INTERNATIONAL ECONOMIC GOVERNANCE AND CHINA’S RISE:
HOW SHOULD THE UNITED STATES AND JAPAN RESPOND?

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PROCEEDINGS

MS. SOLÍS: Hello, everyone. I am Mireya Solís, a senior fellow and Knight Chair in Japan studies at the Brookings Institution. It is a pleasure to partner with NHK world to offer you this roundtable discussion on China's rights and the future of international economic governance: How should Japan and the United States respond?

Our event this morning is going to be taped. You probably have seen that we've taken a lot of care with the microphones and so forth. And later on, it will be broadcast in several countries, really, all around the world.

Now, let me introduce the theme for today. We have a very rich agenda for discussion. Obviously, China's emergence as the second largest economy and its status as a trading powerhouse are well known. But its more recent attempts to exert greater leadership in international economic governance have generated a lot of attention, a lot of discussion.

I'm talking about initiatives, for example, as the establishment of the Asian Infrastructure Investment Bank, or AIIB, the founding of a bank by emerging economies, the New Development Bank, the "One Belt, One Road," mammoth infrastructure project (Inaudible), and the championing of a sizeable trade grouping, the so-called Regional Comprehensive Economic Partnership.

So, I think that this raises a number of very interesting questions I hope we get into today. For example, what does this flurry of initiatives tell us about China's aims and intentions? What is China's vision about international economic architecture? Is China a revisionist power intent on building an alternative multilateral economic or trade order, or is China behaving as a responsible stakeholder willing to provide public goods commensurate with its growing economic stature?

But equally important, I think we should also discuss how will established powers respond to China's greater leadership role? In particular, how will the United States and Japan respond? We're talking about two countries that are giants in the world economy. They rank number one and number three in terms of their economic size.

They lead the way in multilateral institutions like the World Bank and the Asia Development Bank. And today, as we meet here, they're also trying to come to a conclusion in the negotiation of a very ambitious mega-trade agreement, the TransPacific partnership.
So, I think this also then raises a number of interesting questions that I hope we’ll get in today. How can the United States and Japan protect and promote a rules based economic order that matches the realities of the 21st century economy. In which areas of international economic governance will they be willing to accept Chinese led reforms? In which areas will they think that the status quo is best; that existing institutions do the job they’re supposed to do?

Now, to address these important and decidedly complicated set of questions, we have here a panel of world class experts, and I will introduce them briefly in the order in which they are seated. First, Dr. Masahiro Kawai. He’s a professor of the Graduate School of Public Policy at the University of Tokyo, and has had a long and very distinguished career.

Some of his prior positions include chief economist for the World Bank’s east Asia and Pacific region division, deputy vice minister of finance for international affairs of Japan’s ministry of finance, a special advisor to the Asian Development Bank, and dean of the Asian Development Bank Institute.

Dr. Kenneth Lieberthal is a senior fellow at the Thornton China Center here at Brookings. He is a prolific and insightful writer. I think -- don’t you have something like 24 books?

MR. LIEBERTHAL: Mm-hmm.

MS. SOLÍS: (Laughter) You put us to shame. (Laughter) He was a professor at the University of Michigan, and also served as senior director for Asia at the Natural Security Council between 1998 and the year 2000.

Dr. Saori Katada is associate professor at the School of International Relations at the University of Southern California, and is currently an Asia studies fellow at the East West Center here in Washington, D.C. She has written extensively and with depth on a wide range of topics such as trade, financial and monetary cooperation in East Asia and Japanese foreign aid.

Dr. David Dollar is a senior fellow with the foreign policy program at the Thornton China Center here at Brookings. And before David arrived here, he was the Treasury Department’s economic and financial emissary to China. He has a long career at the World Bank, I think over 20 years, and he also has been an advisor for China regarding the establishment of the AIIB.

Dr. Eswar Prasad holds the New Century Chair in International Trade and Economics at
Brookings, and is concurrently the Tolani senior professor of trade policy at Cornell University. Dr. Prasad was previously head of the financial studies division and the China division at the IMF.

So clearly, we have gathered here tremendous expertise to discuss these very important and complex issues. So, let us get a start. And I would like first to discuss, if we may, China's economy, strengths and weaknesses, because I think very clearly when we think about the ability of China to have a larger leadership role, we have to see if it has the economic strength to project its influence to carry out these leadership activities.

Now, we know that many people have long admired China's ability to generate high growth, to rise to become the second largest economy, but if I may say so, in the past few weeks, the confidence on the Chinese economy has taken a hit because of instability in the stock market, because of the decision to devalue the currency, because the larger than expected slowdown of the economy.

So, I was hoping, David, if you can get us started in trying to understand what's going in China's economy. What do you think explains the recent turmoil in the Chinese stock market? Some people say that the Shanghai stock market is a side show; that the turbulence is not really going to affect the fate of the Japanese economy, but some other people may look at this and say, well, this is just a symptom of larger structural underlying issues and there are important problems ahead for the Chinese economy. Where do you fall on this?

MR. DOLLAR: Okay. Well, thank you, Mireya. Really a great pleasure to be here. Mireya just mentioned the stock market correction, the devaluation and the slowdown of China's economy.

MS. SOLÍS: Mm-hmm.

MR. DOLLAR: Of those three, the slowdown of Chinese economy is by far the most important. So, I do think the stock market is still something of a side show. It had a big bubble. Stock prices went up 150 percent while the economy was slowing down, which was really strange.

Prices got out of line with corporate profits. There were a couple of factors at work. They had allowed margin trading. The government talked up the stock market, which is never a good idea, and then, bubbles inevitably burst. That started happening in June, and I think they made a mistake. They intervened when the market was still pretty high -- the government intervened. It wasn't very effective.
So now, we've had a 40 percent correction in the stock market. I don't think that's a particularly big event. There have been stock market bubbles and corrections in China in the past, and I think the world was pretty relaxed until later -- you know, China's devaluation. But it more importantly, this succession of poor economic news from China. So I think, you know, the world is really worried about the real slowdown of China's economy.

MS. SOLÍS: Mm-hmm. Yeah.

