

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

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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.

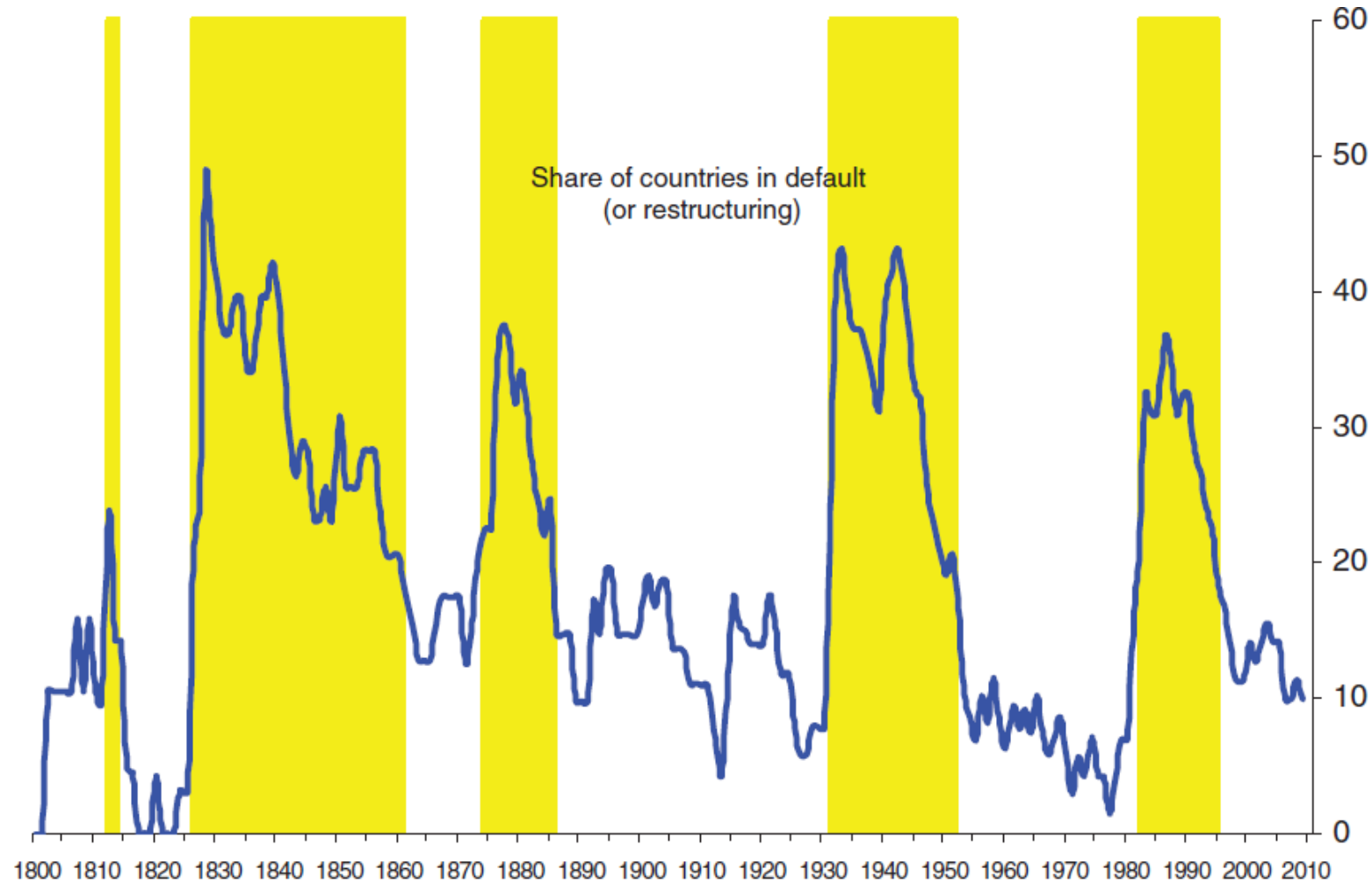
Main messages

- 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

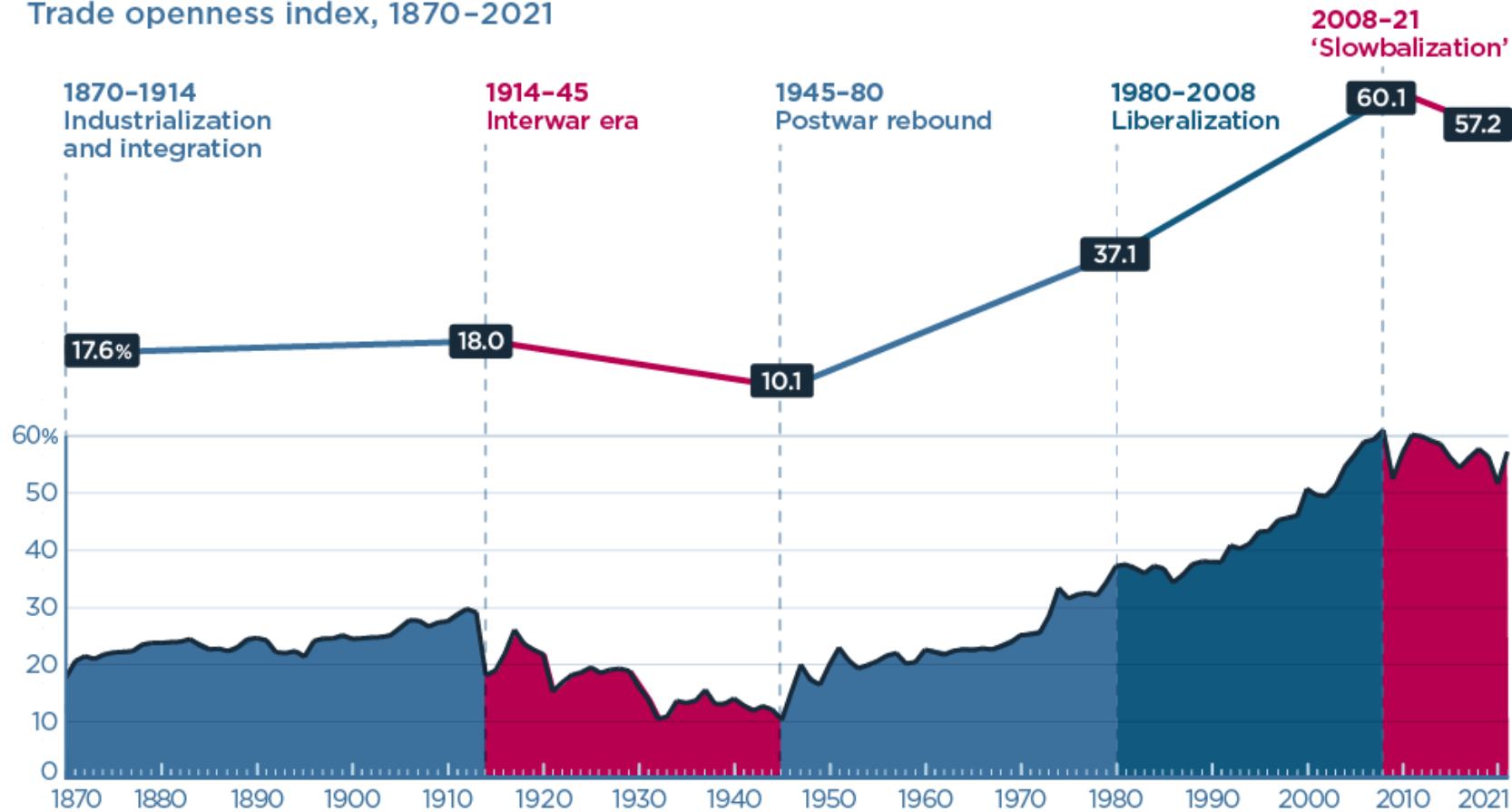


Source: Reinhart and Rogoff (2011)

