

EconoFact Chats: The Doom Loop
Eswar Prasad, Cornell University
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Michael Klein

I'm Michael Klein, executive editor of EconoFact, a non-partisan, web-based publication of the Fletcher School at Tufts University. At EconoFact, we bring key facts, and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein

In his new book, *The Doom Loop*, Eswar Prasad writes “economic, political, and geopolitical factors are fueling a doom loop, breeding turmoil rather than stability, disarray rather than order.” The economic, political, and geopolitical factors that he analyzes in this book include the role of the dollar, and the emergence of cryptocurrencies, the tension between security and civil liberties in many countries, the role of multilateral organizations and the international rules-based system, and the ways in which artificial intelligence, fintech, and information technology are shaping societies and affecting governmental authority. Much of the book also focuses on the tension between China and the United States, and the ways in which other countries try to navigate this emerging bipolar world. Eswar is a Professor at Cornell University and a Senior Fellow at the Brookings Institution. Before moving to academia, he served as the head of the International Monetary Fund's China division in the early 2000s. We discussed his previous book, *The Future of Money* in an EconoFact Chats episode. Eswar, congratulations on this new book, and welcome back to EconoFact Chats.

Eswar Prasad

Thank you, Michael, and it's always great to be on your show and I'm looking forward to our conversation.

Michael Klein

Well, I am too, because I read the book and really enjoyed it. In the book's introduction, you wrote “instability and chaos are becoming the status quo in the new world order.” I imagine that you had some irony in mind when you wrote “the new world order,” since that term was coined by President George H.W. Bush in the wake of the collapse of the Soviet Union. At that time, people thought that this would herald in a more stable and prosperous world. Are there certain events or periods when this new instability began or became much more pronounced?

Eswar Prasad

Actually, Michael, it's good that you brought that up...the origin of the term world order, because it's worth thinking about the creation story of this book. When I started thinking in 2022, 2023 about where the world economic order was going, I ended up with a slightly different thesis in mind. And the thesis was going to be that in the 1990s, with the break up of the Soviet Union, the United States became the dominant power in every respect—economic, financial, military. Now, of course, economic power at least is more evenly distributed. And you know, as economists, we tend to think that usually competition is good for balance, for efficiency, and even for stability. So my book was really going to be a story about all the forces that would take

us back towards this equilibrium, which might be a different one with more than one power, but would be stable in its own right. And we could think about the present phase we're in, which is certainly characterized by a lot of volatility, as a transitional phase, you know, a passing phase before we get to a more stable place. But as I thought about all the forces that could take us back to this equilibrium, and you listed many of them, I came to the conclusion that in fact, instability might be becoming the norm. And the unfortunate thing as we go back to recent history is that, you know, in the 1990s, and even the early 2000s, even the early 2010s, we thought we had it all figured out. That, you know, many of the forces like globalization would work to promote a future of shared prosperity, and that liberal market-oriented democracies would become the paradigm that everybody would turn towards. But what we've learned in the last few years is that that paradigm has had a lot of intrinsic fragilities, which has led to the chaos we're at right now.

Michael Klein

In the book, you talk about power and you talk about economic size as one source of power, but you also discuss other sources of power: the role of a country's population, control over natural resources, military might, and the quality of a country's institutions. But you make a very important distinction between having power through these factors, and wielding it effectively. Can you explain how power can be squandered?

Eswar Prasad

If you think about the two major superpowers right now, China and the United States, you know, some people consider Russia a superpower, but in my view, it has a lot of nukes but it's really an economic shell. If you think about the US and China, they've been trying to wield their economic power in different ways, not just through direct interventions in different places, but more importantly, by garnering influence among other countries. And the US used to be seen as a trustworthy and reliable ally, and many countries therefore viewed it as the country that they wanted themselves to look like in terms of having open democracies, free markets, and so on. China was pushing for a very different vision of the world, and it was using its economic power quite effectively for a while at least, in order to accrete more power by giving countries more financing that they were denied from official institutions or from Western powers. But in fact, right now China's also facing a bit of a pushback. So this is actually a very difficult and complicated issue, how a country can manage to bring other countries into its sphere of influence. Both the United States and China have at different periods made some progress, but I think right now neither country is doing a particularly effective job at this, and the US in particular seems to be pushing away many other countries it would like to be in its fold.

