

Peterson Institute for International Economics

Maurice Obstfeld on trade and the international financial system

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[00:00:14.04] - Anjali V. Bhatt

Hi and welcome to PIIE Insider Live. I'm Anjali Bhatt, Communications Manager and Research Fellow here at the Peterson Institute for International Economics. I often say that one of my favorite parts of my job is that I can just walk into the office of some of the world's top economics answers and just ask them questions and then they answer. So with PIIE Insider Live, you're coming with me to ask those questions and get those answers. Today we're speaking with Maurice Obstfeld, the C. Fred Bergsten Senior Fellow here at the Peterson Institute and the former Chief Economist of the International Monetary Fund. Before we get started, today is also the first day of the IMF and World Bank fall meetings and the second week of PIIE's fall meetings. We have lots of events going on. You can watch all of these at piie.com/events. Or check back on our site or on our YouTube to watch anytime. Tomorrow, on October 15th at 9:00 AM, Cecilia Malmström will be hosting a new episode of Trade Winds on how the world is adjusting to the new trading landscape. On Thursday, October 16th at 9:00 AM, PIIE President Adam Posen will moderate a panel on the changing dollar regime, which Maury actually will be speaking on.

[00:01:19.12]

So we won't be spoiling what he has to say about the dollar today. You'll have to log in on Thursday to hear that. Also on Thursday, October 16th at 1:30 PM, we're hosting the Governor of the Bank of Canada, Tiff Macklem, for a conversation on Canada's economic outlook and global trade. And then finally, on October 17th at 1 PM, we're hosting several European Central Bank officials for discussion on the future of the euro and Europe's fiscal capacity and economic outlook. You can watch all of these events on our website at piie.com/events. Or on the Peterson Institute's YouTube. Okay. And before we get started, if you're watching on Zoom, feel free to put your questions in the Q&A box. So hi, Maury. Thanks for joining us.

[00:02:02.22] - Maurice Obstfeld

Hi, Angela. It's great to be here.

[00:02:04.20] - Anjali V. Bhatt

Okay. So today is the first day of the fall meetings. And like every, or I guess twice a year with the spring and the fall, the IMF releases their World Economic Outlook, the WEO. So that came out this morning and it says something similar to what our colleague Karen Dynan said you said at our Global Economic Prospects event last week, which is that the global economy is actually stronger than expected and the worst forecasts haven't materialized, but global growth will remain subdued this year and next. Does this mean that the delegates to the fall meetings will be relatively relaxed about the state of the global economy?

[00:02:40.21] - Maurice Obstfeld

Well, when the last WEO forecast came out in April, it was shortly after the Liberation Day announcements, and in fact, the IMF staff had to scramble to redo their forecasts, and they were pretty grim, mirroring what was going on in the markets at that time. Uh, since then there have been trade deals, uh, of sorts. Markets have recovered. Uh, there seems to be more stability, although maybe it's only temporary, as we saw in last week's, um, disputes between the US and China at a renewed higher level. Uh, and, uh, That I think is reflected in the forecasts. Not robust growth going forward, but not as bad as what was thought. And that's very much in line with what Karen said. You know, underlying this, however, if you read between the lines, is the sense that growth is still fragile. And there are many downsides that the chief economist, Pierre-Olivier Gourinchas, mentioned this morning in his review, the prospect of increased trade tensions. Once again, the trade landscape is not totally stable, especially with this US administration. There's always a chance that something will happen. There's very high debt levels around the world. There's still a legacy of COVID and countries other than the US, certainly the US, but— look around, look at France— are having fiscal stresses.

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There's a concern about the elevated level of asset prices in the world. Are we seeing a stock market bubble? Will the AI revolution pan out in the way that markets seem to expect? There are threats to central bank independence that, uh, Gudrun Schoss also mentioned. Certainly in the US, the Fed has been under relentless attack. And Things are not great elsewhere in the world with the rise of populist movements. There's always the threat of pressure on what we think of here at Peterson as sound economic policymaking.

