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Thoughts on “Geopolitical tensions and international financial fragmentation” (Geneva report 28)

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What's at stake

- The globalized trading system that flourished after the end of the Cold War is fracturing, due to interrelated
 - domestic forces
 - geopolitical forces
- On the surface so far, international finance has shown a Teflon-like resilience, expanding since the GFC (albeit more slowly than before) while trade has stagnated
- Public trade backlash contrasts with missing finance backlash (so far)
- But financial fragmentation is occurring and will grow
- It will have costs

An excellent, comprehensive survey

- In five chapters:
 - Evolution of external portfolios: what can we see?
 - International currencies: can the dollar's reign last?
 - Global payments: will novel payments technologies lead to more integration or greater fragmentation and new risks?
 - International financial architecture: How will geopolitics impact the global financial safety net, and how can it adapt?
 - Policy implications
- Countries face new tradeoffs between sovereignty and economic/financial integration in a way we haven't seen since the collapse of the Bretton Woods system in 1971-1973
- Structural transformations may rival those that started in 1989-1991 – but with effects likely to reverse, not promote, globalization

Geopolitical stress is bound to fragment global foreign investment

- When foreign default or seizure is possible, the social (national) return to investment may fall short of the private return
- An early insightful analysis is Keynes “Foreign investment and national advantage,” *The Nation & the Athenaeum*, August 1924
- Keynes’s argument was modeled by Murray Kemp (1962)
- Keynes disputes the “old-fashioned” (pre-WWI) view that “the investor is capable of looking after himself” and allowing him to do so ensures that “national income will become greatest”

Keynes's example

“Consider two investments, the one at home and the other abroad, with equal risks of repudiation or confiscation or legislation restricting profit. It is a matter of indifference to the individual investor which he selects. But the nation as a whole retains in the one case the object of the investment and the fruits of it; whilst in the other case both are lost.... With home investment, even if it be ill-advised or extravagantly carried out, at least the country has the improvement for what it is worth. The worst conceived and most extravagant housing scheme imaginable leaves us with some houses. A bad foreign investment is fully engulfed.”

We should expect more financial restrictions

- Keynes's argument is not unlike some of the arguments for reshoring trade on national security grounds
- Expect more outflow restrictions, which also may be motivated by security considerations
- We are seeing more restrictions on investment inflows on security grounds
- There may be more pursuit of macroeconomic rationales for inflow controls or taxes; or measures to coerce other countries
- FDI flows show clearest evidence of geopolitical stress ([Aiyar et al. 2023](#))
- Financial sector is historically a ripe target for populists of Right and Left

Aside from controls, *trade* costs fragment finance

- Obstfeld and Rogoff (*NBER Macro Annual 2000*): Trade costs can play a role in financial puzzles like high saving-investment correlation, home portfolio bias, low international risk sharing
- Reyes-Heroles (job-market paper, 2015)
- Eaton, Kortum, and Neiman (*JEDC*, 2016)
- Kleinman et al. (NBER working paper 31951, 2024)
- Costinot and Werning (NBER working paper 33709, 2025)
- Hassan et al. (*BPEA*, 2025): A sufficiently severe trade war may induce countries to switch anchors from the dollar to the euro, as difficulty in accessing the US market makes the risk-mitigation properties of a euro anchor superior

Some key insights from the chapters

- Most research on fragmentation has focused on flows, but a focus on stocks is also warranted as exchange-rate and other asset price changes help shape international positions – and they too are driven by preferences
- Many changes one might ascribe to geopolitics are in fact driven by other factors – e.g., escaping “original sin”
- The dollar vehicle role is critical in trade, not just financial markets
- Trade invoicing may be the most “fundamental” of dollar functions
- Euro trade invoicing has risen sharply since 2015, but it did so after 2000 too, only to collapse in the GFC – is this time different?
- RMB invoicing has risen but remains relatively low
- More FX transactions in a range of EM currencies, not just RMB
- Global fast payment systems are very fragmented geopolitically already – what does this tell us about the future of stablecoins?

A coherent GFSN is under threat

- It is already a patchwork in some respects, but there are unifying institutions and structures
- Such as the centrality of the US dollar
- This won't change tomorrow, but is under threat in the longer run owing to a range of current US policies
- Pursuing bilateralism rather than multilateralism can raise coordination problems, e.g., for debt treatments or conditionality (China; US/Argentina)
- One criticism – not enough discussion of prospects for “soft law” international regulatory cooperation (Basel/FSB/IOSCO/FATF), though this does receive brief mention in the final policy chapter

Summary

- International financial markets have become increasingly broad, deep, and complex since the end of the Cold War
- They are dynamic, underlying technologies are changing rapidly, and the role of “third countries” is rising
- At the same time, the United States (the key financial power) has now turned revisionist
- Ambitions of the key trade power, China, are pursued as it speaks the language of multilateralism – but will it walk its talk?
- This report is a wide-ranging and indispensable guide to the structure and evolution of global finance in a time of turmoil



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Thank you.

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