THE WORLD ECONOMY: AN INTERVIEW WITH C. FRED BERGSTEN

BY BENJAMIN J. COHEN

COHEN: It is twenty years since your days as a student at The Fletcher School. What do you regard as the most significant changes or developments in the world economy over that period of time?

BERGSTEN: In the past twenty years there have been a lot of major structural changes, in both the world economy and in the U.S. position in the world economy. In terms of the United States two major things have happened. One is that our economy has become deeply enmeshed in international economic affairs. The share of trade in our economy has more than doubled over that period; over the last five or six years, changes in our international position have dominated the course of our overall economy. So we've become deeply dependent. At the same time, over those twenty years, we've had a great pluralization of world economic power. Twenty years ago the Europeans had just formed the Common Market, their currencies had just become convertible, and Japan was still regarded as a developing country which was to be given special help as in the Trade Expansion Act of 1962. The developing countries were at most a dim image for most people. Nobody had ever heard of OPEC, though it had been created just a few years before. So we had an enormous shift in relative power. The United States' position, quite naturally, has declined relative to Europe, Japan, and now even a number of developing countries. So from the U.S. standpoint you've had kind of a scissors movement. On the one hand we have become more dependent on world economic trends. On the other hand we have become less able to dictate or even lead the course of those trends. That has been the big difference in terms of the U.S. economy and how both our foreign policy and our economic policy have to be formulated.

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If you look at the world economy more broadly there have been dramatic changes. The monetary system has moved from fixed rates to flexible rates, the dollar has moved from being overwhelming to a position where it is still dominant but in a world of several key currencies, Special Drawing Rights, ECU, and other assets. The trading system has moved from a reliance on tariffs to a much more sophisticated array of non-tariff barriers, domestic industrial policies, industrial targeting and the like. During that period there's been substantial further liberalization of the traditional barriers, but new problems have arisen and there is right now a new wave of protectionism which I think is most alarming. Energy markets have of course changed dramatically. So it's been a period of much turbulence.

COHEN: Let's take those three major substantive areas that you just touched on — monetary relations, trade relations and energy — and speak a little more about each from the U.S. point of view, given this greater dependence that you spoke of. For example, in the international monetary area, we are much more dependent now than before on what happens to our exchange rate. In recent years we've had a very overvalued exchange rate which, among other things, has generated protectionist pressure in the United States. Do you see the lack of management of the exchange rate as a serious problem? Do you think that, over time, this is going to lead the U.S. toward a position in favor of greater management of the exchange rate or do you think that we will continue to have an essentially unmanaged float?

BERGSTEN: I think the overvalued dollar is an enormous problem. The U.S. trade deficit is soaring well beyond $100 billion this year and next, creating lots of unemployment domestically, and representing a major drag on economic growth and a major source of pressure for trade controls and for a retreat from an open international system. I think the message is getting through that the unfettered flexibility of rates under the system that has existed for the last ten years is just too costly. We saw it when I was in government in 1978 and 1979. The dollar depreciated sharply and added to inflationary pressures here. It went to undervalued levels, by any objective measure, and now it's overshot in the other direction. There's also increasing unhappiness about the exchange rate system in other parts of the world. So I do think there's a growing consensus toward the need for an improved system. Indeed, the major holdout is the current U.S. administration which has resisted intervention — I think incorrectly — and has resisted talking about systemic change.

But there is a growing sentiment to make some improvement. What would that be? I think not to go back to fixed rates. What is needed, and is widely perceived to be needed, is some kind of synthesis between the excessive rigidity of the fixed rate regime under Bretton Woods and the excessive flexibility, overshooting, and volatility that we have had under the unmanaged floating rate regime of the past ten years. What is needed is something in between. My own preference is for a target zone system where the major countries would try to agree on criteria against which to judge the appropriateness of exchange rate relationships. There would be constant monitoring of those relationships to try to keep rates within a fairly wide zone, even 15 to 20 percent to start, but to try to avoid major incorrect rates through better policy coordination, direct intervention, and whatever else might be needed to achieve that outcome.

