Geoeconomic Challenges to Policy

100 Years Celebration of Banco Central de Chile

November 2025

Matteo Maggiori

THE GLOBAL CAPITAL ALLOCATION PROJECT

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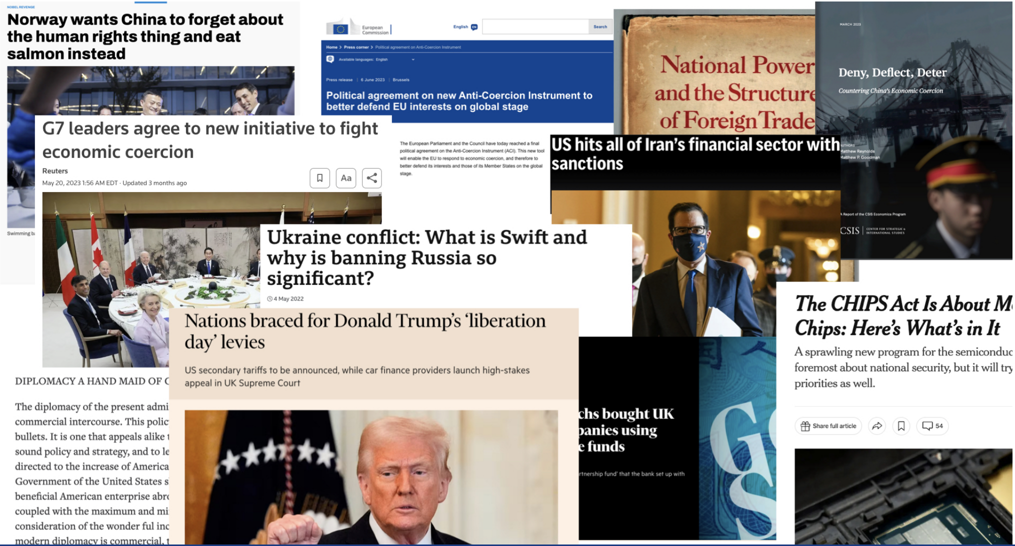
Why do we care? An Activity that Shapes the World



What is Geoeconomics?

- **Geoeconomics:** Hegemonic countries use their economic strength from existing financial and trade relationships to achieve geopolitical and economic goals
- Fundamental questions:
  - Is geoeconomic power effective? In which dimensions?
  - What are the origins of this power and how is it wielded?
  - Is it zero-sum or positive sum globally?
  - Which sectors are strategic? What is a national security externality?
  - How should countries protect themselves from hegemonic influence?
  - Trade off between economic security and gains from trade?
  - How do we measure all this and inform policy?

Our Research Agenda on Geoeconomics

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Clayton Maggiori Schreger, A Framework for Geoeconomics, Forthcoming Econometrica

Clayton Maggiori Schreger, A Theory of Economic Coercion and Fragmentation, 2024

Clayton Maggiori Schreger, Putting Economics Back Into Geoeconomics, MacroAnnual 2025

Clayton Maggiori Schreger, The Political Economy of Geoeconomic Power, AEA P&P 2025

Clayton Coppola Maggiori Schreger, Geoeconomic Pressure, 2025

Reading List

Concepts of Power in Economics and Political Science

- In modern economics power is too often reduced to only mean "market power." But a sovereign or large firm is powerful in a broader sense

- Some important concepts of power in Political Science:

  - *"A has power over B to the extent that he can get B to do something that B would not otherwise do"* (Dahl 1957)

  - **Relational Power**: an actor, like a government, influences another actor to take a desired action

  - **Structural Power**: an actor influences an entire economic environment, e.g. setting the rules of the game or coordinating (Strange 1988)

  - Topic is "one of the most troublesome in the field of international relations." Only point of agreement is "unsatisfactory state of knowledge" (Gilpin 81, Baldwin 13)

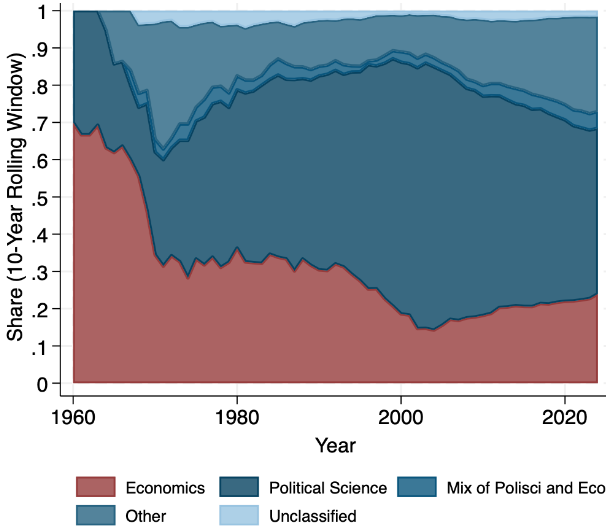
Hirschman: National Power and the Structure of Foreign Trade

Largely and unjustly forgotten history of this topic in economics

Hirschman (1945): *National Power and the Structure of Foreign Trade*

- Distaste for mercantilism: exertion of power in zero-sum game over fixed resources
- In the debate of "plenty vs power" (Viner 1948) does not support the laissez faire view that plenty is always best achieved by ignoring power
- Theory of power imbalances and how they arise from different trade patterns
- Measurement of power imbalances: the Hirschman-Herfindahl concentration index

