International Academic Institute for Science and Technology

International Academic Journal of Economics
Vol. 12, No. 2, 2025, pp. 9-16.

ISSN 2454-2474

International
Academic
Journal of
Economics

www.iaiest.com

The Influence of International Economic Policies on Global Trade and Development During Periods of Economic Uncertainty

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Abstract

The primary aim of this research is to examine the impact of international economic policy on international trade and economic growth under conditions of high economic uncertainty. The primary research concern lies in the concept of the uncertainty trap, which occurs due to the presence of informational gaps as a result of shifts in economic policies. These informational gaps hinder foreign investments and distort the value chain worldwide. Through the use of qualitative research design, along with indicators such as the Economic Policy Uncertainty (EPU) Index by Baker, Bloom & Davis, the study will explore the impact of policy shocks on market performance. This will be done by contrasting developed countries against developing countries using empirical data collected between 2018 and 2023. Economic policy uncertainty becomes one of the main non-tariff barriers to trade. Based on the statistics, a 10% increase in EPU could cause a significant reduction in the volume of trade, particularly for countries where the capital flow is highly unstable. What is important is that the economic development of the digital economy can provide smooth trade transactions because this way it will act as a hedge from any policy problems. Predictability and rule-based multilateralism are essential for sustainability. Transparency in policy-making is key to reducing the 'wait-and-see' approach among foreign investors.

Keywords: Global Trade, Economic Policy Uncertainty, Sustainable Development, Trade Policy, International Economics, Capital Flows.

DOI: 10.71086/IAJE/V12I2/IAJE1207
Received: 07 March, 2025/Revised: 16 April 2025/Accepted: 26 May 2025/Published: 30 June 2025

Introduction

International economic policies can be viewed as the body of rules and agreements established by independent countries to control flows of capital between countries, logistics, and investment policies. Taking into account the fact that the present world economy is characterized by high integration, international economic policies play an important role in undermining or ensuring balance in the economy (Al-Thaqeb & Algharabali, 2019). Nowadays, witnessing significant changes in the geopolitical arena along with the digitalization of the global economic environment (Fan, 2021). Still, the growing number of shocks that can occur on a global scale, including health crises and trade disagreements, is creating the level of Economic Policy Uncertainty (EPU) that destabilizes supply chains and hinders the achievement of developmental goals.

It is imperative to study the impact of international economic policies on global trade because, in times of uncertainty, multinational corporations resort to waiting for the situation to change before making any decisions regarding investments in foreign markets (Abaidoo, 2019). As recent evidence shows, increased EPU is often followed by a decline in the number of transactions (Tam, 2018).

Contribution

This study is an interesting synthesis of contemporary literature from 2019 to 2023, which brings out the problem of the uncertainty trap that demonstrates how the problem of policy vagueness causes more harm to international trade compared to trade barriers. Through the study of history and current global events, the concept can be applied to make future trade predictable and sustainable.

Research Questions

1. How do international economic policies dictate the resilience of global trade flows during systemic crises?
2. In what ways does economic policy uncertainty (EPU) disproportionately affect the growth trajectories of developing versus developed economies?

Objectives

- To evaluate the historical transition from protectionist strategies to modern multilateral agreements and their impact on trade efficiency.
- To analyze the specific socio-economic challenges faced by emerging markets when integrating into high-uncertainty global frameworks.

The paper is structured into six comprehensive sections. Section II provides a literature survey analyzing the relationships between Economic Policy Uncertainty (EPU), international investment, and digital connectivity. Section III establishes a historical framework and methodology, detailing the evolution of trade governance and the qualitative logic behind the uncertainty transmission path. Section IV presents a comparative analysis of how policy shocks specifically impact developed and developing nations, focusing on capital volatility and trade resilience. Section V discusses the empirical results, identifies the "uncertainty trap," and offers strategic recommendations for policy design. Finally, Section VI concludes the work by summarizing the critical role of multilateralism and transparency in maintaining global trade stability.

