Asia as a whole has prospered, Southeast Asia—11 countries with a combined population of more than 700 million—has benefited the most from the rules-based order. Without such a system, the region's relatively small and economically isolated economies might have suffered the consequences of having larger, more powerful neighbors. Now, as rules-based multilateralism gives way to geoeconomics and strategic interdependence, Southeast Asia will be hard hit. But that also means the region has a strong incentive to find ways to deal with the fracturing of the global economy.

Nevertheless, a return to the old, rules-based multilateral order is improbable. Southeast Asian states don't have the economic or strategic heft to force change unilaterally, while larger, more powerful stakeholders no longer see obvious benefit in an order that, paradoxically, they had themselves built. An alternative approach, more likely to succeed, is to seek a system that is "multilateral enough." What does this mean, and how might such a system work for Southeast Asia?

## Southeast Asia's success

To answer that question, we must first look at how the rules-based multilateral order and its accompanying globalization have fueled the region's success. Three features of the system have been pivotal: a level playing field, a commitment to peaceful dispute resolution, and a norm of cooperation in the face of shared challenges. These features have allowed Southeast

Asian nations to overcome their inherent disadvantages: small domestic markets, capable but not obviously superior militaries, and lack of advanced technology.

A level playing field flattens the distribution of geopolitical power: since everyone is treated equally, scarce resources need not be expended on inefficient and costly displays of power. Peaceful dispute resolution elevates the significance of genuinely substantive issues over zero-sum exercises of might and aggression. Collaboration to address shared challenges makes the system more efficient and avoids unnecessary duplication as each state contributes what it does best.

In different external political and economic circumstances, Southeast Asia could easily have been left geopolitically vulnerable, isolated from technological advancements, and unable to draw on economies of scale. Instead, world markets were receptive to supply by small economies that were export-oriented and manufacturing-focused and with established supply capacity and transportation infrastructure that could rapidly expand. "Factory Asia" emerged from Southeast Asia, together with Japan and Korea, and from the late 1990s onward, China.

International accords were critical to this process. In 1996, the Information Technology Agreement mediated by the World Trade Organization (WTO) eliminated tariffs on IT components and products. This allowed Indonesia, Malaysia, the Philippines, Singapore, and Thailand to emerge as the world's manufacturing and assembly hub for mass-produced semiconductors, hard drives, and consumer electronics. Starting in 2005, after a 10-year phaseout of advanced-economy protectionist import quotas on textiles and apparel, Cambodia, Vietnam, and Indonesia attracted considerable FDI inflow for those industries. Meanwhile, Cambodia, Laos, and Vietnam leveraged their accession to the WTO to develop credible commitment mechanisms for domestic reform and thereby attract more foreign investment.

By embracing open regionalism—the idea that regional trade deals can be building blocks, rather than barriers, to global integration—Southeast Asia acknowledged the advantages of deep engagement with the international system. Today, trade among the 11 members of the Association of Southeast Asian Nations (ASEAN), who form an integrated economic community, amounts to only 25 percent of their combined GDP, while trade with the rest of the world fluctuates between 80 and 90 percent. By contrast, trade among EU members exceeds 60 percent of the bloc's GDP, more than its external trade of 40 percent.

All these achievements are now at risk as the international system shifts toward strategic interdependence and geoeconomics, where economic tools serve geopolitical goals. Three cascading shocks have driven the change.

## The China shock

China's 2001 entry into the WTO exposed the US market to a surge of inexpensive manufactured imports. In the decades that followed, prices of goods imported from China remained low even as quality rose. American consumers and downstream businesses benefited, but competitor firms struggled. Factory closures and job losses, with no clear route to relocate resources, devastated middle-class communities in America. The China shock is now felt and discussed elsewhere as well.

It is important to note that the China shock is consistent with the principle of comparative advantage. The China shock speaks to the distribution of gains within an importing nation. Comparative advantage describes how trade delivers net aggregate gains to all trading nations but is silent on the distribution of gains and losses within those economies.

This characterization of the China Shock is, moreover, agnostic about trade balances. Even regions or countries running a bilateral surplus with China can experience it. What matters is the variation in relative price brought about by trade, not whether the trade balance is in surplus or deficit. Every change in relative price due to trade must disadvantage some production factor somewhere in the importing economy. The resulting economic pain fuels calls for policies that lash out against not just China but the international economic system generally.

From the perspective of the country experiencing it, the China Shock is a supply shock. At any given price, imports from China increase in quantity and quality, i.e., the supply curve shifts out. Instead of lashing out against that supply shock—with tariffs, import quotas, and geostrategic actions—a better remedy is to provide support for workers and communities hurt by it. In other words, redistribute from those in the importing economy who have gained toward those who have lost. However, in many nations, that is political infeasible.

## The US shock

The US shock, in contrast to the China shock, is a demand shock. It refers to the raft of tariffs, sanctions, export restrictions, and investment controls directed not at a single adversary but against all other economies. To take one example, Vietnam, which had been sending a third of its goods exports to the US, was initially hit with a 46 percent tariff (later changed to a baseline of 20 percent, with 40 percent charged for some products). Even Singapore and South Korea, who had free trade agreements with the US, suffered tariff actions, with Singapore's bilateral trade deficit against the US providing no apparent relief.

