Discussion of “US Politics, Geopolitics, and the Post-Modern World Economy” by Maurice Obstfeld

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XXI Conferencia Anual de Estudios Económicos
FLAR/CAF

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(*): The views expressed here are my own and not necessarily those of other members of the Board of the Central Bank of Chile.

Main messages

- US politics in the period 1969-1973 set the stage for the new modern world economy:
  - Floating exchange rate system.
    - The end of the foreign official convertibility of U.S. dollars into gold.
  - Independent IT central banks.
    - Wage and price freezes/oil price shock/new monetary theory and policy frameworks (Kydland and Prescott 1977; Calvo 1978).
  - Globalization in trade and FDI.
    - New China policy at that time (the demise of Soviet bloc).
  - Global financialization.
    - Flexible exchange rate, independent monetary policy and capital mobility/also...
  - Ascendancy of free market economics.

Main messages

- It is important to notice that the new modern world economy came accompanied by a new geopolitical situation.

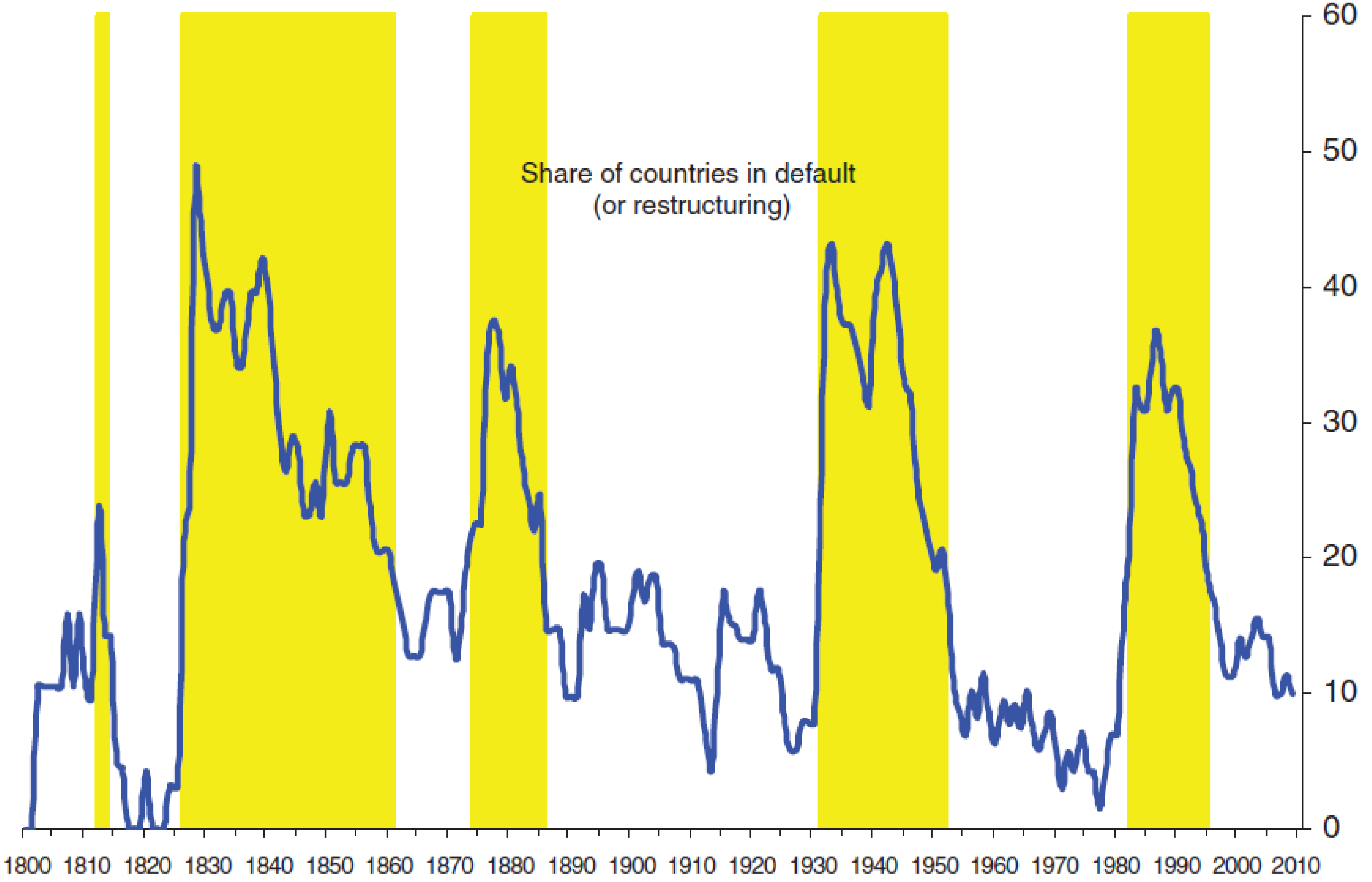
- The current global turmoil is setting the stage for the next act.

