THE INTERNATIONAL ECONOMY

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888 16th Street, N.W., Suite 740
Washington, D.C. 20006
Phone: 202-861-0791 • Fax: 202-861-0790
www.international-economy.com

IIE *Celebrates* Twenty-Five

TIE: **Despite all the talk about the transformative effects of globalization, some things do not change. Looking back on 1981 when the Institute for International Economics was founded, what policy challenges in the international economy remain the same today?**

Bergsten: Three big challenges remain the same: global imbalances, energy price pressures, and trade protectionism. In fact, one of the things that led to our creation was the emergence of all three of those challenges in the 1970s. Many felt that the country was not well equipped to handle them and so we ought to create a think tank devoted to that set of issues. A quarter of a century later, have we learned anything? The answer is that we clearly haven't yet learned enough to keep them off the radar screen.

TIE: **So how's the policy world performed on these three challenges if you had to give a grade?**

Bergsten: The policy world dealt pretty well with the imbalances in the 1980s and even into the

Founded in 1981, the Institute for International Economics quickly came to dominate global economic policy research. TIE *sat down with director Fred Bergsten, who started it all and today remains the dominant force in an important Washington, D.C., institution.*

C. Fred Bergsten

An Exclusive *TIE* Interview

1990s. The United States finally started to get its budget deficit under control and the imbalances—particularly through major changes in exchange rates—were pretty much eliminated by 1990. But then people forgot and imbalances started to rise again in the late 1990s.

Trade protection achieved the second best performance in my view. People bought into the bicycle theory—if you stop liberalizing, you fall back into protectionism—and kept liberalizing negotiations going forward. The reduction in barriers to trade has had a huge impact. Gary Hufbauer from our team quantified it about a year and a half ago and found that the United States is a trillion dollars a year richer as a result of trade globalization in the last fifty years. At the moment, the collapse of the Doha Round may represent a recrudescence of all that risk.

We've seen relatively little improvement in energy policy. The markets did respond a fair amount to the 1970s oil shocks and the United States has experienced a big reduction in energy usage as a share of the economy. That was also partly a triumph of policy. President Carter, helped by the 1978 Bonn Summit, finally did decontrol oil prices, a measure Congress had blocked for five years after the first oil shock. But I'd say the lack of an effective energy policy for the last twenty years is the biggest single threat to global economic stability.

TIE: **Does it bother you that while the imbalances always could lead to disaster down the road, so many of the usual rules don't seem to be working? We have a president who's been in office for six years, and he took a surplus and turned it into a significant deficit. If you'd had a crystal ball in 2000 and known this fact, you would have said the ten-year bond would be at 12 percent by now. Yet the long bond has stayed below 6 percent, and for a while was at 3 percent. By the same token, U.S. current account imbalances are such that**

The United States is a trillion dollars a year richer as a result of trade globalization in the last fifty years.

you've had so many investors—the latest being Warren Buffett—lose their shirts betting on the dollar collapse. There seems to be some temporary revision of the rules on how we interpret these imbalances. How has the Institute come to terms with what is at least temporarily a source of frustration among economists?

Bergsten: I'd stress "temporarily" because, when the Institute was created in 1981, I was already saying the trade deficit is going to rise to $100 billion. People scoffed. I predicted protectionism would erupt. People scoffed. I said the dollar was way overvalued. People scoffed. Well, I was early then too. And in 1983 I was saying it even more assuredly and I was still premature. It wasn't until early 1985 onward that the dollar dropped over 30 percent on average in two years and by over 50 percent against the deutschemark and yen. Perhaps temporarily the usual rules aren't holding. But Buffett just made a big timing mistake. If he'd sold dollars in 2002, he'd have been an even richer man. He sold in the one year the dollar happened to go up and then whipsawed himself because if he had held on a little while longer he would've been OK.

TIE: **The point is just that if you were to imagine a world in which the U.S. current account imbalance is at 7 percent of GDP, most people would say it would never get there.**

Bergsten: The specifics always differ but we know that markets as well as governments can make big errors for prolonged periods of time. In this cycle, the European economy is a drag but the U.S. economy has boomed through increased productivity. It's a matter of time until the imbalances and exchange rates are corrected.