MR. DOLLAR: And they've over invested for a number of years. So, the fundamental issue is they have excess capacity in real estate, manufacturing, local government infrastructure. So naturally, investment is slowing down. It's making the economy slow down. So far, it's not bad. You know, I think they really are growing in the 6 to 7 percent range, but everyone is worried that the slowdown will be much worse. I think that's what the world is reacting to.

MS. SOLÍS: Mm-hmm. Any other views on the panel on how the Chinese economy is doing?

MR. PRASAD: Well, I think the level of interest and concern about China comes from the fact that China is the second largest economy in the world, after all, and it's become the largest contributor to global GDP growth after the financial crisis. So, anything that happens in China has big repercussions everywhere.

Now, it's a little difficult always to read the tea leaves in China, first of all, because of the capacity of some of the statistics, and concerns about whether headline numbers like GDP growth, in fact, reflect the true state of the economy. So, anytime things to be not working quite as well in the stock market or with the currency, it tends to take on a life of its own, because investors worldwide interpret that as a signal of something going wrong in China.

Now, I think David has hit upon the key issue, which is what is happening in the economy is really crucial. Now, my own view is that if you look at the manufacturing sector and a lot of the indicators one hears about in the press, freight volumes, import volumes, purchasing manager's index, electricity consumption, all of these are about the manufacturing sector of the economy, which has certainly taken a big hit.

And as David pointed out, there's already a lot of excess capacity in terms of investment,
so we can't count on that to be the main driver of growth. There is a sense that perhaps, other parts of the economy, the services sector, household consumption are all doing somewhat better, but it's not clear from the available data that all of this holds up very well.

But I think the bigger issue for China, really, is not whether growth can hold up at a reasonable rate in the next year or two. The government has enough policy space in terms of both monetary and fiscal policy to boost growth, if it wants to. But the big question is how it does it. And if it does it the wrong way, as David pointed out, some of these problems that already exist -- the high level of excess capacity, the unbalanced economy, that could become worse, and that ultimately, could have negative repercussions for China and indeed, the world economy.

MS. SOLÍS: Thank you very much.

SPEAKER: Yeah. I agree with David and Eswar. I want to provide some additional points.

MS. SOLÍS: Mm-hmm.

SPEAKER: Right after the (Inaudible) shock, China adopted the famous four trillion Iran stimulus package. That was a huge, huge package, and that impact is still lingering in terms of excessive investment, too fast an expansion of credit, and local government debt.

So, we have that sort of a problem, and in that context, the economic growth slowdown may be taking place. Now, manufacturing activity seems to be slowing down. The famous (Inaudible) index -- that summarizes three indicators. One is bank lending, which has been growing relatively high. But the power consumption and railway transport volume -- indeed, the last two are not doing very well.

But the last two really capture the industrial or manufacturing activity. So, it looks a manufacturing slowdown is really taking place. But on the other hand, the service activity is still sustained. I believe the service activity is growing at around 8 percent, and perhaps, manufacturing around this time, 5 to 6 percent. So, it seems to me that GDP may not be growing at 7 percent per year, but perhaps close to 7 percent.

But the bigger issue is this high leverage over investment, credit and local government debt. So, to how China can manage this without experiencing a massive slowdown of economic growth is a big, big challenge.
MS. SOLÍS: Very interesting. And I think that there is consensus in the panel that the big items to really focus on are the structural causes -- why the slowdown in the economy or these more fundamental issues.

But I just want to go back a little bit to the problem in the stock market. I understand that it's turbulence. It doesn't really tell us what the big picture regarding the Chinese economy is. But people have looked at that episode to make another kind of assessment, and that is, the competence of Chinese authorities to deal with economic travails. And many people have been very negative in that kind of assessment.

They have felt that the intervention was heavy handed, ineffective and has not given us confidence that there is a steady hand at the helm of the Chinese economy. I wonder, Eswar, if you could react to that kind of argument. How do you assess how the Chinese government responded to what transpired in the stock market this summer?

MR. PRASAD: The initial problem, which David properly pointed out, was the fact that the government did cheerlead the stock market on its way up. Now, the point, I think, that needs to be taken from the episode with the stock market where they've intervened with the stock market in (Inaudible) and then pulled out, is what the government is trying to do, which at some level is a grand experiment.

It is a grand experiment in the following sense: My view is that the Chinese government is committed to market oriented reforms, but not in the way you and I might think about market oriented reforms. It's to a lot freer play of market forces, but while the government still maintains stability and control with a paternalistic hand.

MS. SOLÍS: Yes.

MR. PRASAD: And that is a very difficult balance to strike. So, what we saw in the stock market, for instance, was some set of statements that the market needed to discipline itself; that the market needed to find its own bottom. At the same time, because the market was falling too quickly and creating this perception of incompetence in economic management, they had this whip saw (sic) approach of going into the market, trying to stabilize it a little bit, and then going out again. And that's not a very consistent set of messages.
We've seen this with currency, as well, where with the initial move to a more market
determined exchange rate. Initially, the currency did flow somewhat more freely, but then very quickly,
they clamped down when they thought the market was getting ahead of itself, and financial markets often
tend to overshoot. So, there may be some logic to it, but unless this is communicated clearly as a more
basic set of reforms, it's going to be difficult.

And I think this points to a more fundamental problem with the reform process. While the
government does seem very committed to financial market reforms, unless you have the real side reforms
in the economy and the broader institutional reforms, it's not going to work well. So, you can say that the
market needs to discipline itself, and this is a country where the markets are not used to disciplining
themselves.

But if you don't have good corporate governance standards, accounting and auditing
transparency, then those who invest in the stock market are doing it more out of a flight of fancy, because
the market is going up, rather than because they have any faith in the fundamentals of a company. So, I
think what this points to is the need for a clearer communication about the ultimate objection, perhaps
less of a paternalistic hand, and a broader set of reforms that underpin these financial sector reforms.

MS. SOLÍS: Thank you.

MR. DOLLAR: Yeah, I would say that you'll still find Chinese officials who will defend the
stock market intervention, saying they prevented panic. But I think the common view is that the
intervention didn't work. You know, the market dropped 40 percent, and it was probably a necessary
correction.

Maybe the government intervention slowed it a little bit, but you know, I don't get a sense
in China that you know, people feel that the government intervention was effective. And then on top of
that, the way they handled the currency devaluation, you know, they wanted to have a more market
oriented daily fixing, but they announced it was combined with a one-off, 1.9 percent devaluation. That
created a lot of confusion.

