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THE EFFECT OF GLOBAL GEOPOLITICAL RISKS ON TRADE OPENNESS

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Abstract

As global geopolitical risks continue to intensify, international trade openness is encountering severe challenges. This study utilizes panel data from multiple countries spanning 1985 to 2022 to systematically investigate the impact of geopolitical risks on national trade openness. The empirical results show that geopolitical risks significantly suppress trade openness, confirming the detrimental effects of geopolitical shocks on a country's degree of external economic liber- alization. Furthermore, greater fiscal freedom and sound fiscal conditions are found to effectively alleviate this negative impact, highlighting the role of robust fiscal institutions in enhancing national resilience to external shocks. Heterogeneity analysis reveals that the negative effect is more pronounced in countries with lower government integrity and weaker monetary freedom. To mitigate the institutional instability brought about by geopolitical shocks, this paper suggests strengthening fiscal governance, reinforcing financial market mechanisms, improving the quality of government governance, and enhancing regional cooperation to build collective risk man- agement capacity, thereby promoting the long-term and sustainable development of global trade openness.

Keywords: Geopolitical risks Trade openness Fiscal freedom Fiscal health

Introduction

With the deepening of globalization, international trade has become a critical engine for national economic development. How- ever, in recent years, the increasing frequency of global geopolitical risks—such as regional conflicts,

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great power rivalries, and economic sanctions—has posed significant challenges to the international trade system. Geopolitical risks not only undermine political trust and the willingness to cooperate among nations but also exert profound effects on trade openness through various channels. As a key indicator of a country's ease of participation in international economic activities, trade openness is directly linked to its potential for economic growth and the efficiency of resource allocation . Therefore, it is of substantial theoretical and practical significance to explore how global geopolitical risks affect national trade openness and to identify the factors that may mitigate or intensify such effects.

The existing literature has made preliminary efforts to examine the relationship between geopolitical risks and trade openness. On one hand, some studies suggest that geopolitical risks reduce trade openness by increasing transaction costs, weakening market ex- pectations, and intensifying policy uncertainty. For instance, geopolitical tensions may lead to rising tariff barriers, the proliferation of non-tariff measures or even the disruption of global supply chains, all of which constrain cross-border trade flows. On the other hand, some research emphasizes the moderating role of institutional environments, arguing that sound institutional frameworks can buffer the impact of external shocks. Fiscal freedom and fiscal health, in particular, are considered essential for a country's ability to cope with external risks as they provide a stable economic foundation and flexible policy space. Moreover, governance indicators such as government integrity and monetary freedom are also found to be closely associated with a country's capacity to respond to geopolitical risks. These studies offer valuable insights into the underlying relationship between geopolitical risks and trade openness. However, limitations remain. First, there is a lack of systematic analysis that fully captures the mechanisms through which various factors influence this relationship. Second, few studies conduct heterogeneity analysis, making it difficult to distinguish how countries with different characteristics respond differently to geopolitical risks.

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To address these gaps, this study seeks to advance the existing literature by investigating the impact of global geopolitical risks on national trade openness from multiple dimensions and uncovering the underlying transmission mechanisms. Specifically, this research develops an integrated analytical framework in which global geopolitical risks serve as the core explanatory variable and national trade openness as the dependent variable. It also incorporates fiscal freedom, fiscal health, government integrity, and monetary freedom as moderating variables to explore their roles in the risk transmission process. Based on this framework, the study employs cross-country panel data and conducts empirical tests using fixed effects models, interaction term analyses, and subgroup regressions to assess the overall and heterogeneous impacts of geopolitical risks on trade openness.

The empirical results demonstrate that global geopolitical risks have a significant negative effect on national trade openness, corroborating the view in existing literature that geopolitical shocks hinder international trade. More importantly, the study finds that higher levels of fiscal freedom and better fiscal health significantly attenuate this negative effect. This suggests that countries with ample financial resources and sound fiscal structures are more capable of withstanding external shocks and maintaining higher levels of trade openness. Furthermore, heterogeneity analysis reveals that the adverse impact of geopolitical risks on trade openness is more pronounced in countries with lower levels of government integrity and weaker monetary freedom. This finding underscores the importance of governance quality and monetary policy flexibility in enhancing national resilience to external uncertainties.

This study contributes to the literature in several key ways. First, it enriches the theoretical framework linking geopolitical risks to trade openness by introducing multidimensional moderating variables and highlighting the critical role of institutional settings in the transmission of risks. Second, by applying heterogeneity analysis, the study identifies cross-country differences in the

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effects of geopolitical risks on trade openness based on variations in governance capacity, thus offering policy-relevant insights. Third, the findings bear important practical implications. For countries exposed to heightened geopolitical risks, improving fiscal freedom, strengthening fiscal health, enhancing government integrity, and increasing monetary freedom represent strategic measures to safeguard trade openness and bolster economic resilience.