TIE: **Do you agree with Federal Reserve Chairman Ben Bernanke's assessment that essentially there's a shortage of non-American investment opportunities for the global capital markets?**

Bergsten: I wouldn't put it that way but, as I said, Europe's growth is disappointing. Japan's growth has been disappointing. The other big financial markets have not been all that appealing so, in a sense, it's the same thing.

TIE: **How has the ability of policymakers to shape the global economy changed since the Carter Administration days when you served in the Treasury? Have the international institutions kept up with developments in the global economy?**

Bergsten: Policymakers understand the issues a lot better now, but I don't think their performance is much better. Active policy cooperation has fallen out of style. Some would say that is good news. Central banks have developed more credible monetary policies and anti-inflation reputations, so maybe there's less need for active coordination. But the imbalances themselves reflect in part the lack of adequate policy cooperation.

Most of our institutions have deteriorated. The IMF has clearly deteriorated. The G7/G8 coordinating mechanisms have deteriorated in part because they've lost political legitimacy since their membership no longer tracks with the underlying power structures in the system.

The standing of the WTO is mixed. WTO dispute settlement was a big step forward and continues to work pretty well. But if the Doha Round of

Federal Reserve Chairman
Ben Bernanke

Bergsten on Bernanke

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trade negotiations does fail then even that process could atrophy. On the institutional side, there's been a failure to keep up with globalization and in fact some retrogression.

***TIE:* To what extent during this period have advances in technology affected policymakers? When you push a button money speeds around the world almost instantly and so you have this kind of globalization of liquidity. Yet central bank reserves relative to the size of the markets now are much smaller than twenty-five years ago. The central banks used to have more clout. Today, they are like actors on a stage trying to project and magnify what is not really the same amount of clout. How does that limit the scope of institutional management of the system?**

Bergsten: I'm skeptical of that premise. There's no doubt the amounts of money are much larger but that doesn't necessarily reduce the central banks' clout and efficiency. All the officials have ever had the ability to affect is the small difference between *ex ante* supply and *ex ante* demand at the margin. Whether the total flows are \$1 trillion or \$10 trillion, the amount that you're trying to affect at the margin is a much smaller share of that.

The size increase is being used as an excuse and a cop-out by officials not to try to do what they used to do. My evidence is that, for all their anxieties about exactly what you said, the Clinton Treasury intervened three times in eight years and every time the intervention worked like a charm. Despite all their protestations, policy officials contradicted themselves with the success of their own measures. They say, "If we tried to do it every month it wouldn't work," but nobody's asking them to do it every month. In short, I think the record on intervention has been pretty good when it is done correctly.

***TIE:* How do you feel about what came out of the latest G7 meeting? Growth gaps seemed to be stressed, rather than imbalances.**

Bergsten: I don't think it's a change in substance but rather a change in words, partly because the G7 thinks those words might be tactically more successful with the Chinese.

***TIE:* You served on the Meltzer Commission on International Financial Institutions as ranking minority member several years ago. Where does support for change in those institutions stand in the United States today? Is there a chance that Congress will simply say the hell with them?**

Bergsten: I don't think there's much chance Congress will say to hell with them. Part of the reason is that Congress is afraid to be blamed for gutting the fire department when there still might be fires. I don't think anybody would want to take the risk of eliminating the IMF.

There's a huge debate as to what the IMF should do and how it should best do it, however, particularly during a period of imbalances. What ought to be emphasized is the new G5, created by the IMF, operating under the heading of multilateral surveillance. But they're going to have to be a lot more aggressive in terms of really putting a blueprint forward.

What is interesting today is that the IMF and WTO are both stalled. The WTO is stalled because the Doha negotiations have been suspended. The IMF is stalled over the issue of imbalances. What's required in both cases is for the leaders of the international institutions, Pascal Lamy and Rodrigo de Rato, to come forward with a plan. There's too much pussyfooting. They say, "We can't be trusted private advisers if we've got to be a public umpire at the same time." In my experience as a U.S. government official, you have to try to do both. Operating purely on the inside doesn't mobilize public opinion and political forces for the needed support.

Leadership means bringing your members along and trying to overcome the difficulties with them. If you don't bring them along, you of course take a risk of being fired. Then-IMF Director Pierre-Paul Schweitzer told the United States in 1971 that it had to devalue the dollar against gold to deal with the imbalances at the time. The United States agreed to

The United States gains about $1 trillion a year from globalization, or $10,000 per household or 10 percent of GDP. It's a big payoff.

do it and Schweitzer ultimately lost his job but the world went forward.

