**Unedited Event Transcript**

**Book Launch: Currency Conflict and Trade Policy: A New Strategy for the United States**

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Bob Zoellick: I want to thank all of you for joining us. It's a privilege for me to be here. I've been looking forward - I'm Bob Zoellick and I've been looking forward to this book for a very long time. In some respects, *Currency Conflict and Trade Policy* is a capstone of my good friend, Fred Bergsten's decades long research and writing on exchange rates, their effects on international trade, domestic adjustment, protectionism, domestic politics and the international economic order.

Now as I hope everybody here knows, Fred was the founding director of the Peterson Institute of International Economics from 1981 to 2012. He's currently a Senior Fellow and Director Emeritus. He handled Henry Kissinger's economics on the National Security Council staff, a topic always worth digging into, given Henry's long affection for international economics. And then he also served as Assistant Secretary of International Affairs at the US Treasury under President Carter.

But in addition to a friend from whom I've learned a great deal over the years, he's widely known as one of America's foremost thinkers on international economics, policies and of course the builder of a very great institution.

And I'm also pleased to introduce Joe Gagnon, who is the co-author; been working for many years on this topic with Fred. He had a very accomplished career at the Federal Reserve before coming to the Peterson Institute. He was the Associate Director of both the International Finance and the Monetary Affairs Divisions before joining the Peterson Institute in 2009.

And we're very fortunate to be joined by Congressman Bill Foster, who represents the 11th District of Illinois. Congressman Foster is a physicist. He served at the Fermilab, was part of the team that discovered the top quark, which I learned is the heaviest known form of matter; for those of you in the room, that's something like a reserve currency.

He serves on the Committee of Financial Services as well as Science, Space and Technology, so I'm glad someone at least assigned him to the appropriate committees. But most important to me, is that I discovered

he's form Naperville, Illinois, where I grew up and went to high school, although it's changed a little bit since I left.

Just a brief word about this book, which I'm very excited about. One can approach reading this book, or discussing it, from a variety of perspectives. How might one define currency manipulation? What are its effects? What can be done about currency manipulation, either by the United States or the rest of the world? What should be done, consistent with US domestic economic policies and wider international economic interests? And in particular, if things are done, how do we preserve freedom from monetary policies?

However, I think that the most important issue that this book addresses is a systemic problem that has plagued international economy through much of the 20th and 21st centuries. So that's a big issue.

Both the IMF and WTO have recognized for decades, and it's part of their charters, that government intervention with exchange rates can distort, manipulate, if you will, the international efforts to reduce trade barriers. This was part of the problem that led to the breakdown of the international economic order in the 1920s and 30s, contributing to the Great Depression and the political security breakdown.

It's one of the problems that the founders of the IMF tried to deal with as outlined by a wonderful book written a couple years ago by Ben Steele. And the IMF and WTO charters are supposed to address this issue. Because the IMF charter refers to precluding manipulation of exchange rates and the WTO refers to exchange rate practices that frustrate the commitments to reduce trade barriers.

Now the US Congress picked up on the IMF language. That's the origin of the report about manipulation in the 1988 Trade Act, which followed Congress' interest with efforts that former Secretary of Treasury, James Baker, pursued with international economic coordination in the second Reagan term. An issue, by the way, I might add, that Fred Bergsten's research helped provide the foundation for.

And that's why we have an annual Treasury report from that 1988 action, that's supposed to assess whether countries are manipulating exchange rates. But neither of the WTO or IMF provisions could be put into practical effect. And the reason that I've been following this research and the development of their policy ideas so closely, is that I believe that Bergsten and Gagnon have cracked the policy nut of this problem. Because they've come up with a principle basis for assessing manipulation, and they've recommended some very practical US and international responses.

So, today, I will turn over to Joe first, then Fred, to explain the essence of the book, then Congressman Foster to comment and then we'll go up and have some Qs and As. So, please.

Joe Gagnon: Thanks, Bob, for that great introduction and thanks to all of you for coming. It's nice to see a lot of familiar faces out there. So, the issue of currency conflict goes back, has deep historical roots, back at least to the 1930s. Over time, as the international monetary system has evolved, the nature of currency conflict also has evolved.

But one of the fundamental things it hasn't changed is, there's an asymmetry in the system. The pressure is put on the deficit countries to adjust, not in the surplus countries to adjust. That's a financial market pressure. And for the US, oftentimes the first pressure is not the financial market pressure, but political pressure and backlash against trade deficits, leading to protectionist pressures, and that's something we've seen in the past year with the election that we just saw.

In recent years, the conflict has taken the form of government purchases of foreign currencies to hold down the values of the domestic currency, which when it's excessive, we call manipulation.

We, in the book, focus on all of government purchases of foreign currency assets, not just foreign exchange reserves, but also sovereign wealth funds and borrowing in foreign currencies is actually a negative in that equation. And the sum of these is net official assets that governments hold.

Currency intervention is the net acquisition of these official assets. That's how we define it going forward, just to be clear. This intervention soared in 2003 and remained elevated through 2013 at about a trillion dollars a year, which is out of all historical bounds. We estimate that over 600, at least 600 billion of that was excessive, and we call this the decade of manipulation.

So, just an aside, I'll be talking about the trade balance, trade surplus. I'm going to use the definition, the current account balance, which is the widest and, I think, best measured definition of the trade balance.

So, on the left here, what I have is an indication of global imbalances from the surplus side. So, if you take every country that has a trade surplus, in a given year, and add up those surpluses, you get the red dash line on the left. And then if you take the same countries and you add up their currency intervention, you get the solid blue line.

So the decade of manipulation is quite clear because in 2003 the blue line jumps up, it stays elevated around a trillion dollars a year, and then only in the last two years, it's come back down.

Now you can see definitely a correlation there. It's not everything, but it's an important correlation. But there seems to be a gap that opened up in the last couple years. Well, it turns out that actually that's China. China had a lot of inflows in 2007, which pushed the blue line up farther, and then a lot of outflows in 2015-16, which pushed the blue line down.

If you take China out, and look at all other surplus countries, you get sort of a more stable pattern, where again intervention is the biggest driver of imbalances during the decade of manipulation, but it's not the only thing going on. There are other reasons why countries can have a surplus.

Okay, so who are these countries? Well in the book we identify 20 countries that bought excessive amounts of foreign currency for at least one year during this 11-year period. And Fred's going to show the criterion we use in a minute.

But there are basically three groups of countries. There's the manufacturing exporters, that's eight countries here. Financial centers is four countries. And then there's the resource exporters, and eight countries on the next slide.

So the first column here shows that the number of years in that period of 11 years, a number of those years they actually bought excessive amounts of foreign currency, and Taiwan and China lead the pack. And the manufacturing exporters, as a group, by the way, were the biggest purchasers of currency, by far, during this period.

And you can see the second and third columns show you how much they accumulated by the end of the period, both in dollars and as a percentage of the GEP, some big numbers. And then the last two columns express their currency intervention and their current account balances as shares of GEP over the entire period, not just the years they manipulated but the whole period. To give you a sense, there were some large current account balances and interventions.

The financial centers, although they're smaller in dollars, they actually did more intervention relative to their economies and that's clear at the bottom of the table. And the resource exporters are here, led by Norway.

Now I know we can all agree that resource exporters should save a significant amount of their resource exports for future generations, and we agree. We actually go at length in the book to discuss a generous sort of

criterion which, to decide how much saving is enough, or too much, or excessive.

Most resource exporters don't save enough, and we, of course, think that perhaps they should save more for their own purposes, but just because your resource exporter doesn't give you carte blanche to do unlimited amounts, and we think these are the countries, that at least a few times, exceeded what would be reasonable.