Michael Klein

One of the points you alluded to already, and sort of a central point in the book to my mind, is the inherent tensions between developments that could bring stability but instead they foster greater turmoil. An important part of this is globalization. There was a belief that greater globalization would be stabilizing, and this isn't a new idea. There's a famous book called *The Great Illusion* by Norman Angell that argued that economic interdependence meant that wars were economically and socially irrational. This book was published in 1909, and events a few years later proved that this thesis was tragically wrong. What were the modern arguments for the economic, social, and political benefits of globalization, and how have they played out?

Eswar Prasad

There was a very important sense, Michael, in the 1990s and the 2000s, and even early 2010s, that globalization would be a positive sum game, where through greater integration, through trade and financial linkages, countries would see a future of shared prosperity. And that this would actually be a counterbalance to the intrinsically zero-sum game of geopolitics, where one country can gain influence only at the expense of another country. And it actually did work that well for quite a while. So, for instance, when China entered the World Trade Organization and therefore had access to markets around the world, including in the United States, there was a sense that China would reciprocate by opening up its own markets. And American businesses salivated at the prospect of having access to China's markets, having access to China's labor pool as a base for their supply chains, and to have the ability to sell not just goods but also financial services to a rapidly rising and expanding middle class, which it was presumed would want those services. Now it turns out that China did not quite live up to its end of the bargain. They got access to markets around the world, but didn't provide equitable access to foreign firms, including US firms, in their own markets. So businesses have become disillusioned, and American and foreign businesses, which used to be bridges that could help get over these geopolitical rifts, have in fact turned away. So, in fact, even globalization is now becoming seen as a zero-sum or positive-sum game. So what my book points out is that this has provided a very fertile opportunity for skilled politicians to use the 'politics of resentment,' as I refer to it in my book, to argue that globalization, rather than technology or other forces is really responsible for the difficulties that many people face in terms of lost jobs, or even the loss of economic opportunity. And what we've found is that there is this intrinsic fragility of democracy because there is a sense that the game is rigged. That not only do the benefits of better technology, of globalization, go to the economic and political elites, but they can also twist the rules of the game in a democracy in their favor. If you think about regulatory and tax policies in the United States, these largely favor those who are already economically privileged. So now you have economic forces infecting domestic politics, and as we've seen in the context of the US-China relationship, that is now affecting geopolitical relationships and making them unstable as well. So now we have this negative feedback loop between economics, domestic politics, and geopolitics, hence the 'doom loop.'

Michael Klein

You alluded to the fact that China didn't really live up to what people thought its obligations would be when it entered the world trading system. And this relates to the rules-based international system. It was meant to foster a stable and prosperous world economy, and as you said, it succeeded for some time, but it's come under attack. How did this system work when it did work well? And why did it succeed, at least for some time?

Eswar Prasad

So in the aftermath of the Second World War, the Great Depression, and the other huge problems the world faced on the economic and geopolitical fronts, a rules-based order was set up largely led by the United States and other Western powers. And that rules-based order, typified by institutions like the International Monetary Fund, where I used to work, the World Bank, the United Nations, the International Court of Justice, has in my view underpinned global prosperity and stability as well. That rules-based order has come under attack from both sides. In the United States right now, we have a very narrow definition of what are national interests, and that means