2.Theory framework and hypothesis development

In the context of deepening globalization, trade freedom—an essential indicator reflecting a country's market openness and willingness to engage in international economic cooperation—is increasingly shaped by a range of internal and external factors. Among them, geopolitical risk, characterized as a cross-cutting uncertainty encompassing political, economic, security, and diplomatic dimensions, has emerged as a significant disruptive factor affecting trade freedom. While existing research has predominantly focused on the implications of geopolitical risk for cross-border capital flows, investment decisions, and economic growth (Jha et al., 2024), there remains a relative paucity of systematic analysis on how geopolitical risk influences trade freedom. This study aims to fill this gap by analyzing how geopolitical risk at the national level undermines trade freedom through multiple transmission mechanisms and, based on this, proposes a theoretical hypothesis. Geopolitical risk can directly affect the formulation of trade policies via heightened security expectations and strategic precaution mechanisms (Baek et al., 2024). When a country encounters external uncertainties such as regional conflicts, international military frictions, or deteriorating diplomatic relations, it often prioritizes national security over economic liberalization. This shift manifests in intensified trade controls, restrictions on import-export categories, and even the suspension of trade agreements. For example, sensitive technologies and raw materials may be added to export control lists, or tariffs may be imposed on certain imports under the

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pretext of national security. Such policy realignments effectively reduce trade freedom (Hossain et al., 2024). Moreover, geopolitical risk may distort market expectations and compress firms' risk tolerance, indirectly affecting trade behavior. Under high-risk environments, enterprises—particularly small and medium-sized ones—may scale back international operations due to concerns about policy volatility, exchange rate fluctuations, or logistical disruptions, leading to a decline in overall trade activity (Nguyen et al., 2022). Financial institutions, in turn, may tighten lending criteria for trade-related businesses based on risk assessments, thereby exacerbating financing constraints and further curbing firms' trade flexibility (Cong et al., 2025).

From an institutional perspective, rising geopolitical tensions tend to trigger government interventions grounded in protectionist

logic. In situations involving strategic rivalry or diplomatic isolation, governments are more inclined to adopt inward-looking eco- nomic strategies aimed at enhancing "strategic autonomy"—for instance, by imposing local content requirements, tightening foreign investment screening, or promoting import substitution policies. Although such measures may strengthen self-reliance in the short term, they run counter to the principles of trade liberalization and global economic integration, thus eroding institutional trade freedom (Jin et al., 2024; Khan et al., 2023).

Furthermore, geopolitical risks may tarnish a country's international reputation and weaken the foundations for multilateral cooperation. Frequent geopolitical incidents may generate doubts in the international community about a country's political stability and policy consistency, thereby undermining its bargaining power in multilateral trade negotiations. At the same time, under increasing geopolitical fragmentation, trading partners may relocate supply chains or impose reciprocal trade restrictions based on political alignments, ultimately reducing the scope and depth of bilateral and multilateral trade liberalization efforts. The recent upward trend in the global geopolitical risk index has coincided with a

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decline in trade freedom scores across multiple countries. For example, during periods of heightened geopolitical tensions—such as U.S. policy shifts toward protectionism and intensifying conflicts in the Middle East and Asia-Pacific—trade freedom has notably declined. Similarly, several developing economies have witnessed a drop in trade freedom amid regional security disruptions or domestic political instability. These patterns suggest that geopolitical risk may suppress trade freedom through policy adjustments, market responses, and institutional changes. National-level geopolitical risk, as a form of systemic uncertainty, may reduce trade freedom by reinforcing security-first policy rationales, constraining corporate trade capabilities, inducing protectionist tendencies, and undermining the trust foundation for international cooperation. Therefore, this study proposes the following hypothesis.

H1. A higher level of geopolitical risk at the national level is associated with a lower level of trade freedom.

In examining the adverse impact of geopolitical risk on trade freedom, existing literature has predominantly offered explanations from the perspectives of political security, institutional uncertainty, and policy control. However, whether a country possesses internal adjustment mechanisms to buffer the external shocks brought about by geopolitical conflict and uncertainty remains an important and underexplored issue. Against this backdrop, financial freedom, as an institutional variable reflecting the degree of marketization in the financial system, the fluidity of capital, and the level of regulatory intervention, may play a mitigating role in the transmission of geopolitical shocks and thereby weaken their constraining effect on trade freedom. First, countries with higher levels of financial freedom often possess more flexible and open financial systems (Zhao et al., 2023), wherein capital markets can offer diversified financing channels and risk-hedging instruments. When rising geopolitical risk leads to increased trade uncertainty and higher transaction costs, enterprises in these countries are more capable of alleviating operational pressures through flexible financing ar- rangements,

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foreign exchange hedging, and international capital allocation. Such financial flexibility enhances firms' capacity to withstand external shocks, thereby preventing systemic declines in trade freedom triggered by geopolitical disruptions (Ugurlu-Yildirim & Ordu-Akkaya, 2022). Second, financial freedom helps to maintain market confidence and institutional stability, thereby anchoring international expectations regarding a country's trade policy and commitment to openness. Although geopolitical risk often accompanies sudden regulatory tightening and policy shifts, in countries with well-established, transparent, and rule-based financial systems, international investors and trading partners are more inclined to believe that the state will refrain from using trade restrictions as a primary response to geopolitical tensions. This form of "institutional credibility" enhances a country's perceived policy stability in the global economy, helping to offset the risk premium associated with geopolitical shocks (Jakubik & Ruta, 2023).