Actually, what set off the big market sell-off around the world was people took that as a
signal that maybe things were much worse in the Chinese economy. So unfortunately, I think their
reputation has taken a hit.
MS. SOLÍS: Yeah.

MR. DOLLAR: And there is this, you know, sense now -- and you've seen some nasty columns -- I won't mention specific economists, but you know, basically saying the bloom is off the rose. It's clear these leaders really don't know what they're doing in terms of economic management.

And then just one more sentence is, I agree with Eswar that there are all kinds of reforms that are needed for the real economy. You know? They are still very closed in a lot of sectors. They need to open up. There are a lot of things that are more important than the issues we've discussed so far. But lacking confidence in the ability of the technocrats and the leadership to deliver reform, that spills over into all of these areas, and I think that there's a sense that they're not moving with reform. Very large capital outflow is coming out of China now. So, I think it's a risky situation where they really need to stabilize expectations.

MS. SOLÍS: Ken, and then Kawai-san.

MR. LIEBERTHAL: I would agree with this. I think we should really be watching to see what they've learned from these two episodes.

MS. SOLÍS: Yeah.

MR. LIEBERTHAL: There clearly are very smart economic decision makers at and near the top in China. They clearly were not the ones that pushed for these particular interventions. And so, we'll have to see whether the shortcomings of these interventions and the unanticipated ripple effects strengthen the hands of advisors who have a -- who would have argued against the interventions, if they had more access at the time.

And I've heard, for example, that there are economists who really felt very strongly that the party should have pulled back from pumping up expectations about the stock market before the -- you know, before this market began to burst -- before this bubble began to burst.

They were afraid to voice their views for fear that they would be punished later for having caused the bubble to burst. When you have that kind of situation, then you run into these kinds of problems. The question is whether the leadership will learn from this and make this a little bit more open and demonstrate a little bit more finesse going forward. I think it's an open question.

MS. SOLÍS: Mm-hmm. Thank you, Ken.
MR. KAWAI: Yeah. On the stock market issue and the exchange rate issue, there are two mistakes. Well, more than two, but at least two (Laughter). One, on the stock market -- the stock bubble really took place. The interest rate reductions started in November of last year and continued several times, up until the bubble you know, peaked in June of this year.

So, somehow, the authorities allowed this huge bubble to continue. And of course, after the bursting of the bubble, the interest rate was further reduced. And then, there are some other non-market reactions. But this bubble -- allowing the bubble to take place was a very, very important mistake.

On the exchange rate issue, the divergence between the reference exchange rate and the market exchange rate, this divergence had been there for -- you know, from the beginning of this year or late last year. So, if the Chinese authorities have wanted to make a convergence between the reference rate and the market rate, they could have done so much earlier. Why would they do so in the middle of the stock market collapse?

And by doing so, they sent the wrong message to the international market that the Chinese economy was so bad that they had to devalue their currency. So, that was not quite China's intention. China's intention to was to close a gap between the reference rate and market rate, but that could have been done much earlier and in a much more gradual fashion without surprising the market.

So, clearly, the communication was not correct, and the timing was not correct.

MS. SOLÍS: Thank you, Zama. That's really interesting. I want to go back to the reform program and you know, go back to the point thought Eswar made that you know, the Chinese government is trying to let the market play a larger role. At the same time, they care deeply about the stability, and there's inherent tension there.

So, I was wondering, David, if you could share with us your views as to whether the reform program in China is on track. Can China -- as Professor Kawai also mentioned, is trying to move to a different economic model, one less driven by investment -- one more driven by consumer demand. Perhaps services will play a larger role.

Is China trying to do that, or do you think there will be a lot of bumps ahead, a lot of stepping back?
MR. DOLLAR: Okay, great question. And let me start by saying the discussion so far, has been pretty negative (Laughter). So, let me switch gears --

MS. SOLÍS: All right.

MR. DOLLAR: -- and be a little bit more positive.

MS. SOLÍS: Very good. Very good.

MR. DOLLAR: So, just a sentence or two before I answer your question.

MS. SOLÍS: Mm-hmm.

MR. DOLLAR: You know, there is real progress with this rebalancing. And you know, Hiro I've talked about the service sectors are growing much faster. You quoted the real GDP data, which is important. But it's interesting. In the nominal GDP data, industry is growing at 2 and services are growing at something like 11 or 12. You know? So, there is a bright spot.

Service sectors are growing. Consumption is mostly services. Household income is going up. I think a lot of that is being driven by demographics, to be perfectly frank. You know? So, there's some good things happening. And then, on the reform, they've laid out an ambitious agenda in their third planning resolution.

To be fair, there's some areas where they're moving ahead. They're doing quite a bit on financial reform. But also, they've made it much easier to register enterprises, for example, so there's been a big surge in private enterprise registration. You know, you can point to some specific things.

That said, you're going to find economists like me who are frustrated, that having laid out a very nice plan two years ago, there's a lot of it that they're not moving on. And one of my favorite issues is, you know, these service sectors that are growing, they're still largely closed to foreign investment and foreign trade.

They could get a lot of dynamism by opening up financial services, telecom healthcare logistics, and they're moving very slowly. You know? So, I think it's a mixed picture, but let's not be too negative. There definitely is some parts of the reform that are moving, and there is some real evidence of rebalancing. I think the world has gotten a little too negative about China this year. They will get close to their 7 percent growth target this year.

MS. SOLÍS: Would it be fair to say, Eswar and David, that they were perhaps, a little bit
negative because you know, as China’s economic footprint grows, many countries have become
dependent on how the Chinese economy is doing. That can be an opportunity, but it can also be a risk.
And we know that the commodity market, for example, has taken a hit.

So, I wonder, how much have other countries been affected by what goes on in China.
And is that affecting our view on how deep or not so deep are the problems in China?

MR. PRASAD: well, given how much China is contributing to global GDP growth and given
how important it's become in specific markets, especially commodity markets, anything that happens in
China does have ripples worldwide, especially to the smaller commodity exporting economies.

And there is also this irony here that if, in fact, this rebalancing program that David talks
about does get a lot of traction, then there has been progress in relation to the indicators he has talked
about; that's services, sector -- now it calls for a slightly larger share of the economy than the
manufacturing sector. The share of consumption, that is total consumption, private plus public as a share
of GDP is now a little over 50 percent. The household saving rate is no longer rising.

