**Interview with C. Fred Bergsten**

C. Fred Bergsten was the founding director of the Peterson Institute for International Economics from 1981 to 2012. He is currently Senior Fellow and Director Emeritus of the Institute and a member of the President’s Advisory Committee on Trade Policy and Negotiations. Previously, he served as Assistant Secretary for International Affairs and Undersecretary for Monetary Affairs at the US Treasury. Below he discusses why concerns over currency wars are justified and more broadly laments the role of the dollar in the international monetary system.

*The views stated herein are those of the interviewee and do not necessarily reflect those of Goldman Sachs*

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**Allison Nathan: Where do you think the dollar goes from here?**

**Fred Bergsten:** I think the trade-weighted dollar (TWD) will continue to rise. The real question is by how much? As a basis of comparison, the dollar rise of all time was in the first half of the 1980s when the dollar basically doubled in value over a five-year period – 1980 to 1985. The second biggest run was from 1995 to 2002, which was a run-up of about 50%. My strong suspicion is that the TWD will not repeat the magnitude of either move mainly because the dollar is unlikely to appreciate much against the RMB and other emerging market currencies, which now play a much greater role in the world financial system and the exchange rate indexes than in the past. However, if you focus on bilateral exchange rates, the dollar move against the yen is already approaching 50%, which I think could go somewhat further, and the move against the euro about 10%, which I think could double. But, in reality, one could characterize these past and future moves as yen and euro weakness rather than dollar strength; on a trade-weighted basis, which is what counts, the yen and the euro have gone down against everything, while the dollar has gone up against the yen and the euro but not against other key currencies like RMB.

**Allison Nathan: How do current conditions globally compare to these other periods of past dollar strength?**

**Fred Bergsten:** The most striking similarity is the outperformance of the US economy relative to its main country competitors – Europe and Japan. In the Reagan boom of the 1980s, the US economy experienced a strong V-shaped recovery from the deep recession at the start of the decade. The late ’80s was even better period for the US economy – arguably the best period in the post-war era – given the combination of rapidly rising productivity growth and job creation, which also helped push the budget into surplus. Today, the US economy is also exhibiting relative strength although more due to weakness in other economies – the Euro area and Japan – than in the past. Another similarity with the early 1980s that seems to be playing out is a collapse in the oil price that should keep the US trade deficit from rising as far as it otherwise would on the strengthening dollar.

In terms of differences, I have already mentioned the main one, which is the increased importance of emerging markets in the global economy and, increasingly, in currency markets. In the early ’80s, the financial markets were still almost entirely comprised of the G5/G7, so when you needed to correct the huge over-valuation of the dollar, the G5/G7 were able to work together to resolve it. It is interesting to note that implementation of the Plaza Accord, in which the G5 intervened heavily to bring down the dollar, marked the first period when emerging markets became important. The so-called Newly Industrializing Countries (NICs) – Korea, Taiwan, Hong Kong, Singapore – maintained their dollar pegs and rode the dollar down against all the other G5/G7 currencies; they therefore became the big surplus countries of the late 1980s. Of course today China, India and others are important considerations in the global markets. It will be particularly interesting to see what China does here because just as the NICs rode the dollar down in the ’80s, China is now riding the dollar up given that the RMB basically remains pegged to the dollar.

**Allison Nathan: How might dollar strength affect trade relations? Could it spark a rise in protectionism?**

**Fred Bergsten:** That depends of course on how much the dollar moves; the doubling of the value of the dollar in the early ’80s that pushed the current account deficit to unforeseen levels led to a huge political reaction. This reaction was a key motivation of the Plaza Accord that largely aimed to reduce the risk of protectionist trade pressure and a blowup of the global trading system.

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Despite a substantial rise in the current account deficit during the late 1990s run-up, protectionist pressure was lower in part because the economy was doing well; this pressure did not begin to rise again until the heightened focus on Chinese foreign exchange intervention in the early part of the 2000s.

This time around there is already substantial congressional pressure for the US to take legislative action against currency intervention – not just against China, but against Japan, Korea and others if they were to start intervening again. If the dollar were to continue to appreciate enough to significantly increase the trade deficit and, in turn, slow growth and job creation, that pressure would very likely intensify. And Congress would have a lot of leverage because the administration is currently pursuing a very active trade agreements agenda that includes negotiating the Trans-Pacific Partnership, the Trans-Atlantic Trade Investment Partnership and potentially trying to secure Trade Promotion Authority again. This White House trade agenda gives Congress a shot not only at trade policy in the usual sense, but at the exchange rate. So if the situation ran far enough, Congress could force the Obama Administration’s hand. I think that is the sleeper scenario that has not gotten enough attention.

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Allison Nathan: At what point might the US intervene against dollar strength?

Fred Bergsten: A 15% move in the TWD would likely at least double the US current account deficit to $1 trillion per year from $500 billion currently and reduce US growth by 1-1.5 percentage points annually for two to three years. That trillion dollar figure might be the magic number that prompts action. The TWD has already appreciated at least 5% over the last six months, so getting to 15% is not hard to imagine.

Allison Nathan: What steps might the US take?