COHEN: Can you tell us which countries you have in mind when you speak of the "major countries"?

BERGSTEN: It would be most pragmatic to start with the five major countries that have been meeting for some time as the Group of Five — the United States, Germany, Japan, the United Kingdom, and France. One could even start with the smaller group of three, because the dollar/deutsche mark rate is probably the most important exchange rate today for financial reasons and the dollar/yen rate is probably most important for commercial reasons. If one could get some more effective collaboration, even between the U.S., Germany and Japan, that might be a good start.

COHEN: And exactly how would they agree on the criteria for setting targets for exchange rates?

BERGSTEN: All the analyses would have to be based on one or another variant of purchasing power parity, taking the basic view that what you want to do is to equate the current account competitiveness of countries accurately through the exchange rates. My Institute published a study by John Williamson[1] last fall that took a more sophisticated approach, but came out with roughly equivalent conclusions in terms of current levels of misalignment. There could be reasonably widespread agreement on that methodology. It would not lead to agreed-point estimates of where rates ought to be but it could lead to agreement on ranges or zones of the magnitude that I mentioned. And it seems to me it is a practical step forward.

1. John Williamson, *The Exchange Rate System* (Washington: Institute for International Economics, September 1983).

COHEN: What you have in mind would not just be coordination of direct intervention in the exchange markets, but also coordination of domestic monetary and fiscal policy?

BERGSTEN: Yes, it is inevitable that even the United States, for reasons that I mentioned at the outset, move toward more effective coordination of its macroeconomic policy with that of the other major countries. There have been episodes where that has been done to greater or lesser extent. The record so far is not particularly encouraging. But I do think it's inevitable and desirable within wide margins as I've suggested with these target zones. Actually, one of the purposes of the target zone system would be to provide pressure in that direction — healthy pressure — to get signals from the international markets more quickly and more forcefully and to be under some obligation to respond to them in a constructive way.

COHEN: When we talk about the United States in this vein, we are up against the reality of a still somewhat insular view of economic policy. How would we go about persuading the American public that it is in this country's interest to modify its economic policies for the common good?

BERGSTEN: There would have to be an educational effort to disseminate widely the kinds of notions that I mentioned at the outset — how deeply enmeshed the U.S. itself has become in the world economy, how external events have been decisive in the course of our economy for a number of years now, and, therefore, how we simply *must* take external factors into account in setting our own policy. That, in turn, leads to the next question: how could one carry it out effectively — through what institutional arrangements and through what sensitization of the Congress, the Federal Reserve, and the Administration, to do it? I'm modestly encouraged, actually. Over the last six to eight years we've seen the development of export caucuses in the Congress and we have not seen as much protectionism as one might have expected given the high level of unemployment and the trade deficits. I think there is a growing awareness, which could be mobilized with effective leadership, which would have to come from the President and from Cabinet officers speaking often and aggressively in this direction. But the underpinning is there and the educational process, with proper leadership, could have its desired effect.

COHEN: When we talk about the international monetary area, of course, we also have to remember the subject of international liquidity and also the problem of global debt. Parallel to your proposal regarding exchange rates, do you have in mind a need for more systematic and more multilateral control over the supply and rate of growth of international liquidity?

BERGSTEN: There is greater need for multilateral control over the growth of liquidity, but I don't think we have a full understanding at this point of how important that is under flexible exchange rates. To the extent we move back toward less flexibility in the exchange rates, concomitantly, there would be a greater need on the liquidity side.

What bothers me most in that area now, perhaps, is not only the totally unfettered nature of the liquidity-expanding process, but the increasingly unstable base; to wit, the movement to a multiple reserve currency system. Several major currencies other than the dollar — notably the deutsche mark and the yen — have been playing increasing roles over the past few years. A study I've done at the Institute, which we'll be publishing shortly, shows that central bank portfolio switching has added to the destabilization of exchange rates.[2] Just like private speculators, central banks have tended to buy currencies when they're strengthening beyond their equilibrium levels and sold currencies when they're weakening below their equilibrium levels. That has added to currency instability and been a further destabilizing factor in the markets.