[00:04:54.05] - Anjali V. Bhatt

Okay, so that's a lot to keep in mind. But those are all things that the IMF, you know, covers, studies, and analyzes. But during the spring meetings, Treasury Secretary Bessant said that the IMF is suffering from mission creep, including devoting disproportionate time and resources to work on climate change, gender, and social issues. You were at the IMF, now you're here. What are your thoughts on that?

[00:05:22.18] - Maurice Obstfeld

Great question. One of the things I'm proudest of at the IMF is that we did a big chapter in the WEO on climate, the effects of global warming, higher temperatures on GDP throughout the world, which turned out to be most severe, as you might imagine, in the developing world, Sub-Saharan Africa, very, very poor and vulnerable areas. And at the time, that was a little bit out there. There had been a little bit of work in the Fund on climate before Simon Johnson, a former Peterson Fellow, won the Nobel Prize last year, was Chief Economist and did a very good chapter together with Warwick McKibbin, who also is a Peterson Fellow. So we have a lot of really, we've got a real stake in this. Carlo Cottarelli, who was the head of the fiscal affairs department at the time, also started talking about the need for a global carbon tax. And the fiscal affairs department did a lot of really important work on fossil fuel subsidies, which have two effects. They worsen global warming, but they also are a budgetary cost. In countries that subsidize gasoline, petrol, home heating oil, you know, and the like. So, you know, we started doing some work and as you can tell from the topics I mentioned, many of them are quite relevant to the fund.

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Now, we actually got some pushback from the membership about doing this.

[00:06:56.09] - Anjali V. Bhatt

What year was this?

[00:06:57.13] - Maurice Obstfeld

This was 2016.

[00:06:59.16] - Anjali V. Bhatt

Okay.

[00:07:00.05] - Maurice Obstfeld

So we got pushback from the membership and Madame Lagarde furiously defended us. She had actually tried to get the IMF to take a position on the Paris Accords of 2015. The board declined. She published her own statement, but we were able to build up some serious expertise in the research department. Initially, the staff was, you know, we can't work on this stuff. We don't know anything about it. But then they really got into it and they wanted to do more work. So, you know, fast forward and the Fund under Kristalina Georgieva has gone more deeply into this. They've gone more deeply into gender as an issue, which Madame Lagarde was also quite interested in. And, you know, I wanna start out by saying that these are serious macro issues. They have macro impacts. They affect the way the economy works. They affect, you know, the ability of women to participate in the labor force. I mean, this is, you know, not niche material. That being said, you know, the fund has limited resources. The fund has a small staff. They have a limited budget. And their comparative advantage is in macroeconomics, financial surveillance. That's sort of the bread and butter.

[00:08:30.16]

And in fact, financial surveillance was not something the Fund did until, you know, relatively recently, maybe 20 years ago, they really got into that business. And so all that stretches their resources for core things. So some felt, even before the Trump administration came in, that the fund had gone too far in this direction. So, you know, when Secretary Bessent criticizes the emphasis here, I would say that you can make a case that they are maybe not pursuing the right balance, but eliminating these fields entirely eliminating these as macro topics, I think is totally the wrong approach. And it just amounts to sticking your head in the sand, given the importance of these issues for macroeconomics, for growth.

[00:09:25.07] - Anjali V. Bhatt

Yeah, that makes, that makes a lot of sense. Um, I think we can't just stop talking about climate change and economics. That's, it's here, it's happening, and we need to, we need to deal with it. Um, okay, but we can stick to our mission here at Peterson and we can talk about tariffs as we do. So per our tariff tracker by Gary Hufbauer and Yuzeng, which you can look for on our website, that shows that the tariffs are really raking in a lot of money for us. You and our colleague Kim Clausing earlier this year wrote a paper recently about tariffs as fiscal policy. So it seems like there, there's a lot of money coming in from the tariffs. What does that mean for the federal budget?

[00:10:09.04] - Maurice Obstfeld

Well, the program of the Trump administration to raise tariffs, you know, originally was motivated less by the revenue side of things than by the idea that we have a big trade deficit. Tariffs operate on the trade deficit. I don't want to say they correct it because I don't believe they really do. And that's something, you know, we may or may not get to. The idea that higher tariffs will promote manufacturing. Again, that's questionable, but that was a goal. And then at some point, um, during the campaign, uh, President Trump's team realized, since they also wanted to extend the tax cuts and the Tax Cuts and Jobs Act of 2017, that tariffs yield revenue and that actually you could, you could cover the resulting deficits with tariff revenue. And, you know, President Trump started discussing this idea that, well, you know, in the 19th century, the US relied so heavily on tariff revenue that it was able to fund the government. In fact, there was no income tax until the Constitution was changed in the early 20th century through an amendment that allowed income taxation. So the idea that President Trump had was, well, we can go back to the 19th century.