***TIE:* Is there any support for the World Bank in this country? Is there any support for international aid?**

Bergsten: I'm actually surprised at the big increase in support for aid, including support from President Bush. Look at what Bush has done with the foreign aid budget. It's doubled and tripled, depending on how you define it. The support has included his own Republican leadership, including Bono's mobilizing not only Jesse Helms but also the Republican Senate caucus. That's been a positive development. Whether this translates into support for the World Bank is not so clear. But neither has it led to any attacks on the World Bank.

***TIE:* Many feel the World Bank should refocus. There was a proposal to forgive the loans in arrears and put the fiction of lending institution to rest, because the countries who really need the focus on poverty are the ones who can't pay back loans anyway.**

Bergsten: I was in the minority on the Meltzer Commission but we all agreed on debt relief. The World Bank and the regional banks have all pretty much forgiven their outstanding debt. On that issue we succeeded.

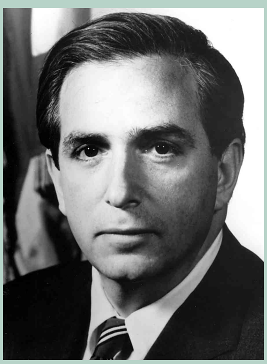
***TIE:* We had high hopes for James Wolfensohn when he came on as World Bank President in 1995. After all, he restructured companies for a living. Now it looks as if current World Bank President Paul Wolfowitz has a revolt on his hands.**

Bergsten: But again it's at the margin. The inertia is so huge in that institution that it would require a really massive effort to change it. Even if you do it, it would be a decade before the change really showed up.

***TIE:* How has American awareness of and feelings about globalization changed over the last twenty-five years?**

Bergsten: I think that's one of the big developments over the life of the Institute. There was a pretty strong bipartisan consensus in favor of globalization that held from when I started in this business over forty years ago until the NAFTA debate in 1993. NAFTA was a watershed. For the first time, the United States did a free trade deal with a low-income country. That crystallized for the first time what we now think of as anti-globalization sentiment.

All the studies we've done suggest that there is a huge disjunction between the analytical facts and public perception of them. The Institute has done several studies on this topic and they have been heavily cited in the media. U.S. Treasury Secretary Henry Paulson cited one recently in his first international speech, that the United States gains about $1 trillion a year from globalization, or $10,000 per household or 10 percent of GDP. It's a big payoff. Our team also quantified the adjustment costs at about $50 billion per year. That's a twenty-to-one benefit-cost ratio. Yet every time the Congress votes on a major



Richard Darman

Truth in Advertising

"The concept of target zones as adopted in the Louvre Accord in 1987 was another major success though under the term 'reference rates,' because Deputy Treasury Secretary Richard Darman said he couldn't call it the same thing we called it."

—F. Bergsten

It's Politics, Stupid

"The proximate cause of U.S. Treasury Secretary Jim Baker's doing the Plaza Accord in 1985, and U.S. Treasury Secretary John Connally's doing the Smithsonian Agreement in 1971, was not the international financial risk but the domestic political risk."

—F. Bergsten

James Baker: *U.S. Secretary of the Treasury from 1985 to 1988 in the second Reagan Administration.*

trade issue, whether it's fast track authority or CAFTA, the vote is almost evenly split. Clinton lost three times trying to get fast track extended. Bush won by a margin of a few votes.

So why the disjunction? What our studies on the politics show is that the difference in perception derives almost wholly from educational levels. Everyone who's a college graduate or has some college welcomes globalization as an opportunity. Everybody who's a high school graduate or less is terrified because they don't feel they can cope with the adjustment required. Since the average American worker is pretty close to being a high school graduate, that means perceptions split almost evenly down the middle.

In the long term, the answer is more education. Our studies showed that every increase of one year in the average training level of the work force increased workers' support for globalization by 10 percentage points. If you could raise the average worker who's a high school graduate to being a community college graduate, let alone a full college graduate, you'd have a working majority.