COHEN: What about the global debt problem? Do you see that as a temporary blip in the long term evolution of the international monetary system, or is this something that is going to hang over us for decades?

BERGSTEN: I think debt will be a continuing problem for some time to come. The depth of the problem really depends on whether the macroeconomic prospects for the world can be improved from the poor position of the last few years. My colleague Bill Cline did a thorough study which showed that the problem was manageable on a continuing basis under current arrangements if world economic growth could pick up to 3, 3½ percent for the next few years; if interest rates would not jump back up; if protectionism could be avoided; and if continued private capital infusions were at least enough to avoid forcing the debtor countries into default.[3] Having said all that, though, there is clearly some uncertainty as to whether those parameters will be met. To get the debt burden off

2. C. Fred Bergsten and John Williamson, *The Multiple Reserve Currency System* (Washington: Institute for International Economics, forthcoming 1984).
3. William R. Cline, *International Debt and the Stability of the World Economy* (Washington: Institute for International Economics, September 1983).

the back of both the debtor countries and the world economy as a whole, probably some longer-run consolidations or stretch outs are going to be needed. That makes most sense on a country-by-country basis rather than in some grand global scheme, but I do think that a stable solution is going to require some longer-run approach than we've had so far.

COHEN: In that study by your colleague, Bill Cline, that you cite, he argues against any kind of systematic consolidation of debt on the grounds that this would reduce the incentive for banks to continue to lend to these countries in the future. Do you feel that problem would not arise if it is done on a case-by-case basis?

BERGSTEN: I think it does make a big difference. For example, Mexico right now is looking for a stretch out of its principal repayments as a reward for good behavior, for having achieved effective adjustment. In that context, a stretch out would probably encourage the banks to continue lending — they would see a more stable debt profile over time, they would be responding to effective adjustment devices and, therefore, would be encouraged to stay in the process in a more stable way. The problem would come if a stretch out were forced by essentially bad behavior — a brinksmanship staring down of creditors by a major debtor country. If a stretch out were forced in that way, the reluctance to put in new money would grow. But even in those circumstances the banks would be pretty much forced by the lenders' trap, as Cline called it in his study, to keep infusing at least enough money to avoid an out-and-out default situation. That incentive is probably going to remain in almost any conceivable circumstance.

COHEN: So do you feel, then, that the banks will continue to be the primary source of capital to the developing countries in the next decades?

BERGSTEN: I think the banks will continue to be *a* major source, but certainly at lower levels than in the past. In the past, after all, they were aggressively expanding their lending way beyond what might have been needed had the developing countries themselves been pursuing more prudent growth paths. Now, even at lower levels of LDC deficits, the banks will be financing a smaller share. They'll do what they have to, but not beyond that. Therefore we need to be looking for new mechanisms both to unleash untapped sources of private long-term money, and also to create a bigger role for the public financial institutions — the World Bank notably, and the regional development banks — acting as financial intermediaries and providing a greater share of the financial flow. If you think back to the period before the first oil shock, about three quarters of the total source flow to developing countries was public, one quarter was private. During the period from 1973 to 1981, that reversed; it was about three quarters private, one quarter public. Again, I think we need some synthesis; it may be that a half and half kind of relationship for the future would provide a more stable basis both for the developing countries and for the world economy as a whole.

COHEN: Let's turn our attention to the second major area that you mentioned at the opening — the area of international trade. One could develop the hypothesis that increasing protectionism is a plausible scenario for the future as Americans try to reduce their dependence on the outside world. You yourself emphasized that there are quite strong signs of protectionist pressure in the United States. Do you see this as a serious threat or do you feel that the United States will remain a force for trade liberalization?

BERGSTEN: The fundamental question is whether the United States is, and believes itself to be, able to compete effectively in the world economy. I happen to think we can. If you look back to a period as recent as 1978 to 1980, U.S. exports were growing at twice the rate of world trade, we recouped a share of world markets for manufactured goods not seen since the late 1960s, and we had a current account improvement of $60 billion dollars in just a couple of years, excluding the oil price effect of the second shock. So the underlying competitive position of the U.S. is strong, and we don't need protectionism to insulate us from a world of industrial policies or to gear us up to cope with "Japan Inc."