So, all of this suggests an economy going in the right direction, but very slowly. But if
China does shift very substantially, then it's going to mean much less investment driven growth, which is
going to mean much less demand for commodities. But of course, the good thing for the rest of the world
is if China starts generating domestic demand through consumption rather than through investment, there
is going to be less excess capacity that will need to be exported to the rest of the world.

So, things are moving in the right direction, but very slowly. But the issue about the
reforms, I think David has correctly pointed out that the notion that reforms have completely stalled is not
quite right. But my concern, which picks up from where he left off, is that we are getting a slightly
unbalanced approach to the funds, with financial market reforms moving forward, perhaps slowly and in a
very erratic way, but the intentions do seem to be good. And they are making progress in some issues.

One of the issues was liberalizing interest rates, so they both deposit, and lending rates
could be determined by the market. They are almost all the way there. There are freeing up the currency
in their old way. There is a formal explicit deposit insurance system in place. So, things are happening
slowly.

But on the real side of the economy, the progress has been much more limited. And I
think this unbalanced approach, where you have more financial market liberalization, perhaps more
capital accounts opening without the real side of the economy being fixed. That poses some risks in
itself, and I think this is what makes it a particularly fraught time for China; not that there is no reform, but
that the reform is taking on a slightly unbalanced aspect.

MS. SOLÍS: Kawai-san and then Ken.

MR. KAWAI: Yeah. This shift from investment led to consumption led economy, and
also, from manufacturing dominant to services driven economy -- these two are taking place, but very,
very gradually. Now, Eswar mentioned the number -- the consumption to GDP ratio being 50 percent.
But household consumption to GDP is just above 35 percent, which is extremely low. And investment to
GDP ratio is more than 45 percent, maybe 47 percent or so.

So, investment has to come down and consumption has to go up. Now, the sort of
average world household consumption to GDP ratio would be something like 55, 60 percent. So, China
has to move a long way -- this 20 percent change. And that cannot take place within a very short period
of time. It's another 10 year program, maybe even 20 years or so.

But this transformation is something that is going to go on. But during this process,
China is going to be less dependent on import. Commodity import will be less, and also, China's
domestic ability to produce value added would become higher. So, during this economic transformation
of China, the impact on global trade is going to be gradually negative, although services sector
development may have some potential to generate the services trade. But the point is that the impact on
those economies that are heavily dependent on export to China would continue to be affected.

MS. SOLÍS: Okay. So, Ken, I'm sorry, I think you had a couple of points, and then, I'll
move on to talk about the leadership initiatives, because we need to talk about what China is putting on
the table. But Ken, I think you had a point on this.

MR. LIEBERTHAL: Well, we have to keep in mind in China that this is a huge political
system that is in reality, very decentralized --

MS. SOLÍS: Yes.

MR. LIEBERTHAL: -- in terms of operational policies. So, what we've seen, we see Xi
Jinping as a man who is personally dynamic, almost charismatic. He has really dominated the kind of set
him abroad goals -- the directions in which to move and the vocabulary that we talk about with that. And it's not surprising to me that it's in the financial side that we've seen the most reform initiatives, because those are the things that a relatively small group at the top can decide on, and everyone has to react to -- reserve ratios for banks, interest rates, et cetera, et cetera. All right?

But most of the economy has depended on the initiative of leaders at provincial level and municipal level and county level and township level. At each level, there's a huge amount of flexibility. And I think the reality is that the way the current leadership has been promoting its efforts has actually made it more difficult for local level leaders to get on board and to take the initiative.

I could explain it in a more detailed way, but we're out of time. But let me just say that for a lot of this, you have to keep in mind that there's a huge political reform that's a necessary component of this.

MS. SOLÍS: Mm-hmm.

MR. LIEBERTHAL: I'm not talking about democratization. I'm talking about differently incentivizing local level leaders. And they haven't figured out how to do that effectively at this point.

MS. SOLÍS: Very interesting. Saori?

MS. KATADA: Well, I have more questions than answers, given the kind of expertise we have at the table. But you know, one thing that the Chinese leadership has to manage is not the external expectations, but internal, and when this shift is taking place. And now, Xi Jinping has announced this our new normal; and you know, how that would affect the political stability, and obviously, the provincial, so on, is important.

But the general public has been feeling that change, too, so I wonder how that would affect the Chinese political system. Also, the other element that I would like to know more about is the surplus capacity that China has. I mean, Kawai-san has mentioned that there is a shift change taking place.

But China has this massive machine of production and construction and so on and so forth. How would that -- you know, could that be dealt with in terms of employment, investment and so on? I think that might kind of lead into that international dimension.

MS. SOLÍS: Yes.
MS. KATADA: But I would like to kind of ask the experts on this panel.

MS. SOLÍS: Well, if you don't mind, let us jump into the discussion about the new initiatives and international economic diplomacy, and how they may be tied in to the domestic economic needs of China, the political constraints or opportunities and so forth.

So, maybe David or Eswar or anybody else could start telling us what is new in Chinese international economic diplomacy? You know, I went in the introductions to several of the initiatives. How far do they go? Why have they generated so much attention? Is there something really new here in what China is putting on the table?

MR. DOLLAR: Well, I think what's new is, you know, the Chinese -- capital has been leaving China for a while now.

MS. SOLÍS: Mm-hmm.

MR. DOLLAR: I mean, you know, China has become a major creditor around the world. There's a lot of Chinese investment in different parts of the world, Chinese financing and infrastructure. So, some of these initiatives like Asia Infrastructure Investment Bank, it's hard to say that the whole impetus is new, because China has been doing things like that.

So, what's new is doing it in a multilateral framework. And then, with the "One Belt, One Road," I think you also have to say the scale is definitely rising. And I think that you then bring in the fact that the leadership of China feels that China has reached a point where it should play a more assertive role in the world. And so, doing visible things like AIIB makes sense.

So, I think you have the confluence of politics and economics encouraging these initiatives. And then, the -- you know, my own view is that we should be happy that China is pursuing some of this through multilateral channels, and China is actually a big financer and supporter of the World Bank and the IMF and the existing institutions. So, China is you know, making a lot of money available for the existing institutions, plus its new efforts. And I think we should largely have a positive attitude about that, though there are some concerns that are raised.