What is the evidence that currency intervention really does affect trade balances? Well, in a series of papers I've written, both on my own and with some co-authors of the IMF, we try to explain trade balances across country over time in terms of fundamental factors, and we actually have a number of factors, which aren't shown here.

What I'm just showing here is the policy factors. These are the economic policies that we find matter. There are other factors, demographics, etc., that matter, too, in our regression, but these are the policy factors.

What we find is that there are big effects of these policies, but the effects of all underlying variables on trade balances are actually influenced importantly by financial markets. If a financial market is open to borrowing and lending across borders, that changes the relationship.

So in the left column, countries that have very closed financial markets, a lot of restrictions on borrowing and lending across borders, which China was close to for most of this time, not quite at the bottom, but near there. For those countries, currency intervention is really almost the only thing that matters.

Basically, if private citizens can't borrow and lend across borders, the only way you can have a trade surplus or deficit is if the government does the borrowing or lending. Because, after all, don't forget, a trade balance is the difference between saving and investment in the country. If you have surplus, you are a net saver abroad, and if you have a trade deficit, you are borrowing from abroad.

Well if the private markets won't let you do that, then the government has to do that for you. On the other hand, as you go to higher capital mobility in the highest including the United States, there's still some significant effect, but smaller, about 31 cents for every dollar of intervention shows up in the current account trade balance.

Now, there is a lag effect sort of, there's some lags going on here. The cumulative sum of past intervention is the official assets and that has a small but important effect for high mobility countries. And finally the

fiscal balance doesn't have much effect in a closed economy, but if you open up potential market and governments borrow, that tends to push up interest rates and private capital tends to flow in and you get a trade deficit. So, we find these are the important effects.

This is just a graphical display of statistical results I just told you. On the left we're showing the relationship between currency intervention and trade balances, showing a higher currency intervention. It's higher trade balance. On the right we show the fiscal balance and the relationship there, higher fiscal balance, higher trade balance.

Each dot here is one country. So each dot is a different country. And the data are averaged over 15 years. First 15 years of 21st century, to smooth out any temporary fluctuations. Then we see a strong positive correlation between these policies and trade balances.

Now you might think we're talking about trade, maybe trade policy should matter. Tariffs, trade barriers. But, in fact, there really is no relationship and if you put these variables, on the left I show the average tariff rate by country and on the right I show World Bank's measure of the costs of trade, how much it costs to trade between countries. Neither of these seem to be related to trade surpluses.

And the reason is because these policies don't affect saving an investment. In the end, if you raise a tariff, the exchange rate can move to offset it and leave the trade balance unaffected. Whereas the previous policies do affect saving an investment.

So, what are the effects? How does this translate into actual examples? At the peak of the imbalances in 2007, I've listed four economies. China on the left, the black bar shows that China had a record trade surplus at the time of 350 billion dollars. The model estimates I just showed you imply that if China had much less intervention down to the world average, if all countries had the same amount of intervention, China would not have had a trade surplus. It would have been almost zero.

And the US had a large deficit of 716 billion. That would have been 35% smaller if we hadn't had these big differences in intervention so that US intervened more, and other countries intervened less. Pull us to a world average, it would have had a big effect on our trade balance. Much smaller, 35% smaller.

Also, fiscal policy is the light gray bar. The US had a large fiscal deficit at the time. If we had shrunk it to the average of the world, we would have had another 25% reduction in the trade deficit. China, on the other hand, had an average fiscal deficit at the time, so, had no effect.

Now, that's about the effects on trade. What about the effects on employment? Well, China had very rapid growth of exports in early 2000s, a burgeoning literature and economics, estimates that on the eve of the Great Recession, the US had lost a million manufacturing jobs and perhaps another million related jobs, although the second part of that, the second million, is a little more controversial.

We show in the book that, if China had not manipulated its currency, it's exports would have grown, but not quite as fast. They would have been limited to the growth rate of Chinese imports. And that would have reduced these losses by about a third at that point. Also, all the big capital inflows China was lending to us by our bonds, including Treasury and mortgage bonds, that enlarged the housing bubble, financed more housing and made the bubble steeper and the crash deeper.

And then, after 2009, countries continued to do manipulation, as I showed you. This slowed our recovery down. Now you might have argued that we could have had even more stimulative monitoring of fiscal policy, and I was saying so at the time, but what we had was quite an unprecedented amount of policy stimulus.

There were a lot of disagreements about how much could be done. Given what we had, if we had been able to have a smaller trade deficit, it would have employed at least another million people during this recovery.

So, in the end, one of the key points is that this deficit is just not sustainable. We've been in deficit almost every year for over 30 years. On the right is the cumulative sum of the debts we've been borrowing, and this is a net international investment position of the US, which is now deeply negative territory and declining further.

In about 10 or 15 years, if things don't change, we'll be reaching levels beyond which no country has sustainably managed. So there is a threat there. Even if perhaps before we get there, the political pressures and protectionist pressures might actually loom larger.

Finally, as I mentioned, in the last two years, there's been a reduction of manipulation and if we do our test over those years, we get fewer countries. We get the financial centers basically are still hanging there big time, but the rest is much diminished and much reduced. And that's a good point to turn it over to Fred, to take the rest of the book.

Fred Bergsten: Well, Joe has documented the substantial economic costs of currency manipulation and how it contributed importantly to the two unsustainabilities that we focus on in the book. The one, the more

traditional, external, financial unsustainability, in his chart about the current account deficits and the negative international investment position, are serious but long term problems.

The other, the domestic political unsustainability, is the one that we think has arisen dramatically and substantially in this recent period. We know from the period in the 1980s, when Secretary Baker had to mount the Plaza Agreement to bring down the exchange rate of the dollar and correct the US imbalance. It was not because the US had any trouble financing the imbalance, money was pouring in. The problem was that the Congress was erupting with trade barriers that could have destroyed the international trading system.

And we've seen something like that here just in the last couple of years. The backlash against globalization and trade agreements in particular, has of course had many causes, and Congressman Foster is going to talk about that.

But currency manipulation has been cited more by the opponents of globalization than any other single issue. It played a big role in our political campaigns last year. It continues to be a source of huge contention in the Congress, in the political discourse, et cetera, to the point where most members of Congress have said, "No more trade legislation unless we do something serious about currency manipulation."

So we think that one of the important intellectual contributions of this book is to suggest that the traditional focus of economic analysis, the external financial sustainability of a country's external balance, is perhaps even not the most important. Certainly not the most immediate and particularly not for the United States, where the internal political reactions, to big trade deficits, to a China shock, to the unfairness of a trade practice, like currency manipulation, all combine to underpin the backlash against globalization, which is now, of course, as the campaign showed so dramatically, become a central political and policy issue in this country.

And, lest you think this is partisan, it's of course, not just President Trump and his team. It was the Democrats in the election campaign, at least as much, if not more, than the Republicans, and as I'll describe in a moment, the blame for this problem, festering all this time, there's much of it to go around, many folks to blame, and much political difficulty at hand.

But I want to stress right at the outset, we think that's a very important conclusion from this book that has not pervaded the economic literature in the past, to look at the domestic politics as well as the international finance of imbalances.

Now, these unsustainabilities that I talk about, especially the domestic political unsustainability, have, of course, been exacerbated by the weak policy response of the US government and as Bob stressed, the failure of the international economic order to deal with them effectively. I say this with some caution because some of the people who were running the policy are in the room here, and I discussed a lot with them the way we put it in the book, and before I finish, I'll say a few nice things about what they did. But the bottom line is, they failed to deal with the problem.