[00:11:36.07]

Let's cut taxes on earners. Let's cut income taxes. Let's fund ourselves with tariffs. They did that in the 19th century. No problem. And that's the idea. Now, Kim and I wrote a piece last year on how much revenue could you raise? Could you actually raise enough revenue to Get rid of the income tax? Answer is no. But we are raising, as you said, a lot of revenue from tariffs, and it may be running at present at around \$200 billion a year or, you know, \$2 trillion over a 10-year horizon. Now, that's not enough to get rid of the income tax. It's not enough to get rid of the income tax on everyone earning, you know, under \$150,000. It's not enough to plug the hole in the federal deficit that was created by the one big beautiful budget bill act. I think I had one too many Bs, but who's counting? Um, so, uh, you know, we've sort of moved to this system where we're not— we still have income taxation, but we're also depending a lot on tariff revenue. And the problem with that is at least twofold. It's actually manyfold, but, you know, one fold of that is that tariffs are a regressive tax.

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They fall most heavily on low-income people who don't save a lot and are very vulnerable to this increase in the cost of living. They're also a very distorting tax. They basically induce the US to move production into goods for which we don't have a relative efficiency advantage, goods that we could be— that we produce domestically because of the tariff that we would actually be able to import more cheaply from abroad. So that's a loss in national income. And they also distort consumption, meaning that we actually discourage people from consuming goods that the economy can acquire more cheaply than the tariff-inclusive price. And that's a consumption distortion. You add to that the administrative costs, which are actually severe for tariff

compliance and fall most heavily on small businesses. You add to that the resources that firms expend trying to get exemptions from the tariffs, of which there have been many, and you have something that, that actually is very costly for the economy, much more costly than, for example, having a VAT, value-added tax, at a much lower rate, and even more costly than the income tax would've been, and certainly much more regressive than taxing the incomes of high earners.

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So this is sort of problematic, and I worry that going forward, it's going to be very hard to reverse.

[00:14:42.11] - Anjali V. Bhatt

Okay. There was so much there that we could talk about. Um, first of all, what is a VAT? What is a value-added tax?

[00:14:49.25] - Maurice Obstfeld

Well, value-added tax is basically a consumption tax.

[00:14:52.25] - Anjali V. Bhatt

Okay.

[00:14:53.07] - Maurice Obstfeld

Um, that's, that's, you know, and it too, it too is regressive. But my point is that, um, it's easier to enforce than a tariff. So you have lower compliance costs. You know, Europeans do it very smoothly, for example, Japanese do it very smoothly. Um, but also you could have it at a much lower rate. Than the tariff rate and raise the same amount of revenue because it applies to all consumption. It's a lot more consumption than the US imports.

[00:15:20.24] - Anjali V. Bhatt

So you can have a lower tax on a broader base rather than super, super high tariffs on just what we import. And that would be more efficient.

[00:15:30.05] - Maurice Obstfeld

Yeah.

[00:15:30.20] - Anjali V. Bhatt

Okay. So there are a couple of things that you said that the tariffs are trying to accomplish. You know, there's narrowing the trade deficit. There's bringing manufacturing back. There's revenue. Are there other things the administration is trying to do with these tariffs? And for all of these things, like, will it work?

[00:15:55.29] - Maurice Obstfeld

Well, there are things you could do that for which you could make a better case. For example, you know, suppose you say that our supply chains are too extended internationally in ways that make us vulnerable to geopolitical shocks, and maybe we should bring those industries back home. So using a tariff for that purpose might accomplish the goal of bringing the industry back home. However, you know, this is true generally of tariffs. Like any legitimate goal you can accomplish with a tariff, you can accomplish more efficiently with some other tool. So for example, if you want to bring a particular industry back home, you can subsidize that industry. And that will, you know, create incentives for firms to produce domestically, and maybe they'll be producing inefficiently relative to what foreign firms could do. But you're not taxing the consumption of that good as a byproduct. Like, why do you, why would you want to do that? You don't want to do that. You just want the good to be produced here. So for some things, tariffs could work, but in general, there are better ways to do it. Now, there are other things for which they won't work.