MS. SOLÍS: Great. Ken?

MR. LIEBERTHAL: President Xi Jinping convened a conference almost a year ago now - - a somehow unusual conference in the Chinese context, that was a broad review of foreign affairs and
China's role in the world. And one of the major themes of that conference was that China, although it remained a developing country by many measures, is successful enough that it should become much more active and assume much more responsibility and provision of public goods, and participation in multilateral organizations, as well as its own individual diplomacy.

And I think we’ve seen that contribute to this sense of willingness to take more initiative -- not just to react and to plead, but to take initiative, and in some cases, try to lead. And I think they are seeking to learn how to, say, through the AIIB -- how do you actually run a multilateral organization? What is involved in that? How do you make that successful and not make it appear to be just an extension of China foreign policy, but rather be China as a real contributor to Asian development?

So, it's a change of mindset. And I think that really informs part of the difference in initiatives that we've seen, as versus you know, under the previous administration in China.

MS. SOLÍS: Saori and then Kawai-san. Saori?

MS. KATADA: Yeah. So, in some ways, is China doing what the U.S. did in the 1940s through the Bretton Woods institution system? Is it the kind of starting point of much more -- kind of a larger challenge, or would this be more of the way for Chinese leadership at this point to demonstrate that it has not -- kind of create more legitimacy in kind of creating, you know, these institutions you know, that kind of domestic audience.

SPEAKER: I think China has been told for some time now that as China's capabilities increase, and its willingness to contribute increases, the Bretton Woods Institutions will adjust to give them a larger role. I think they're trying to play a larger role. They've been frustrated in some parts of that. IMF reform is the prime example.

And so, they're also increasingly taking initiative in -- you know, to create new institutions and contribute to them. My guess is, the Chinese don't where this will come out, and part of it will be a reflection of the capacity of the Bretton Woods Institutions to be responsive and vibrant, with a greater role not only for China, but for other relatively successful developing countries.

MS. SOLÍS: Mm-hmm.

SPEAKER: So, we'll have to see how that plays out. But I don't think they start off with a totally revisionist mindset. And at the same time, I think they're demonstrating that they aren't willing to sit
there and just be frustrated, either.

MS. SOLÍS: Kawai-san.

MR. KAWAI: Yeah. Well, China became the world's number two economy in 2010 --

MS. SOLÍS: Mm-hmm.

MR. KAWAI: -- measured by the market exchange rate. Today, at TPP, China is number
one, exceeding the U.S. So, China, having become the one with the largest economies -- you know,
wanting to play a much bigger role internationally and multilaterally, but that's not quite a natural
evolution. Now, Japan in the 1960s, established the Asian Development Bank, together with the U.S. and
other countries. That was in 1967. And Japan became the world's number two economy in 1968.

So, for China, it's very natural. So, what we want to see on the part of China is to play
really a constructive role providing international public goods that the rest of the world need. So, there is
a potentially aspect, although we don't know the political intentions behind this move. So, I'm sure we
continue to discuss today --

MS. SOLÍS: Yes.

MR. KAWAI: -- on these political contention issues, also.

MS. SOLÍS: Yes, yes, we will. Thank you so much. Eswar, you also wanted to join this.

MR. PRASAD: So, China is a large and economically powerful country, and this is a role
that it has ascended to recently, and like -- and as it was growing into adulthood, I think it was very
awkward in terms of its international engagement, somehow using rather brazenly its economic power to
put forward not only its' economic, but also its geopolitical and strategic interests.

What I've seen in the last couple of years is a much more savvy and disciplined way of
engaging with the world. I'm saying let's not just do it on our terms, but let's do it through a broader,
multilateral engagement process. And this, I think, is a much better approach.

Now, one interesting question in terms of international governance, to build on the points
that have been made here, is whether China is actually trying to rewrite the rules of the game of
international governance, and I sense that there is some of this.

But I think the Chinese policymakers have become savvy enough to recognize that trying to
impose their own set of rules on the game is not going to work very effectively. But setting up the
institutions like the AIIB, where they aspire to not only follow the rules of international governance, but do better than the existing institutions serves a very useful purpose.

Number one, it gives China a lot more influence in designing the rules of the game in the future. And second, it serves as a catalytic role, or to put it less technically, gives a kick in the backside to the existing institutions to get their acts together in terms of improving their own governance.

So, I think to borrow a phrase from Kawai-san, this more constructive approach to international engagement by China is certainly a positive move, in the sense that I think it is going to contribute eventually to better global governance.

But then, the question becomes, at what point does China start trying to write the rules of the game in its own fashion. We are not there yet, but I think we will get there, and it’s going to get more interesting.

MS. SOLÍS: Yes, indeed. So, let me ask a question about the timing. Because I think that when people talk about China's international diplomacy, they always make reference to the fact that China, for a long time, decided to keep a low profile, and that seems to have gone out the window. And they are clearly out there with a number of you know, attractive, compelling, to some, controversial initiatives that we're discussing today.

So, why now? I mean, we can think about, perhaps, the fact that it's a capabilities issue -- the fact that China now, since 2010, is the second largest economy. But it seems to me that there's something about the current administration of Xi Jinping that seems particularly proactive, because those capabilities were already present in many ways in Hu Jintao’s era. Right?

So, we are going to try to decide what changed the mindset of the Chinese. Why are they willing to now go out on a limb more and have their own ideas; the AIIB, the "One Road, One Belt," all of this. What explains the timing? Is it capabilities? Is it that we are living in an international system in transition, a plastic moment, if you will, where the Chinese feel that they can have an imprint, because we are seeing the Bretton Woods Institution under stress?

What is your sense as to why we are witnessing these new initiatives today? So, I'm sorry, you want to jump into that?

MS. KATADA: Yes. I think I can see two kind of basic forces behind this.
MS. SOLÍS: Mm-hmm.

MS. KATADA: One is what I mentioned, the domestic. So, new normal with the excessive capacities, so on and so forth. It has to have some way to get this out of the system, which would allow China to have, you know, more investment abroad. Obviously, through a bilateral channel, too, but again, with various reasons to the governance and the challenge to the existing system are all reform -- kind of an incentive to reform the existing system. That will be one basis. So, timing is the slowing down of the Chinese economy that kind of triggered more incentive for it to go outside. And obviously, that's been happening.