However, if our domestic macroeconomic policy is poorly carried out; if we have high levels of unemployment on a sustained basis; if the dollar exchange rate remains overvalued (as it is now by perhaps twenty-five percent) for a considerable period, undermining the competitive position of our industry and workers; then the pressure for protectionism will grow and will be satisfied with an increasing array of import barriers. If the problem at the macro and exchange rate level can be corrected, then the enormous progress that our exports have made in recent periods probably will again come to the fore and be a force for trade liberalization.

COHEN: But what about the various trade barriers that have been built up during this period of overvaluation? Some people would argue that there is a kind of "ratchet effect" — that once they get put into place they don't get removed again so that, over time, there is an accumulation of trade barriers that clogs up the international trading system. One could cite the multifiber agreement as one instance where, once barriers were put in place, they simply multiplied and were never removed. Are you not concerned about that as a possibility? Do you feel that these trends can be reversed? Or do you think that trade barriers will continue to proliferate as they have in the past?

BERGSTEN: I do worry about the risk of a ratchet, but the empirical evidence is mixed. You're quite right, that the Multi-fiber Arrangement and its predecessors have been with us for twenty years and barriers continue to tighten. On the other hand, we have some industries in which import barriers have been erected and then eliminated — steel has been on and off a couple of times; color TVs were on and came off; footwear was on and came off. I think there is something of a ratchet, but it is by no means total. The short answer is that of course it is better to avoid barriers; once put in place, it is harder to eliminate them than it would have been to avoid putting them on in the first place. But I wouldn't despair that the addition of several new barriers during the last couple of years of dollar overvaluation means an inexorable slide toward greater protectionism here, *if* the underlying problems can be corrected.

COHEN: The major force for trade liberalization during the post-war period has been the GATT [General Agreement on Tariffs & Trade], with the most recent round of the GATT negotiations — the Tokyo Round — completed in 1979. Most people regard the ministerial meeting of the GATT that met in 1982 as a failure. Do you feel that we've seen the last of the major rounds of GATT trade liberalization, or do you think that there are going to be more in the future?

BERGSTEN: I think there will be another major round, probably bigger than all of the other rounds, taking up most of the latter part of this decade. Remember that after the Kennedy Round concluded successfully in 1967, there were many voices which said there would never again be a round of that kind — it couldn't be done economically, it could never be pulled off politically. It did take a number of years to get the Tokyo Round going but, when it occurred in the latter half of the seventies, it again enabled a major further push toward trade liberalization and was an important barrier against protectionist backsliding. I think those are the two major reasons why we'll have another.

There are a number of new trade problems that simply have to be dealt with to avoid anarchy in international trading arrangements — services problems, trade-related investment problems, problems associated with some of the new technologies and trade therein. Those problems simply have to be dealt with on a multilateral basis to get some rules of the road, to avoid anarchy. In addition, the traditional use of a multilateral negotiation to resist protectionism is very important.

I'm fond of something called the bicycle theory, which says that trade policy has to either be moving ahead, toward greater liberalization, or it topples in the face of protectionist pressures from individual sectors. And I think the empirical record is pretty strong in support of that theory. To hold back the protectionist slide and curb restrictive pressures from vested parochial interests you need to couch trade policy in the broader context — the national interest in greater welfare for the consumer and the economy as a whole, and the benefits to export interests from opening markets worldwide. That, in turn, seizes the interest of a President, a Congress, a prime minister of another country and gets a political commitment made to proceed in the liberalizing direction.

I think those two forces will come together, probably after our next election year, and we'll get a major new multilateral negotiation in the late 1980s. If we do not, then I think that we will move toward greater protection because, without some renewed forward momentum of that type, the erosion of the open trading system will accelerate.

COHEN: Turning now to the third area — the area of energy — many people would argue that there was no event — or no two events — over the last decade in the international economy as important as the two oil shocks. Yet, now the subject of energy seems to be passé; people don't talk about energy. Is the energy problem behind us?