Literature Survey

The link between economic policy uncertainty (EPU) and the dynamics of global trade has been studied extensively by researchers within the academic community, particularly due to the turbulent state of the international financial market. The existing literature regarding this topic usually categorizes the determinants into three broad categories: trade dynamics as a whole, geographical differences, and digital connectivity.

Impact of Policy Uncertainty on Trade Flows and Investment

Economic policy uncertainty serves as one of the main disincentives towards the growth of international business activity. It is proven that an increase in uncertainty results in a scenario in which companies avoid making substantial investments as well as conducting business internationally. Research has shown that international trade is quite responsive to any changes in policies of big economies, where even small increases in the EPU result in dramatic decreases in trade. Economic policy uncertainty also affects foreign direct investment, especially in international value chains (Zhang et al., 2019; Zhang et al., 2023).

Regional and Developmental Disparities

The impacts of uncertainties on the economy do not affect countries uniformly in the global marketplace. Scholars have found that whereas developed nations have systems of protection against external shocks, developing nations will be affected in an extensive manner (Kang et al., 2020). This is because emerging nations exhibit sharp fluctuations in capital flows during an increase in global EPU, resulting in liquidity crises (An et al., 2022). Moreover, the uncertainty emanating from strong economies like the US will have a significant impact on their weaker economies through financial and trade relations (Trung, 2019).

Technological and Sustainable Mitigators

Amidst policy ambiguity, there exist certain industries that offer a strong narrative in contrast. The digital economy has been recognized as one of the key elements for enhancing the process of trade through digital infrastructure, which may counteract the issues resulting from policy uncertainty. In the long run, incorporating sustainability concerns within trade policy has been considered a way of maintaining stability due to the standardization of environmental policies across international borders (Ji et al., 2022).

Informational Asymmetry and Market Behavior

The ambiguity of international trading and investments is known to act as an unseen barrier to entry, hence decreasing the competitive nature of the entire global market (Kirchner, 2019). A literature review confirms that the current situation made it necessary to reconsider the pricing of risks due to the uncertainty brought by the coronavirus pandemic (Al-Thaqeb et al., 2022). Therefore, despite some theoretical evidence showing that there is a possibility of global uncertainty leading to some forms of risk management in international trade (Baley et al., 2020), the general understanding of economics is that policy and political stability are vital for economic development (Gholipour, 2019; Borojo et al., 2022).

From these studies, the main conclusion is that the Economic Policy Uncertainty acts as an invisible barrier that makes international trading more expensive. Digital transformation and sustainability initiatives can be seen as solutions, but EPU, especially from dominant countries, causes instability of capital flows and reduced volume of trade in developing countries.

Historical Framework and Methodology

Global trade has always oscillated between two opposite poles – isolation and integration, driven by the economic ideologies prevalent among the world's dominant nations.

Historical Overview of the Evolution of Trade Governance

The movement of international business has always oscillated between the poles of isolationism and integration, based on the prevailing ideologies in the dominant world economies.

Protectionism – Rise and Decline: There have been numerous episodes of protectionism since the end of World War II, whereby events such as the Smoot-Hawley Tariff Act enacted in 1930 resulted in economic downturns. Such trade policies were designed to protect local economies against foreign competition, but instead created more tariffs and triggered a great depression in the process. This era illustrated how uncertainties in economics could be caused by unilateralism and international instability.

Multilateral Movement: Since then, international trade has adopted a multilateral framework, moving from GATT to WTO in 1995. This model is made to ensure sustainability, and it operates according to three basic principles: non-discrimination, reciprocity, and dispute resolution.

International Organizations (WTO/IMF): Uncertainty management is offered by international organizations such as the WTO, IMF, and the World Bank. By providing the security of rules, it eliminates the chance of any drastic changes in policies. During unstable periods, when the economy is volatile and geopolitically insecure, the IMF provides liquidity so that there will be no sudden crash. The role of the WTO comes in as the venue for negotiations, hence there is no uncertainty that deters investments.