I think the other one that I would like to put on the table as a political scientist is the geopolitics. I think there is this kind of impetus for China to go west instead of looking at the Pacific, you know, solely. Obviously, U.S. is on this side and Japan, and so on and so forth.

And in order to kind of -- you know, China would like to avoid a major confrontation or clash with the kind of Pacific side, and there are a lot of benefits to be gained on going west. First, China is on very good terms these days with Russia. China needs a lot of investment in these kind of silk road going to the east -- sorry, going to the west.

And also, China's relationship with Europe is getting increasingly important, as well as the access to resources and market and so on in the Middle East and Africa. So, I think that impetus has emerged quite clearly. You know, BRICs is surviving, despite many of the challenges. I think all of these have triggered China to be very interested in this type of initiative.

MS. SOLÍS: Would you say that China's aspirations are regional or global?

SPEAKER: I would say global. So, picking up on the last comment -- so you know, I understand China's interest in you know, going west, having different supply lines, natural resources. But Central Asia is essentially a set of small economies. So there will be opportunities for some very specific resource related investment.

I'm very skeptical that anything like high speed rail all the way to Europe -- I just think this is not going to be economic (Laughter). Sea travel is much, much more efficient than land travel.

So you know, I'm really skeptical that there's that much opportunity for China to go west. There's definitely some, and I'll exploit it. I think it's interesting -- President C (sic) started talking about a
new Silk Road initiative, which would have largely been to the west. And very quickly, as I understand it, coastal provinces in China and other interest groups said, wait a minute. Wait a minute. We can waste a lot of money investing in Central Asia.

So, the whole notion of "One Belt, One Road," all right, is to say well, strengthening the maritime route is as important. And I suspect that over time, there will actually be more investment opportunities. As you think about the maritime route, you go south from China to coastal China, Southeast Asia, you know, India on to Africa.

When I talked to Chinese officials about you know, what does "One Belt, One Road" encompass, the answer is the whole world. You know? Africa is part of "One Belt, One Road." Latin America is part of "One Belt, One Road." And investing in the United States -- this is the biggest destination of their investment. You know?

So, I can see it as a much more general, big global push for Chinese companies which have capability now to go out, and China has resources. And so, yes, investing in Central Asia will be one component, but there will be very significant investments and activities elsewhere.

MS. KATADA: Other parts are already going on now, I guess, maybe (Inaudible).

SPEAKER: I'm interested in the political scientist's views about something that (Inaudible) -- which is how does this interaction with the rest of the world feed into domestic politics? Or, how does domestic politics feed into this?

So, for instance, if you think about the setting up of the AIIB, it gives China a leadership role. Does that create more space for the leaders who want to follow to sort of say that we need to make changes in our economy, so that we can lead more effectively? Do you think there is any major feedback effect?

SPEAKER: Do you want to take that? I'll take it later, too.

SPEAKER: Insofar as we can judge popular opinion in China, I think that there has been a lot of evidence that there is strong support for China to play a larger role, and more of a leadership role in global institutions and regional institutions.

This previous notion of let's, you know, kind of be modest about our capabilities and be patient is one that increasingly was out of step, with the sense of what China has accomplished, and what
its role in the world ought to be. So I think, yes, it does create some more space for leaders domestically.

There is another dimension with this, with TPP negotiation, as you mentioned earlier, Mireya, is hopefully reaching --

MS. SOLÍS: We'll see (Laughter)?

SPEAKER: -- a conclusion today or tomorrow or something like that.

(Simultaneous discussion)

MS. SOLÍS: We'll see this week (Laughter).

SPEAKER: We've seen in the past, China has taken international obligations as a vehicle for promoting domestic reform.

MS. SOLÍS: Mm-hmm.

SPEAKER: And I know that a considerable amount of discussion in China has been if TPP does get established, should China seek to join in part, to use the obligations of joining, and obligations imposed on China, to promote some of the more difficult domestic reforms and to show that you know, China can meet its international obligations and be a major player.

And so, there's an interesting feedback mechanism in kind of both directions. There's popular support for a larger international role, accomplishing developing leadership positions internationally, improve the increases of space for leaders domestically. But at the same time, taking on more international obligations gives the more leverage to push through reforms at home, lest they see -- lest they be seen as failures in their international efforts. So, it's a dynamic that I think is generally likely to be more beneficent than destructive.

MS. KATADA: I think in some ways, it strengthened the hands of those who are trying to reform the country. So once, like we were just discussing the SDR issue -- the fact that SDR is going to be -- you know, is planning to be in -- I'm sorry, (Inaudible) is going to part of the SDR -- would strengthen the hands of those who are promoting you know, the industrial role and you know, the reform change in the domestic side. I think that legitimizes what they're doing through the international channel, and I think it does it -- I totally agree with Ken -- with what Ken was saying, and that's --

(Simultaneous discussion)

MS. SOLÍS: Kawai-san. Thank you, sir.
MR. KAWAI: Just going back to China's intentions and you know, objectives behind all of these international and multilateral objectives.

I think you know, as long as the "One Belt, One Road" initiative and projects financed by AIIB would benefit, would provide a large economic benefit to other countries, I think that itself would be a good thing. On the other hand, the other countries which consider China's intentions to be largely jail political rather than jail economic -- one big example is India, I think, they do not seem to have endorsed the "One Belt, One Road" initiative.

MS. SOLÍS: Mm-hmm.

MR. KAWAI: -- as a good initiative, because that involves highly geopolitical elements. So, I think one of the challenges for China -- you're never going to convince Eswar or me about the resident board, okay. The resident board is a nightmare basically (laughter). You've got non experts and it just creates a lot of confusion among the staff about who is actually making decisions. You don't have any major corporation that has a resident board of directors basically and I know it's a different business but, you know. I agree with Mireya that there is going to be enormous scrutiny. There are going to be projects in India and Indonesia, Philippines, Vietnam, these countries all have very active civil societies. To me that's the best protection on the environmental issues, is that civil society scrutiny.

MR. PRASAD: Let me flip around the question to you, should Japan and will it get involved in the AIIB?