BERGSTEN: I would be reluctant to say the energy problem is behind us, because the world is still dependent for a very large share of its consumption on a very volatile region of the world, the Middle East. I do think an enormous amount of adjustment to the new price level has occurred and will continue to occur. So, in some sense, the world is adjusting to a new equilibrium range or level of the oil price. But, I would reiterate, there is still a great deal of vulnerability. It is not as great as it was, certainly, a decade ago or even five years ago, but I would not regard the problem as behind us.

It is extremely important for all importing countries to have defenses against future supply interruptions and/or sharp price rises, primarily through strategic petroleum reserves like those that have now been built in this country. Coordination of those kinds of defensive programs through the International Energy Agency remains very important; it would be a mistake to forget about them or downplay their importance.

Ultimately, I still think it would make sense to try to work out some kind of arrangements between producers and consumers to try to moderate the range of possible future price fluctuations. A commodity agreement for oil, if you will. That's awfully hard to work out; it seems that at any point in time either the producers or the consumers aren't interested because the market is moving in their direction. But perhaps if we get a balance of uncertainties at some point, a balance of recognition that stability at new levels is in everybody's interest, something of that type might possibly be pursued.

COHEN: Energy is perhaps the most obvious example of how the U.S. economy has become more dependent on the outside world, the theme that you started with. Can you foresee any policy measures which would reduce that dependence on imported energy in the future, or is a strategic reserve stockpile the only defense that we can design against that kind of dependence?

BERGSTEN: The United States has already implemented a number of measures to defend itself against the dependence on oil that existed a decade ago. Domestic price decontrol, of course, was the most dramatic, both in terms of its effect on domestic production and its impact on energy consumption. There has also been a little-noticed, but important, shift in the composition of U.S. imports of oil. The Middle East is now a very marginal supplier of the U.S., with Western Hemisphere and African suppliers being much more important. And the share of imported oil has dropped to one-fourth of our consumption from one-half just a few years ago. So a number of things have occurred. At this level of dependence, a sizeable stockpile operated under flexible rules for its mobilization is probably adequate to defend our own interests.

There does remain the broader question, of course, of the interests of our allies and the world economy as a whole. I'd counsel simply the continuation of efforts to economize on the use of energy, the development of alternative production wherever possible, and cooperation among the consuming countries that, in addition to its real effect, could act as a deterrent to any future effort by producers to gouge prices or interrupt supply.

COHEN: One proposal that is currently an issue in the political campaign is the import tax on oil, which, presumably, would act to stimulate both domestic production and also conservation. What is your view on that?

BERGSTEN: I think an oil import tax is a bad idea. The enormous rise in the price that has already occurred over the past ten years is adequate to bring forth the needed conservation of use and stimulate alternative sources of output. There is a further reason: if the U.S. were to put on a tax of that type, we would be sending a signal to the oil-producing countries that they ought to raise their prices further. We would be charging ourselves a higher price and they would immediately respond, "Why should the U.S. Treasury get that added revenue rather than the producing countries?" They would see it both as a signal that we were ready to accept a higher price and as an invitation to them to try to do whatever they could to acquire that higher revenue for themselves.

COHEN: One major area that we haven't touched on is that of the Third World and the calls of the Third World for a New International Economic Order (NIEO), going back to the declaration of the General Assembly in 1974. Whatever happened to the New International Economic Order?

BERGSTEN: Well, a lot of the New International Economic Order actually evolved over the course of the latter 1970s. It wasn't done under the rubric of the United Nations or the NIEO or UNCTAD [United Nations Conference on Trade and Development], but an enormous amount of change occurred in programs of the IMF [International Monetary Fund], the World Bank, the GATT and in various areas like commodity agreements which responded in some important measure to the legitimate concerns of the developing countries. Take the IMF; the compensatory finance facility has been considerably liberalized over the last ten years with the result that billions of dollars are extended to developing countries in almost every year to help offset the decline in their terms of trade. That was one of their major concerns and it's been met. The World Bank and IDA [the International Development Association] have expanded their lending by a factor of ten over the last decade, much of it on soft, concessional terms to poor countries through IDA. So the transfers have increased substantially. Trade liberalization, though interrupted by protectionist bouts here and there, has permitted the exports of the advanced developing countries to grow by very impressive rates over the last ten years or so. So, to some extent, quietly (and maybe that's the most effective way to do it from a political standpoint), there has been a response, at least in part, to major concerns expressed by the developing countries. They have been integrated more with the world economy, and I think healthily so.