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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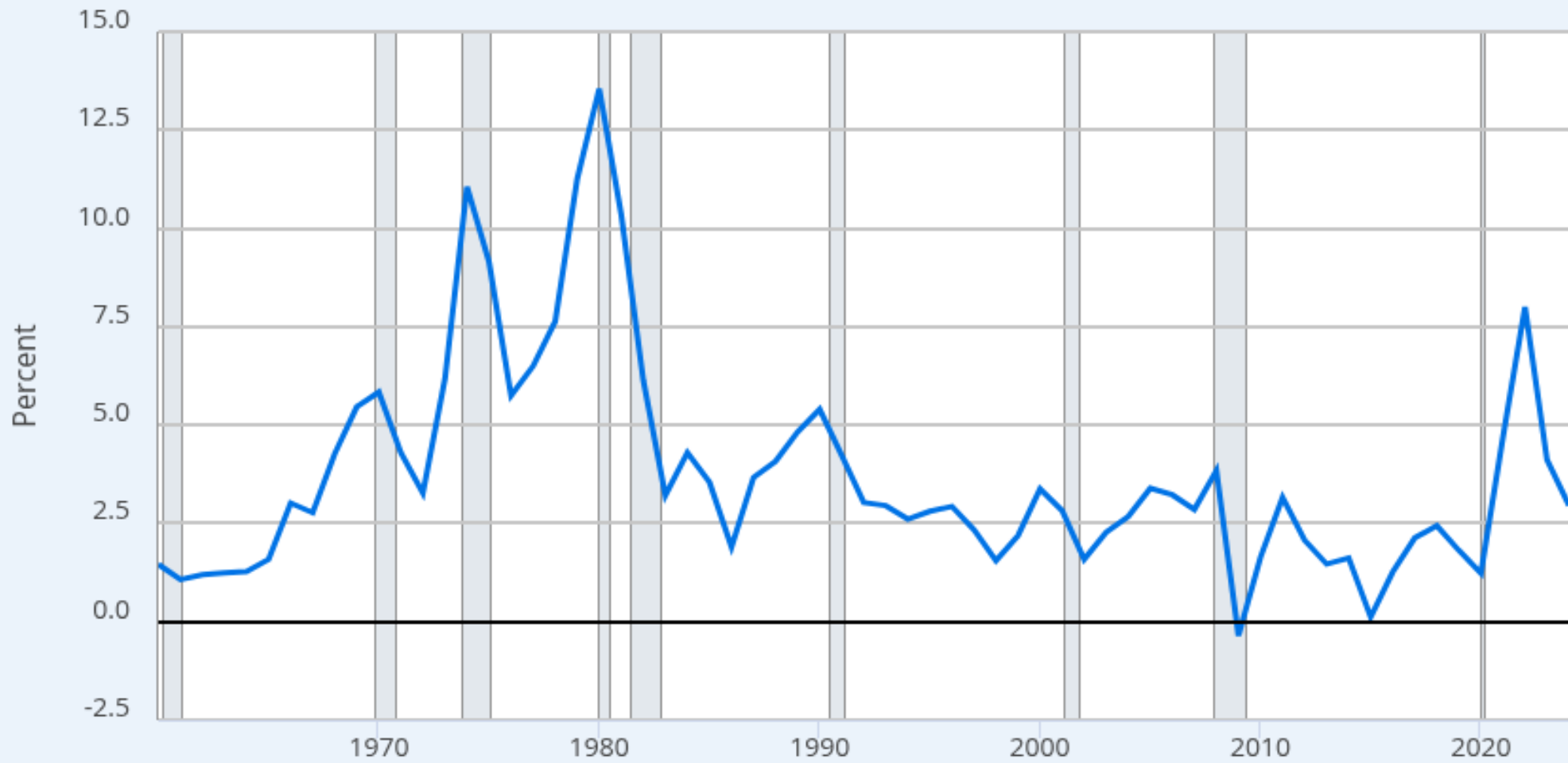


Note: The trade openness index is defined as the sum of world exports and imports divided by world GDP. 1870 to 1949 data are from Klasing and Millionis (2014); 1950 to 1969 data are from Penn World Tables (10.0). 1970 to 2021 data are from the World Bank.