Hirschman: National Power and the Structure of Foreign Trade

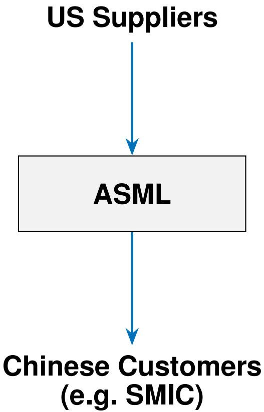


- Limited impact among economists
- By 1970s, foundational text of International Political Economy
- In economics, HH-index widely used to measure firms' market power; lost its connection to the power of countries

Power as Slack in a Participation Constraint

$$V(x^*, z, \cdot, \cdot)$$

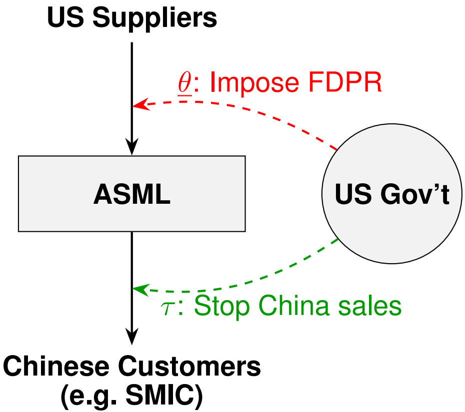
- Entity's privately optimal actions: $x^* = x(z, \cdot, \cdot)$
- Takes as given a set of aggregate variables z



Power as Slack in a Participation Constraint

$$V(x^*, z, \underline{\theta}, 0) \qquad V(x^*, z, 0, \tau) \qquad V(x^*, z, 0, 0)$$

- Entity's privately optimal actions:
  $x^* = x(z, \theta, \tau)$
- Takes as given a set of aggregate variables z
- Hegemon threatens $\underline{\theta}$ if demands not accepted
- Demands that entity undertake costly actions τ

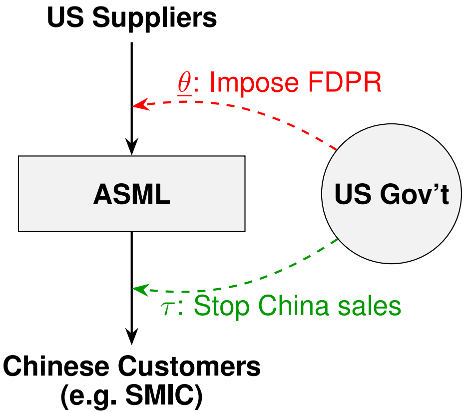


Power as Slack in a Participation Constraint

$V(x^*, z, \underline{\theta}, 0)$ $\quad$ $V(x^*, z, 0, \tau)$ $\quad$ $V(x^*, z, 0, 0)$

- Entity's privately optimal actions:
  $x^* = x(z, \theta, \tau)$
- Takes as given a set of aggregate variables z
- Hegemon threatens $\underline{\theta}$ if demands not accepted
- Demands that entity undertake costly actions τ
- **Participation constraint**:

$$V(x^*, z, 0, \tau) \geq V(x^*, z, \underline{\theta}, 0)$$



Micro and Macro Power: Strategic Sectors

- **Micro Power**: $V(x^*, Z, 0, 0) \; - \; V(x^*, z, \underline{\theta}, 0)$
  - The maximal value of costly actions that the hegemon can demand out of the target before contract is rejected
  - Sector is **strategic** if it lets the hegemon form valuable threats on other sectors
- **Macro-Power:** Hegemon exploits difference between private cost of actions to targeted entities and the social benefit to itself via manipulating the equilibrium
  - Sector is **strategic** if it lets the hegemon manipulate aggregate quantities and prices
  - Some strategic sectors have high indirect influence in the Leontief inverse sense, summarized as Lagrange multiplier on PC constraint

Sketch of Modeling

- N countries, a set $\mathcal{I}$ of productive sectors, a set $\mathcal{F}$ of local factors
- Each sector and factor are located in one country:
  - $\mathcal{I}_n$ is the set of sectors in country n
  - $\mathcal{F}_n$ is the set of local factors of country n
- Unit mass of firms in sector i produces a differentiated good y_i using:
  - Intermediate goods x_{ij}, where j is the source sector
  - Local factors of production ℓ_{if}, where f indexes factor
  - Production function $f_i(x_i, \ell_i, z)$
- Vector z of aggregate quantities, e.g. external economies of scale
- Each country n has a representative consumer and government

Representative Consumer of Country n

- Utility function: $U(C_n) + u_n(z)$, where C_n vector over each good C_{ni}
  Simplifying assumption: U is identical across countries, homothetic
- Consumer owns domestic sectors and factor endowments $\bar{\ell}_f$ in their country
- Budget constraint:
$$\sum_{i \in \mathcal{I}} p_i C_{ni} \leq \sum_{i \in \mathcal{I}_n} \Pi_i + \sum_{f \in \mathcal{F}_n} p_f^{\ell} \bar{\ell}_f$$
  Sector i profits Π_i, good price p_i, factor price p_f^{ℓ}
- Marshallian demand $C(p, w_n)$; Indirect utility $W(p, w_n) = U(C(p, w_n))$
- Market clearing: $\sum_{n=1}^{N} C_{nj} + \sum_{i \in \mathcal{I}} x_{ij} = y_j; \quad \sum_{i \in \mathcal{I}_n} \ell_{if} = \bar{\ell}_f$