Methodology and Conceptual Logic

Qualitative analysis is used in analyzing the effect of international economic policies on the performance of the market economy through the transmission process. Different from the conventional quantitative approach that focuses on price changes, the qualitative approach examines the barriers that arise due to policy uncertainties.

Conceptual Diagram

The impact of policy shifts is analyzed through a logical sequence that dictates the reaction of global markets:

Policy Shock: A sudden regulatory change, such as a trade war between major economies, a pandemic-driven border closure, or a sudden withdrawal from a trade agreement.

Increased Economic Policy Uncertainty (EPU): This leads to a spike in the EPU index, creating a gap in information for traders and financial institutions. Market participants lose the ability to forecast future costs or demand accurately.

Behavioral Reaction: Investors and firms adopt a wait-and-see approach. This leads to Capital Flight from emerging markets and a significant delay in Foreign Direct Investment (FDI) projects as companies wait for policy clarity.

Trade Contraction: The cumulative effect is a measurable decline in global trade efficiency, a tightening of international credit, and a reduction in overall trade volume.

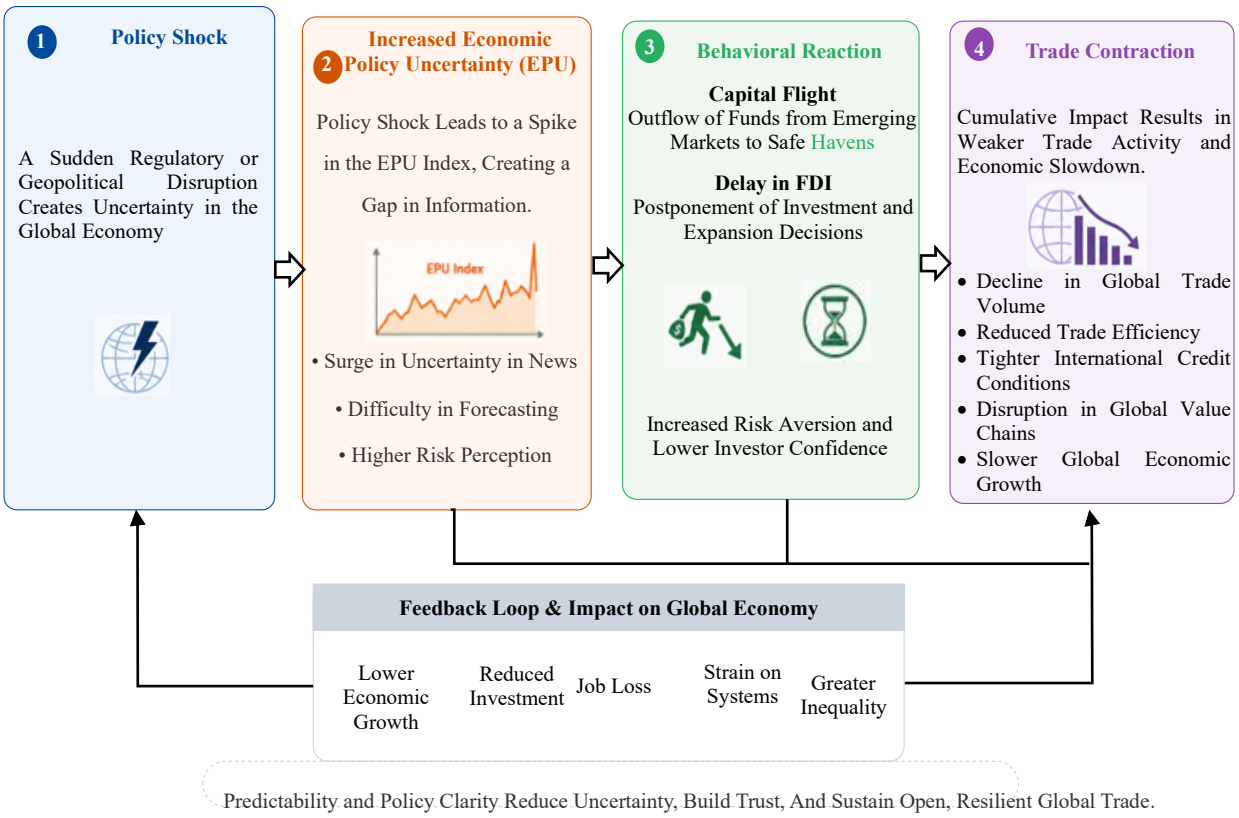


Fig.1: Uncertainty Transmission Path and Global Economic Fallout

Fig. 1 demonstrates that the emergence of trade wars and epidemics creates shock at the level of the system and results in EPU (policy uncertainty). This causes the parties to adopt a wait-and-see attitude, which causes money flight and deferred investments. Therefore, there is reduced trade, and inefficiency occurs.

Data Integration and Metric Focus

The empirical basis of the theoretical model mentioned above consists of the following recognized indicators and sources of information:

EPU Index by Baker, Bloom, and Davis: The most important indicator used to measure the level of policy uncertainty is the count of news. It measures the number of times that words related to uncertainty, policy, and economy appear in leading newspapers to indicate the state of global risks.

Efficiency and Digitization Indicators: Indicators employed in measuring the degree to which the digital economy advances might be employed in addressing the shock created by inefficiencies and frictions within physical trade or policy. This measure seeks to evaluate the extent to which digital trade can protect against any trade shocks.

Indices of Capital Flow: Used in capturing the extreme volatility experienced within emerging economies. It evaluates the extent to which global EPU shocks cause extreme capital outflows within developing countries as compared to developed countries.