[00:17:11.20]

So for example, a big one is the trade deficit. So it seems obvious to people that if you, you know, tariff a good, its price goes up. Actually, the Trump administration denies that its price goes up, which kind of undermines their argument that it will lead to more domestic production of that good. But leaving that aside, you put a tariff on a good, it's good. Most economists believe its price will go up.

[00:17:40.12] - Anjali V. Bhatt

Okay.

[00:17:40.25] - Maurice Obstfeld

And therefore, you know, less of it will be imported, more of it will be produced at home. Okay. So you might say if we're, you know, importing more, if we're importing less and producing more

of it here, then our trade balance will improve. But that might be true for a single good or even a single industry. But when you look at the broad-based tariffs that Trump has levied, which apply to all imports in principle, and I say in principle because of exemptions, that has important macro effects that, you know, will tend to counteract favorable effects on the trade balance. So for example, you know, suppose we want to produce more goods at home that we currently import. Well, the labor and capital to produce those goods has to come from somewhere, and a lot of it is likely to come out of the export sector. Well, if we import less, produce those goods at home out of resources that would earlier have been used to produce exports that we don't produce anymore, we're importing less, we're also exporting less. And so what happens to the trade balance? It becomes much less clear. So, you know, I think that the hope that such broad-based balance will bring a radical improvement in the trade balance is misguided.

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And if you add to that the fact that our fiscal policy, which has turned very expansionary with the One Big Beautiful Bill Act— there you go, I got it out— is increasing the US budget deficit. You know, basically we need to borrow the funds from somewhere to cover that budget deficit. A lot of them are going to be borrowed from abroad because US households have a really low saving rate. But if we're borrowing from abroad, you know, that's a sort of inflow of funds that is going to be accompanied by a larger trade deficit. And so You know, it's all not really hanging together when you think about the goals of the administration or the goals, at least, that they purport to have.

[00:20:11.12] - Anjali V. Bhatt

So for the trade deficit, at least, one of the reasons that tariffs are being used to lower the trade deficit is because in theory, if the US has a trade deficit with another country, that means that they're ripping us off. According to the administration, right? Have we been ripped off? Is A, is that what a trade deficit means? And B, you know, do we need to do something because we've been getting ripped off by everyone else?

[00:20:43.02] - Maurice Obstfeld

I mean, A, no, and B, no. I mean, look, I mean, the administration has been very focused on bilateral trade deficits. So let me start with those. You know, basically we have a pattern of trade with other countries where we are in surplus with some countries, we're in deficit with other countries. It doesn't mean that the deficit countries are ripping us off. It means that, you know, they produce something that we really need and they may not need or be able to afford things that we sell. So the big example is that everyone cites is vanilla from Madagascar. We need

vanilla for our ice cream and yogurt and smoothies and cakes. And they're relatively poor. They don't import big-ticket items from the US. So we're going to have a bilateral deficit with Madagascar. It's not that they're ripping us off. It's just the pattern of trade, the gains from trade, if you will. Now, That's bilateral relationships. Um, if you look at our bilateral relationships, it turns out that we have a lot more bilateral deficits in dollar terms than bilateral surpluses, which tells you that we have an overall deficit in trade. We basically, uh, consume more than we produce.

[00:22:13.25]

So does that mean that countries are ripping us off? The fact that we consume more than we produce, that we choose to consume more than we produce. I don't think it's really obvious that that's the case. You know, the focus on trade policies doesn't really hold a lot of water in my view. You know, none of the macroeconomic evidence or the econometric evidence supports that trade policies have a major effect on aggregate imbalances. I mean, in theory, they could have some effect, but it's not a major effect. And even some of the historical episodes that are most discussed, for example, the flood of Chinese imports in the 2000s after China joined the WTO, that flood of imports is a small fraction of our overall trade deficit. Same for NAFTA countries after 1995. I mean, it just doesn't explain our deficits at the time. These are primarily macro phenomena and reflect, you know, that we consume and invest more than we, than we, than we produce. Now, it might be that That's actually good for us because if we didn't run a deficit and borrow all those funds, we would invest less. And investment is good for innovation, for growth, for our standards of living.