- Global reordering moment.

Transition costs…

- The transition to the modern world economy was not smooth…especially for some EMEs…

Share of countries in default or restructuring: 1800-2009



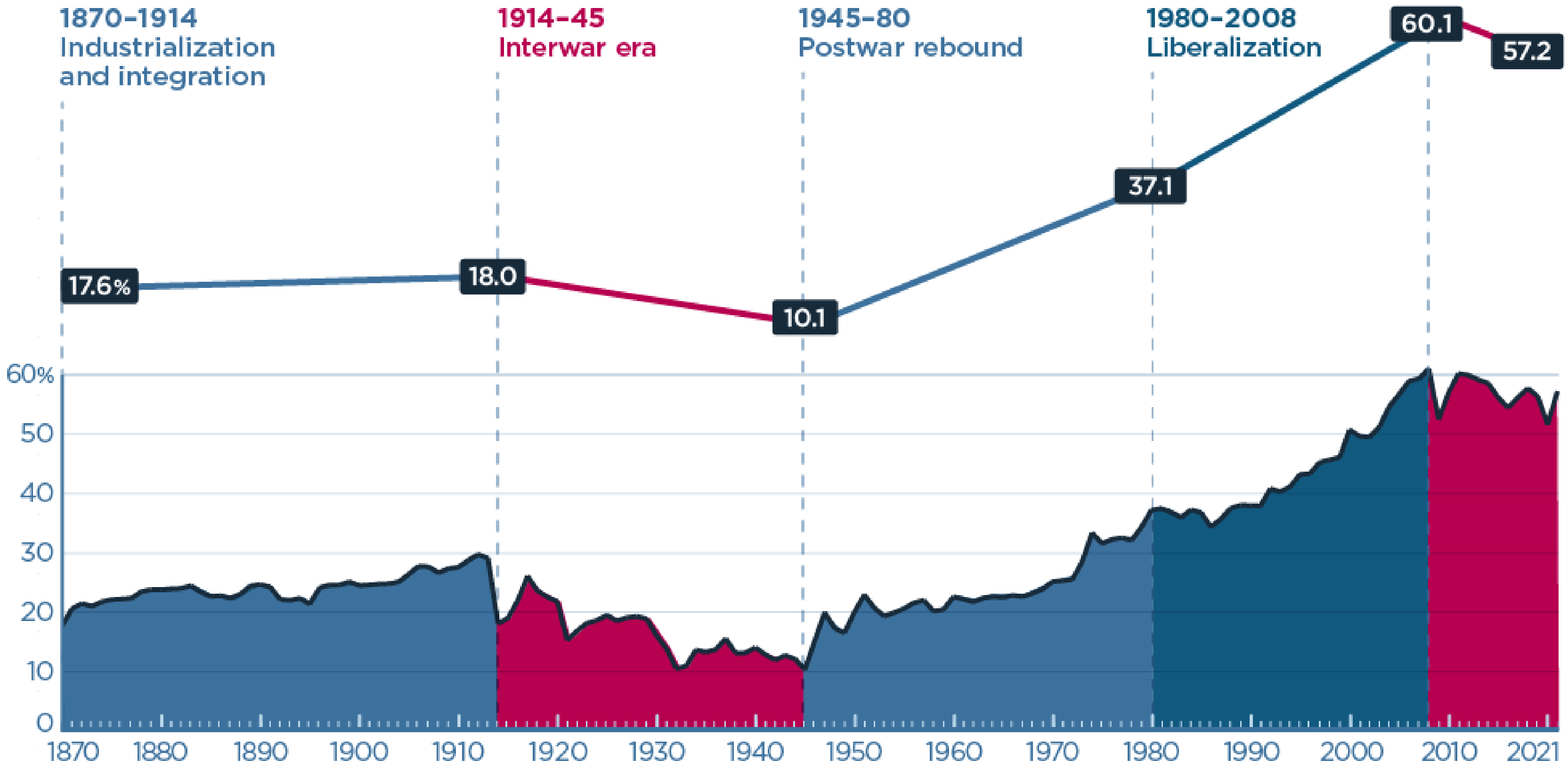
Source: Reinhart and Rogoff (2011)