In the short run, if you change the question and say, "Are you for or against globalization if the government is effectively helping the losers in the process to get back on their feet," support shifts from 50–50 to 70–30 in favor. But one of the huge failings of both parties is in implementing and seriously carrying out domestic safety net and adjustment programs. That would help dislocated workers. We've costed it out and it's not that expensive. It could be done, but neither the Clinton Administration nor the Bush Administration nor their predecessors have effectively linked their zealous desire to maintain an open and liberalized international trade environment with the domestic adjustment requisites. I'm convinced that until that is done we will have a very unstable foundation for trade policy in this country. The world global trading system is thus at risk because you don't know when the United States might cop out.

TIE: **We've been in this period of prosperity. Heaven forbid if we went into a serious downfall.**

Bergsten: This clearly raises the specter of protectionism. If you cyclically adjust U.S. trade policy and ask what's it going to look like two years from now if we face a recession, if unemployment's at 7 percent, if the global current account deficit is up to $1 trillion, if the bilateral imbalance with China's at $300 billion, then I would not put very many bets on the continued openness of the global trading system.

TIE: **You're right about training and adjustment investment, but the problem seems to be that whenever trade policy is debated, the interest groups representing people who need adjustment assistance that you're trying to pull in can't be separated out from the ones who want to add all kinds of protectionist measures. That's why the coalitions break up every time.**

Bergsten: I put a lot of weight on the exchange rate as a predictor of protectionism. The reason is that it affects the domestic politics of trade policy in a big way. It puts more industries in the pro-protectionist camp because, while they can compete at equilibrium, they're in big trouble when the dollar's overvalued by 30-40 percent. Likewise, the pro-trade export forces weaken or become disinterested.

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The Future of the World in a Nutshell

"I see two giant topics. One is going to be a change in the configuration of global economic power that voids current institutional arrangements. Europe has declined, Japan is declining, they're both driven down in part by demographics but also lack of dynamism. China's rising, India's rising, and so are emerging economies such as Korea, Mexico, and Brazil. The United States is somewhere in between, but more rising than falling."

—F. Bergsten

TIE: There's no doubt that was true in 1985, when Treasury Secretary James Baker and Fed Chair Paul Volcker worked out the Plaza Accord.

Bergsten: That was the epitome of it.

TIE: Baker could see the trouble but others in the Reagan Administration didn't. If he hadn't done the Plaza Accord, there could have been a catastrophe.

Bergsten: The proximate cause of Baker's doing the Plaza Accord, and U.S. Treasury Secretary John Connally's doing the Smithsonian Agreement in 1971, was not the international financial risk but the domestic political risk.

TIE: There's no doubt about it.

Bergsten: Congress was about to go on a protectionist binge. I sense that risk now. In the short run, the reason I'm so worried about the imbalances and currency misalignments is that the international financial disequilibrium can disrupt the global trading system. That in turn can lead to big problems on the financial front.

TIE: The markets are so powerful that if the Congress is poised to do something stupid, many people are in a position to call up and say, "Back off, are you nuts?" I think it's already happened to Senator Chuck Schumer (D-NY) with his idea to put tariffs on Chinese products unless the value of China's currency is allowed to rise.

Bergsten: But there's a second development over the life of the Institute and that is the ability of multinational firms to put in place what they call natural hedges. They develop multiple production facilities so they can shift their production base and work around currency misalignments. Multinational companies in the past ten or fifteen years have given up on governments. They see governments as never doing anything to stabilize currencies, which inevitably get out of whack.

For more than twenty years, former Fed Chairman Paul Volcker and I have been trying to stir up domestic political support to promote more stable international monetary arrangements. That effort has failed because the firms have already taken their own actions to work around the overvalued dollar. Firms of course prefer not to have dollar overvaluation, but it's a factor they can work around.

A third thing that has changed since the Institute was founded is the diminished political power of organized labor. It's the immobile factors of production—such as labor—that are hurt most by currency misalignments because they don't have any natural hedge. But the weakened political power of the unions would be the third element in the trilogy that

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explains why the imbalances have been sustained a lot longer than we thought possible, because they don't have the ability to apply pressure to change it.

But overall, globalization has probably gone too far to be reversed. It has probably gone past the tipping point. The critical mass of pro-globalization beneficiaries is huge.