As Joe outlined, we had a decade of manipulation. Its amounts were massive. Its economic effects were huge. Its impact on jobs during the most sensitive period, the Great Recession, the tepid recovery, those were periods when US economic interests were severely prejudiced by all this. And the policy reaction was, to be mild, tepid, no sanctions were ever applied against any of the manipulators, starting with China, but the others as well. Despite all the huge costs.

Now, to amplify Bob's point at the outset, the administration, to its great credit, going back to Bush, 43, did attempt to mobilize the IMF, to take action against China as the biggest manipulator. And according to some accounts, they came close, but they failed. And even if they had gotten IMF agreement to do something, the sad truth is, the IMF charger doesn't include any effective enforcement devices. So, even had they prevailed, they would not have necessarily gotten much out of it.

And so here we saw in dramatic form, the failure of the Bretton Woods regime. The problem, goes back to Bretton Woods. Keynes flagged the issue of surplus countries needing to come under symmetrical pressure to adjust or else the world would face a deflationary bias on an ongoing basis. And that's what we have.

This instance of currency manipulation demonstrated if we ever needed more proof that there was no effective international pressure on surplus countries, particularly on their exchange rate policies, so even when they blatantly violated the fundamental rule of the IMF, thou shalt not competitively devalue, nothing was done about it.

And that, to us, in writing this book, comes across as the single most important gap in the international financial architecture. And the failure to have some effective remedy in that area must, must be resolved.

Now, before I go to the remedy, let me just say there were some positive results from the efforts that many of our colleagues here carried out over this period. The RMB, the Chinese currency, did eventually go up 30 to 40%. But it took 10 years. And in the meanwhile, and I've got a chart on

this I'll show in a moment, in the meanwhile, there was enormous amount of crockery broken, as Joe described.

More subtly, but perhaps more importantly, we have discerned that there may be evolving now, as a result of the discussion of this issue over the last decade or so, a kind of new culture or new way of thinking, a new norm of international behavior against currency manipulation. It certainly was not, there was no absence of efforts by folks in the administrations, going back to Bush 43, but also of course, Obama. In the G7, in the G20, bilaterally with the Chinese. In the side agreement to the Trans-Pacific Partnership.

So in all those forums, and many others, they were trying to politely, diplomatically, dissuade the manipulators from doing it. And I think there is some evidence that new norms are developing. Japanese have been under a lot of domestic pressure to manipulate again the last couple years, but they've stuck with their G7 pledge not to do so.

The Chinese are now, in fact, upon our reading, the most constructive participant in the international exchange rate system. The Chinese are intervening massively to keep at half, for the last two to three years, to keep the renminbi from dropping further. In fact, they're carrying out the kind of systemic reform we would like to see, namely countries actively resisting movement of their currencies away from long-run equilibrium levels. The Chinese have spent over a trillion dollars to keep the RMB from weakening, which of course would be a bad thing, despite their capital flows, given the fact they still run the world's largest current account surplus.

So, there is some evidence that new norms may be coming into place, and on that, we would put at least some hopes, if not bet the store. And as Joe said, toward the end of his remarks, manipulation is in remission. For the last two to three years, manipulation has basically ceased. It's reversed in the case of China, as I mentioned. But for most of the other manipulators, with a few exceptions, like Joe's last chart shows, manipulation has gone into remission.

It was not incidentally coincident with the election of inauguration of President Trump, as he and his Secretary of the Treasury have claimed in recent days. That doesn't seem to have had anything to do with it. It goes back, considerably longer. But all that is some cause for hope that maybe the talk, the efforts of the last decade or so, despite what I characterize as a weakness, may have had some positive effect.

But our bottom line is you cannot count on it. Markets have shifted, downward pressure on the Chinese currency because of the outflow of

private capital, specific things in the case of the other key countries. Therefore, one cannot count on manipulation not coming back. And given its huge costs; given the temptation countries are going to have; if their economies slow down; if a new world recession hits; if their exports weaken; if their trade balances start to go south; if they become unwilling to continue to rely on their currency economic reforms, as in the case of China; then manipulation could be back. And those huge costs that we outlined, would be again with us.

So, we conclude that much more robust policy measures are going to be needed. In the book, it's chapter five, we outline a whole menu of possible policy changes. Some of them are macroeconomic and monetary, some of them are trade policy. We much prefer the macroeconomic and monetary, because those apply across the board. We think they'd be more effective.

They certainly would be less distortionary. They would apply to both sides of the trade balance, exports and imports, which are of course affected by currency manipulation. The trade measures, by contrast, would only apply to imports, whether it's countervailing duties or surcharge - it would apply only to imports, only half the problem. So the macro and monetary are to be preferred.

Likewise, the little 2 x 2 matrix shows that some of the potential measures are multilateral, mobilize the IMF, reform the IMF, use the WTO, and some are purely unilateral, as in the case of the US alone taking some of the measures.

As a spoiler alert, I tell you that our bottom line proposal, our big proposal that Bob alluded to, is going to be unilateral action by the United States. We say that, because, while we prefer multilateral stuff, we don't think it's going to happen, unless the US takes a strong unilateral lead first.

Moreover, we note that some of the most important multilateral systemic reforms of the post-war period were galvanized by US unilateral action. The Nixon shocks in 1971 were brutal. I opposed them at the time. But it turned out they got the world to shift from fixed to flexible exchange rates. The most dramatic and most positive reform of the international monetary system in the post-war period.

In 1985, people forget this, the day after the Plaza Agreement, President Reagan gave a very hawkish speech on trade policy, which launched the US aggressive use of Section 301. The Congress passed Super 301.

The US went into a period of very aggressive implementation of trade policy measures, including managed trade, all of which helped persuade the world over the next decade in the Tokyo round, to convert the GATT

into the World Trade Organization. To have an effective multilateral dispute settlement mechanism, clearly galvanized by the US going unilateral in a way the rest of the world did not prefer.

So, even though we're going to say the main policy recommendation is unilateral, it is not by any means rejecting a multilateral world, indeed we hope it would galvanize the multilateral world.

So, among this menu, I won't have time obviously to discuss much of it. I want to focus on our main policy recommendation, which we think just in and of itself might do the trick. You can do other things as well; I'll mention briefly, but the one policy recommendation that we want to emphasize is what I call "Countervailing currency intervention."

Countervailing currency intervention, on our recommendation, would be undertaken by the United States, against manipulation, as defined by a set of objective criteria, which I'll outline in a minute. Manipulation undertaken by any systemically important currency manipulator. Note the acronym, SICMs, that "sic ‘ems!" So, if you want to "sic ‘em," you use our criteria and currency manipulation.

We define SICMs as the G20, because we're not worried about trying to rope in every small country. Israel shows up on our list, as I look at Stan Fisher, who confessed to me back in the day when he was there that he actually was a currency manipulator, which he had to do; competitive reasons. Well, we're not after the Israel's of this world. But we are after the big manipulators, and we think the G20 universe would do it.

Coordinated, countervailing currency intervention, I'll call it CCI, is a very simple concept. If Japan buys 100 billion dollars’ worth of dollars to keep the dollar over-valued and the yen undervalued, to improve their competitive position, we buy 100 billion dollars of yen to offset their actions, neutralize it, and therefore we think, deter it.

Indeed, all we think the United States has to do is announce that policy. If the United States announces and maybe on a few occasions does something just to prove its credibility, if the US makes clear that it's going to counter any currency manipulation by a SICM, then we believe the policy will disappear.

It's just like Mario Draghi, five years ago at the European Central Bank, saying, "Well do whatever it takes." Well, it stopped the crisis. It's led to stability in the Eurozone and he's never had to spend a euro. So, like any good deterrent, the policy works and never has to be used. And that is in fact both our normative recommendation and our prediction. That if the US were to undertake and announce such a policy, that would do the trick.