Transition costs…

- Nonetheless, this change, it brought significant opportunities/benefits for many countries around the world (for the countries that implemented sound policies).

- But economic context now is different in terms of many structural conditions compared to the context in the 70s and 80s.
    - Integration/larger shocks/propagation/amplification.
    - Better macro policy frameworks.
    - Initial conditions…

Trade openness index, 1870–2021



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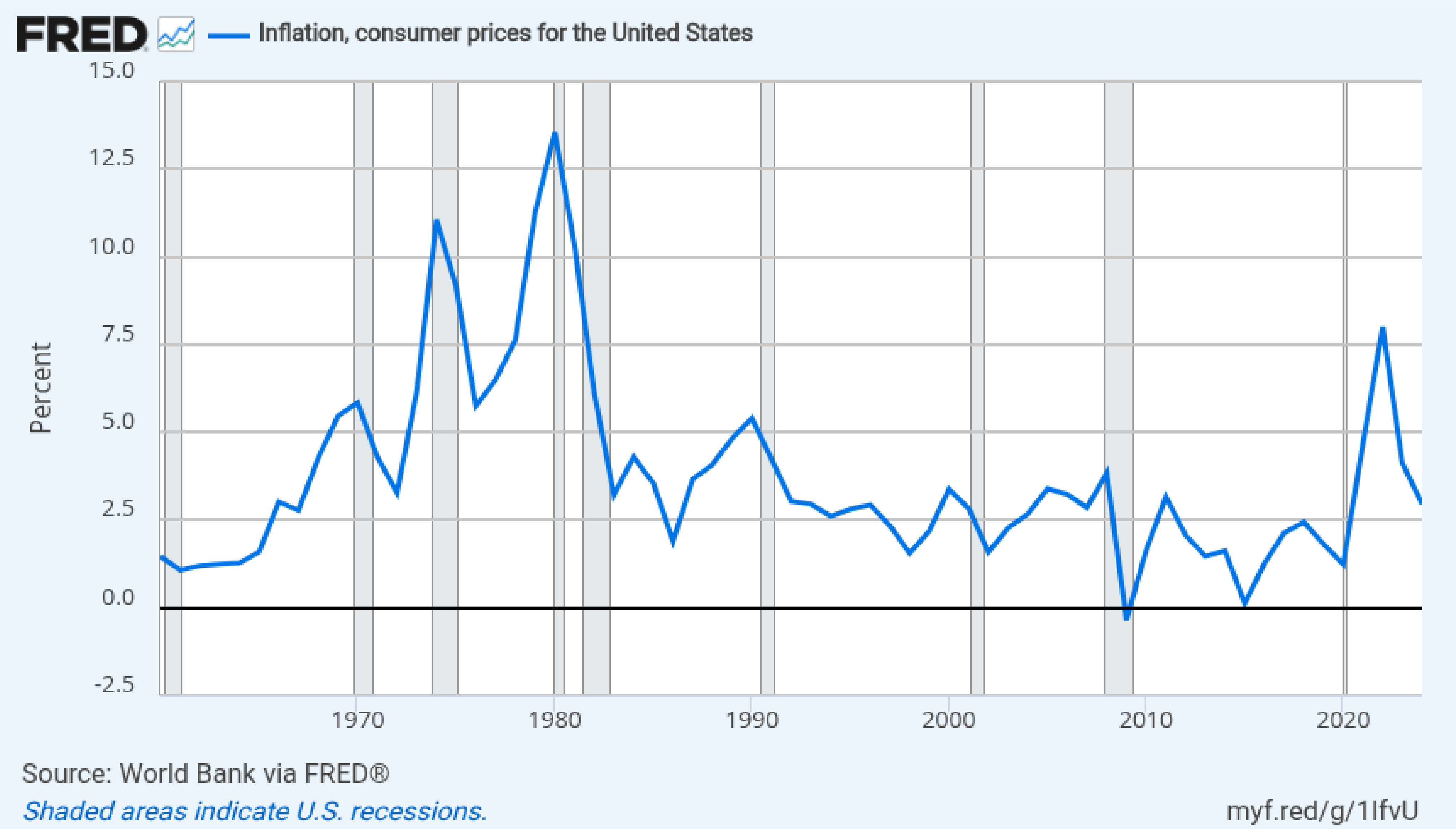
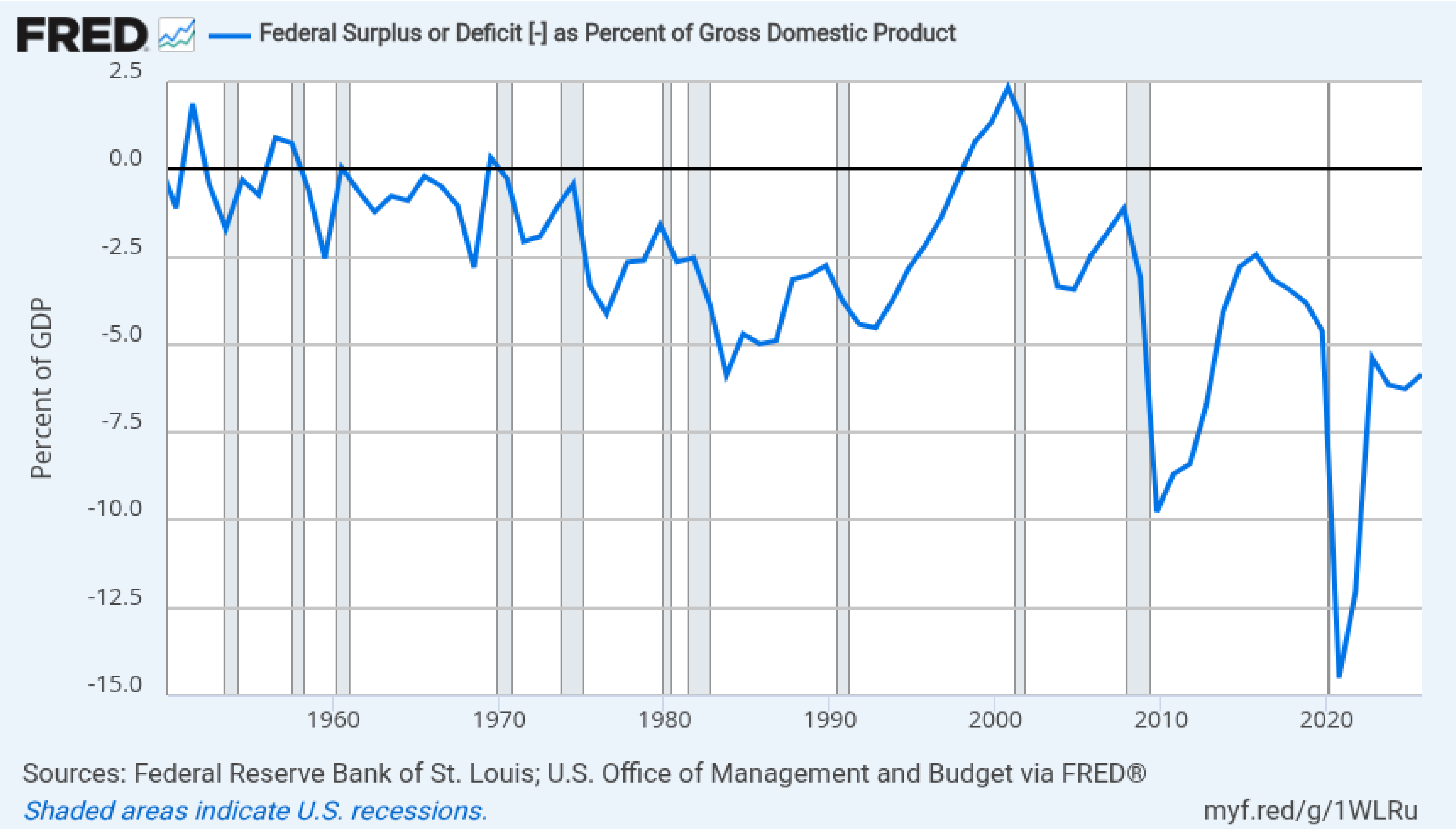
Note: The trade openness index is defined as the sum of world exports and imports divided by world GDP. 1870 to 1949 data are from Klasing and Milionis (2014); 1950 to 1969 data are from Penn World Tables (10.0). 1970 to 2021 data are from the World Bank.