[00:23:53.21]

But, you know, the idea that somehow these deficits are forced on us by the rest of the world, I think is something for which there's limited, limited evidence.

[00:24:03.17] - Anjali V. Bhatt

So picking up on that, that, yeah, the deficits have been forced on us, we're being ripped off. And so we need trade policy is the administration's chosen tool to deal with that. You've called this sort of broader change in US policy as being driven by a grievance narrative. What do you mean by that?

[00:24:28.11] - Maurice Obstfeld

Well, the grievance narrative, you've alluded to, is that everyone's ripped us off in trade. There's also a narrative that You know, financial inflows from the rest of the world are forcing us to run

these big trade deficits. And the idea here is that, you know, other countries save more. They want to invest in the US. Those funds flow in. They lower our interest rates. They raise our asset prices. Those two developments make us spend more. But those channels, while they, they, they may have some credence qualitatively, are not quantitatively enough to explain our deficits. For example, if you look now, sure, we have a booming stock market, but there's a lot of foreign investment in the US. So foreigners gain some of that increase in wealth. So it's not going to fully feed through to U.S. consumption. And, you know, are foreign financial inflows forcing us to run a deficit? Well, actually, our interest rates are pretty high. So if you— if your story is there are these foreign financial inflows which lower our interest rates and force us to spend more than what we produce, well, why is President Trump complaining about our high interest rates?

[00:25:57.07]

And trying to bash the Fed, it doesn't really add up. And in fact, the more proximate cause of our big current account deficit is our even bigger fiscal deficit, which forces us to borrow abroad and forces our interest rates to be higher than otherwise. Uh, there's a third element of the grievance narrative, which is, um, also economic, but it reflects more the frustration with the idea that the US should be a major supplier of foreign aid, foreign military assistance. Of course, we've had these very unfortunate, to my mind, cuts in the USAID budget and in what we do for poorer countries, which doesn't cost us much but has a huge impact and also increases American soft power. You frequently have heard people on the administration's list of spokespeople complaining about foreigners freeloading on security, ripping us off, being pathetic. So that's the third part of the grievance narrative. And what it all adds up to is the idea that the US should be more self-sufficient, shouldn't depend on the rest of the world, shouldn't help the rest of the world. Should be more of a, you know, autarkic actor in the world economy. And that, I would argue, is bad for the US and bad for the world economy.

[00:27:35.14] - Anjali V. Bhatt

So on that note, then, you know, the idea that because we've been ripped off, because, you know, other countries are freeloaders, we should be cutting all of these aid budgets, etc. I, I am struggling to square that with giving \$20 billion to Argentina.

[00:27:54.10] - Maurice Obstfeld

Um, and so you're not the only one now, Julie. You know, it's being asked more widely.

[00:27:59.25] - Anjali V. Bhatt

So President Milei, um, Argentinian President Milei is actually at the White House like right now, um, talking to Trump. Um, what is this \$20 billion swap framework? Um, what does that mean?

[00:28:14.23] - Maurice Obstfeld

What is a swap framework? Well, technically, Secretary Bassett insists it's not a bailout. So let's call it a rescue. It's basically, we don't know the details, maybe they'll be announced today, but the US is going to lend money to Argentina. The US Treasury will lend money to Argentina. It's not a swap from the Fed. Very important distinction because the Fed does not currently have swap facilities with Argentina. It has standing swap facilities with the major global advanced country central banks. In fact, unlimited swap facilities with those countries. But it's a swap from the Treasury. Basically, the Treasury will give, it will create a, It will create a standing facility, I assume, where the Argentines can draw up to \$20 billion. In exchange, they'll give the Treasury pesos. At some point, they'll be expected to return the dollars and take the pesos back at the initial exchange rate for which the exchange—

[00:29:30.03] - Anjali V. Bhatt

That's why it's called a swap. I see.

