

Comments on “A Theory of Economic Coercion and Fragmentation”

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Clayton, Maggiori and Schreger (2024) develops an analytical framework to examine how a hegemon exerts economic power over foreign countries and how those countries can implement policies to insulate themselves.

The paper presents a rich set of results, but in this discussion, I will focus on what I believe to be a key aspect: the dual role of the hegemon. Specifically, the hegemon possesses the ability to extract rents from foreign countries through coercive measures, while simultaneously leveraging its coercive power to improve contract enforcement and expand production possibilities.

I will proceed to illustrate the dual role of the hegemon using a simple Edgeworth box model with two countries and two goods.

Each country is populated by a representative agent with preferences given by

$$U(x, y) = x^{1/2} + y^{1/2}.$$

The endowments of the hegemon (H) and the rest of the world (ROW) are given respectively

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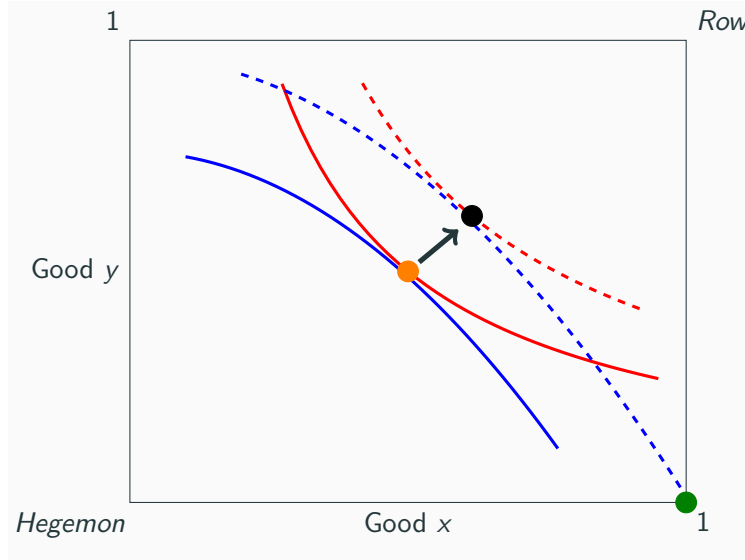


Figure 1: Model Illustration

by $\omega = (1, 0)$, $\omega^* = (0, 1)$. The pair of resource constraints is therefore

$$\begin{aligned} x + x^* &= 1, \\ y + y^* &= 1. \end{aligned}$$

In the absence of power considerations, symmetry in preferences and endowments implies that equilibrium would occur at the center of the Edgeworth box, illustrated by the orange point in Figure 1. The red curves represent the indifference curves of the hegemon, where upward movement indicates an increase in its utility. In contrast, the blue curves represent the indifference curves of the rest of the world, where downward movement indicates an increase in their utility. As highlighted above, recall that H is endowed with the entire good x and ROW is endowed with the entire good y .

Suppose now that H can exert coercion by presenting a credible take-it-or-leave-it offer to ROW. That is, ROW can accept the offer or face exclusion and consume the autarchic allocation. The optimal allocation for H solves

$$\begin{aligned} \max_{x,y} \quad & U(x, y) \\ \text{s.t.} \quad & U(1 - x, 1 - y) \geq U(0, 1) \end{aligned}$$

That is, H maximizes its own welfare subject to leaving an allocation for ROW that delivers at least the same utility as the autarchic allocation. Graphically, the hegemon seeks

to maximize welfare along the blue dashed indifference curve (i.e., the indifference curve that goes through the initial endowment). The optimum lies at the tangency point between the indifference curve of H and the blue dashed curve. Notably, notice that this allocation could be implemented with a lump-sum tax on ROW, and policies that distort relative prices—such as tariffs or subsidies—would be inferior.

What policies can ROW adopt as anti-coercion? Anticipating the policy from H, the best policy for ROW is to maximize the welfare under autarchy, in line with the insight from Schelling (1980) that highlights that countries should invest in outside options to enhance their bargaining power. In this example, ROW’s high vulnerability arises from its complete lack of endowment in good x . In a more complex setting where factor allocation is endogenous, ROW would likely diversify its production. In a dynamic context, this could involve accumulating reserves to increase its resilience.

So far, we have abstracted from any benefits associated with a world order led by a hegemon. However, as the analyses in Clayton, Maggiori and Schreger (2023, 2024) highlight, a hegemon can also enhance the enforcement of contracts on a global scale. For instance, by punishing defaulting firms, the hegemon can effectively increase the overall size of the Edgeworth box. This dual role—as both a rent extractor and a contract enforcer—reveals the potentially ambiguous welfare consequences of a hegemonic world order.

Clayton, Maggiori and Schreger (2024) provides a comprehensive framework with a rich production structure, examines an application to financial sanctions, and constructs empirical measures guided by the theory. Recent global events underscore the urgency for additional research in this area.¹ As this literature continues to evolve, I look forward to seeing more contributions from this team of authors and further developments of the field.

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¹See among others, Becko (2024); Bianchi and Sosa-Padilla (2024, 2023a,b,c); Kooi (2024); Lorenzoni and Werning (2022); Itskhoki and Mukhin (2022); Itskhoki and Ribakova (2024); Broner, Martin, Meyer and Trebesch (2024).

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