Incidentally we think the private markets would help a lot. If the private markets knew that the US government was going to oppose manipulation, in an effective and comprehensive way, we're pretty sure the private markets would react to the manipulation themselves, so they could make the money and therefore avoid the need further for the US government to come into the act.

How might this work in practice? Well, what we decided to do was simulate the RMB case, the most important case, if the US had carried out our policy when I first recommended it, back around 2005. If the US had come in and countered the Chinese intervention, then the exchange rate of the RMB would have gone up the same 30% to 40%, but would have done it in two years instead of ten.

Now at the time, so you don't think this is Monday morning quarterbacking, my colleagues, Morris Goldstein and Nick Lardy, Bill Cline and John Williamson, I myself, were all saying very, very loudly, as loudly as we could, that the RMB was undervalued by 30% to 40%. We now know we were right! It went up 30% to 40%, exactly as we said it should.

The problem was that it took a decade and all this crockery that Joe described, was broken in the meanwhile, with all the costs and maybe some costs that are not going to be so easy to reverse, in terms of the domestic politics, as well as the economics. So this simply shows that we would have gotten, with effective CCI, we would have gotten rapid, effective adjustment of the currencies, and indeed, had the policy been in place, before the start of the Chinese manipulation, we would guess that the manipulation itself may never happen.

And by the way, if you're wondering what it would cost the US government to do all this, the answer is, it would be a huge money maker. Because remember, by definition, you're buying undervalued currencies. If you get it right, and you buy the RMB down at that low point and then it rises up so, you make a huge amount of money.

That's not the reason to do it, but in one of the boxes in the book, we show that the US would have made over $200 billion dollars in capital gains from buying RMB back in the day when it was so hugely undervalued. Again, that's not the reason to do it, but if you worry about the effects on the FISC, don't worry, that's not a problem.

Final point, a key question for this notion of countervailing currency intervention is of course, how do you know who's a problem and who do you hit when? So, we have outlined objective criteria. Now traditionally,

this issue of currency imbalances, has rested on analysis and definition of currency misalignments.

So, economists have made careers, hundreds of books, thousands of articles, trying to discern when and how much a currency is misaligned. And the intellectual, as well as political difficulties over that issue are legion and have blunted any kind of international agreement over the years.

So Joe and I resolved to try to get away from the problem of determining currency misalignment, which we knew would never get agreement anywhere. And so we said, forget that, let's have objective criteria to determine the outcome.

Joe and I first published some of this over four years ago, and it's actually found its way in slightly modified form. It's already found its way into US legislation, the Trade Facilitation Act that Congress passed a year ago, which came out of the currency debate around the Trade Promotion Authority, actually embodies most of our criteria.

But we only have three. The first, and it's listed last, but I'll put it first orally. It's legitimate for some countries to want to self-insure by building their reserves. So our first test is whether a country's reserves are already adequate. If the reserves are still very low, okay, manipulate, you build up to a level and self-insure yourself adequately.

Our tests for that are the equivalent of three months' imports or 100% of your external foreign exchange liabilities. All the manipulators on our list, far, far, far exceed those criteria, so that's really not operational.

The two operational questions are the first two: Does a country run a current account surplus exceeding 3% of its GDP. And does it manipulate by intervening in the markets in one direction by amounts exceeding 2% of its GDP over the past 12 months.

That's actually an incredibly generous definition, because if you're a country with a big GDP, like China or Japan, that gives you a lot of scope. So, might have to wiggle that a little bit in application, but those are the basic rules we would lay out.

A number of our friends from the Treasury are here today and we're delighted to say that those are the same criteria those two, the current account and the intervention criteria, those are the same criteria that the Treasury has been announcing in its annual foreign exchange reports for the last three reports, since the new legislation went into effect and Treasury was tasked with defining and implementing those terms.

On that basis, they've come to the conclusion, which we share, that no country should be indicted right now for manipulation. Some countries meet two of the three or four tests, nobody meets them all. But the Treasury's concocted a monitoring list to closely watch the countries that are nearby, and we certainly want to watch them as well ourselves. But we believe that if those principals were accepted, as the criteria, and you have the weapon of countervailing currency intervention announced and ready to roll, if somebody violates, you have a pretty strong deterrent to a return of the practice.

Finally and very briefly, there are additional things you could do. Bob mentioned the desirability of improving the international monetary system to deal with some of these issues, and we totally agree. We espouse the US government going to the IMF and seeking real reform.

A system of what's come to be called over the years, reference rates, where the main countries agree on equilibrium rates among their currencies, commit themselves not to intervene, to let their market rates move away from those levels, and under the strong version of the proposal, actually take steps to push their currencies toward that level.

Now, monetary reform has been tried for decades. It has failed. Perhaps if the US moved unilaterally in the way we suggest, that might spark a little more interest in the rest of the world in putting multilateral measures in place that would deal with the issue. We'd like to multilateralize the policy and the more one could do it in that direction, the better.

As Bob said, there are steps one could take on the trade side. I showed that in my earlier chart. We don't think any of those are really very likely or very desirable, with one exception. We would suggest that the US attempt to include the currency issue in any future trade agreements that it negotiates. That's partly a recognition of the fact that manipulation, on our reading, is the most serious unfair trade practice in the world over the last decade and a half.

It's also recognizing the political reality, Congressman Foster I'm sure will talk about this, that there's a lot of sentiment in the Congress not to agree on any new trade agreements without currency provisions. And Ambassador Lighthizer, Secretary Ross, have now said that they intend to try to include it in the NAFTA negotiation.

NAFTA countries are not a problem, in terms of manipulation, neither Canada nor Mexico has manipulated. In fact, they're both big deficit countries. So they wouldn't meet our criteria. People don't realize, Canada

and Mexico both have bigger global current account deficits than the United States.

So even within a Trumpian intellectual framework, you're barking up the wrong tree to go after Canada and Mexico. But, you may want to put currency in the renegotiated NAFTA, in order to provide a template or a basis for when it might really matter in a bilateral with Japan or revived TPP or something of that nature.

So we would do that. But we don't like the use of countervailing duties, import surcharges, things like that. We don't see that as desirable in rounding out the response to this policy problem.

So, to conclude, currency manipulation was a major economic problem for a decade. It was the number one unfair trade practice throughout that period, and it played a central role in poisoning the well for future trade agreements and even globalization more broadly. Fortunately, it is now largely in remission, but it could easily and quickly return, so we need to deter it. And now in the period of remission, is the time to do that, when nobody would be indicted as a result.

So our recommendation, the United States should announce a new policy of countervailing currency intervention. We hope all of you will agree with that and support it. I thank Bob and Congressman Foster for joining us to lead off the discussion. And thank you all for attending.

Congressman Foster: Thank you all. As was mentioned, I'm Congressman Bill Foster, and I represent 100% of the Strategic Reserve of Physicists in the United States Congress. I guess I'm best known for being actually the only PhD Scientist of any kind in the US Congress, so you can either applaud or cry.

But I'm also a businessman actually. When I was 19, my little brother and I started a company in our basement with 500 bucks from my parents, and that company now manufactures about 70% of all the theatre lighting equipment in the US. And so we're 90% of the lights on Broadway, 50% of touring rock and roll, and 70% of just churches, schools, community theatres and so on.

And I actually had my partners buy me out when I went into politics about a decade ago. But all of the time when I was involved in the management of the company, we kept 100% of our manufacturing in the Midwest, which is something I'm very proud of. But it wasn't easy. Our supply our chain, a lot of it went offshore. You can no longer really buy electronic components realistically in the United States any more, which is a huge national security problem, not to mention a financial problem for our country.