Through the process of combining history with the logic of transmission of uncertainty, it can be stated that international economic policies not only support trade but also determine the level of risk involved. It is predictability, not the absence of tariff barriers, that is found to be the primary factor driving contemporary globalization. The situation created by the loss of clarity in policy formulation becomes a non-tariff barrier in itself and adversely impacts the global value chain structure.

Comparative Analysis of the Impacts of Policy Uncertainty on the Effectiveness of Preventing Money Laundering

Impact on Developing Countries

The vulnerability of developing countries to changes in the global economy is increased during times of high uncertainty. The following part examines how changes in global policies lead to growth disruption among emerging economies.

Analysis of Capital Inflow Volatility

Emerging economies are likely to go through periods of highly volatile levels of inflow of capital from abroad as a consequence of global economic policy uncertainties. In instances where uncertainties are high in developed countries, emerging economies usually face the problem of reversing capital flow and extreme outflow of capital.

Vulnerability of Trade Blocs

Asian countries that are well-integrated into the global value chains tend to be highly sensitive to changes in policy. In fact, for example, uncertainty about international economic policies tends to have a direct adverse effect on foreign direct investment (FDI) flows because investors are always looking for security rather than growth when conditions are risky. Countries that depend on their commodity exports will suffer from subsequent effects if it experiences policy uncertainty that results in low demand, thus causing depressed prices. The policy shift strategy embraced by MNCs adversely affects developing countries, which do not have the financial capacity to bridge the gap created.

Impact on Developed Countries

The resilient institutions that exist in advanced countries do not protect them from experiencing the repercussions of global policy uncertainty, frequently adjusting their trading strategies in light of this threat.

Trade Agreements as a Response to Global Uncertainty and Geopolitical Tensions, trading nations are now shifting towards friend-shoring as a way to minimize the impact of policy uncertainty in risky regions. Despite the likelihood of increased costs for consumers and inefficiencies in international trade, friend-shoring can help avoid policy unpredictability that may occur in certain regions.

Analysis of Policy Spillovers shows that global economic policy uncertainty caused by great powers, like the USA, brings about significant spillovers, making the state of the world economy entirely dependent on the economic state of the great power country. As a result, advanced countries that are trading partners experience synchronized declines in manufacturing output and trade.