that many of these institutions are not seen as serving the US interests, and the United States, which as I mentioned has been responsible for setting up this order and these institutions to a large extent, is now pulling back. At the same time, many emerging market economies like China, India, Brazil, feel that the international financial institutions in particular, those like the IMF and the World Bank, have not changed in a way that reflects the new economic realities. So for instance, we have these paradoxical situations like the IMF giving more voting power to Japan, although Japan's economy is much smaller than India's, and India has a smaller voting share than Japan, simply because again voting shares at the IMF are a zero-sum game, and change has not been easy to come by. So what we've had is a situation where the emerging market economies have banded together and started setting up their own institutions, largely led by China, like the Asian Infrastructure Investment Bank or the New Development Bank set up by the major BRICS economies: Brazil, Russia, India, China, and South Africa. So what we have right now is a situation where in principle we could have a better outcome as these institutions compete with each other, and try to improve their standards, but in my view what we have right now is a fragmented rules-based system where different groups of countries feel that they're obeying different sets of rules, governed by different institutions. So rather than providing cohesion, the rules of the game are fracturing in a way that are creating dissension and therefore generating instability, rather than stability.

Michael Klein

Eswar, you mentioned a narrow view of national interest. And the source of tension as regards the rules-based international system is...or at least one source of tension is that ceding to international rules means that you're giving up some degree of national sovereignty. And some politicians successfully exploited this tension, you know, so-called America First policy and so on. How do you think this tension has played into politicians, and is going along with the rules-based system really the source of the kinds of problems that we're seeing? The distributional problems that you referred to earlier?

Eswar Prasad

So we see this phenomenon playing out around the world. It's worth reflecting on the fact, Michael, that this book is not really a book about Trump, or just about the United States. In fact, I had finished the first full draft of the book in October 2024, before the November 2024 elections, and felt that perhaps the thesis of the book was a bit too dark. But of course, all the events of the last 15, 16 months, have if anything, validated the thesis of the book. But we see this play out around the world, even in the United Kingdom, where Britain was gaining a lot from its integration with the European Union. 'Britain First' policies led to Brexit. I think the reality is that when there is a lot of economic ferment in an economy and you feel that there are people that are getting left out of the economic growth the country is experiencing, and these people feel in particular that economic opportunities are denied to them, then it becomes a very fertile ground for politicians to speak to the "politics of the other." And "the other" can be very broadly defined—; as the economic and political elites within a country, as globalization, as China being the problem, or immigrants coming into a country. And this infects domestic politics in a way that the notion of shared interests gives way to the notion that each country needs to protect its own interests so that they're not taken advantage of by others. And this ends up really moving away from any notion of common prosperity based on common rules, and this leads to each country retreating to its own borders. And I think ultimately this is not very good for the world at

large, either in terms of economic prosperity or geopolitical stability. But the thread again runs through domestic politics, which is the connecting thread that links all of this together.

Michael Klein

Rules are made by those with power, and I would expect that there would be a correlation between a country's dissatisfaction with the international economic rules and its lack of voice. But the irony here is that the United States has helped shape these rules and has been very influential in setting them up, but now it's one of the most vocal critics of the rules-based system in the current American administration. So I guess you would explain this by the way that politicians have exploited dissatisfaction with economic outcomes by scapegoating globalization, would that be right?

Eswar Prasad

That's right. The sense of blaming 'the other,' as I said very broadly defined, is a very potent force when you have people who are facing economic desperation because they've lost jobs...because in a market economy you typically have a lot of churn. Some industries do well, some industries don't. Some firms prosper, others disappear. This is all normal, but there is a sense right now that there is not just a market economy working, but that the rules are stacked against certain people, the rules both domestic and international. And the sense of unfairness, I think, is very potent in terms of the ability of certain politicians to exploit this politics of fear and resentment rather than of hope.

Michael Klein

So, Eswar, throughout the book, you cite the tensions between the United States and China. Do one of these countries' gains come necessarily at the expense of the loss of the other country? Is this truly a zero-sum game?