I just wanted to thank Dr. Bergsten and Dr. Gagnon for finally writing down the book. I've been enjoying conversations with Fred for as long as I've been in Congress, about trade issues generally, and always been asking him, "Okay, where is all of this written down?" And now it finally is.

The thing that I most appreciate about his book is that we're sort of flooded with books these days that analyze and wring their hands over some problem, like what are we going to do when the robots take all the jobs and this sort of stuff. And then you go, "Oh, let's go look at the end and how you're actually going to solve the problems." And the solutions don't exist. But this one, you just open up page 156 and you see an actual workable solution to this problem.

The idea that it is feasible now, on a unilateral basis, to take unilateral action based on the three-part test that the Treasury files a report, I think is it bi-annual or annual? Bi-annual. Semi-annual. Yeah. The report comes out and I actually read that report and see who's been tagged. And so this is a big deal.

The average member of Congress doesn't understand all this sophisticated, all the numbers that have to be understood to really understand what's going on. But they go back home and they see the damage done when manufacturing goes offshore.

Both Bernie and Trump complain about this - but I think they complain a lot more about globalism, not enough about automation. It's very hard to run a campaign against automation because no one has a clear plan or even a desire to stop it. Both Trump and Bernie complain about, say, Mexican truck drivers, and the real danger is actually robot truck drivers in the long term. I think that's actually going to be a dominant consideration in our politics going forward.

But there is a section of globalization that has caused real and unnecessary damage and that is the currency manipulation. And I think it's actually going to become more important, not necessarily because there'll be a business cycle somewhere or other and that they'll start manipulating, but because the margins.

Right now the big thing driving globalization, much of it, is just wage differentials. And that's difficult to stop unless you just shut down global trade. But, as more and more manufacturing ships to robots, then the differential of going to where you manufacture is going to go down. And that increases the impact of currency manipulation.

If you are a manufacturer in a commodity industry, if you have a 5% structural disadvantage, it is rough, and we were fortunately able to keep our manufacturing only because we were a specialty industry with very high margins, driven by our intellectual property and by, sort of the, I guess everyone wanted to use the same lighting systems that were used by Disneyland or Broadway or this sort of stuff. So we were able to maintain high margins in our business. But that wasn't true of a lot of the low margin commodity manufacturers.

And the tragedy that happened in the 2000s was completely preventable and should have been prevented. I saw it happening, as a manufacturer, and didn't really have the framework, hadn't taken the time to get the framework to understand what should be done.

And the thing that's so impressive about this book, and the key idea behind it, it is actually feasible right now. What Fred and Dr. Gagnon are proposing, are basically unilateral actions that the United States can take, based on, for example, the three-part test of the Treasury, which includes a bilateral trade balance trigger.

And that is actually a difference, I think, from what you propose, but I think politically, it's much more reasonable. The United States is not going to take action against something that's not a problem for the United States.

However, there's a path to multilateral, sort of a mutual defense agreement, among other countries, so that when, for example, China resumes massive currency manipulation, it will hurt both the EU and the US and that with an agreement in place, that something that causes a big bilateral imbalance with either the US or the EU, will trigger a response by everyone. Then I think that you'll actually have a much stronger system. But it's not necessary to do it right now.

And so, seeing all this in one place is actually very good. The history of this - I learned a lot reading it when I was flying in last night. I read ahead of time the conclusions and the key part of it, but actually spent the flight reading it. And I learned a lot. But the key idea here has to be really understood and appreciated. And I'm going to spend a lot of time selling this to other members of Congress as the way forward.

I don't know how to sell this to the Trump administration, but I think that actually it sort of fits into their intellectual framework, the fact that it's a unilateral thing is not unnatural to his apparent psychology. And it actually makes sense. It's something where you actually wouldn't have to make any enemies today by declaring this.

Because it would not trigger, but it would trigger the moment that currency manipulation resumed. And so that's another, it's one of these things, ideas, that I think the time may have come.

As a member of Congress, I often, sort of, view my job as having a very large number of possible projects, things and balls I'd like to move forward. And then when the stars align, maybe you can move one of them forward. I think this may be the moment when something like this has a chance.

We have a very successful, the Treasury three-part test, is exactly what you want. It would have worked to say this in the past and it will work if it's going forward. It is something that I think is politically feasible.

The only congressional action I think I'd like, and Fred talks about this in the book, is that you need a slightly larger bazooka in the Hank Paulson's sense, that if you want to really deter currency manipulation, you need a bazooka so big that you won't have to use it.

And so having a little more explicit authorization for a larger amount of money, or some understanding that the mix of Federal Reserve and Treasury actions would allow the Federal Reserve to have a much larger role than it historically has been, would be an alternative.

There was a political worry that when you actually do this, that, "Okay, what are you doing using Federal tax dollars to buy a bunch of foreign currency?" And is that going to be a problem? But I believe that will not be a problem, in fact, because that will come at a moment of pain for US business. And you'll say, "Look, we are doing exactly what they're doing" and I believe that will be politically defensible. It's a guess, as is everything in politics.

But I think this is still the way forward, so I really thank you guys for bringing this idea forward and I know I intend to do my best to follow through on it.

Bob Zoellick: So I'll quickly try to get to questions, [inaudible 0:55:41.3] important to me so, Fred asked me as we got together to make a quick comment based on what I heard, and so I just want to share five points with you.

One - as I mentioned in the introduction, I think this book is particularly interesting because it supplies a missing link. So, missing link in the scientific sense might be a little different, but we all know the connection between exchange rates and trade, but we haven't been able to link them in a workable way in the international economic system, with rules and disciplines and some ability to act.

Second point, this book is also about economic diplomacy. And I just want to draw out some aspects of how, as the Congressman mentioned, how to translate some policies into action. Very importantly, it emphasizes a principle basis for action. And I want to underscore this, because Fred came to this a little bit late in the presentations and I don't want to lose this, because whether you act unilaterally or multilaterally, I think it's very important that the United States be able to outline a principle basis for action.

Fred Alluded to this, and those of you that are students of economic history know that US often had to prod the system to change, with flexible exchange rates, or, we have some people here, Barbara Weisel, from USTR, some additions in terms of trade agreements or even the environmental and labor connectivity, but if you're going to be able to sustain it and expand it, it's important to do so on a principled basis.

And that's the third part, which I think, a key part of this work, and for those of you assessing it, is to assess these objective criteria that Fred mentioned. The size of the current account surplus, the size of the reserves. There are two pieces that I want to draw attention to that maybe came up in different ways.

Many economists have been worried about these types of actions because they would fear that it could interfere with monetary policies. And what Fred didn't have in his chart, but I think I'll let him comment on it, is the action of the intervention has to be in a foreign currency, and therefore, that differentiates even extraordinary monetary policies. So it would have to be somebody buying dollars, for example, not just for having an expansive monetary policy in Japan.

And people can make their own determination, but at least, I think, that excludes the problem of restricting the flexibility of central banks to have aggressive monetary policies.

The other one that I want to draw attention to is the Congressman mentioned to it, is bilateral verses multilateral, and Fred and others can comment on this. As the Congressman points out, there is a distinction in the Treasury standards that focus on bilateral versus multilateral. The book does not focus on the bilateral. And the reason I'm highlighting this is that I think if there is any guiding element of the Trump administration's foreign policy or international economic policy, it's a focus on bilateral trade deficits.

I think this is deeply mistaken focus. The United States has a surplus with Australia. Australia has a surplus with China. China has a surplus with the

United States. What have we learned? Other than the fact that we have different trade paths? I have a deficit with my supermarket. I do not go in the evenings to stock shelves to have an offsetting account. I get money somewhere else.

So I think this is driving our policy towards Mexico, Germany, Japan, China, South Korea, and I think it's important, but I'll let Fred and Joe differentiate. That is not what this book is about. It's not to try to rectify bilateral trade deficits. It's to look at the overall current accounts.