Now, the paradox, perhaps, is that the greatest transfer of all has been the one we talked about before, through the private banks. I sometimes say, only half jokingly, that Walter Wriston [chairman of the board of Citibank/Citicorp] and his colleagues did much more than Willy Brandt and his colleagues ever dreamed about, in terms of resource transfer. That permitted the developing world to avoid adjusting to the first oil shock and to continue to grow at rapid rates. That finally caught up with them after the second oil shock and the world recession so, in retrospect, one can ask whether it was all done so judiciously. But it was a huge transfer of resources from sources not envisaged at the time that any of the NIEO talk occurred and shows that response and adjustment take place even in unexpected and unplanned ways.

COHEN: Some would argue that, while it is true that these kinds of changes have occurred which embody many of the original proposals of the NIEO — compensatory finance facility in the IMF, generalized system of preferences [GSP] under GATT and so on — the yield has been very small. There are so many qualifications or exceptions from the generalized system of preferences, for example, that the measured benefits, many claim, have been relatively small and concentrated in a relatively small number of countries. Do you feel that there is room for, and a possibility of, significant broadening of these kinds of concessions that have been made to Third World countries, such as the GSP and the compensatory financing facility?

BERGSTEN: There are really two questions there. Broadening the benefits is one possibility, but differentiating among developing countries is another. Probably the most effective way to spread the benefits of GSP to poor developing countries is to limit its application to some of the more advanced and successful developing countries. The process of graduation and maturation does make sense and, over time, one should differentiate within the developing world as to the treatment that the different countries get. There is a problem in doing that right now, of course, since some of the most advanced of the developing countries are precisely those that have the greatest debt problems and to cut off right now the access of Brazil or Mexico to generalized tariff preferences could further intensify their debt difficulties and that whole range of problems. But ultimately one should recognize the progress those countries have made, move them up the ladder toward more equal treatment vis-a-vis the industrial countries' treatment and thereby provide greater opportunities for the poorest countries. That has already been done with concessional foreign aid, almost all of which does go to the poorest countries. A similar trend in terms of help on the commodity front and on the trade front probably is called for and should be a long-term policy objective.

COHEN: You mentioned commodities and, of course, for most Third World countries primary commodities still account for the majority of their export revenues. The most recent crusade of the United Nations Conference on Trade and Development has been for an integrated program on commodities for price stabilization. Do you foresee anything like this actually coming into existence or are we just going to have a small common fund of the sort that was agreed a few years ago?

BERGSTEN: When I was in office I worked a lot on commodity agreements and we altered U.S. policy in substantial ways so that the U.S. did join some of the existing commodity agreements, such as in tin, coffee, sugar. We actually created a new one in natural rubber. The record of all those, however, is a little spotty, partly because of world recession and inadequate resources for the buffer stocks. So I would not see a very widespread expansion of either commodity agreements of that type or the common fund.

One has to recall that the original common fund was envisaged by its sponsors as a device to basically prop the price of commodities above market levels and therefore use it as a device for transferring real resources. I would not accept that notion, nor do I think would any government in an industrial country. Therefore, the common fund that emerged was a much more modest effort to pool the buffer stock financing facilities of the individual commodity agreements to achieve modest gains. I don't think, therefore, that it will be of very great significance either economically or as a political symbol and I would not expect a great deal more in that area.

If one wanted to do a lot more in the commodity area, and use it as a basis for resource transfer, I think probably it would have to be more along the lines of the compensatory finance facility of the IMF, being further mobilized, or more bilateral programs like the one that the Common Market carries out through the Lomé Convention with its STABEX Agreement with some of its formerly associated countries. I think in the Central American context, for example, the United States, as part of a new initiative there, might offer the equivalent of a STABEX convention. The Central American countries are very small, very dependent on commodities, have seen a 40 percent deterioration in their terms of trade over the last four or five years. So, I think part of the U.S. Central American initiative might well be a STABEX Agreement to help even out the swings in their commodity earnings and thereby try and provide some more stability to them.