Furthermore, as a market-oriented institutional arrangement, financial freedom facilitates optimal resource allocation and the efficient flow of production factors, thereby strengthening the self-adjustment and recovery capacity of the trade system. High levels of financial freedom allow financial resources to move freely according to market signals, enabling rapid reallocation to less-affected or comparatively advantageous industries and regions. This promotes the reconfiguration of global supply chains, thereby increasing the adaptability and resilience of trade structures. In addition, financial freedom influences the policy preferences of governments con- cerning trade liberalization. In environments with high financial freedom, governments are more likely to rely on market-based mechanisms to manage economic fluctuations and less inclined to resort to administrative trade interventions. As a result, even under elevated geopolitical risk, policymakers in such countries are more likely to stabilize the economy through indirect measur- es—such as financial incentives, exchange rate adjustments, or credit support—rather than imposing direct import/export

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restrictions or raising tariffs. These differentiated policy responses allow countries with greater financial freedom to maintain higher levels of trade freedom when facing external shocks (Riti et al., 2022). Thus, when financial freedom is considered as a moderating variable, it is reasonable to hypothesize that it functions as a "buffer" in the relationship between geopolitical risk and trade freedom. Specifically, the adverse impact of geopolitical risk on trade freedom is expected to be significantly attenuated in countries with higher levels of financial freedom. Accordingly, we propose the following hypothesis.

H2. Financial freedom moderates the relationship between geopolitical risk and trade freedom, such that the negative impact of geopolitical risk on trade freedom is weaker in countries with higher financial freedom.

In the context of deepening global trade integration, geopolitical risk has emerged as a major source of external uncertainty, continually disrupting the stability and openness of national foreign economic policies. Existing studies indicate that heightened geopolitical risk often leads to a resurgence of economic nationalism, the expansion of protectionist measures, and a contraction of external economic engagements, thereby weakening trade freedom. However, the quality of domestic institutions and the strength of state governance also play critical roles in shaping the intensity and pathways through which such risks affect trade.

Among these institutional dimensions, fiscal health—defined as the sustainability of a country's fiscal system, its capacity for fiscal resource management, and its ability to respond to external shocks (Goswami & Panthamit, 2022)—may serve as an important buffering mechanism in the transmission of geopolitical risk to trade freedom. This study seeks to explore why and how fiscal health can moderate the detrimental effects of geopolitical risk on trade freedom. Countries with sound fiscal health are better equipped with macroeconomic stabilization tools and risk response mechanisms. They can employ countercyclical fiscal measures to support trade-related sectors and prevent short-term shocks from causing long-term structural declines in trade liberalization. When geopo- litical

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events such as regional conflicts, escalated sanctions, or strategic frictions disrupt import-export channels and increase oper- ational risks for businesses, fiscally healthy governments can promptly implement a comprehensive set of fiscal responses—including subsidies, tax reductions, export rebates, and emergency credit programs—to sustain firm-level production and maintain international trade activity. These measures effectively counter the synchronous downward pressure on trade freedom caused by market panic and policy contraction (Yang & Chan, 2023).

Moreover, fiscal health enhances a government's ability to uphold its commitment to openness under conditions of high external risk. In countries facing severe fiscal constraints, governments are more likely to raise tariffs, impose export taxes, or intervene administratively in foreign trade flows in order to address revenue shortfalls or stabilize domestic demand. Conversely, countries with strong fiscal positions can pursue trade policy adjustments in a more stable and gradual manner, thereby avoiding abrupt policy shifts that undermine trade freedom. Fiscal abundance also reduces the need to instrumentalize trade for short-term economic stimulus, mitigating the risk of trade policy being driven by protectionist impulses (Fan et al., 2024). A sound fiscal position contributes to greater institutional stability and international credibility, helping to preserve trust in a country's policy commitments during periods of geopolitical tension. In such contexts, global markets are highly sensitive to perceived policy consistency and economic resilience. Fiscal health acts as a stabilizer by demonstrating a country's ability to make sustained policy commitments, thereby reinforcing its credibility within multilateral trade frameworks. International trade partners are thus more likely to continue their commercial re- lationships with fiscally stable countries, mitigating the actual impact of geopolitical uncertainty on global value chain participation.

From the perspective of resource reallocation, fiscal health enhances a government's capacity to promote strategic trade diver- sification and structural

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transformation. When geopolitical shocks affect specific regions or product categories, fiscally healthy countries are more capable of encouraging firms to explore new markets, invest in cross-border infrastructure, or develop substitute industries. These initiatives facilitate export upgrading and trade network diversification. In contrast, countries under fiscal pressure often lack the resources to implement such forward-looking reforms, making them more susceptible to path dependency and reactive policy adjustments. Accordingly, we propose the following hypothesis.

H3. Fiscal health moderates the relationship between geopolitical risk and trade freedom, such that the negative impact of geopo- litical risk on trade freedom is weaker in countries with higher levels of fiscal health.

3.Data and variable description

3.1. Data

After excluding observations with severe data deficiencies, this study ultimately selects data from 191 countries worldwide spanning the period from 1995 to 2023. The sampled countries are distributed across six continents. To mitigate the influence of outliers, all continuous variables are winsorized at the 1st and 99th percentiles.

3.2. Variable description

Dependent variable: trade freedom (Freedom). This study measures trade freedom using the annual Trade Freedom Index jointly published by the Heritage Foundation and The Wall Street Journal. This index captures the degree to which a country's policies support open trade with the rest of the world.