Fourth point, what the book also deals with, for some of you who come from different economies and they didn't have time to go into it in depth here, is the authors do ask why countries might need high reserves or current account surplus. S

So, as Fred and I discussed this book a year or so ago, I pointed out that if Kuwait didn't have the sovereign wealth fund, it's not so clear after Saddam Hussein invaded it in 1990 that it would exist as a country. So if you're a small economy, or you're a vulnerable economy, there may be different considerations that people have to take into account.

In addition, they do note the difference, for example, natural resource economies, a point that Joe mentioned, and you'll see they also discuss the considerations of financial centers. I think in a very practical economic diplomacy logic, what they've also suggested is rather than getting in a big debate about this, we'll exclude the smaller accounts. And I think, if you're going to have a chance of building this multilaterally, that might help you lessen the opposition.

The fifth and the last point is the counter currency intervention. Just again, to have a little historical sense, here, this is a very interesting potential tool. For it to work, the country needs to have a currency that is straight at our markets. And that may be one reason why this couldn't have worked with China at some point in the past 15, 10 years, but would work today. And it's also why it works more for the big economies than the small economies.

So, the last point, however, and this also goes with something the Congressman said, I frankly think, from my experience, Congress might like to play in this by setting up such an account, but as Fred emphasized, the key aspect is you probably never have to use it. Because the very fact that you would threaten to use it may have a deterrent effect. All the more so if you explain the principle basis by which you're at.

So with that as a supplement, why don't we open this to [inaudible 1:01:55.9]. So dispositive. Yes, in the back, and maybe, since we're on a

website here, if you could just give your name and introduce yourself briefly.

Fred Bergsten: Go to the mic back there.

Bob Zoellick: Go to the mic.

Fred Bergsten: Go to the standing mic.

Bob Zoellick: You have to go to the standing mic so they get you. You have to go to the mic.

Fred Bergsten: Go to the standing mic.

Bob Zoellick: You have to literally go.

Fred Bergsten: There's also a traveling mic here.

Bob Zoellick: Okay and we're going to have a travelling mic.

Sergio Amaral: My name is Sergio Amaral. I am the Brazilian Ambassador. I like very much the presentation and have a lot of interest for the book. But I have one question which is about the practical implications for policy. President Trump has mentioned several times that he wants to reduce the deficit and he mentions often two cases. China and Mexico.

I understand that China is no longer a currency manipulation as it used to be in the past. And apparently, if I understood you well, the Mexico case doesn't apply because Mexico doesn't have a surplus.

So what would be the practical impact of the policies you suggest.

Fred Bergsten: The answer to that is very simple. President Trump's fundamental goal is presumably to strengthen the American economy and to create jobs in the United States. Everybody in this room knows that a focus on bilateral trade deficits is not the way to achieve those fundamental purposes. And so, as this process evolves, we simply have to try to convince the President and his team, that the goal he is enunciating is reasonable, but the approach he has in mind is totally misplaced.

Now, once you get past that admittedly very large hurdle, then the answer is simple. Because if he really wants to deal with the trade deficit, not the bilateral trade deficit with China or Mexico, but the trade deficit, and wants to strengthen that, to strengthen the American economy, then he has to pursue macro policies on a multilateral basis.

And if he wants to focus on the exchange rate, which ultimately is what you have to focus on, if you're going to achieve those basic purposes, then something of this nature, I think becomes as Congressman Foster said, a natural, given their mindset, but let me defer to him.

Congressman Foster: Well, I think one of the things that is probably in the process of happening is that the Trump administration, like all administrations are understanding they have this fundamental conflict of interest. They deal with other countries at many different levels. They deal with Japan, they're trying to deal with, for example, the base in Okinawa, is under negotiation at the same time that currency manipulation might be under negotiation.

And so because of this conflict of interest, they don't always have the interests of the workers of the Illinois 11th District, or our high-tech businesses as their only consideration. And so I think this is one of the things, you can see that I think already, in what's happened with China, which is much less aggressive than what he has promised in the campaign. And I think is going to continue.

Bob Zoellick: Just a quick other comment, I think part of the argument here, and it's a good point for policy, is maybe to put things in place before the crisis breaks and to have some preventive effect, which, given the description that Joe started out with about the international current accounts, one might very well see that the challenge that occurred in the past would occur again. Next question.

Fred Bergsten: Dan Trujillo is in the back.

Bob Zoellick: Dan? Did you -

Meg Lundsager: Hi! I'm Meg Lundsager, I'm at the Wilson Center, but I was on the IMF board for a number of years and to give a little bit of defense to the administration that I used to work for, several of them, as a matter of fact, there was a continuous effort, in terms of getting the IMF to do more work on exchange rates.

And one of my frustrations was getting support from other board members. So my question for you is, why are countries that are also suffering from, let's say, Chinese currency manipulation, why weren't they supporting me when I was pushing more activist fund role at the IMF, and they were very quiet, even though they were not accumulating reserves, they were letting their currencies appreciate, and feeling the trade effects, same as United States, but I couldn't drum up their support to really try and galvanize the IMF to be more activist.

So I'm asking all four of you, why is that and how do we try and change that to get a more multilateral response that could be more effective in the long run, as opposed to it just always being the US taking action?

Fred Bergsten: Yeah, this was a big puzzle and frustration for Joe and me, too, as we worked on it. Partly we think the other countries were just not as aware of the problem as they should have been. There have been studies now that show that the China shock, of which manipulation was a big part, was a critical factor in the Brexit vote in the UK. There are two major studies that show that.

Joe's work showed that the Eurozone as a group was losing 50-100 billion dollars of output per year, as a result of the manipulation. His numbers show the US was losing roughly 200 billion dollars a year. The next biggest loser was the Eurozone, 50-100 billion dollars a year. You're right. They should have been in the queue. Why not?

Well, they don't really speak with a single voice on international monetary issues, as you know. They are kind of afraid to take on China, as you know. They were not really, I have to say, pushed very hard by your top colleagues in the administration.

When the administrations, both of them, nonpartisan, both administrations were unwilling to label China as a currency manipulation, despite the fact that US law clearly called for you to do so, and Treasury's own analysis clearly showed they were manipulating. When the US was unwilling to step up to the plate itself and say China is a manipulator, I think it undermined your effort to get your colleagues to step up.

So it was a combination of factors, but certainly, and this goes to something Bob said, we stress in the book that if the US goes the path we suggest, do the countervailing currency intervention, we certainly should go to the Europeans and try to get them to work with us on it. The euro is the second reserve currency for all their problems. They have the second biggest impact.

Admittedly there's a German problem. Germany, über alles, resists any kind of international steps that would sanction surplus countries. Being defensive is the world's biggest surplus country. And of course, hiding behind the fact that they don't have their own exchange rate, that you have to talk about the euro.

But when the US tried to get some rules, you know that well, at the G20 summit in Seoul in 2010, it was Germany, not China, that led the opposition. And Germany and China were in league.

So that's a big problem and the US diplomacy would have to go first I think to Berlin.

Joe Gagnon: If I could add one small additional point as perhaps the economics profession also, basically didn't have a belief that these policies could matter as much as they did. There was a bunch of research in the 90s that said intervention didn't really do that much persistently, and it was consistent with the view that financial markets are efficient and whatever governments do, the financial markets will undo.

But I think we now see that there's been a [inaudible 1:10:47.5] change since those studies were first published. Intervention has risen by 2 orders of magnitude, at least, and that's suddenly information in the data that wasn't there before, to identify an effect that is important. And that realization is just beginning to hit the economic profession.