Eswar Prasad

So my view, Michael, is that at least if you think about geopolitics, it's hard to see both countries gaining together. Now certainly one can make the case that a more peaceful world is good for economic prosperity of both countries, and one can argue that superpowers have a shared interest in this. But the reality is that if you look at China trying to expand its sphere of influence in Asia and in other places well beyond its backyard, that certainly is coming at the expense of the United States. Now there is an interesting irony here, Michael. The United States is withdrawing from, you know, long-standing alliances. Trump even talks about withdrawing from NATO, which has been a key security alliance underpinning the cohesion of the Western economies. And it is now China that has been trying to project itself as the defender of multilateralism, of globalization, of the rules-based system. The difficulty that China faces, though, is that other countries don't quite trust its institutions because it's remained a relatively closed economy, and while China does have a very significant economic power that it has been using more or less to good advantage, countries are also very cautious about getting too close into China's economic and financial embrace. If you look at countries in Asia in particular, they are caught in a very difficult place. They don't see the United States as a reliable ally, as I alluded to earlier, but at the same time, they do have economic and financial linkages with China that mean they cannot pull back from China, but they don't want to get too close to China at the same time. For much of the rest of the world it is a very difficult time caught between these two very unsavory alternatives.

Michael Klein

That brings me to the next question I wanted to ask. You have a chapter on what you call the middle powers – countries that have to navigate between the United States and China in a bipolar world. What are some of the challenges facing these countries and how are they addressing these challenges?

Eswar Prasad

So the middle powers, Michael, comprises practically every other economy. Now my European friends don't like it very much when I refer to Europe as a middle power. Europe I think has the ability to be a great power, but it hasn't quite risen to the occasion, as you well know, based on some of your own work, Europe does have a monetary union, but the other aspects of the economic union, including fragmentation of the financial system, even the payment system, the lack of fiscal policy, and political cohesion has kept Europe from punching at its weight. So they're stuck in the middle like everybody else. Now, I had thought that given how important global stability is to the middle powers, they could serve as a glue, sort of bringing the two superpowers together. This was in the more cheerful version of the book that I started with. But I quickly came to realize that in fact, the middle powers may not serve this stabilizing role. Now the middle powers of course include large and small economies, rich and poor economies. And there was a very important speech at this year's Davos World Economic Forum meeting in Switzerland, where Mark Carney, the Prime Minister of Canada, talked about how the middle powers basically need to accept that we are now entering a world where instability is the norm. He of course took the words out of my mouth; I just did a soft launch of my book in Davos because it wasn't quite coming out yet, and of course Prime Minister Carney put it in much more eloquent terms. But he also provided a path forward. He said, quite pragmatically, that the middle powers will not agree on everything, but he said let's just find some areas on which we agree and move forward with agreements on those. And that's what we see happening. Europe is signing trade deals with India, with Mercosur and so on. India's trying to sign trade deals with other countries, other than the United States and China. And India in fact is an archetype of the middle power that could play an important role. But India has taken this approach of issue-based alliances, where essentially as an example, and I'm oversimplifying a bit here, when Russia invaded Ukraine, India did not participate in financial sanctions on Russia because access to cheap Russian oil was very important, so it sided with Russia and China. But India sees its broader interests as much more closely aligned with the United States and democratic economies of the West. Now, this approach may work well for India, but it doesn't create any deep-rooted alliances. And the same is true of the middle powers more broadly. If one takes Mark Carney's approach to heart, you could set up, you know, agreements on a variety of specific issues, but these are not built on any fundamental shared values, or a deep understanding of common values. So I think these transactional relationships might certainly be the only practical way to move forward, but they don't really foster any stability because countries bounce from one extreme to the other, from one alliance to the other based on the specific issue at hand. So it's a pragmatic way forward, but certainly not going to foster much greater geopolitical or economic stability.

Michael Klein

Eswar, I'd like to move to a bit of a broader view. There's a famous quote from Martin Luther King, who said, 'the arc of the moral universe is long, but it bends towards justice.' But in your book, you write, 'there is little to suggest that the arc of human development will inexorably

bend towards liberal market-oriented democracies, once regarded as the epitome of civilization.’ This sentence appears in a chapter that discusses how people may view the loss of civil liberties as a small price to pay for political stability. Can you discuss this trade-off, and what led you to this rather dark conclusion?