Independent variable: geopolitical risk (GPR). The geopolitical risk data are obtained from the GPR index developed by Caldara and Iacoviello (2022). This index quantifies geopolitical risks—including armed conflicts, elections, government changes, political instability, internal unrest, wars, and terrorist

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attacks—based on textual analysis of news articles. Covering a wide range of countries since 1985, the GPR index is one of the most comprehensive and publicly available datasets on geopolitical risk and has been widely employed in empirical studies. Following the methodology of [Author, Year], this study calculates the annual GPR index by averaging monthly values, which serves as a proxy for a country's geopolitical risk.

Control variables. In line with Thakkar and Ayub (2022), this study includes several macroeconomic indicators as control variables: GDP per capita (GDP), general government final consumption expenditure (Consume), gross national expenditure (Expense), and manufacturing value added (LCU).

4.Empirical results

4.1. Descriptive statistics analysis

To gain a comprehensive understanding of the distributional characteristics of both the core and control variables across the sampled countries, this study conducts a descriptive statistical analysis for all variables, as presented in Table 1. The dataset comprises 5326 observations, covering multiple countries and years, which ensures strong representativeness and comparability. The mean value of trade freedom is 69.08 with a standard deviation of 15.50, indicating considerable cross-country variation. The maximum value is 95, while the minimum is 0, highlighting a substantial range and underscoring the global heterogeneity in trade openness. This variation reflects the complexity of trade freedom, which is influenced by a country's policy environment, institutional arrangements, and external shocks.

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Table 1 Descriptive statistics.

Variable	N	Mean	SD	Min	Max
Freedom	5326	69.08	15.50	0	95
GPR	5326	1.068	0.263	0	1.587
GDP	5326	8.372	1.554	4.394	11.81
Cosume	5326	23.61	2.691	17.85	29.93
Expense	5326	25.50	2.724	19.38	31.66
LCU	5326	24.77	3.925	12.70	35.46

The GPR has a mean of 1.068 and a standard deviation of 0.263, with values ranging from 0 to 1.587. Although its variation is relatively limited compared to trade freedom, it still captures significant differences across countries in terms of their exposure to geopolitical tensions or conflict events. Notably, some countries exhibit a GPR value of zero, indicating minimal or no exposure to geopolitical risks in certain years—likely reflecting their long-standing stability or neutrality. Regarding the control variables, the natural logarithm of GDP per capita has a mean of 8.372 and a standard deviation of 1.554, with values ranging from 4.394 to 11.81. This wide range signifies pronounced disparities in economic development levels across the sample countries, which is crucial for explaining trade freedom, as economic development often shapes a country's trade policy preferences and openness.

The average values of general government final consumption expenditure and gross national expenditure are 23.61 and 25.50, respectively, both with relatively small standard deviations (2.691 and 2.724), suggesting a relatively concentrated distribution across countries. These two variables are included to account for the influence of macro-fiscal policies on trade freedom—particularly their stabilizing and interventionist roles during external shocks. Lastly, manufacturing value added has a mean of 24.77, a standard de- viation of 3.925, a minimum of 12.70, and a maximum of 35.46. As a critical component of international trade, this variable reflects each country's industrial structure and its embeddedness in global value chains, which may, in turn, affect trade freedom. In summary, the descriptive statistics suggest that both the core explanatory variable (GPR) and

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the dependent variable (Freedom), as well as the control variables, exhibit substantial cross-national heterogeneity. This provides a strong empirical foundation for exploring how geopolitical risk may affect trade freedom through various mechanisms. Moreover, the inclusion of relevant control variables helps to mitigate potential omitted variable bias, thereby enhancing the robustness and credibility of the empirical findings.

4.2. Correlation analysis

To examine the relationships among the variables, this study further computes Pearson correlation coefficients for the main var- iables, as reported in Table 2. The results reveal a significant negative correlation between Geopolitical Risk (GPR) and Trade Freedom (Freedom), with a coefficient of —0.078, which is statistically significant at the 1 % level. This finding provides preliminary empirical support for the hypothesis that geopolitical risk undermines trade freedom.

Regarding the control variables, the correlation between GDP per capita (GDP) and trade freedom is relatively weak and statis- tically insignificant (coefficient = 0.018), suggesting that the level of economic development may have a limited direct effect on trade openness. The correlation between government final consumption expenditure (Cosume) and trade freedom is also low (coefficient =0.019), while the correlation between gross national expenditure (Expense) and trade freedom is slightly higher at 0.032 and is sig- nificant at the 5 % level. This implies a potential positive association between government spending and the degree of trade openness. Overall, the correlation analysis indicates that while geopolitical risk is negatively associated with trade freedom, the impact of macroeconomic controls is more nuanced. The significance and direction of these relationships warrant further investigation through

multivariate regression analysis to control for potential confounders and establish more robust causal inferences.

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4.3. Baseline regression

Table 3 presents the baseline regression results examining the impact of geopolitical risk (GPR) on trade freedom (Freedom), with various macroeconomic control variables included to test the robustness of the findings. All columns (1) through (4) incorporate country and year fixed effects to account for unobserved heterogeneity across countries and time trends.