The US shock should be viewed as broader than just the act of a single administration. Indeed, most recently, US trade policies have notably shifted from interruptions to trade being justified

as temporary, in pursuit of a larger objective such as national development or alliance management, to where trade itself is suspect.

The China shock has not been America's only grievance against China. The world's second-largest economy is seen as following the letter of WTO rules while violating their spirit. For instance, in 2012-2014 China first claimed environmental exemption for its rare-earth export restrictions but eventually accepted the WTO ruling that those restrictions reserved resources for China's downstream industries, unfairly disadvantaging foreign competition.

The deeper charge is that China has done more than simply avoid the strictures of multilateral rules. Instead, it has used its status as an emerging economy to exploit gaps and ambiguities in WTO regulations. Thus, concerns about its export prowess have transmogrified into a suspicion that China, instead of viewing the rules-based system as an incentive-compatible mechanism, practices what might be called *rules-compatible mercantilism*.

## The Multilateralism shock

The multilateralism shock is a system-wide shock. As the US began to repudiate the multilateral order, other advanced nations saw a playing field that was no longer level and began to wield industrial policies to recover their positions. With a geo-economic mindset settling into national policymaking, what had been gainful economic interdependence turned into threat-laden strategic leverage, with trade morphing from competition over productivity into contestation over chokepoints and the balance of payments. National policies came to be more self-seeking than adapted to rules-based multilateralism.

As a result, for many, rules-based multilateralism came to be viewed as a costly global public good, whose benefits accrued more to other countries than one's own. The US and other developed economies, who initially enjoyed disproportionate shares of growth in economic prosperity, began to see the cost-benefit ratio becoming less favorable (Gaspar, Hagan, and Obstfeld, 2018; Quah, 2026). With benefits falling further and further below costs, it was natural for significant parts of the world to retreat from full support for the system.

As each country seeks to gain an edge over its rivals, the collective effect is a breakdown of multilateral order, which is detrimental to all. Even if more than 70 percent of cross-border trade still follows WTO rules, disruptions to trade by individual nations have risen more than threefold since 2019 (Georgieva, 2023). Thus the multilateralism shock bears the features of the classic prisoner's dilemma or, as Armstrong and Quah (2026) call it, an Epic Fail outcome.

## Building a multilateral-enough system

The disruption of rules-based multilateralism represents a profound threat to Southeast Asia's continued development. How can the core functions of the system be rebuilt by non-hegemonic, if strongly incentivized, states? The answer lies in what the IMF and others have called flexible multilateralism: like-minded states coming together to form a coalition in pursuit of a specific goal, even in the absence of universal consensus.

To succeed, any such coalition must be built around the same three principles that we initially identified as the bedrock of the old international system: a level playing field, peaceful dispute resolution, and a norm of cooperation when faced with shared challenges. These conditions make a coalition *multilateral enough*; outside of the coalition, the larger environment can be left loosely organized.

In other words, the collection of all nations, however coalitions form out of its subsets, is a flexible topology. Groupings can come together to seek treaties and explicit agreements, but no one is forced to do so. A coalition of states with aligned incentives, so that inadvertent cooperation emerges, is better than one holding on vainly to a binding contract. But, in the analysis here, either pathway works, as long as the coalition that emerges can view itself as multilateral-enough.

ASEAN is one such coalition. Not a full multilateral system, it is focused on specific challenges of concern to its members. But it has also nonetheless been open to new members (indeed, it recently accepted Timor-Leste as newest member). Two other multilateral-enough coalitions are the Regional Comprehensive Economic Partnership, which includes ASEAN plus China, Japan, and South Korea; and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, a more eclectic group that recently added the UK.

Flexible, multilateral-enough coalitions can extend beyond a region or geography. An informative example is the WTO's Multiparty Interim Appeal Arbitration Agreement. Set up in 2020 to settle trade disputes after the Appellate Body ceased to function, it began with 16 members and has grown to more than 30 across six continents.

## Core principles

These examples illustrate how, even as global consensus is no longer available, Southeast Asia can continue to deploy, and provide new applications for, the principles of a multilateral-enough, flexible topology to advance the best of cooperation and multilateralism. International institutions such as IMF can play critical, independent roles in keeping open and inclusive the new flexible topologies that emerge. The world does not have to ossify into competing spheres of influence but can be flexibly multilateral.

In the last half-century, Southeast Asia reaped significant gains from the rules-based, multilateral world order: faster growth, more jobs, improved well-being. In return, "Factory Asia" provided affordable, mass-produced electronic goods and textiles to the rest of the world.

But today, the world order is shifting toward geoeconomics and strategic interdependence. The China, US, and Multilateralism shocks are planet-sized trends not likely to be undone by a single US election or other personality-based changes in international leadership and policymaking. Even so, the core principles of the multilateral system can be preserved in a flexible topology that relies on alignment of incentives rather than rigid rules.

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