***TIE:* Bipartisanship used to be a lot more common in Washington. Republicans and Democrats could work together and develop workable compromises on big issues. But the criticism now's so nasty between them, and the sides won't come together. Has that been difficult for the Institute?**

Bergsten: We have made a major effort to avoid partisanship. The interesting downside is that, since our people are correctly viewed as nonpartisan, they don't get called to serve in too many government jobs because these days the political appointee positions go to mostly partisan supporters. In terms of the Institute's credibility, however, nonpartisanship has been critical to our success. Look at TIE's latest ranking of think tanks ("Think Tanks: Who's Hot and Who's Not," Summer 2005). Only the Institute for International Economics and the Center for Strategic and International Studies of the 17 institutions considered were viewed by the Congress and by the media as being neutral and nonpartisan. Particularly since I started the Institute coming out of the Carter Administration, I made a very strong effort to avoid any appearance of partisanship. I had of course served in the Nixon White House too so I was a nonpartisan technocrat myself. Nonpartisanship is our fundamental tenet here.

***TIE:* We've seen global research economists take the center stage, in particular people like Fed Chair Ben Bernanke, along with former CEA head Glenn Hubbard, Columbia University Professor Jeff Sachs, former IMF chief economist Joe Stiglitz, and former Treasury Secretary Lawrence Summers. How has the role of research economist as policy shaper evolved over the last twenty-five years?**

Bergsten: There are two opposing trends. On the positive side, the need for expertise has increased as the issues have gotten more complex, particularly as globalization has accelerated. But the other side of it is the extreme partisanship that has begun to carry many to the top of the political ladder.

***TIE:* What about the 2008 presidential election? How do you think China and trade will play out as issues in 2008?**

Bergsten: It depends on how the economy goes over the next couple of years. If we have a soft landing, then I doubt trade could be an issue. On the other hand, if things go badly and continue that way, then trade will be very big. Some prominent Democrats take the view that globalization—if not a cause of the major current problems—is a proxy for job insecurity, income equality, and wage stagnation. They might choose to attack globalization during the course of the campaign. On the trade issue, the lack of an adjustment policy or safety net does render globalization vulnerable to those charges. Of course, for a candidate to take a protectionist stance, like Dick Gephardt or John Connally, is unsuccessful politically because it sounds pessimistic and almost un-American.

***TIE:* How do international security issues play into the globalization debate?**

Bergsten: I recently chaired a meeting with Pakistan's President Pervez Musharraf, and the discussion was about how to deal with Pakistan's acute

Unwitting Trade Hero?

"The greatest loss to U.S. trade policy in the last year was the political demise of House Majority Leader Tom DeLay (R-TX). Only thanks to 'The Hammer' did trade legislation get through the Congress during the last five years. DeLay kept the rolls open, he bought votes, and he cleared the legislation by sometimes a margin of only one or two votes."

—F. Bergsten

Tom DeLay

security problems by helping strengthen their economy, in particular through a free trade agreement with the United States. One part of the sensible remedy to the security problems of failed states is to try to strengthen their economies.

TIE: **The typical solution on domestic income inequality is to increase education. Education is the dividing line. But it almost doesn't matter how high wages are in this country. Instead, it comes down to this—if you're in the markets then you're on the upside, and if you're not, you will never catch up. Wages are never going to be able to keep up relative to how well the investor class does. We're telling the bottom half of the country—the wage earners—this lie: that if you can only get to community college then you can catch up. In reality, becoming wealthy means being in the market, owning a piece of real estate, or being more entrepreneurial in general.**

President Bush tried in a clumsy way to attach Social Security to the market. Did he in his optimism obscure the fact that really the only way to correct income inequality is through the market?

Bergsten: An interesting question. I suspect there is a correlation between education levels and being in the market.

TIE: **Specifically, can we address the China issue? What do you think should happen or will happen with China under new Treasury Secretary Paulson? And what do you say to those who characterize you as a weak dollar advocate?**

Bergsten: I would characterize myself as an equilibrium dollar advocate. The dollar reached a historical weak spot in 1995 and I was calling on the Clinton Treasury to intervene, as they finally did, to keep the dollar from falling too low. But the fact is that the dollar's been overvalued most of the last twenty-five years. That means most of the time I've been in favor of a weaker dollar. But I wouldn't call it being in favor of a "weak" dollar. I want the dollar at a level that helps stabilize the current account at some sustainable level, which I define now as about 3-4 percent of GDP.

As for China, it's a tragedy that the Chinese have this huge blind spot about their currency. I'm a big fan of Chinese trade policy. They've still got some protectionist areas, but they brilliantly used WTO entry to help overcome the domestic resistance to reform. I think if former Premier Zhu Rongji were still in office, China would have probably revalued several years ago. It would have been well on its way to resolution of the misalignment problem.