The results consistently show that the core explanatory variable, GPR, exerts a significant negative effect on trade freedom across all model specifications. The estimated coefficients range from —7.412 to —7.913, all of which are statistically significant at the 1 % level. These findings strongly support the study's baseline hypothesis that higher geopolitical risk significantly suppresses a country's

trade freedom. This suggests that geopolitical turbulence—by increasing uncertainty, disrupting policy coordination, and weakening international cooperation—poses a considerable impediment to open trade environments. Regarding the control variables, GDP per capita (GDP) exhibits a positive association with trade freedom in all four models, with statistical significance at the 5 % or 10 % level in columns (2) through (4). This implies that economic development tends to facilitate greater openness in trade policy.

Table 2 The results of correlation analysis.

Variables	Freedom	GPR	GDP	Cosume	Expense	LCU
Freedom	1.000					
GPR	—0.078***	1.000				
GDP	0.018	—0.098***	1.000			
Cosume	0.019	—0.054***	0.335***	1.000		
Expense	0.032**	—0.041***	0.232***	0.239***	1.000	
LCU	0.000	0.049***	—0.042***	0.188***	0.243***	1.000

Notes: *, **, *** indicate significance at the 10 %, 5 %, and 1 % levels (two-tailed), respectively.

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Table 3 Baseline regression results.

Variables	(1)	(2)	(3)	(4)
	Freedom	Freedom	Freedom	Freedom
GPR	—7.863***	—7.598***	—7.412***	—7.913***
	(-3.08)	(-2.99)	(-2.89)	(-3.06)
GDP	0.145*	0.207**	0.167*	0.161*
	(1.74)	(2.34)	(1.77)	(1.70)
Cosume		—0.114**	0.101	0.063
		(-2.23)	(0.58)	(0.36)
Expense			—0.222	—0.153
			(-1.32)	(-0.91)
LCU				—0.114***
				(-2.67)
Constant	64.826***	67.164***	68.051***	70.152***
	(42.73)	(32.91)	(32.35)	(30.08)
Observations	5326	5326	5326	5326
R^2	0.269	0.269	0.270	0.271
Country	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes

Notes: Robust T values clustered by firm are reported in parentheses. *, **, *** indicate significance at the 10 %, 5 %, and 1 % levels (two-tailed), respectively. In column (2), the inclusion of government final consumption expenditure (Cosume) yields a negative and significant coefficient (—0.114) at the 5 % level, indicating that increased government spending may, to some extent, hinder market mechanisms and trade liberalization. The models' R2 values increase modestly from 0.269 to 0.271, suggesting that the addition of control variables slightly

improves explanatory power. Nevertheless, the core effect of GPR remains robust and stable across specifications. In summary, the baseline regression results confirm that geopolitical risk significantly constrains trade freedom, providing a solid empirical foundation for the subsequent analysis of potential moderating effects.

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4.4. Moderating effect analysis

4.4.1. Financial freedom

Table 4 presents the moderating effect of financial freedom (Finance) on the relationship between geopolitical risk (GPR) and trade freedom (Freedom).

Table 4 The results of moderating effect analysis.

Variables	(1) Freedom	(2) Freedom	(3) Freedom	(4) Freedom
GPR	—	—	—	—
	14.705***	14.537***	11.368***	11.156***
	(-3.47)	(-3.42)	(-3.14)	(-3.11)
GPR*Finance	0.137**	0.137**		
	(2.09)	(2.08)		
Finance	—0.010	—0.009		
	(-0.16)	(-0.15)		
GPR*Gov			0.097***	0.097***
			(2.82)	(2.83)
Gov			—0.115***	—
				0.115***
			(-3.00)	(-2.99)
GDP		0.114		0.198**
		(1.23)		(2.12)
Cosume		0.153		0.196
		(0.88)		(1.17)
Expense		—0.242		—0.290*
		(-1.45)		(-1.80)
LCU		—0.102**		—0.095**
		(-2.46)		(-2.24)
Constant	65.916***	70.344***	71.821***	75.730***
	(17.08)	(16.74)	(22.56)	(21.27)
Observations	5324	5324	5195	5195
R^2	0.292	0.294	0.278	0.281
Country	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes

Notes: Robust T values clustered by firm are reported in parentheses. *, **, *** indicate significance at the 10 %, 5 %, and 1 % levels (two-tailed), respectively.

Column (1) represents the baseline moderation model, while column (2) incorporates control variables to further examine the robustness of the results. Both sets of regressions control for country and year fixed effects to account for

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time trends and unobserved country-specific factors. First, in terms of the main effects, GPR continues to exhibit a significant negative impact on trade freedom in both models, with coefficients of —14.705 and —14.537, which are both statistically significant at the 1 % level. This confirms that global geopolitical risk strongly suppresses national trade freedom. Compared to the baseline regression results

(Table 3), the coefficient of GPR is notably larger in this model, indicating that the negative effect of GPR on trade freedom becomes more pronounced when the interaction term is introduced.

More importantly, the interaction term GPR*Finance is positive and statistically significant at the 5 % level in both models, with a coefficient of 0.137. This suggests that financial freedom significantly mitigates the adverse impact of geopolitical risk on trade freedom. In countries with more open financial systems and freer capital markets, governments and businesses are better equipped to mobilize resources and overcome the financial constraints imposed by external shocks, thus enhancing their capacity to sustain and implement trade liberalization policies. Furthermore, financial freedom may also provide a buffering mechanism by improving foreign capital flow and stabilizing financial markets, which helps countries better cope with geopolitical risks. As such, Hypothesis 2 is validated.