Congressman Foster: I think if I had one criticism of the economic analysis of why China's manipulative actions shouldn't have mattered, which were coming through at the time, that just hold your breath and it will be okay and fine. I think that there's an inadequate recognition of the asymmetry between the time it takes to create a job and to kill a job. That this is a fundamental, it's an asymmetry.

You see it in individual business. You see it macroeconomically at the rate of job creation verses we've seen our economy destroys 750,000 jobs a month and the best we can do is to rebuild them at maybe a third of that rate, maybe a quarter.

And so this is the reason that dumping works. That if there's a business cycle downturn, and there are two countries, one of which dumps to protect the existence of its industries, the other one doesn't. Then when the dumping, when the downturn is over and everyone's recovered, the country that protected its industry through dumping has a monopoly position because it's competition's been wiped out.

And this is why we cannot allow dumping and really currency manipulation, simply broad-spectrum dumping. You see that in the disappearance of whole classes of industries in the US in response to the manipulation time.

Bob Zoellick: So, Meg, this is a critical question and I'm going to prolong because I think the answer is really important for this group and others to consider. Because it's a real issue of whether this book just becomes a book or whether it actually has a chance, through economic diplomacy of being action.

So point one is the one that Fred mentioned. Information. You were at the IMF, you know. Bureaucracies tend to preserve the status quo unless they're really shaken. Okay? So the information here might help.

Point two, people would be afraid of arbitrary action, so they may identify the problem, but they're worried that the solution is worse than the problem. So this book helps by putting out standards for people to debate for the action. And what policy. So I imagine many of your IMF colleagues would have been afraid that the action would have justified trade protectionism, which wouldn't have solved the problem, but as always pressed by the domestic political audience.

Third, a concern for freedom of monetary policies. As you know well, treasuries and certainly central banks don't want to have their freedom of action interfered with by having to deal with messy trade issues. And so you have a bureaucratic interest that you have to answer here. I think the book answers it, but that will be for others to determine.

The fourth would be the cost of aggravating the manipulating country. So if you're a smaller country, why take the aggravation. And that goes to the fifth issue, which is really one that [inaudible 1:13:59.6] discussed years ago dealing with the Great Depression. You do need, what do you want to call them, hegemonic leaders, or systemic leaders, to prod the system. The US has done this over the course of the past 70 years.

However, if it doesn't do so in a principled way, it will make things worse. So right now, the concern would be if the US does this in a way that just seems unilateral, seems to be protectionist, and focused on bilateral trade deficits, you'll blow.

Fred Bergsten: Get Trujillo?

Bob Zoellick: Dan.

Robert Rogowsky: Robert Rogowsky, the Middlebury Institute of International Studies.

Bob Zoellick: That's okay, we'll get Dan. Go ahead.

Robert Rogowsky: Oh, I'm sorry. Just a follow-up on your question, Winston Churchill it is said, said the United States will do the right thing after it's tried everything else. If for some reason we don't do this, what do you see happening over the next, four, five years, in the international financial structure that might correct the problem or lead us to where inevitably something like this has to be done?

Fred Bergsten: Well, forecasting that is pretty difficult, but if you look at the history of the issue we address in this book, what you find is it always comes back. Surpluses develop, they wax and wane, but they always get big, at different points in time and driven by different causes. The surplus countries resist adjustment and successfully so, given the gap in the architecture that we described. Domestic political reaction will come again in the United States and elsewhere, with threats to the open system.

I don't know if it will be five years, Bob, or whether it will be ten. The big US eruptions occurred in 1971 with the Nixon shocks, in 1985 with the Plaza Agreement, and again more recently. So every decade or so, we tend to have an eruption of these pressures that threaten a lot of the basics of our open international economic policy. Reasons were mentioned during the conversation about why this might be more likely to occur in the future. Congressman mentioned that.

I would say within a five to ten-year period, yes, it will come again, and Bob's point about pre-empting, putting preventive medicine in place, particularly doing it during this period of remission, when you don't have to indict somebody, makes an awful lot of sense.

Bob Zoellick: Joe, did you want to add anything on this or are you comfortable?

Joe Gagnon: Just, I would say, we're on a path that the US net debt will reach a level that no country has sustained. Now the US is unique, but it's not clear which way that cuts and it just raises the possibility that if we don't resolve this problem in the next 10 years, then the world gets to be a more unstable place because people get scared of piling up more and more credits against the US and look for what is the alternative, and it's not clear. I don't want to be a scare-monger, because I think that that's a ways away, and I think the US is unique in some ways, but it is a worry.

Bob Zoellick: So Dan.

Shaun Donnelly: Dan left, I think.

Bob Zoellick: Oh he did? Oh, I'm sorry. Okay. Please.

Shaun Donnelly: Thanks, I'm Shaun Donnelly from the US Council for International Business. Wanted to ask about trying to implement this proposal. Particularly in the light of the current international environment with the US decision on Paris climate change agreement, on NATO and so on, and the debate about US unilateralism.

Should the US just try to come up this plan and announce it and implement it unilaterally or is it worth trying to invite our G20 partners or

some other group to do it. And if you go that route, what's the risk of getting caught up in a five-year debate, is it 20% or 15%, some of these criteria. Thanks.

Fred Bergsten: Well, as I said in my remarks, we would certainly like to multilateralize the process, to the maximum extent, and particularly given the circumstances of today, that would be highly desirable. And so we spelled out several ways to multilateralize.

One would be to take this initiative in the IMF, that I talked about. Try to change the IMF rules in a way that would conform to the change in US policy, but with multilateralize the process. Likewise, putting it into free trade agreements.

Now that may not sound to you like multilateralizing, but it would be. Because as the Treasury worked out in the TPP context, you get together with the FTA partners, you drive toward agreements on the criteria and the mechanism for implementing them and hopefully even remedies in case the commitments were broken.

So we have several things in the book that explicitly talk about multilateralizing the process. There are a couple things we do in the WTO as well.

But we believe those could only work if the other countries were convinced that the US was going to move on its own anyway. And so it would be a very narrow tightrope to walk, where you would be acting, but you would be trying to do it in a cooperative way to the maximum extent possible. And you'd take the view that the US moving on its own would provide some significant incentive for the other countries to do it.

I mean, there are lots of analogies historically, where the US, Bob said, has moved simultaneously at home and abroad. In a perverse way, the credibility, if you want to call it that, of the Trump administration, to take strong unilateral action, would help give credibility to an action of this type. And you always have to ask what the counterfactual is. Go back to the first question from the Brazilian Ambassador.

If something like we're proposing today were taken instead of going after bilateral deficits with Canada, Mexico, China, et cetera, et cetera, Germany, it might actually look less bad to the other countries and you might have some sighs of relief, at least willingness to go down that path. But, to emphasize, it would require some skillful management.

To pick up a point I wanted to make after the Congressman spoke, but I'll make it here. The role of Congress, I think, is really important in this. I

mean, I agree with Congressman Foster. It would be highly desirable for the Congress to explicitly authorize countervailing currency intervention and in fact authorize borrowing to increase the resources of the Treasury to carry out the policy.

I stress if they spent those resources, it would not count against budget authority, it would not add to the budget deficit. But the exchange stabilization fund would need borrowing authority, which means it would count against the debt ceiling if you ever had to mobilize.

They've got 100 billion dollars now. The Fed traditionally matches 50-50, so you've got a war chest now, but if you needed more, the Congress could authorize it. Interestingly, the Senate passed this idea in 2011. The Senate passed the Currency Bill in 2011. They called it Remedial Currency Intervention, but it was this idea. The House leadership would not take it up, or it would have passed the House and become law.