Fred Bergsten: One option would be to attempt to reverse the dollar’s strength through coordinated action akin to the Plaza Accord. But given the current economic fragility in the Euro area and in Japan, these countries would unlikely be willing to coordinate to drive their currencies back up. Alternatively, in cases where the other countries were intervening, the US could undertake what I call Countervailing Currency Intervention, which rests on the same theory and fundamentals as countervailing duties in trade, namely offsetting any currency intervention with equal, but opposite intervention. For example, if the Koreans buy a billion dollars to keep the won weak, the US would buy a billion dollars’ worth of won. If the US undertook Countervailing Currency Intervention two or three times, I am pretty sure that the other countries would be deterred from intervening again.

Some people might consider this protectionism, but I would call it anti-protectionism; when a country intervenes to keep its currency substantially under-valued, that is equivalent to imposing an export subsidy plus an import surcharge, which in my mind is highly protectionist. In particular, I view Chinese currency intervention as probably the most protectionist national economic policy in modern history and I think that the US should have reacted to it long ago.

But the other option is for the US to just sit back and take it, especially when no intervention is involved, chalking the costs up to the price it pays for having the dominant global currency. That is essentially the view that the US has taken for the past thirty years as it has run big trade deficits at the same time that other countries have taken aggressive actions to strengthen their trade surpluses. And the domestic political reaction has been surprisingly small, except when it really gets out of hand like it did in the mid-80s. But would our domestic politics take that at this point? That is a big uncertainty in my mind.

Allison Nathan: Should the US play that more passive role?

Fred Bergsten: As a systemic matter, no, because the US is no longer the dominant economy and has sufficiently globalization itself to the extent that it can no longer ignore the impact of its external economic position on the domestic economy. But you are then left with the dilemma that there is no alternative to the dollar, at least at this point. So if you don’t let countries pile up dollars – in other words, run surpluses – then you have to ask what is going to finance the world economy? These are the fundamental questions that have plagued international monetary reform for four or five decades. You would hope to find a middle course in which key countries would be willing to put some limits on how much their currencies depreciate and, therefore, on the costs to the US.

Allison Nathan: Some argue that currency depreciation resulting from monetary policy is justifiable. Do you agree?

Fred Bergsten: I wish it were so simple. The G7 quite formally as well as most analysts have made a sharp distinction between currency depreciation generated by QE or monetary policy more broadly and currency depreciation generated by direct intervention in the currency markets. The former has been regarded as acceptable on the grounds that monetary policy is aimed at domestic objectives using domestic instruments with the exchange rate effect just a byproduct. In contrast, direct intervention has been viewed as objectionable because it is aimed at specifically shifting the exchange rate using foreign instruments. But countries on the other side of the equation – the Brazilians have been the most vocal but there are many others – note that the effect on them is identical whether their currencies shoot up against the dollar and the yen because of Fed/BOJ QE or against the RMB because of Chinese currency intervention. They don’t care much about the cause. That is a legitimate issue that could well lead to concern in a lot of countries.

“The unwritten rule of the dollar-based [monetary] system is that the US play a passive role in the exchange market and permit other countries to set their exchange rates against the dollar.”

Allison Nathan: How does current dollar strength end?

Fred Bergsten: Hopefully it ends with the economies of the Euro area and Japan growing again, which should allow them to move back to monetary policy normalization. One way to view all this is “simply” a timing problem in that the US had its crisis first and is now recovering first, which is allowing it to exit from easy policy first. But if the Euro area and Japan are relatively soon to follow on the recovery path – say within two or three years – and have not done too much damage to the US and global economy in the
meantime, then the big growth/monetary policy asymmetries at
the core of this might be overcome without any huge disruptions.
If the asymmetries last in the range of five years, then some
exchange rates would likely move much farther out of line and
other types of responses such as intervention may be required.

**Allison Nathan: Is the primacy of the dollar in the international
monetary system a good thing or a bad thing for the US?**

**Fred Bergsten:** The conventional wisdom is that the international
role of the dollar is great for the US and bad for the world. I think it
is the opposite. The international role of the dollar is great for the
world because it gives countries an easy vehicle to use for
international trade, finance, etc., and it enables them to set their
exchange rates against the dollar. It is bad for the US for two
reasons. The first reason is the flip side of what I just said – the
unwritten rule of the dollar-based system is that the US plays a
passive role in the exchange markets and permits other countries
to set their exchange rates against the dollar. Ceding that power
has clear disadvantages.

The second reason is that the primacy of the dollar has led the US
to be complacent about its external economic position. The US
does not seem to worry much about the competitiveness of its
currency, which has cost a lot of jobs and growth, because the
resulting trade deficits are easy to finance. It even contributed to
the subprime crisis in the sense that the supremacy of the dollar
attracted a huge inflow of foreign money. At some point, I am
cconcerned that the chickens are going to come home to roost.
They have not so far because the main competition has been
weak. But just look at the experience of the deficit countries in the
Euro area: capital inflows generated by the creation of the euro
were great until those flows dried up, leaving Europeans with the
mother of all financial crises. Someday, the US will not be exempt
from the same fate. All that being said, I think we are condemned
to continue an outsized international role for the dollar and suffer
the costs, because I don’t see a constructive way out of that role
anytime in the short-to-medium run.
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