Sources: Our World in Data; World Bank, World Development Indicators; and author's calculations for 2021.


FRED
Inflation, consumer prices for the United States
15.0
12.5
10.0
7.5
5.0
2.5
0.0
-2.5
Percent
1970
1980
1990
2000
2010
2020
Source: World Bank via FRED®
Shaded areas indicate U.S. recessions.
myf.red/g/1IfvU

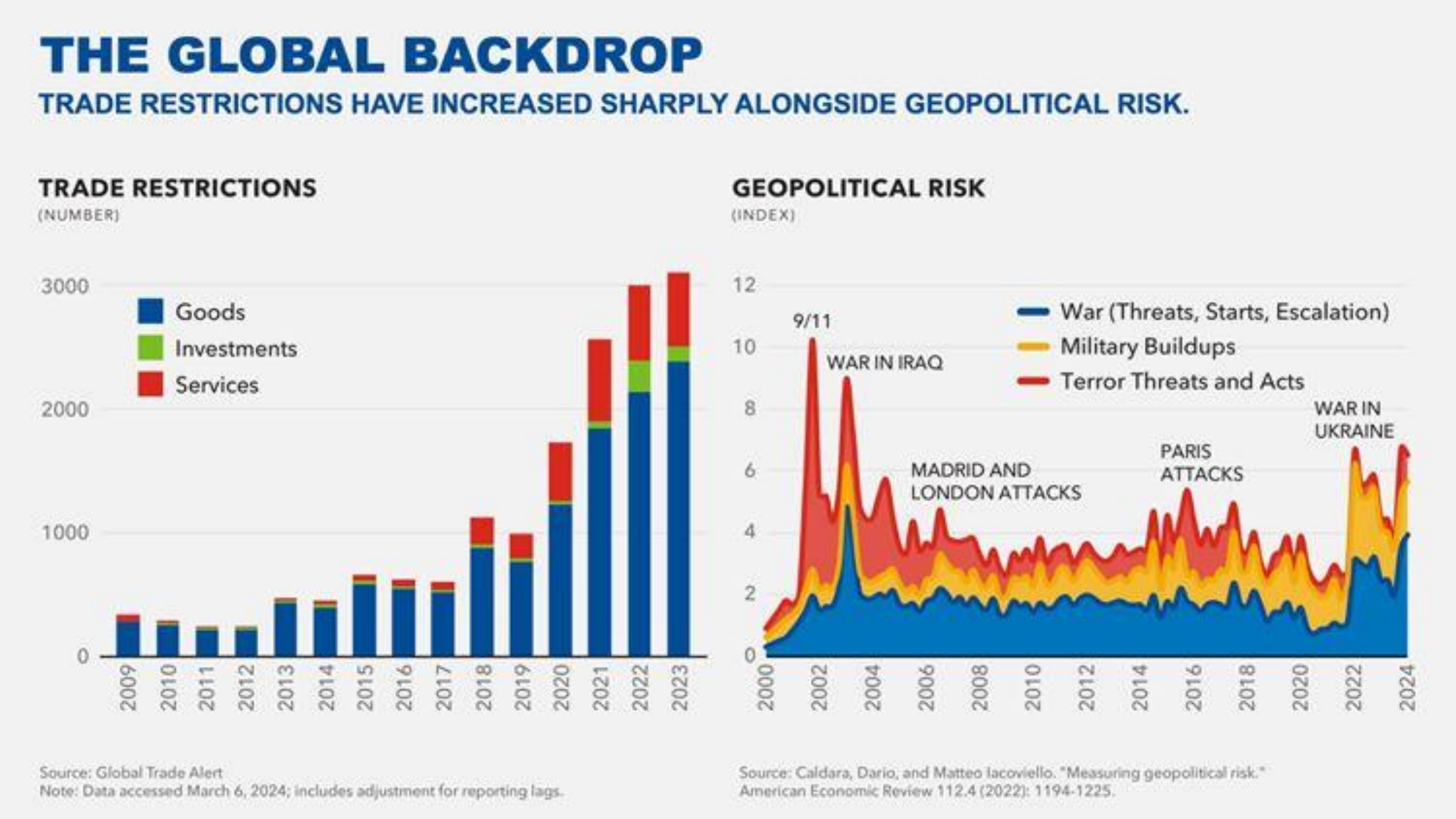

FRED
Federal Surplus or Deficit [-] as Percent of Gross Domestic Product
2.5
0.0
-2.5
-5.0
-7.5
-10.0
-12.5
-15.0
Percent of GDP
1960
1970
1980
1990
2000
2010
2020
Sources: Federal Reserve Bank of St. Louis; U.S. Office of Management and Budget via FRED®
Shaded areas indicate U.S. recessions.
myf.red/g/1WLRu

Geopolitical risks

- Moving to a new equilibrium?
  - Clayton, Maggiori and Schreger (2025): “Hegemonic powers can increase their own welfare by voluntarily and credibly constraining their use of coercion. A hegemon that commits to limiting its demands can dissuade other countries from pursuing costly anti-coercion policies.” (International institutions as commitment devices).
  - If countries with significant geoeconomic power are perceived as willing to exert significant degrees of that power, other countries will respond. Fragmentation would be the equilibrium in this case.
  - Risk of fragmentation: Obstfeld second-generation currency crisis models, critical threshold?

- Some geoeconomic risks have materialized and more in general, geopolitical risks have increased.

Geopolitical risks have increase…(trade restrictions…)