It's very interesting how many of the people who drive a Toyota and use foreign-made products will still overtly enunciate a very nationalist and protectionist stance. But globalization may well be past the tipping point.

TIE: **It's almost as if China needs somebody behind the curtain there who says state enterprises and our employment buffer can take it. No one wants to be the fall guy.**

Bergsten: The unemployment that would be created by the revaluation has to be weighed against the widespread benefits that would result.

TIE: **If China keeps undervaluing its currency, eventually either the situation is going to implode or overheat. Some whisper that the leadership will do whatever it takes to maintain stability until the 2008 Olympics, but then the danger period begins.**

Bergsten: I don't think China's zeal for stability is going to end with the Olympics.

TIE: **Back to the Institute after twenty-five years. What do you say to someone who wants to come along and start up a think tank? How did you keep it fresh, keep it relevant? What's the secret?**

Bergsten: Well, there're two or three elements. The most important is your intellectual capital and your staff. I was both skillful and fortunate at being able to assemble a really world-class staff. Gary Hufbauer, John Williamson, Bill Cline, Mac Destler, Jeff Schott, and others. I was able to put together a superb team very quickly and then retain that core group for twenty-five years. Some of them left for a year or two but they always came back. And they haven't run out of ideas. Then of course I kept adding fresh talent with Marcus Noland, Morris Goldstein, Adam Posen, Mike Mussa, Ted Truman, Martin Baily, Nick Lardy on China, and Anders Åslund on Russia.

TIE: **You sometimes brought international people in temporarily to refresh things and keep it vibrant. You always captured some interesting people.**

Bergsten: I also reassigned people to different topics. Bill Cline worked on debt for a while, and then John Williamson took on debt and Bill switched to trade. We try to pursue what I call a "rolling agenda" by systematically and constantly trying to anticipate what the world agenda is going to look like in the intermediate period. You don't want a short-term focus or an abstract ten-year view. We've missed some issues, but on the whole we've done a pretty good job anticipating what will be on the policy radar screen and getting our work going so that we can add to the debate on a timely basis.

TIE: **What's your biggest coup?**

Bergsten: Well, there are some large coups and some small coups. The biggest included the 2002 Trade Act, which would not have passed without the trade-adjustment assistance package that included wage insurance and a health care tax credit. We developed those ideas and costed them out. The concept of target zones as adopted in the Louvre Accord in 1987 was another major success though under the term "reference rates," because Deputy Treasury Secretary Richard Darman said he couldn't call it the same thing we called it.

In 1999, I had Gary Hufbauer do a Policy Brief applying the basic research he'd done five years earlier on the incredibly bad cost-benefit ratio of an import quota bill for steel that had passed the House and was set to pass the Senate. Then we put out his analysis showing it would save fewer than 3,000 jobs at an average consumer cost of $800,000 per job. Every Senator had that analysis in his hand on the floor. Senators Roth (R-DE) and Grassley (R-IA) cited it, all the opposition cited it, and every newspaper had a story on it that day. The bill was voted down. It was a prototypical application of think tank work to a particular policy issue. We had done the underlying analysis earlier, kept the work updated, applied it to the specific issue, and put it in the hands of the people making decisions and the media.

Beyond those specifics, some of the things we've done affect the way the world thinks about issues, such as the bicycle theory on trade and competitive liberalization.

TIE: **Do you think the fact that you do not have a huge endowment is actually an advantage? Basically every year you have to prove your relevance. Has that it forced you to make sure you were delivering at a higher level?**

Bergsten: It's not too big a burden to raise annual funding but we could face a period of volatility, particularly when at some point I retire as the director and my chairman Pete Peterson retires and we have the inevitable turnover. Hence we're running a capital campaign in this twenty-fifth anniversary year.

TIE: **You're really talking about a reserve fund more than an endowment.**

Bergsten: We call it a capital fund. I would like it to be more substantial but, at the same time, I think that it would be a mistake to cover the lion's share of your expenditures because you should have to continually meet the market test. The deal I made with the German Marshall Fund at the Institute's founding guaranteed the amount of money we needed for the first three years but, if I couldn't diversify our funding by that point, I'd have deserved to fail. Some other think tanks actually started at the same time with either huge startup amounts or some funding angel and they actually failed.