4.4.2. Fiscal health

Table 4 presents the moderating effect of fiscal health (Gov) on the relationship between global geopolitical risk (GPR) and national trade freedom (Freedom). Column (3) represents the baseline moderation model, while column (4) incorporates control variables to further assess the robustness of the results. Both sets of models control for country and year fixed effects.

From the results, geopolitical risk continues to show a significant negative impact on trade freedom. The coefficients of GPR in models (3) and (4) are —11.368

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and —11.156, respectively, and both are significant at the 1 % level. These findings are consistent with the baseline regression and the financial freedom moderation results, further confirming that geopolitical risk, as a typical external uncertainty factor, consistently suppresses national trade policies.The key finding is that the interaction term GPR*Gov is positive and statistically significant at the 1 % level in both models, with coefficients of 0.097. This suggests that fiscal health significantly mitigates the adverse impact of geopolitical risk on trade freedom. In countries with stronger fiscal health, the government possesses more robust macroeconomic management capabilities, greater fiscal reserves, and more reliable debt management mechanisms. As a result, these countries are better able to address fiscal pressures and the adjustment costs of trade policies caused by geopolitical risks, thereby maintaining a relatively open trade system even in an unstable international environment.

However, the main effect of fiscal health on trade freedom is significantly negative (coefficient = —0.115, significant at the 1 % level), suggesting that in some cases, fiscal health may be associated with tighter fiscal constraints and government spending cuts, which could suppress trade openness in the short term. This finding highlights the importance of considering the heterogeneity of fiscal health's impact across countries with different economic structures when analyzing its moderating role. In summary, fiscal health enhances a country's resilience to geopolitical risks and weakens their negative effects on trade freedom. This moderating result aligns with that of financial freedom, underscoring that internal institutional resilience plays a critical role in responding to external geopolitical shocks and maintaining trade openness.

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Table 5 The results of robust tests.

Variables	(1)	(2)	(3)
	Freedom	Freedom	Freedom
Commercial	—0.143***		
	(-3.31)		
L.GPR		—8.098***	
		(-3.04)	
GPR			—9.094***
			(-2.69)
GDP	0.171*	0.135	—0.146
	(1.77)	(1.54)	(-0.54)
Cosume	0.079	0.155	—0.307
	(0.46)	(0.88)	(-0.80)
Expense	—0.193	—0.230	0.008
	(-1.19)	(-1.36)	(0.02)
LCU	—0.101**	—0.076*	—0.148
	(-2.39)	(-1.85)	(-1.33)
Constant	60.490***	66.690***	77.091***
	(17.83)	(32.63)	(17.50)
Observations	5309	5128	1304
R^2	0.282	0.293	0.237
Country	Yes	Yes	Yes
Year	Yes	Yes	Yes

Notes: Robust T values clustered by firm are reported in parentheses. *, **, *** indicate significance at the 10 %, 5 %, and 1 % levels (two-tailed), respectively.

4.5. Robustness test

To validate the robustness of our findings, we use commercial freedom (Commercial) as a proxy for trade freedom and conduct regression analysis. The results in Column (1) of Table 5 show that after replacing the explanatory variable, the conclusions of this study remain reliable. To address the potential endogeneity issue arising from bidirectional causality between the independent and dependent variables, we lag the independent variable by one period and perform the regression analysis again. As shown in Column (2) of Table 5, the coefficient for global geopolitical risk remains negative, indicating that even after lagging the explanatory variable by one period, the results continue to hold.

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Furthermore, to mitigate the potential sample selection bias, we perform a Propensity Score Matching (PSM) test for robustness. Specifically, we divide the sample into two groups based on the mean of global geopolitical risk. Countries with geopolitical risk above the mean are treated as the treatment group, while the remaining countries are considered the control group. We then match the groups using the control variables as covariates. After matching, the samples are used for model testing. The results in Column (3) of Table 5 show that the conclusions of this study remain robust.

Following the approach of Sohag et al. (2022), this study uses the weighted average geopolitical risk (GPR) of other countries in the same continent (excluding the country itself) as an instrumental variable to examine the impact of geopolitical risk (GPR) on trade freedom. This approach is both theoretically and empirically sound.

From a theoretical perspective, this instrument helps address potential endogeneity issues between geopolitical risk and trade freedom, particularly reverse causality and omitted variable bias. Specifically, in some cases, a country's trade freedom could influence its geopolitical stability (e.g., trade-dependent countries might avoid conflict to maintain trade flows), leading to estimation bias. By using the geopolitical risk of other countries in the same continent as the instrumental variable, we can extract the part of GPR that is highly correlated with the country's own GPR but not directly influenced by its trade freedom. This helps isolate the net effect of geopolitical shocks on trade freedom.

From an empirical standpoint, geopolitical risk exhibits significant regional spillover effects. Conflicts, regime changes, or security crises in neighboring countries often influence the political climate of the entire region and shape external investors' expectations. For instance, war or terrorism in a Middle Eastern country might trigger regional security alerts, thereby impacting the policy environment and international cooperation conditions in neighboring countries (BenMabrouk et al., 2024). As a result, a country's GPR is often highly

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correlated with the GPR of geographically neighboring countries. Furthermore, the instrument (geopolitical risk of neighboring countries) is unlikely to have a direct effect on the country's trade freedom, as trade freedom is primarily determined by the country's institutional arrangements, economic structure, and policy orientation, which are not directly influenced by the political risks of neighboring countries. This satisfies the exogeneity condition for the instrument. In summary, using the weighted average geopolitical risk of other countries in the same continent as the instrumental variable is both theoretically logical and empirically grounded. It is an effective strategy for identifying the causal impact of geopolitical risk on trade freedom.