[00:29:31.20] - Maurice Obstfeld

Right.

[00:29:32.00] - Anjali V. Bhatt

Yeah.

[00:29:32.17] - Maurice Obstfeld

Well, sorry. No, there are many swaps in financial markets that where the two legs of the swap take place at different rates. That's very common. But in the central bank swaps, the two legs have carried the same exchange rate. I assume that'll be the same here. And that allows Secretary Bessant to say, technically, this is not a bailout because we're just swapping and we'll get the money back at the same rate. Now, Couple of things about that. The swap framework is not the only element of U.S. support that's been discussed or been implemented. Secretary Bessant has discussed buying Argentine dollar debt to support its prices, and that debt, after sharply rising initially in the Milei administration, has fallen, reflecting default fears. So U.S., you know, buys Argentine bonds. No guarantee they won't go down in value. That's a potential taxpayer cost. The US has also intervened directly in the peso market. It just bought, you know,

a lot of pesos with dollars. Now, that's not a swap. The US owns the pesos. If they go up in value, taxpayer in the US will make money. You can judge the likelihood of that. Especially given that the Argentine currency band calls for the peso's lower limit to go down over time.

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So it can depreciate more over time. So that's probably a taxpayer expense. And finally, the Argentines are drawing these dollars in the swap framework so they can spend it supporting the currency, presumably. And so at what point are they going to be able to give it back. For that, they have to start earning some foreign exchange, which they have not been able to do since they signed an agreement with the IMF in April promising that they would earn foreign exchange. Um, so what happens then? You know, what happens if they can't pay back? Do they get more money from the IMF? Well, the IMF board was not thrilled, to say the least. To give them \$20 billion in April. That would be difficult. How do they repay the fund? They owe the fund billions of dollars over the next couple of months. How do they repay the Treasury? Well, Secretary Bessens said the US will do whatever it takes. Well, whatever it takes may be rolling over the swap indefinitely. Or even extending the swap, you know, having a bigger swap. And so what we may be looking at is open-ended support for Argentina, which they can't pay back in the near term or the medium term.

[00:32:37.07]

And then it becomes much more risky for the US taxpayer to think about that.

[00:32:43.03] - Anjali V. Bhatt

That was so much. Okay, so we are almost at time, or I guess we are at time. Wow, time flies. So besides Argentina's ability to pay back its loans, what will you be looking for in the next sort of 6-ish months from the fall meetings and then going forward?

[00:33:01.14] - Maurice Obstfeld

Well, I think geopolitics are really important in this environment. I think what happened in the Middle East in recent days is immensely encouraging. I always like to have something positive to say. And, you know, that's really only the beginning of something, but, you know, hopefully will lead to a more durable stabilization of that region. And I think that would be a very good thing for the global economy. So I'm looking at that. I'm looking at how things pan out in, in Europe, particularly with respect to the Ukraine situation. You know, a degradation of the security situation there could be dangerous and have global economic repercussions. You know, on the other hand, in terms of, you know, the EU, if they are serious about reforms that

would lead to greater unity, for example, through completing their single market, you know, issuing more common debt, moving to a more unified defense arrangement, that could be positive for stability and positive for growth. So this geopolitical setting is very critical at this time and will have a lot of implications. I mean, we also, you know, we think You know, need to be looking at trade policy. Trade war is not by any means over.

[00:34:44.14]

There's still the risks of backward movement. And if there's more stability on the trade side, that would be a good thing for the world economy. But that requires the US to basically stick to its agreements and not decide it's going to deploy tariffs for example, to meddle in other countries' sovereign affairs.

[00:35:10.18] - Anjali V. Bhatt

Okay, so there's plenty for us to be working on here at Peterson, lots for us to watch. Thank you so much for giving us an overview of the trade deficit of Argentina and so much more. And thank you for joining us here on this edition of PIIIE Insider Live. What did you think? What do you want to see next? Let us know at meetings@PIIE.com. And if you're not already, subscribe to PIIIE Insider, the newsletter at PIIE.com/subscribe. And make sure you also tune in to our fall meetings all week this week. Thank you for joining us, and we'll see you next time.