So it was that close, actually, to becoming legislation six years ago. And I would think that would be a highly desirable part of this, both to augment the resources available, but also to strengthen the credibility of the US, make it a permanent policy, and have the Congress as a full partner in the process. That I think would add substantially then to the chance to multilateralize, because the rest of the world would know this was very serious business.

So it's a three-cushion shot: administration, Congress, rest of world, if you do it right.

Bob Zoellick: Do you want to add anything to that, Congressman?

Congressman Foster: No, I'm a little bit skeptical that the US would take very strong action against a country that we do not have a bilateral trade problem with. And so that's my only, my worry about sort of half-complete multilateral arrangement. How you would expand it from an initial US only, with a trigger based in part on a bilateral trade problem. And so that's the only thing I wanted to add.

So I think that as you imagine this building out, I think the psychology of it is very similar to mutual defense arrangement, like NATO or something like that. That comes and goes in the popularity of some administrations.

Fred Bergsten: I might just mention, one idea we include in the book to partially address that issue. We propose in the book, and this an idea that I got from Bob Zoellick. To create an SDR council within the IMF, a group of the five countries whose currencies now make up the SDR. The US, the Eurozone, Japan, the UK, and China. Who would be the five countries that would be

most intimately involved in any kind of new international intervention policy.

Have that as a consultative forum, where you would bring in China, you'd bring in Germany through the Eurozone, and you would genuinely talk it out. There are IMF rules of the road that deal with intervention, taking into account the interest of the country, in whose currency you intervene, never been implemented. There are rules against competitive devaluation, of course. So, to put some flesh on those bones, in a plurilateral way, it would not have to involve the whole world. That would be very complicated. The Congressman is absolutely right about that.

But to get the big players, again, within a context where the US was going to move on its own, seems to me a reasonable possibility. I'd try that.

Bob Zoellick: Yes, please.

Jeromin Zettelmeyer: Jeromin Zettelmeyer here at the Peterson Institute. So, Fred and Joe, you haven't heard much criticism of your proposal yet, and I think that's natural, because it's very elegant, very well established. Let me make two very mild critical points.

So the first one is I think if you're going to implement this in practice, like Mr. Zoellick said, the importance to base countervailing intervention on predefined rules and justify them is pre-eminent. And so of the rules that you showed, I think that the biggest problem will be to deal with the argument that emerging market countries in particular may have legitimate interest in accumulating reserves for the purposes of self-insurance.

And you have covered this with two very mechanical rules, three months of imports, 100% of shortened debt. To give an example, which I think you are aware of. Literature that argues that it may be sound for these countries, given that they are subjected to a lot of volatility to hold much higher levels of reserves.

To make the point differently, I don't think that if your rule had been in place in the mid-2000s, maybe you would have avoided some of the Chinese manipulation. But China would never have been accumulate the 1 trillion that it has now used to stabilize its exchange rate in the other direction. So that's one point.

And the other point, which is more to Joe. So, I completely share your concern about the unsustainability of the US current account. But in this respect, your proposal really has the feel of bolting the door after the horse has left the stable. Because there is no manipulation against the US dollar at the moment, but the US still has a very large current account deficit and

it's about to get bigger. And so I think if we are going to address the lack of sustainability of the US current account, we'll have to think about other measures.

As your simulation shows, even in the 2000s, most of the US current account was driven by things not related to manipulation. And so one will have to think about that. Incidentally, I also believe that that is part of the answer to Meg Lundsager's question of why she didn't get enough support at the IMF Board.

Because, apart from the facts that you mentioned, there is a general belief out there in the world that, to some extent, US insistence on currency manipulation is an excuse for an essentially home-bred current account deficit problem that has to do with US overconsumption.

But maybe also with the fact that the US is just a great place to invest and that the rest of the world wants to invest here. In which case, maybe it's not such a big problem. Anyway, so I just want to say this is a big concern, but I think one that does not relate to your proposal.

Fred Bergsten: Two good questions. [inaudible 1:28:17.7]

Bob Zoellick: Joe.

Joe Gagnon: Well, I'll do the second one first. I would feel less concerned if the US had used its large deficits to have a higher investment rate than other countries, but we have the lowest investment rate of the G7, not the highest, so we don't seem to have used that money wisely, as much as I wish it were different.

Yes, manipulation isn't the whole story of the past 15 years, but it's the single biggest story, very big. And I think what we've seen in the past few years, I have this as the Brazilian Ambassador's question, too, actually. No one's manipulating, we still have a large trade deficit, so what do you have to say about that?

Well, what I think what we see is that with slow growth in Japan and Europe and markets getting a little scared they overdid it in emerging markets, they all turned to the US the past two-three years and pushed the dollar up.

But that's not going to last forever, and already the signs are, it's turning. So I think, when that happens, the big question will come, will countries try to maintain their surpluses in the face of dollar depreciation. And I fear that they will, in which case it becomes manipulation again.

Moreover, I would say that even right now, if we put in place a credible program to prevent manipulation in the future, the dollar would fall immediately. Now, why is that? Because markets know that there's a dollar put out there. They know that, if the dollar should turn a little bit, that they can sell their dollars to the currency manipulators, because the currency manipulators will step in and support the dollar and they won't take losses. The investors won't take losses. That's a dollar put that is holding the value of the dollar up today.

And your other point question - first question.

Bob Zoellick: It was for Fred.

Joe Gagnon: Why don't you do that one, Fred.

Fred Bergsten: Well, Jeromin, it's a fair question, whether emerging markets should be permitted, encouraged to build up reserves even more than they have. We studied that literature you referred to. We debated a lot among ourselves and others as to what were the reasonable levels for self-insurance. And we felt that by choosing the numbers we did, we gave more than adequate scope.

So if China had only built up 2 trillion instead of 4 trillion, they still would have had the trillion to spend in the downward phase of the cycle. And I think we would have felt okay.

As I said in my remarks, every one of the manipulators that we identified, far, far, far exceed the criteria that we had in mind. So we certainly were not putting binding limits on any of the major countries that we were worried about.

Bob Zoellick: I think, just to close on this point, it's a very good one, though, because if we're talking about systemic change, what your question raises is that this is a complaint that the US has with how the system operates. Many emerging markets would say we don't like the way it worked in the 90s financial crises and debt crises and so they've self-insured. And so it really goes back to the question that we also got about how you would do this with economic diplomacy.

And my own guess would be the more you could show some sensitivity to those issues, and there's ideas out there about how to try to help with some of those, the more you get acceptance here. And I think, it was Shaun asked the question, whether this is capable for the Trump administration to do, leave to others.

But it would certainly be one where you would have spent time talking, explaining the logic, information, G20, G7, sort of IMF context. But as Fred said, it's very important at the end of the day, you have a tool, if need be, to drive it forward.

The last thought was that when Fred first developed this. This may also apply for the Congress, it was the idea could you combine it with a willingness to continue trade localization. So if this addressed, for example, some of the concerns that some members of Congress had, might have given you the basis to enact TPP. Well, that doesn't seem to be a viable option now. But I would also create the overall context.

So speaking of deficits, I think we now have a time deficit. So I'll just say, maybe just go and see if the three of you want to add any final comments. Joe? No?

Congressman Foster: Just one final point. In addition to having quantitative objective criteria for triggering this, the size of the response is also well defined in this proposal. This is an equal and opposite currency intervention. So you're not going to have to get into long argument that South Korea, go easy on them, and only do half of the nominal intervention. You will have preset rules that it would be an equal and opposite one without having to get into all the diplomatic side issues that typically dilute the response to things like currency manipulation.

Fred Bergsten: That's a good principle of physics.

Congressman Foster: Indeed, it is.

Bob Zoellick: Any last words, Fred?

Fred Bergsten: No.

Bob Zoellick: Okay, well thanks to all and thanks for our authors.