Timeline and Government Policy Tools

Beginning

Each government chooses:
- Policies on domestic firms, revenue neutral wedges $\tau_{n,i}$

Middle

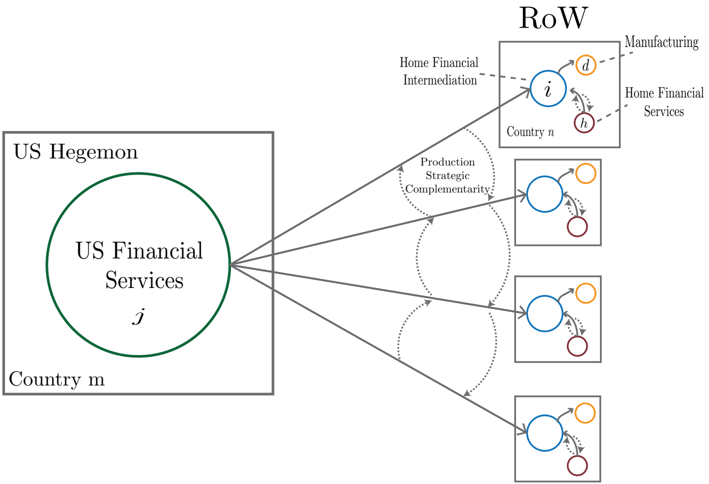
Hegemon government:
- Threatens foreign entities with loss of access to inputs it controls
- Demands costly actions:
  - Additional revenue-neutral wedges $\tau_{m,i}$
  - Transfers T

Rest of the world entities decide:
-whether to accept hegemon's offer

End

Production and Consumption

Application: Financial System as a Tool of Coercion



Intermediary Production and Externalities

$$y_i = \left(A_j(z) x_{i_n j}^{\sigma} + A_{i_n h}(z) x_{i_n h}^{\sigma} \right)^{\beta/\sigma}$$

$$A_j(z) = \frac{1}{N} \sum_{n=1}^{N} \overline{A}_j z_{i_n j}^{\xi_j \sigma}$$

$$A_{i_n h}(z) = \overline{A}_h z_{i_n h}^{\xi_h \sigma}$$

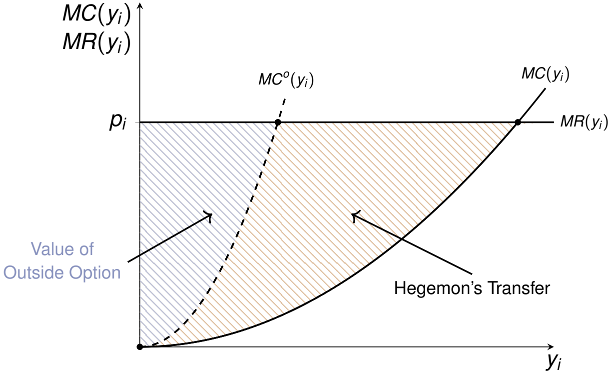
For application, assume constant prices

Comparing Different Global Structures

	Hegemon Finance $\tau_{n,i_n j}$	**Home Alternative** $\tau_{n,i_n h}$
Global Planner	$-\frac{\xi_j}{1+\xi_j} p_j$	$-\frac{\xi_h}{1+\xi_h} p_h$
Nash	0	$-\frac{\xi_h}{1+\xi_h} p_h$
Anti-Coercion		

Hegemon's Power-Building Motives

$$\text{Participation Constraint :} \quad V_i(x_i^*, z, 0, \tau_{m,i}) - T_i \geq V_i(x_i^\circ, z, \underline{\theta}, 0)$$



- Hegemon cares about difference in value between inside and outside option
- Hegemon builds power by manipulating the equilibrium

Hegemon's Optimal Use of Power

- Hegemon subsidizes use of Hegemon System to make inside option better:

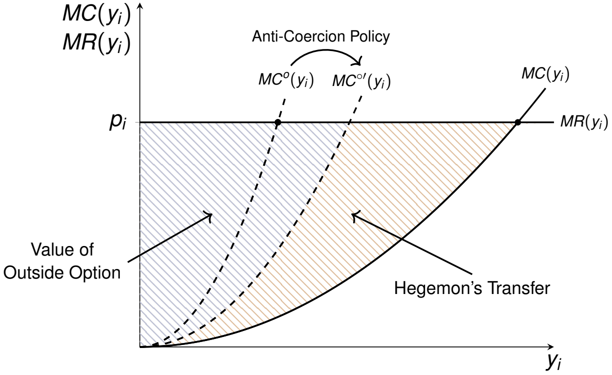
$$\tau_{m,i_n j} = -\frac{\xi_j}{1+\xi_j}\left(p_j + \tau_{n,i_n j}\right)$$

- Hegemon taxes Home Alternative to make outside option worse

$$\tau_{m,i_n h} = \frac{\xi_h}{1+\xi_h}\left(\frac{x^o_{i_n h}}{x^*_{i_n h}} - 1\right)\left(p_h + \tau_{n,i_n h}\right)$$

- Hegemon attempts to over-globalize world economy to induce dependency

Countries' Anti-Coercion Motives



- Targeted entity cares about level of outside option
- Anti-coercion: maximize outside option, manipulate hegemon's demands