Table 1 below presents the comparative measures of economic resilience under conditions of policy uncertainty:

Table 1: Resilience Comparison of Developed vs. Developing Economies

Metric	Developed Economies	Developing Economies
Capital Stability	High serves as a safe haven for global investors.	Low; prone to extreme capital flight and outflow episodes.
Policy Influence	High ability to shape international economic frameworks.	Low; generally, policy-takers are subject to external shocks.
FDI Sensitivity	Moderate; influenced by long-term strategic alliances.	Very High; FDI is often the first to retreat during uncertainty.
Growth Drivers	Diversified; focus on the digital economy and services.	Often concentrated; reliant on trade flows and external demand.
Buffer Capacity	High access to robust fiscal and monetary intervention.	Limited; restricted by debt levels and narrow tax bases.

While developed countries make use of trade deals and friend-shoring as a hedge against uncertainty, developing countries are highly exposed to financial instability, making it necessary to have more stable international economic policies.

Results and Discussion

The analysis of global economic policy trends in times of uncertainty shows that there is a complex relationship between policy volatility and global economic stability. The outcomes obtained through the combination of empirical studies in recent times and qualitative research approaches suggest that the influence of changes in policies is not simply a consequence of those policies, but a consequence of Economic Policy Uncertainty (EPU) created by those policies.

Interpretation of the Uncertainty Trap

The first important outcome of this analysis is the identification of the existence of an Uncertainty Trap, where the lack of clarity about future regulations leads to economic downturns that outweigh the effects of the restrictive measures themselves.

Hesitation to Invest: MNCs conducting international business prefer certainty over a reduction in tariffs. The lack of certain policies makes the MNCs hesitant, which in turn leads to a reduction in investments.

Trade Volume Elasticity: Econometric results demonstrate that the volume of international trade is highly elastic with regard to unexpected fluctuations in EPU emanating from the major economic actors, including the US and China. Increased uncertainty raises the costs of collecting relevant information, which effectively functions as an invisible, non-tariff barrier to trade.

The Impact of EPU on Trade Matrix presents the negative relationship between elevated levels of Economic Policy Uncertainty and various parameters related to international trade. Table 2 demonstrates how EPU creates an economic downturn in the international economy and investment hesitancy. Moreover, it reveals the volatility of capital movements in developing countries compared to the efficiency of digital trade.

Table 2: EPU Impact Matrix

Variable Impacted	Correlation with High EPU	Primary Driver / Source
Global Trade Flow	Significant Contraction	Market sensitivity and risk aversion
Foreign Direct Investment	High Negative Impact	Postponement of long-term projects
Emerging Market Capital	Extreme Volatility	Sudden outflows and safe-haven seeking
Trade Efficiency	Moderate Decrease	Offset by digital economy maturity

Socio-Economic Implications and Spillovers

The results analysis brings out an important difference between the way policy shocks are handled by developed and developing countries.

Asymmetric Risk Exposure: Whereas the developed world adopts policy shocks through fiscal buffers, the developing world suffers from periods of excessive capital flows where uncertainty causes a shockingly abrupt withdrawal of capital.

Resilience Indicator: Development of the digital economy has become another important factor in this equation. Countries that develop efficient digital trading platforms demonstrate higher levels of trade efficiency as well as the ability to overcome both physical and regulatory obstacles during high uncertainty phases.

Sustainable Development as a Policy Approach: It has been shown that sustainable development as a guiding principle in setting up trade policies contributes to greater stability and certainty regarding the rules. The policies aimed at green growth are generally more multilateral and predictable than politically motivated ones.