COHEN: Why limit it to Central America? Why not South America as well?

BERGSTEN: One could do it more broadly, though the big South American countries have diversified their economies more. Brazil, for example, which depended on coffee for sixty percent of its exports as recently as twenty years ago now is down to twenty percent and, indeed, manufactured goods now account for more than half of its total exports. But it is true that there are still some significant dependencies, for example, Bolivia on tin and Colombia on coffee. One could do it more broadly with a little higher budget costs. I was simply focussing on the current effort to do something for Central America by suggesting that commodity policy might be a promising avenue there.

COHEN: Coming back to your opening theme of increasing U.S. dependence, which is one aspect of a growing world interdependence and the greater pluralism in the world, both of these points suggest an increased role for the multilateral organizations — the IMF, the GATT, the World Bank — in the management of international economic relations. Do you foresee an increased role for these organizations with greater authority over individual issue areas through more pluralistic decisionmaking of their members, or do you see them limited by the conflict of sovereignties in this greater network of interdependence?

BERGSTEN: I like to distinguish between nominal sovereignty and real sovereignty, the same way we distinguish between nominal interest rates and real interest rates. Nominal sovereignty is still high, but real sovereignty is declining sharply and all countries, including the United States, must increasingly recognize how tied up they are with others and how they simply must take a broader perspective in setting their own policies. I therefore think it is inevitable that the international institutions will play a bigger role. The current U.S. administration is no great lover of the IMF, but when the debt crisis hit they had to turn to the IMF. The IMF had to be the centerpiece in the response to the international debt crisis; the Congress had to pass a bill authorizing substantially increased resources for the IMF, even though many of its members had various hang-ups against doing so. It's inevitable; it's necessary. In addition to the global institutions, the OECD may become increasingly important as a forum for closer collaboration on macroeconomic policies. One could envisage new mechanisms through which the central banks would more actively collaborate on their monetary policies. Remember, too, that a lot of this cooperation will occur outside the formal institutions. A lot of it is done now and probably will increasingly be done by small, informal groups — like the G-5 in the international monetary area, the steering group within the GATT, the so-called CG-17 — with the more formal ratification and implementation carried out through the existing institutions. But, whatever the forum, increasing internationalization of policy is going to be required of all countries, including our own, as concerns for nominal sovereignty give way to increased perceptions of real sovereignty and, therefore, to recognition of the need to actually implement policies consistent with the implications of interdependence.

COHEN: From all of your remarks, one could justifiably draw the conclusion that you're basically an optimist about the future of the international economy. Would you characterize yourself as such?

BERGSTEN: In answering that question, I sometimes try to look back a decade and suppose that, in the early 1970s, somebody would have hypothesized the following ludicrous assumptions about the coming decade: two massive oil shocks, two swings of one hundred billion dollars each in trade positions, double digit inflation around the world, the deepest recession since the 1930s; and then asked, "Given those assumptions what do you think would happen in the international economic system?" Most observers, probably including myself, would have said, "A collapse, a return to the 1930s, things will go to hell in a basket." And it didn't happen. The international system responded in a resilient way, there were a lot of bumps, to be sure, but we moved from fixed to flexible exchange rates and with a lot of trouble along the way, we did get a new GATT negotiation that further liberalized trade and held back protectionist pressures. There was a response, costly as it was, to the energy crises.

So, there has seemed to be a response mechanism, both through the market and through constructive and far-sighted government behavior, that has enabled us to survive and even move ahead in the face of adversity. The problems now are again very deep and the outlook in some respects gloomy, but I think we may have learned the lessons from the earlier periods, that to try to go it alone and try to export one's problems to the rest of the world simply is not a viable approach. At the end of the day constructive and collaborative solutions will be forced upon us, almost despite ourselves.