Comparing Different Global Structures

	Hegemon Finance $\tau_{i_n j}$	Home Alternative $\tau_{i_n h}$
Global Planner	$-\dfrac{\xi_j}{1+\xi_j}p_j$	$-\dfrac{\xi_h}{1+\xi_h}p_h$
Nash	0	$-\dfrac{\xi_h}{1+\xi_h}p_h$
Anti-Coercion	∞	$-\dfrac{\xi_h}{1+\xi_h}p_h$

Four Lessons from Geoeconomic Theory

1. **Trade off between Gains from Trade and Economic Security:** Increasing returns to scale and specialization are source of *both* gains from trade and hegemonic power by making other technologies poor substitutes for dominant ones

2. **Krugman Meets Geoeconomics:** facing coercive global hegemons countries decide to specialize less and unwind some globalization

3. **Fragmentation doom loop:** each country fragmenting increases incentives for others to do so, kick globalization loop in reverse

4. **Hegemonic View of International Organizations:** these organizations are an expression of the hegemon that optimally commits to limit coercion to attract participation from other countries

Measurement: A Sufficient Statistics Approach

Quantifying Geoeconomic Power: Nested CES

Percentage loss from losing access to Hegemon's inputs:

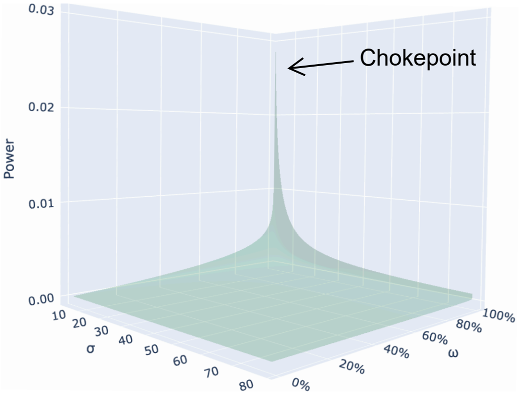
$$\text{Power}_{m,i} = -\frac{\beta}{1-\beta} \sum_{G \in \{M,F\}} \Omega_{iG} \log\left(1 - \Omega_{iGR} + \Omega_{iGR}\left(1 - \omega_{iGR_m}\right)^{\frac{\varsigma_G - 1}{\sigma_G - 1}}\right)^{\frac{1}{\varsigma_G - 1}}$$

- Expenditures shares measured using OECD Input Output Tables, BACI, BaTIS:
  - Ω_{iG}: share on sector (Financial services (F), All other goods and services (M))
  - Ω_{iGR}: share of sectoral spending on foreign inputs
  - ω_{iGR_m}: share of foreign inputs within sector controlled by Hegemon
- Baseline Calibration: Cobb-Douglas outer nest, single sub-sector within Finance and goods + other services
- Elasticities σ_J: Costinot and Rodriguez-Clare (2014) for $\sigma_M = 6$, OECD (2017) for financial services (1.6) and insurance (2.2), $\varsigma_G = \sigma_G/2$ (Feenstra et al 2018)

Sectoral Dominance by the American and Chinese Coalitions

Power is non-linear: strong increase when almost fully control an input

$$\left(\frac{1}{1-\omega_{iGR_m}}\right)^{\frac{1}{\sigma_G-1}}$$



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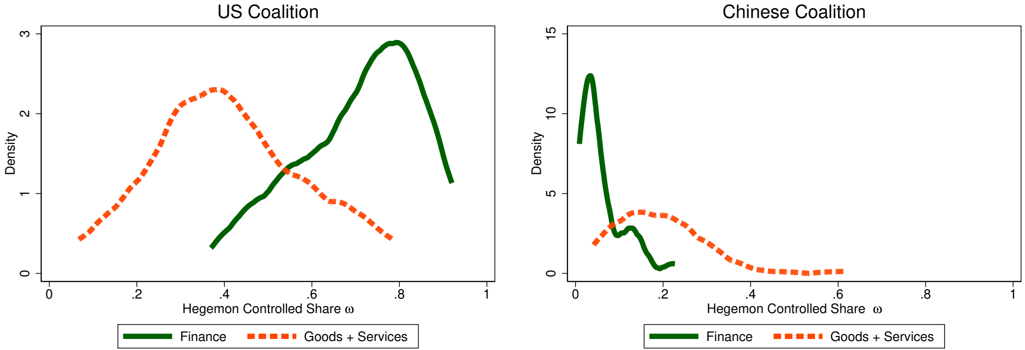
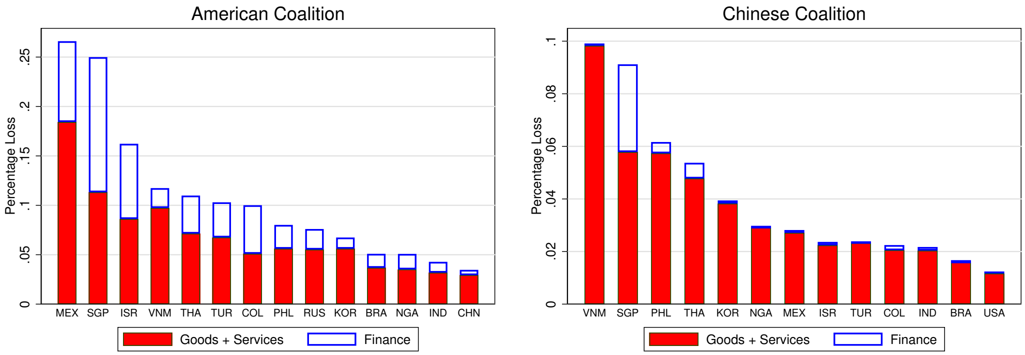