MS. SOLÍS: We're going to get into that in a few minutes, so let me hold off on that one and I promise I'll come in when we get to that. I do want to ask a very big question in the sense that we talked about whether China is a revisionist power or not. Some people feel, have criticized the United States because they argue that the United States is playing on exclusion strategy. And they point to the following things in making that case. One is the fact that China is not in the TPP, the containment argument, if you will. The fact that the United States has not delivered on the reform on the IMF or other Bretton Woods institutions. The fact that the United States has not joined, perhaps cannot join AIIB, and therefore that they should be separate institutions and that they're trying to play a defensive tactic vis a vis China.
And others would completely disagree with this characterization of U.S. policy and they would argue that this is not what’s driving the United States, that the United States actually wants to work with China, welcome China into the WTO, and we are just finding our way with the new institutions. And that would be more towards an inclusion strategy.

I wonder if Americans and Japanese alike, if you can share your views as to what kind of grant strategy might be too ambitious perhaps we don’t have that — but what kind of approach do you think is more consistent with the facts. Is the United States playing an inclusion approach or an exclusion approach?

DR. DOLLAR: I would say definitely inclusive, you know. I think you mentioned a few specific issues but if we stand back and look at the bigger picture the United States has been remarkably friendly to China in the economic realm. China export $400 plus billion of goods to the United States, this has been an enormous advantage for the Chinese economy. They’ve bought treasury bonds in order to manage their exchange rate. People sometimes talk about the U.S. being in debt to China, I see it as we have open capital markets and we’ve graciously allowed the Chinese to participate very substantially now that we’re the biggest destination of their direct foreign investments. So I think objectively the United States has been extremely engaging with China and I’m a little disappointed that the Chinese have been slow to reciprocate. They still have a much more closed economy, a lot of restrictions on foreign investment. I think they are missing an opportunity.

But your question is really about the U.S. attitude. I think on the economic side it’s really very positive. And then you can add in little annoyances which matter a lot to the Chinese; the fact that the U.S. won’t ratify this IMF agreement. It’s hugely important to the Chinese. So it undermines everything I said, which I think is big picture, is undermined by a few relatively small things but those are real for the Chinese.

MS. SOLÍS: And do you think — exactly. Do you think the Chinese understand that in terms of overall approach the United States wants to work with China but then there are the messy unwieldly domestic politics, the congress not moving on the IMF reform, do you think that they see that and make that distinction?
DR. DOLLAR: So I’ve been in plenty of meetings with senior Chinese leaders, I think they get what I said and they often start the meeting by some short version of what I just said. But frankly in the Chinese media, the Chinese internet, there’s a lot of focus on these negative things, the U.S. opposing AIB, the U.S. not supporting China’s growing weight in the IMF. So you definitely have a very dynamic narrative in social media in China that the U.S. is trying to keep China down economically, which I find a little bit ironic and frustrating because I think the United States has been really quite engaging.

MS. SOLÍS: Saori?

MS. KATADA: I think there is this institutional competition going on. I think the strategy could be either inclusionary, ie: expand the members as much as possible, or exclusionary and make the kind of externality so costly of being excluded from that institution that they are incentivized to join. So obviously TPP even though originally, and you write about this a lot, China is not a member but it’s considered a shadow negotiator as everybody kind of has China in mind as they negotiate. And in the long run if TPP is very successful China inevitably has to join once it’s ready or once it becomes ready to join the TPP. So in some ways I think this competition drives but the nature of maybe issue areas or the way they merged makes it either inclusionist strategy or exclusionary strategy to prevail over this. So again, whether you call it the revisionist or reformist that is up to the kind of view of the beholder I guess, but still I think that competition has different strategies depending on the situation.

MS. SOLÍS: Yes, thank you. Ken, I think you had a --

MR. LIEBERTHAL: I very much associate myself with both sets of comments here. I think we clearly have not sought to pursue unexclusionary strategy. Some of the specifics seem to bely that. I think often those specifics have turned on domestic U.S. politics rather than on a grand strategy for how we’re dealing with China as a larger role in the world. And the Chinese, not surprisingly, have focused on some of those specifics and made more of them than reality should warrant in my mind. In the future it’s obviously not going to be totally inclusive or totally exclusionary; it’s going to depend on a wide mix of factors domestically and internationally in the U.S. and China and the global economy. But I think the fundamental effort on the U.S. side will be to have an evolution in the multilateral institutions that does take account of a larger role for China and for other relatively successful developing countries. But really work to not have that lead to changes and standards that roll back what those institutions have
become in terms of our mental standard, corruption, you name it, over a period of years. Now whether we can manage that effectively is a question but I think that will be the approach.

MS. SOLÍS: Thank you. Kawai-son?

MASAHIRO KAWAI: Given the extremely large size of the Chinese economy and the existing economic linkage between China and other developed countries it’s not productive or possible to exclude China from the international economic architecture. I think that that’s clear. So we need to encourage China to play a productive role in the international economic system, and particularly in the area of rules based arrangements. It’s extremely important to pull China into a rules based economic system and encourage China to abide by them. And of course if China is unhappy about the existing rule then China can make a point within that system. So this sort of exercise is increasingly important. So in that sense AIIB is posing a big challenge for everybody even if the U.S. and Japan may not become members of AIIB, the two countries can encourage China and AIIB members to play a constructive role from an international economic perspective.

MS. SOLÍS: So let’s bring in Japan to this discussion as we were asking for. Japan and the United States, obviously everybody has noted they are not in the list of founding members. Would you say that there is full convergence in the views of the United States and Japan regarding AIIB, regarding what this institution stands for, regarding the strategy of involvement with that institution or do you think that there are gaps in the ways in which these two countries think about AIIB?

MASAHIRO KAWAI: Well, at this point I think the two countries are relatively in full agreement and full convergence. I think the two countries take the view of wait and see. Ken, you said it would be better for the U.S. to see for a few years what sort of organization AIIB is going to be, what sort of projects are going to be run, and whether the projects would be environmentally sound, would projects pay a lot of attention to people affected by the project. So, this wait and see approach is the approach that Japan also takes.

