Financial and Trade Globalization, the Dollar, and the Mundellian Vision

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The Future of the International Financial Order: Ideal Visions vs. Political Realities

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BROWN

In Mundell's Vocabulary

The trilemma, the optimum currency area, the policy-mix—are the vocabulary of open-economy macroeconomics.

Start w/Capital Flows and Trade Fragmentation

1. Capital flows represent international investment decisions $\Rightarrow$ Inter-temporal trade
2. Backed by the ability to move goods internationally $\Rightarrow$ Intra-temporal trade

Cannot have 1) w/o 2)

Where we stand, where we are heading

- **Globalization is an architecture, not an on-off button.**
- Cross-border bank lending fell hard after 2008 and never recovered its old path.
- Reconfigured: Private credit and the offshore dollar grew to fill the space.
- The core didn’t weaken — it concentrated. The dollar hub is held in place by everyone else’s choices, not its own merit.

We are heading to a multi-polar world, fragmented periphery, concentrated core.

Opportunities and risks and what to do about each

- Key opportunity: deeper more connected markets with multi-polar safe asset world
- Key risks: global financial cycle fragmentation (dollar based cycle vs multi-polar) fragility from core with sanctions raising value of exit, core getting smaller.

Global interdependence has upside (resilience) and downside (chokepoint weaponization, financial risks)

Strengthening resilience calls for more integration.

Three decades of outcomes against expectations

- Promise: capital flows downhill (rich → poor); integration delivers consumption risk-sharing.
- What happened instead: the Lucas paradox held—importance of productivity/institutions over capital flows—less than full risk sharing due to less than full capital market integration
- Biggest surprise: As the US share of world GDP fell, the dollar's role in invoicing, debt issuance and funding deepened (even reserves ↓ from 70% to 50%)

Financial hegemony decoupled from economic size.

My Own Mundell Inspired Work

OCA criteria are endogenous — and a currency union can fail on **two fronts.**

THE REAL SIDE

asymmetric shocks

Integration → insurance → specialisation → less-symmetric shocks.

Federations — US states, prefectures — insure and specialise heavily; nations barely insure. The euro imported the integration without the federal insurer.

Kalemli-Özcan, Sørensen & Yosha — JIE 2001 · AER 2003

THE FINANCIAL SIDE

capital misallocation

Euro convergence: lower rates pulled cheap capital in.

Under size-dependent financial frictions it flowed to high-net-worth, not high-productivity, firms — so TFP fell.

Gopinath, Kalemli-Özcan, Karabarbounis & Villegas-Sanchez — QJE 2017

Mundell's Vision

Most prescient: Trilemma

- If anything, it is sharpened
- Rey's argument that under GFC, the trilemma collapses toward a dilemma—does not refute Mundell; **"independent monetary policy" corner is harder to reach.**
- OCA also held up. A monetary union without fiscal union and without labour mobility, facing asymmetric shocks, behaved precisely as OCA theory predicted it would: **The crisis out-of-sample validation of the 1961 paper.**

Less convincing: Single global currency.

- Geopolitical fragmentation means currency blocs and strategic diversification, not a world central bank.

1999 Nobel address explains why no global currency:
Economics $\rightarrow$ politics $\rightarrow$ international monetary system

Still thinking w/ Mundell's apparatus for Globalization 2.0

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Every economy is a node. Every shock travels the edges.

Using geopolitical tools in a highly globally interdependent world means:

- Resilience—structural feature.

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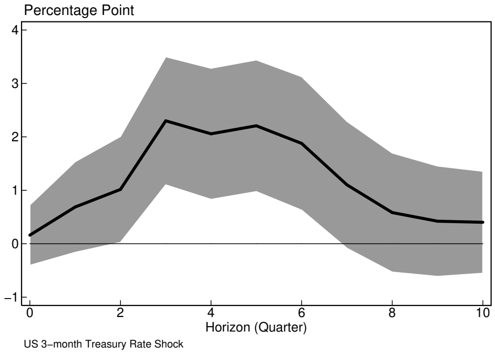
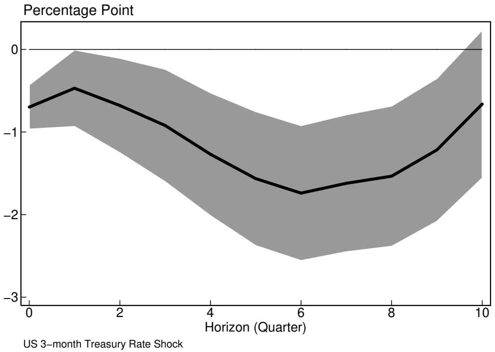
- **Economic leverage**: not from chokepoints (Hormuz) and market power (rare earths); comes from global GE response to heterogeneous policies/policy-mix.

The most immediate financial risk: inflation

- The U.S. monetary policy’s international footprint is large.
- What happens to risk premia and exchange rates?

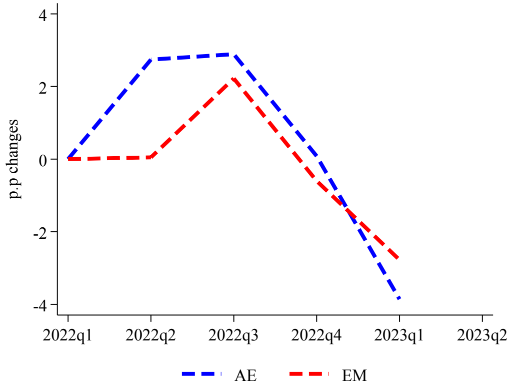
Risk Premia: Diverging Bond Spreads to U.S MP Shocks in EM vs AE

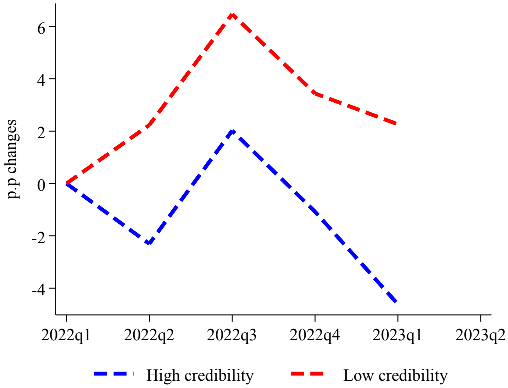




Kalemli-Ozcan (2019, Jackson Hole Symposium).

Policy Credibility and Exchange Rates: 2022-2023 FED Tightening





Kalemli-Ozcan and Unsal (2023, BPEA).