The Sources of American and Chinese Power



US Financial Power: Macroeconomic Vs Geoeconomic Relevance

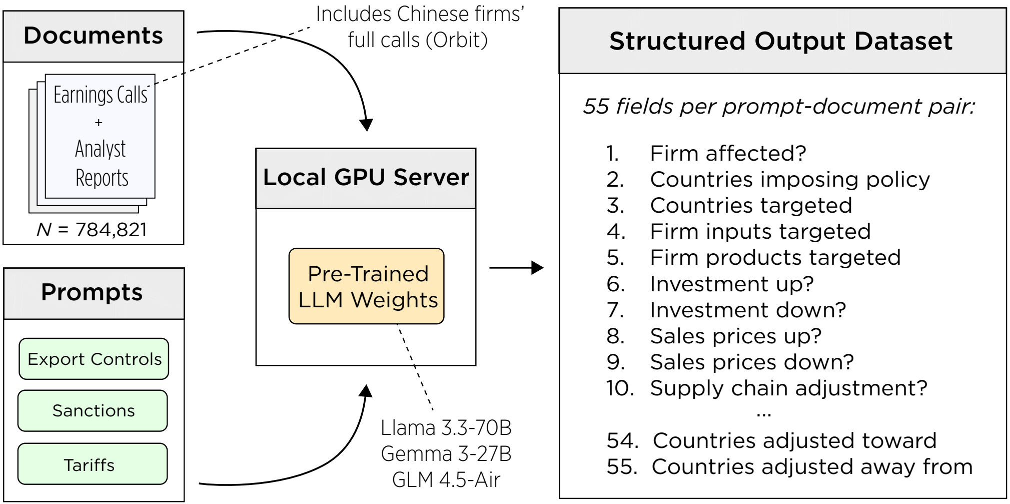
- US (and allies) dominates basic financial services: payments, settlement, messaging, custody
- Financial services are a chokepoint: dominant control, poor substitutes
- Other countries are building alternatives (China with CIPS)
- Suppose China gained a 10% market share, what are the consequences?
  - **macroeconomic consequences: little**
  - **geoeconomic consequences: vast**
- These implications are overlooked in policy debates in the US

Measurement: An Artificial Intelligence Approach

Using AI to Measure Geoeconomic Pressure

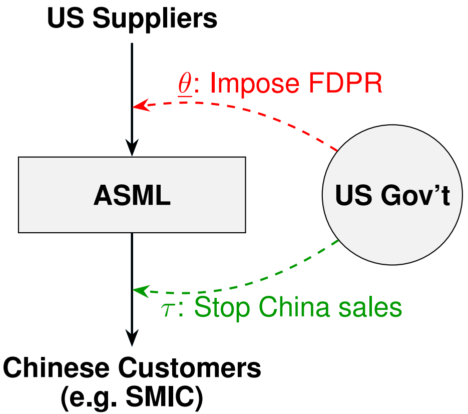
- Firm-level corporate text combined with large-scale, replicable LLM inference
- Measure in near real-time which firms are affected by various types of pressure
  - Who applies pressure to whom? Which means are used and why?
- Characterize how firms respond to each type of pressure
  - Broad range of margins: input prices, pricing, investment, R&D, supply-chains
- Quantify measurement uncertainty via prompt and model perturbations

Using LLMs to Extract Large-Scale Structured Data From Text



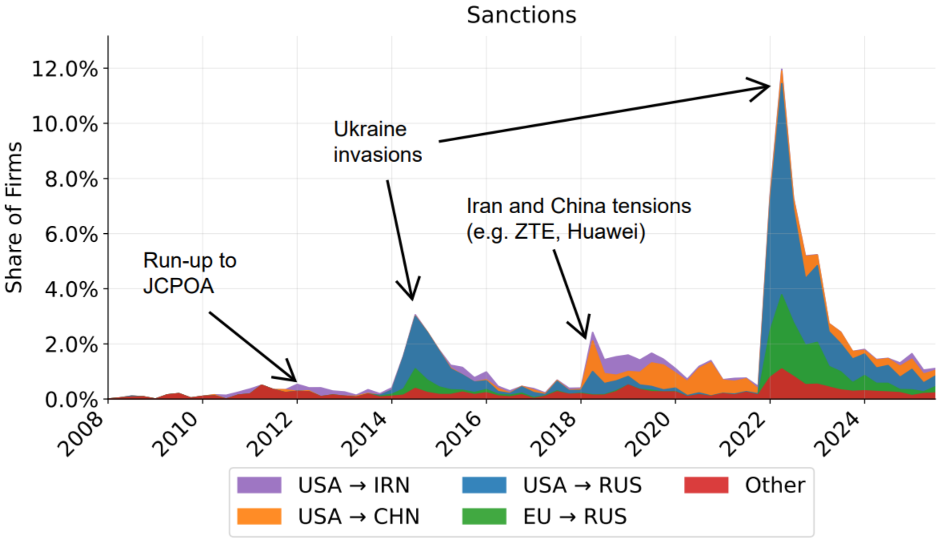
Example of LLM Inference From Textual Data

- ASML flagged as affected by export controls in multiple earnings calls and reports (2021-25)
- Structured field outputs from LLM:
  1. Countries imposing controls: US, Netherlands
  2. Country receiving export controls: China
  3. Firm's products targeted: EUV and DUV systems, lithography tools
  4. Overall impact on firm: negative
  5. Firm's responses: lower sales
  6. Country of lower sales: China



- Additionally, we also capture data from Chinese customers such as SMIC

Aggregate Patterns: Who Imposes Pressure and Whom?