TIE: **It's amazing that when you started there wasn't an effort to close you down by all the large institutions. What are your plans for the next five or ten years? What do you think we'll be talking about?**

Bergsten: I see two giant topics. One is going to be a change in the configuration of global economic power that voids current institutional arrangements. Europe has declined, Japan is declining, they're both driven down in part by demographics but also lack of dynamism. China's rising, India's rising, and so are emerging economies such as Korea, Mexico, and Brazil. The United States is somewhere in between, but more rising than falling. Where we're positioned in this next decade is particularly interesting because we've started to distance ourselves over the last decade or so from our post-war rivals. Europe and Japan were catching up to the United States in per capita income terms until about 1990. Since then we've had tremendous growth, they've seen stagnation, and we're pulling away from them. The emerging economies are now the fast risers. It's going to be a while, but their emergence will lead to a big change.

***TIE:* What will the G5 or G7 look like twenty years out? Are any of the other industrial countries going to be in it? Will the United States be in it?**

Bergsten: The European Union as a single player will be big enough, but Japan? The United States will certainly be in it.

***TIE:* That is a question, the politics of consolidation. You look at Europe resisting consolidating their representation. They're holding up the show.**

Bergsten: Here's a fascinating case. The IMF has set up a "new G5." Who's out of that? The United Kingdom. They were the traditional dominant power in the world economy until World War II. In sixty years they went from top dog to not being in the room. The pace of change is accelerating, so while that jump took six or seven decades, the next will take less. China is already being brought into the IMF's new G5.

The other issue will be, "Whither globalization?" Will the technology and the net gains overwhelm the backlash and resistance? The first century of globalization prevailed until World War I and then was choked off. By the middle of the twentieth century globalization was in the ascendancy again, maybe brought on by the cataclysm of World War II. I don't think the future continuing expansion of globalization is a certainty.

Q. The more globalization creates income gaps over the structurally restrictive regions, the more violent they become.

Bergsten: Exactly. The Institute's Marcus Noland is doing a study that shows how the Middle East has de-globalized enormously, even more than sub-Saharan Africa. A very large part of its economic malaise is tracing through its political instability. The Middle East share of every global variable like trade or international investment has declined in percentage terms in the last several decades. What's cause and what's effect?

***TIE:* Look at the resources in the Middle East that have been frittered away. After the oil price boom began in the 1970s you would think they'd have invested in major economic and cultural institutions, but nothing has developed. Given their resources, their inability to turn that into something of value is shocking. That's the curse of oil.**

This whole notion of trying to educate the world on global risk would be a terrific opportunity for researchers.

Bergsten: As we look to our next twenty-five years, we ask ourselves whether we should go beyond our target audience in the policymaking community and try to reach a grassroots audience.

It's very interesting how many of the people who drive a Toyota and use foreign-made products will still overtly enunciate a very nationalist and protectionist stance. But globalization may well be past the tipping point. You can't imagine people in Holland or Denmark voting protectionist because their livelihood depends on the rest of the world and they've known that for a century or more. But forty years ago in the United States, exports were 3 percent of GDP. This was a closed economy. The transformation from a closed economy to a quite open economy—much more open than Japan's—is really stunning in historical terms. Public opinion hasn't kept up.

***TIE:* You have to hand it to President Clinton—he resisted protectionism. He could have fallen back into the old liberal Democratic approach and protected the Rust Belt. But when corporate America and the business world saw that an incoming Democratic Administration was not going to go backwards on these issues, that's when business really started to restructure heavily, beginning a surge in productivity.**

Bergsten: But Clinton also said to me several times, "My biggest disappointment in my presidency is my inability to bring my own party along on globalization." With all due respect, I don't think Clinton was ever ready to confront his basic constituency on these issues and do what had to be done in order to overcome resistance to them. That's why he wound up stalemated. Bush in that sense has done much better.

I'll leave you with a one-liner: The greatest loss to U.S. trade policy in the last year was the political demise of House Majority Leader Tom DeLay (R-TX). Only thanks to "The Hammer" did trade legislation get through the Congress during the last five years. DeLay kept the rolls open, he bought votes, and he cleared the legislation by sometimes a margin of only one or two votes. With all else equal but no Tom DeLay, I'm not sure anything more will get through.

***TIE:* Thank you very much.** ◆