Source: Gopinath (2024), IMF.

Geopolitical risks

- Trade fragmentation and financial fragmentation costs could be significant (recent IMF-CEPR report).

- Role of technology. Krugman (1980, 1984): what determines the structure of exchange is the distribution of transaction costs across currencies. If one currency has particularly low transaction costs – due to cheaper conversion, deeper financial markets, stronger infrastructure – it will tend to dominate the system, even if it doesn't reflect the underlying trade flows. This is an explanation for the global role of the US dollar.

Perspectives for EMEs

- Fragmentation fuels larger and more frequent supply shocks.

- Identification of transmission channels (input-output, trading partners, choke points).
  - Enhanced monitoring of supply chains.
  - Macro models with supply-chain interlinkages.
  - Choke points.
    - Some EMEs are critical in supply of some commodities.
    - Targeted de-risking.

  - Critical for look-through approach/second round effects.

Perspectives for EMEs

- A sound macroeconomic/financial stability policy framework is key (monetary/fiscal).
  - Credible IT.
  - International liquidity.
  - Financial stability regulation.
  - Critical identification of vulnerabilities.

- Build adequate buffers.

Perspectives for EMEs

- The role of technology: automation and AI.
- Labor markets.
- Political challenge is enormous, in times of (domestic) political fragmentation.

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