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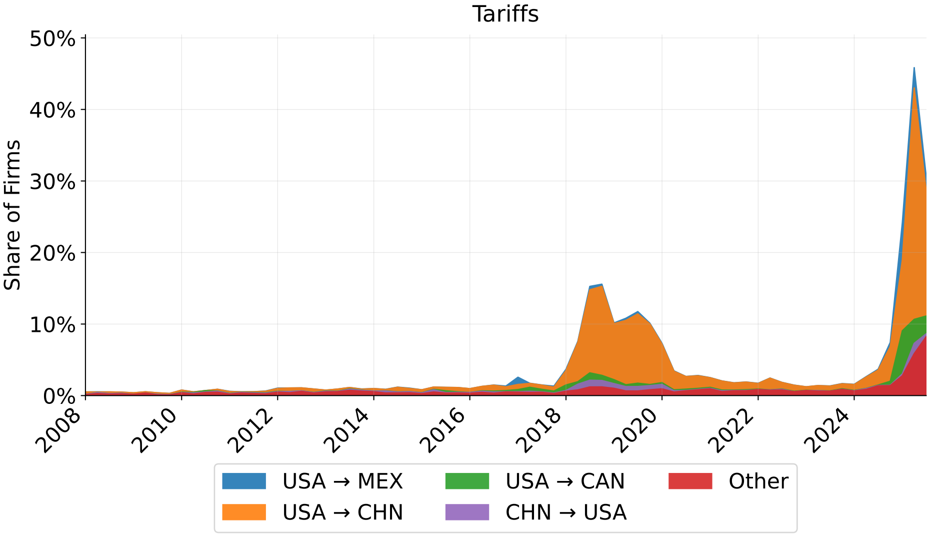

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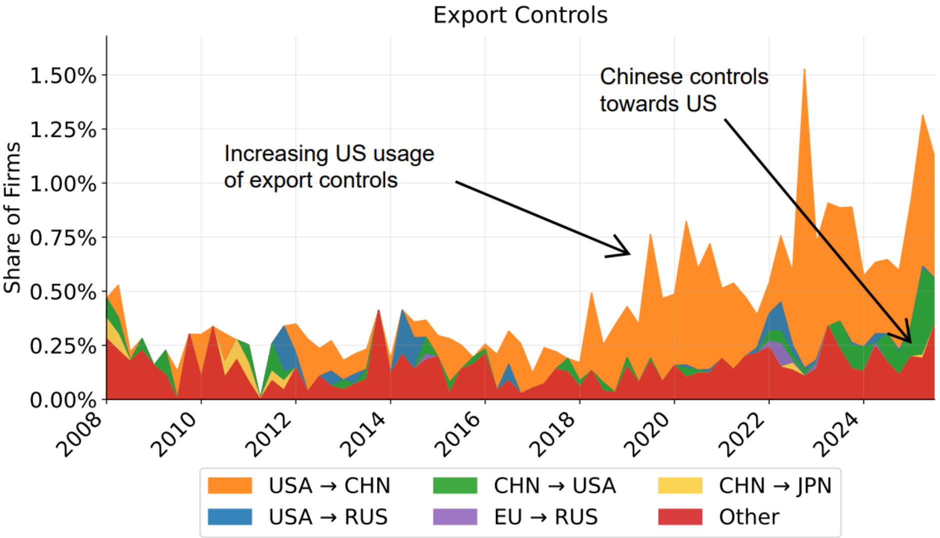
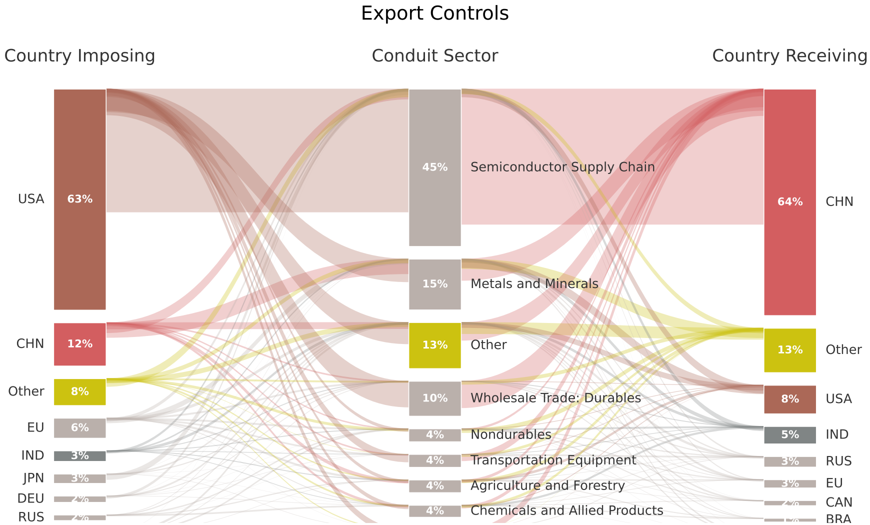


Which Sectors Are Used as the Means of Pressure?