Table 6 presents the test results of instrumental variables. In the first stage, the relationship between the instrument (the weighted average GPR of other countries in the same continent) and the endogenous variable (GPR) is significantly positive (coefficient = 0.685, t-value = 4.47, significance at the 1 % level). This indicates that the instrumental variable has good explanatory power for geopolitical risk. This result supports the relevance condition of the instrument, demonstrating that regional geopolitical risk has strong spillover effects, with a country's GPR statistically influenced by the geopolitical tension in other countries in its region.

Table 6 Instrumental variable analysis

Variables	(1)	(2)
	GPR	Freedom
IV	0.685***	
	(4.47)	
GPR		—41.859***
		(-7.25)
GDP	—0.002***	—0.728
	(-3.40)	(-0.18)
Cosume	—0.003	—1.728
	(-1.05)	(-0.25)
Expense	0.006*	2.509
	(1.84)	(0.24)
LCU	—0.002***	—0.743
	(-5.18)	(-0.27)
Constant	0.083***	104.012
	(9.08)	(0.74)
Observations	5325	5325
Country	Yes	Yes
Year	Yes	Yes

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Notes: Robust Z values clustered by firm are reported in parentheses. *, **, *** indicate significance at the 10 %, 5 %, and 1 % levels (two-tailed), respectively. In the second stage, the effect of GPR on trade freedom remains significantly negative, and the absolute value of the coefficient increases substantially (coefficient = —41.859, t-value = —7.25, significance at the 1 % level). This shows that after controlling for endogeneity bias, the suppressive effect of geopolitical risk on trade freedom is stronger than what was observed in the OLS results. This further reinforces the core finding of the study: geopolitical risk is a significant external shock that constrains national trade
freedom. In contrast, control variables do not attain statistical significance in the second stage, suggesting that geopolitical risk is one of the main drivers explaining changes in trade freedom.

4.6. Heterogeneity analysis

We hypothesize that in countries with lower government transparency, the detrimental impact of global geopolitical risk on trade freedom is more pronounced. This can be attributed to multiple transmission mechanisms arising from insufficient governance ca- pacity. On the one hand, low government transparency often signals severe corruption, inefficient administration, and limited policy implementation capabilities. In the face of external shocks (such as the threat of war, regional conflicts, or terrorism), these countries lack timely and effective response mechanisms, making it difficult to ensure the safety of trade flows and the normal order of cross- border transactions. Geopolitical risks themselves generate concerns among firms about supply chain disruptions, investment security, and rising transaction costs. In countries with weak institutional environments, these concerns are harder to alleviate, leading firms and investors to adopt more conservative strategies that limit international trade activities (Chen et al., 2025). On the other hand, countries with low transparency are often accompanied by regulatory gaps and rent-seeking practices, making it

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difficult for macro-control and resource allocation mechanisms to function effectively in addressing geopolitical risks. This exacerbates the risk of a decline in trade freedom. Additionally, political opacity reduces foreign investors' confidence in the policy environment, further suppressing the willingness of multinational companies to engage in trade (Jia et al., 2025). In summary, the lack of government transparency diminishes a country's overall governance resilience, amplifying the impact of geopolitical shocks and leading to deeper negative effects on trade freedom.

Similarly, we argue that in countries with lower monetary freedom, the suppressive effect of global geopolitical risk on trade freedom is also more significant. This is due to the rigidity of the monetary system and restrictions on capital flows, which exacerbate the internal transmission effects of external shocks. Low monetary freedom is typically characterized by strict government control over exchange rates, tight foreign exchange controls, and a closed or heavily restricted capital account. Such institutional arrangements limit the market's ability to autonomously adjust to geopolitical risks. Specifically, when significant global geopolitical turmoil occurs, such as wars, sanctions, or rising regional security tensions, international trade participants (especially cross-border exporters, im- porters, and investors) need to quickly hedge risks through mechanisms such as exchange rate adjustments, capital flow allocations, and foreign currency settlements. However, in countries with limited monetary freedom, these market-based mechanisms are sup- pressed, causing firms to respond slowly to exchange rate fluctuations, capital withdrawal, or rising financing costs. This, in turn, amplifies trade costs and uncertainty. Furthermore, low monetary freedom often comes with poor monetary policy independence and high inflation risks. During periods of rising geopolitical risk, domestic policies may fail to stabilize market expectations in time or may exacerbate economic distortions through excessive intervention, further eroding the stability of the trade environment. Therefore, in these countries, geopolitical risks have a more

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direct and persistent negative impact on trade freedom through financial channels, particularly affecting import and export activities, foreign investment, and cross-border settlements.

To explore these hypotheses, we follow the approach of Trifonov and Potanin (2024) by dividing the sample into two groups based on government transparency: higher government transparency (LC) and lower government transparency (HC). Additionally, we categorize the sample into high monetary freedom (HFMD) and low monetary freedom (LFMD) groups. Table 7 presents the heterogeneity test results, which show that in countries with lower government transparency and poorer monetary freedom, the negative impact of global geopolitical risk on trade freedom is more pronounced. This finding suggests that governance quality and monetary policy flexibility are key determinants of a country's ability to respond to external risks.