Eswar Prasad

So Michael, despite all these forces that I spoke about that are engendering instability, I really wanted to go in the direction that my heart was pulling me – that eventually, one might think about this as just a passing phase of volatility and maybe in fact competition between the two superpowers will lead us to a more stable world. But as I thought more about it, it occurred to me that there is one fundamental difference between recent eras of competition, where for instance in the 1990s after the Soviet Union broke apart, Japan looked like it might rise as a rival to the US and then it faded. In the 2000s with the creation of the Eurozone, it looked like the European continent might become a power that rivals the US, and then it's somewhat fading. But all of this was about economic competition. In terms of fundamental values, Europe, the United States, Japan pretty much see eye to eye. But now we have a very different conception of great power. The way the United States and China see what the best forms are to organize a political, legal, economic, social system are very, very different. So there is no easy way to meet in the middle. And what is somewhat surprising is that while one might think about this as great power competition...and it matters, because ultimately countries that have similar systems tend to stand together on a variety of issues—after all, liberal market-oriented democracies to whatever extent do tend to see issues from the same lens, while autocracies tend to stick together on most issues. But what is sad to my view, is that rather than this leading to an improvement of standards, we're seeing a deterioration of standards on both sides. China's becoming a much more rigid economy and society. At the same time, the United States is giving up many of the things that characterized US soft and hard power, and that really made it stand out from China...the rule of law, the independence of the central bank, the system of checks and balances, a free and fearless press...in all of these issues, we seem to be backsliding and oddly moving towards the sort of situation that pervades the Chinese system. So unfortunately, this competition I think is going to keep things bubbling for a while, but it's not moving in a positive direction where we aim to something that is more aspirational that the entire world can aim towards, but essentially a deterioration of standards. And again, we see this around the world, in many European countries that used to be bastions of liberal democracy, even in other large democracies like India and so on, we see significant backsliding. And I think the erosion of domestic institutions is really the problem that we are confronting right now, and which causes significant concern rather than optimism.

Michael Klein

Well, you do say that there is some hope in the conclusion of the book, and you write that it largely lies in good institutions that provide guardrails, as well as in the engagement of people. So after writing this book, it sounds like you were less hopeful than you were before you started on this project. Do you think institutions have the power to actually get us out of the doom loop?

Eswar Prasad

If you think even about the US political history, Michael...I mean, we've gone from one side to the other of the political spectrum. And of course, you know, the US being special, we don't just

go from one side to the other we lurch from one side to the other. But the corrective mechanisms have always worked. And the corrective mechanisms include some of the institutions that I spoke about...the checks and balances, the rule of law, a free and fearless press that can hold public officials to account, and of course the working of the democratic process. And what worries me is that I see many of these institutions fraying before our eyes. And again, this is not just a phenomenon in the US, but is happening in many democracies around the world. And that is what makes me a lot more concerned. But this doesn't mean that we should lose hope that we are stuck in the doom loop forever. But it's going to take a lot more work in terms of civic engagement from each of us, as citizens not just of our countries, but of our communities, and of the broader world order, recognizing that only common prosperity can move us forward. And we need better community, business, national leaders who can get beyond preying on our fears and divisiveness and instead, lead us to a better path forward based on hopes and aspirations for a better future. So I don't think the path to a better future is shut off, but it's going to take a lot of work from each one of us.

Michael Klein

And part of that work is recognizing that we're in this kind of a situation, and in your book you do a very good job of that. So, Eswar, thank you very much for taking the time to speak to me today about your new book, *The Doom Loop*, and congratulations on its publication.

Eswar Prasad

It's been a real pleasure, Michael, and as always I greatly enjoyed our conversation. Thank you for having me on your show.

Michael Klein

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