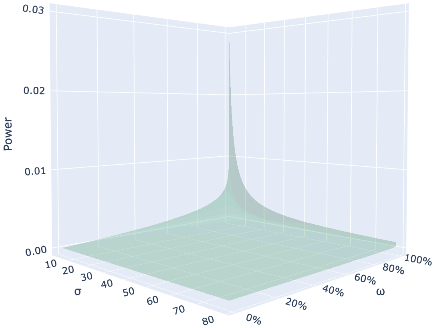


Do Hegemons Target Strategic "Chokepoints"?

- Percentage loss to target n from losing access to hegemon's input in sector j:

$$\text{Power}_{ig} \propto - \underbrace{\Omega_{ig}}_{\Omega_{ig}\text{ : Expenditure share on sector } g} \times \underbrace{(\sigma_g - 1)^{-1}}_{\sigma_g\text{: Elasticity of substitution in sector } g} \times \underbrace{\log(1 - \omega_{ig})}_{\omega_{ig}\text{: Share of expenditures in sector } g \text{ controlled by hegemon}}$$

- Simplified calibration, full formula in Clayton et al. (24); analogy to Arkolakis et al. (12)



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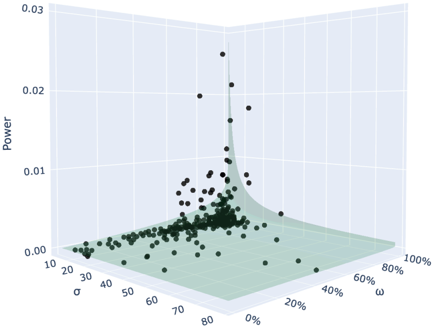
- Measure Power_{ig} at SIC4 sectoral level using hard data (BACI, Fontagne et al. 22)



Do Hegemons Target Strategic "Chokepoints"?

- Percentage loss to target *n* from losing access to hegemon's input in sector *j*:

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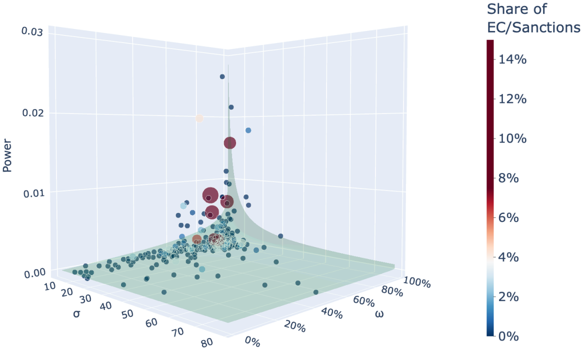
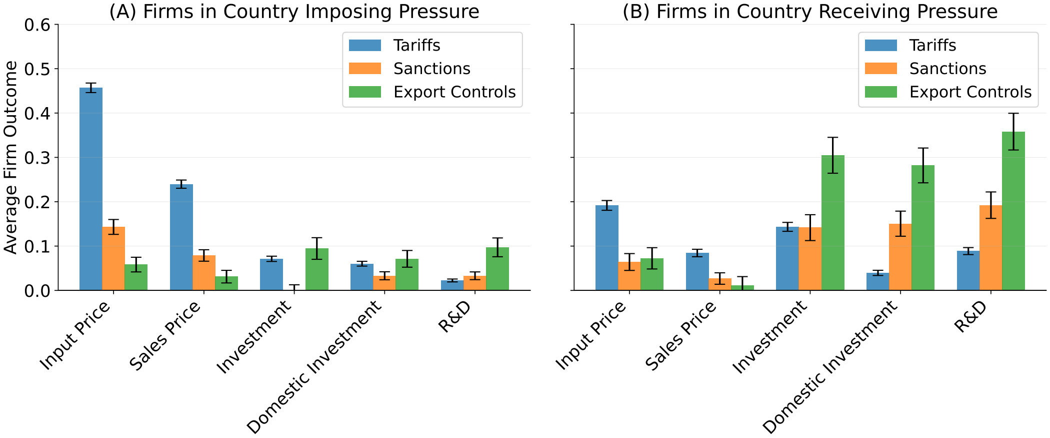
- Simplified calibration, full formula in Clayton et al. (24); analogy to Arkolakis et al. (12)
- Measure Power_{ig} at SIC4 sectoral level using hard data (BACI, Fontagne et al. 22)
- Use LLMs to measure intensity of sector usage by the US in export controls and sanctions towards China



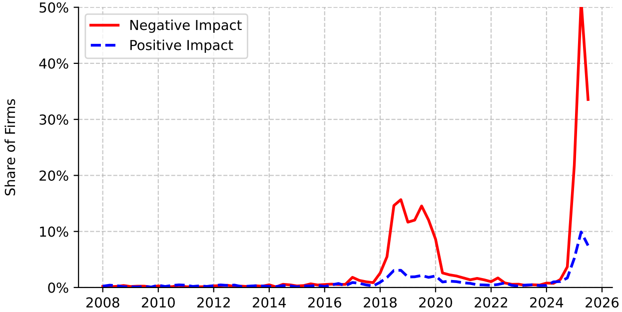
Firm Responses In Countries Imposing or Receiving the Pressure