Table 7 The results of heterogeneity analysis.

Variables	(1) LC	(2) HC	(3) HFMD	(4) LFMD
GPR	—5.987	—9.856***	—6.762*	—8.813**
	(-1.57)	(-3.11)	(-1.78)	(-2.37)
GDP	0.282**	—0.063	0.125	0.300
	(2.13)	(-0.48)	(1.25)	(1.52)
Cosume	0.054	0.133	0.062	—0.191
	(0.22)	(0.57)	(0.37)	(-0.44)
Expense	—0.129	—0.157	—0.195	0.212
	(-0.57)	(-0.67)	(-1.15)	(0.50)
LCU	—0.077	—0.122**	—0.122**	—0.092
	(-1.26)	(-2.18)	(-2.42)	(-1.07)
Constant	65.367***	73.056***	75.740***	60.075***
	(16.44)	(23.24)	(26.59)	(16.51)
Observations	2879	2447	3527	1799
R^2	0.309	0.278	0.284	0.218
Country	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes

Notes: Robust T values clustered by firm are reported in parentheses. *, **, *** indicate significance at the 10 %, 5 %, and 1 % levels (two-tailed), respectively.

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5.Conclusions

This study conducts an empirical analysis of the impact mechanism of global geopolitical risks (GPR) on national trade freedom. It utilizes the Trade Freedom Index published by the Heritage Foundation as a measure and combines the GPR index constructed by Caldara and Iacoviello (2022) to explore the systematic effects of geopolitical shocks on the openness of trade policies across countries. The results indicate that global geopolitical risks significantly suppress national trade freedom. This finding is highly consistent with existing literature, which suggests that geopolitical uncertainty acts as a barrier to international trade flows, further verifying how political and security risks between nations, in the context of global turmoil, suppress trade freedom through institutional expectations, cost channels, and confidence transmission mechanisms.

More critically, this study, while controlling for a series of macroeconomic variables, introduces a moderating effect model and finds that a country's financial freedom and fiscal health can partially mitigate the loss of trade freedom caused by geopolitical risks. A higher degree of financial freedom means smoother capital flows and more mature financial markets, providing businesses and governments with more flexible risk hedging tools, thus enhancing the resilience of the economy to external shocks. Similarly, countries with robust fiscal health, due to stronger policy adjustment space and resource mobilization capacity, are better equipped to implement emergency fiscal interventions and stabilize market expectations, thereby reducing fluctuations in trade freedom.

Furthermore, heterogeneity analysis further reveals that in countries with lower government integrity and poorer monetary freedom, the suppressive effect of global geopolitical risks on trade freedom is more significant. This indicates that the quality of national governance and the robustness of macroeconomic institutions are important mediating variables influencing the intensity of external shock transmission. A sound governance mechanism and a flexible monetary

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system not only help stabilize the domestic trade policy environment but also enhance the institutional flexibility to respond to external risks.

In the current context of rising global geopolitical risks and high uncertainty in the international economic environment, it is urgent for governments to adopt systemic policy measures to mitigate the suppressive effect of geopolitical shocks on trade freedom and enhance the sustainability of institutional resilience and openness. First, efforts should be made to improve national fiscal health by optimizing fiscal expenditure structures, strengthening tax governance, and enhancing budget transparency. This would provide sufficient policy adjustment space when facing sudden geopolitical risk events, avoiding the need to resort to trade controls due to limited fiscal capacity, thereby stabilizing expectations of external openness. Second, financial market reforms should be deepened to increase financial freedom, through the orderly opening of capital accounts, development of diversified financing tools, and improvement of the market-based exchange rate formation mechanism, offering market participants the flexibility for risk hedging and capital allocation, thereby improving the economy's capacity to respond to external shocks. Third, national governance capabilities, particularly in institutional transparency, government integrity, and policy implementation efficiency, should be significantly strengthened to reduce the erosion of trade freedom caused by policy uncertainty, regulatory arbitrage, or rent-seeking behaviors, and to build a more stable, fair, and predictable trade policy environment. Additionally, countries should strengthen their monetary policy frameworks to increase monetary freedom, particularly in middle- and low-income countries, by enhancing the independence and flexibility of monetary policies. This would prevent excessive intervention in exchange rates or non-market-based capital flow re- strictions, ensuring that the national monetary system can maintain appropriate elasticity under global risk shocks and stabilize cross- border trade financial chains. Finally, regional cooperation and multilateral governance mechanisms should be promoted by estab- lishing regional trade risk

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coordination frameworks, enhancing policy communication with international organizations, and linking emergency mechanisms, in order to improve collective responses to global geopolitical shocks and reduce the long-term impact of systemic instability on regional trade freedom. Through the coordinated advancement of institutional improvement, market deep- ening, and cooperation expansion, global economies can achieve sustainable improvements in trade freedom and ensure the stability of the international economy amidst the increasingly frequent risks in the international arena.

Author statement

We hereby confirm that all authors have contributed to and approved the submission of this manuscript. This work is original, has not been published previously, and is not under consideration for publication elsewhere. All authors have no conflicts of interest to declare.

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