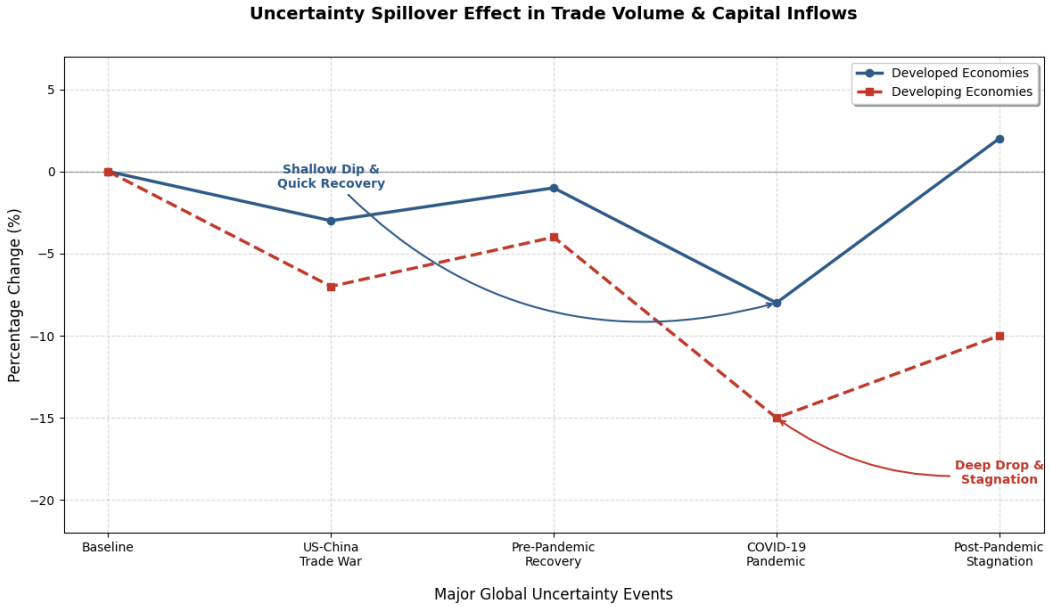


Fig. 2: Comparative Analysis of the Uncertainty Spillover Effect

Fig. 2 shows the contrasting paths to recovery in advanced countries versus developing countries after a shock to economic policy. The Resilience Gap refers to the phenomenon whereby advanced countries experience mild recessions, whereas developing countries face long periods of capital outflow and stagnant trade.

Recommendations for Policy Design

The following strategies are recommended to alleviate the negative impacts of economic uncertainty on global economic policy:

Improving Policy Transparency: It is important to emphasize the need for governments to ensure the clarity of economic policies for the long term.

Improving Multilateral Cooperation: International bodies such as the WTO and IMF need to be strengthened to regulate trade, thereby avoiding unilateral changes in trade laws and causing international trade wars.

Digital Trade Integration: Nations that are not yet developed need to be assisted technologically to improve their digital trade policies, thereby serving as an alternative buffer against trade policies.

Policy Stability Frameworks: Policymakers need to establish mechanisms through which economic stability is ensured. Multi-year trade agreements can be established with provisions for resolving disputes in times of economic crisis.

In conclusion, it is evident from the findings that the international economic policy framework is the main determinant of the global risk environment. While the transition from globalization to friend-shoring and regionalism may serve as an alternative approach for economic security within developed nations, developing nations will only become more marginalized. Sustainable global economic growth amid economic uncertainty calls for proactive measures instead of reactivity.

Conclusion

International economic policies play a critical role in determining global trade stability, especially during times of economic uncertainty. In other words, EPU is a significant non-tariff barrier. The justification for this statement is that

the lack of appropriate regulation results in larger economic costs than the policies themselves. Some of the critical insights obtained from the analysis indicate that the movement of global trade flows and FDI is highly sensitive to policy shocks in major economies, resulting in a wait-and-see approach and preventing additional international development. One of the critical implications of these insights involves the Resilience Gap between developed and developing countries. Developed economies benefit from institutional shock absorbers and friend-shoring approaches to absorb shocks, while a 10% increase in uncertainty implies a severe decline in trade flows. Emerging economies experience significant levels of uncertainty when it comes to attracting foreign investments and persistent economic stagnation. The study shows the importance of developing a digital economy as an effort to make trade more efficient while reducing the impact of policies that would lead to conflicts. For sustainable development to be achieved worldwide, policymakers must emphasize the importance of transparency and multilateralism. It is imperative for regulatory measures to be put in place by multilateral institutions like the World Trade Organization to tackle the problem of asymmetric information.

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