- Pricing outcomes most relevant for firms in imposing country; investment and R&D for firms in countries receiving pressure

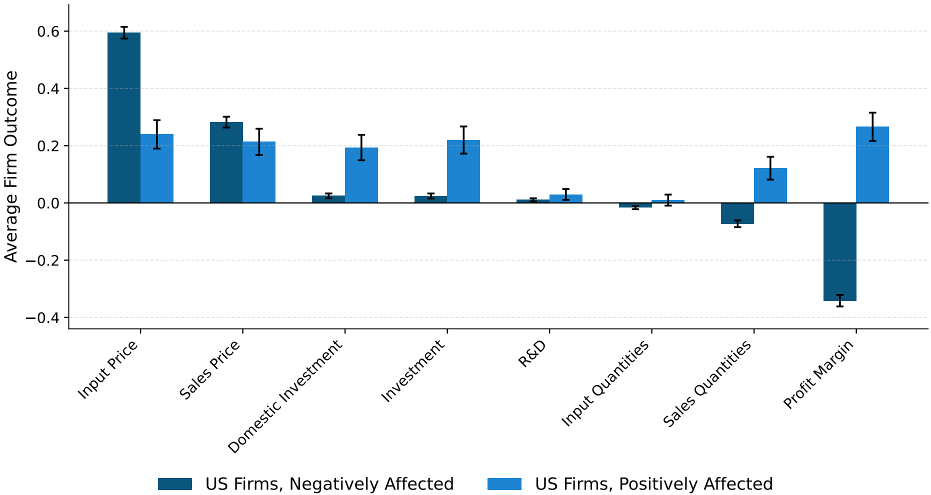
An Ongoing Look at the Trade War of 2025

- An advantage of our approach is ability of examine events in near real-time
- We track US firms reporting positive or negative impact during current trade war:



- Positive effects from lower competition, domestic producer subsidy aspect of tariffs

An Ongoing Look at the Trade War of 2025: US Firms' Adjustment



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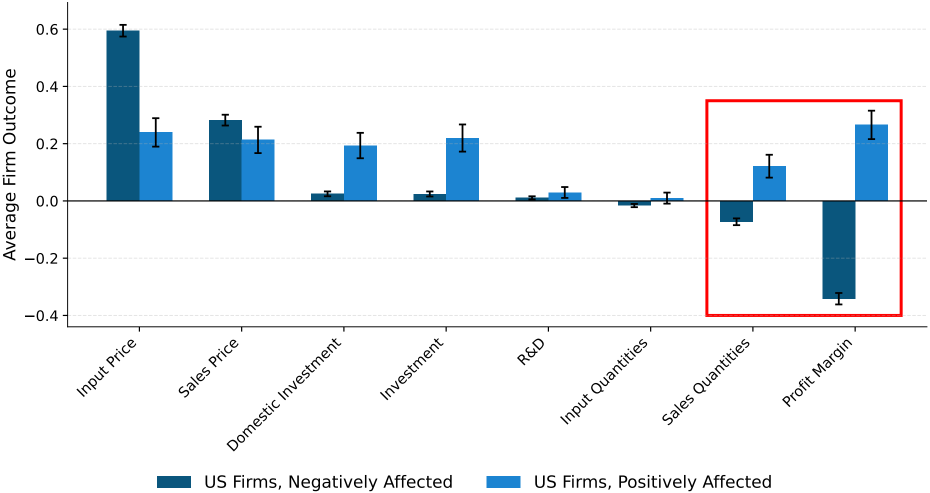
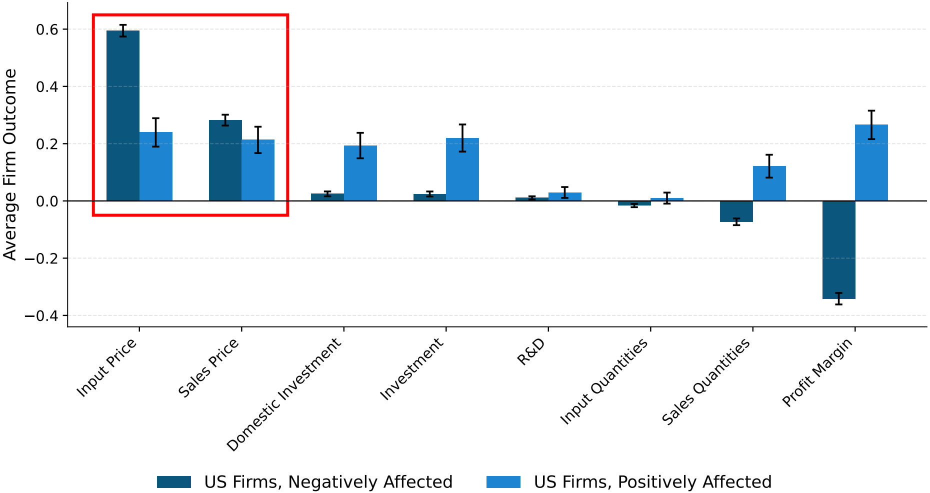


An Ongoing Look at the Trade War of 2025: US Firms' Adjustment



Policy and Future Research

Cannot think of a more pressing global challenge that economists should be studying

Much more to do:

- More modeling: multiple hegemons, political economy, duality with military
- Large-scale data on economic interdependence and causal evidence on the effects of threats
- Quantitative models for policy counterfactuals

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