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



— Inflation, consumer prices for the United States



Source: World Bank via FRED®

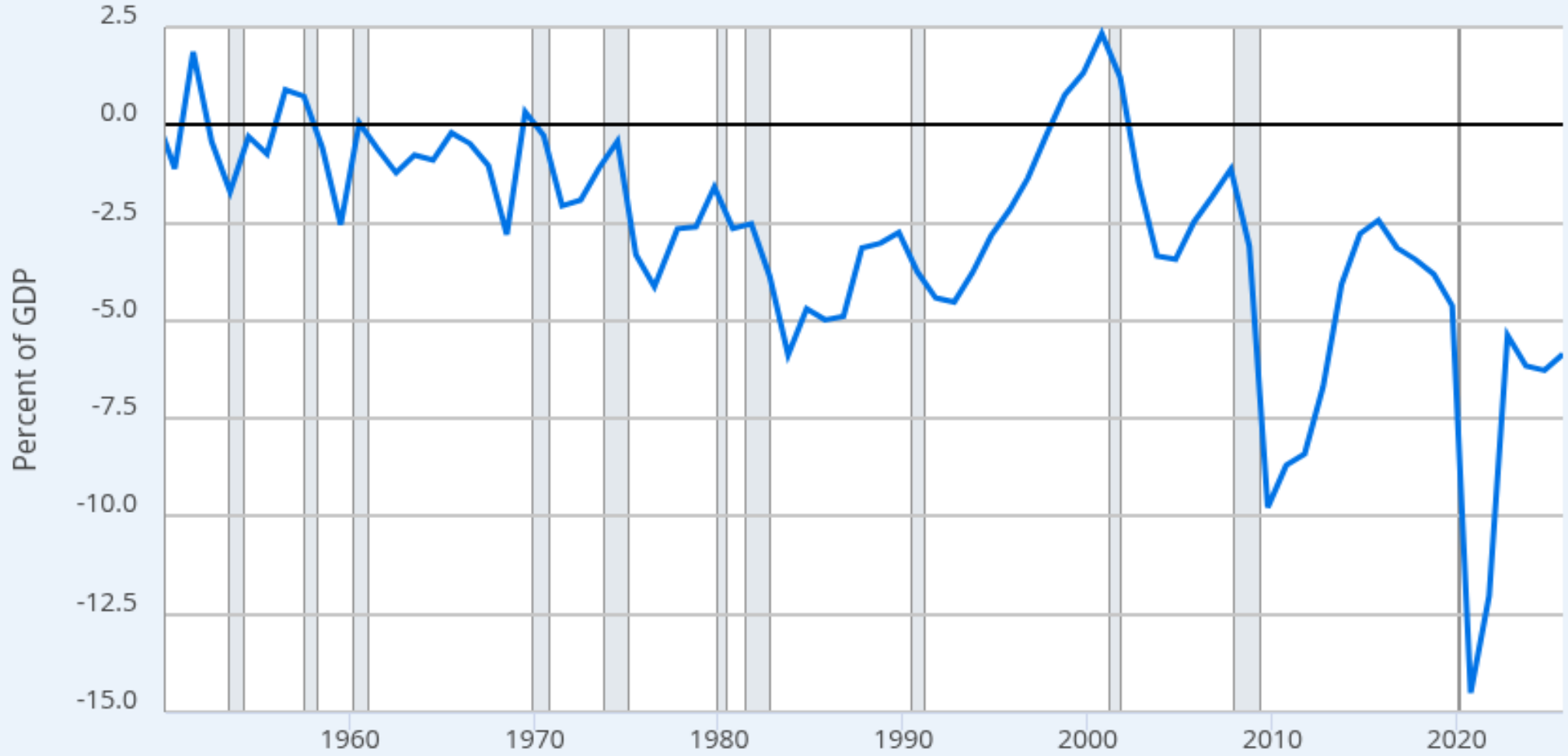
Shaded areas indicate U.S. recessions.

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FRED



Federal Surplus or Deficit [-] as Percent of Gross Domestic Product



Sources: Federal Reserve Bank of St. Louis; U.S. Office of Management and Budget via FRED®

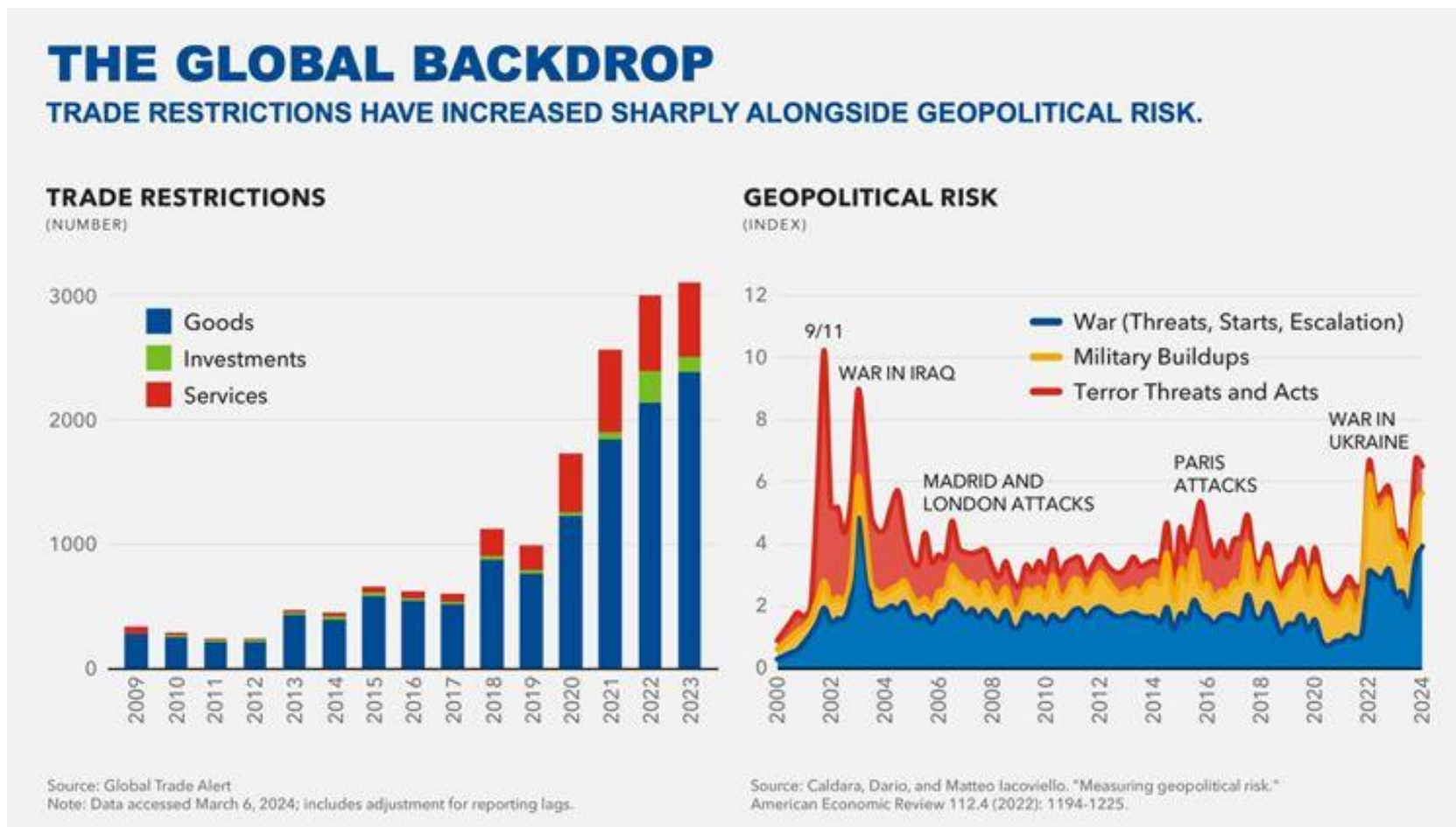
Shaded areas indicate U.S. recessions.

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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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