Also, the two countries encourage the exiting MDBs, the World Bank and ADB to work with AIIB which is the way to go. But having said that, Japan being in Asia and Japan being a big supporter of infrastructure investment in Asia, perhaps Japan has more at stake, a bigger stake, in Asia in terms of infrastructure development than the United States. So if certain conditions are met, at least from
the point of view of Japan, perhaps Japan may be more eager to join AIIB. In the case of the United States this is something that is mentioned, bringing up this AIIB issue to the U.S. congress, could encounter a great deal of difficulty given that the IMF reform has not gone through.

So this political constraint may be less in Japan if conditions and other situations improve. The two top leaders in China and Japan have not been meeting frequently, they have met only in the corridors last year once and this year once. They have not sat down just like President Obama and President Xi Jinping, they have not spent hours together. So this sort of political situation has to improve between the two countries for Japan to join AIIB and other conditions have to be met.

MS. SOLÍS: And, sorry, I'm going to go to you in a second but I also want to introduce another set of issues as we continue with the discussion about Japan's response to the AIB initiative. I agree that there is convergence in the wait and see approach but it seems to me that perhaps people are not aware that Japan has done quite a bit, perhaps much more than the United States, in fashioning a response to the AIB initiative. Three things come to mind. One is the announcement of $110 billion quality infrastructure fund. The other one is a very quick set of reforms of the ADB increasing the lending capacity, streamlining loan approvals. And third forthcoming is a change to the law that governs the Japan bank for international cooperation and the way people have explained it to me is that the bank is now going to display a greater acceptance of risk, meaning that they can now participate in a set of projects in infrastructure which we all know tends to be in the high risk territory sometimes that perhaps were off limits but now they bank can participate.

So why don't we know more about this? Maybe Washington is too focused on what the U.S. does, but I think that Japan has perhaps shown a way in which you can actually meet in a constructive way if you're not yet going all the way into membership in the AIB, but you can be very proactive in how you react to it.

MS. KATADA: I would like to follow up on what Kawai-son said and maybe address your question too. So, for Japan the stake is really high. Japan is after all an Asian country. Japan has been the leader in providing public goods to Southeast Asia and various other places nearby and ADP in Japan is kind of an important project. So in addition to that for the Abe cabinet or Abe prime ministership he has been courting Southeast Asia very actively. He has visited all these places and he has been kind of
revamping Japan’s leadership, Japan is back kind of notion. So to not do anything about this is not an option for Japan. That comes all these very active initiatives because Japan was not able to join, it kind of miss-stepped and had to go with the American kind of position I think with it.

I think Japan has done quite a bit and I don’t know why Americans have not picked it up, you know, maybe it’s like rubbing the salt on the wound that is still kind of hurting because Japan is doing this, why can’t congress do that, so that might be the case. One thing I would like to note is, no, this $110 billion is a little bit of a misrepresentation because (inaudible)’s fund if I remember correctly only went up 30 percent. So yes, it’s a commitment but not in the kind of same promotional way that you hear from the Japanese government, so that’s one. But I think what’s crucial – two things that you mentioned of the three, one, is changes in (inaudible)’s kind of legal structure so that it can take more risk and risk will be backed up by the government budget, and they’re going to discuss it at the lower house in the spring. So that would really mean that Japan would be taking on quite a bit more risk. I think that’s the same kind of way that World Bank is, I think that it has Japanese foreign aid and investment guarantee and so on has gotten even quite a bit bureaucratic and risk averse so this would help Japan take on some of the infrastructure needs which Japan has not been able to address. The other thing is obviously the changes in ADB, an approach that the head of ADB has towards the AIIB. I think they have quite a few discussions starting in May and again just recently Nakao met with president designate, Dr. Jin to discuss the collaboration and co-financing.

So these are very important steps that Japan has taken. They have to really do this in order to make sure that Japan shows this kind of leadership and maintain the reputation of the public good provider in the region.

Just want to mention one thing about the politics and whether Japan can join or not. It’s not only the leadership I worry about, it’s the anti-China sentiment in the LDP party. I did some hearing of the people who are involved in the AIIB issue back in Tokyo a few weeks ago and a couple of them who are called into testify about this AIIB in front of the LDP members said that whenever people – experts – who have some positive thing to say about AIIB, the LDP members said no. And the other one who said, well, no this is not going to work, it’s going to be suspicious and so on, then LDP member kind of perks up. So that type of LDP members would be voting on the Fund and so on would be kind of on a similar
note of the U.S. congress, have these remnants of this kind of resistance to join in the AIIB. Obviously wait and see approach is what Japan is taking, I agree, but there might be some political undercurrent that makes it much harder than one would expect for Japan to join.

MS. SOLÍS: I have a question for you Kawai-son. This goes back to a conversation you already were having. I hear a lot of people say they are not still quite certain whether the transparency will be there, and they always go back to these board of directors issue that we’ve already discussed where there is a difference of onion, I think, in the panel. Do you think if China was prepared to – and I don’t know if it’s even in the cards, maybe you can also comment on that – but would these be something that could be make or break issue for Japan if China were to put that on the table would that sort of help alleviate concerns about the lack of transparency in the bank? What do you think it would take? There are the political issues, the geopolitical issues, but what do you think it would take for Japan to decide to join AIIB?

MASAHIRO KAWAI: Well, if according to my calculation, if Japan joins AIIB Japan would get a number two voting share provided that the U.S. doesn’t join. So that’s in theory. Whether that would be the arrangement that China would give to Japan remains an issue because as a new member when you join the existing MDB sometimes capital increase is not made so your capital contribution could be very small, whether that’s an issue that’s related to governance in Japan’s voice at the AIIB.

Now, on the issue of transparency I am increasingly worried because of the possibility of the diminished role of directors. Directors are not going to be resident in Beijing, directors are located in different capital cities. Board of directors meetings would be held infrequently and also the power of the board members could be limited. I think one of the important considerations would be how much power would be given to the board members. In my view a maximum power should be given to the board members, but at the same time of course bureaucratic procedures need to be streamlined. I full agree on that point. But basically with governance by shareholders could be exercised or not, that’s a very, very important consideration.

So during the wait and see period no matter what sort of governance arrangement is made, I think it will be important for Japan and the United States and outsiders like Canada also to see what sort of projects are being implemented and how they are implemented, and who are the main
beneficiaries. I think that’s the kind of thing that Japan would need to take a look at. And how many public goods are really being provided as a result of actual projects. Rather than benefiting China, largely China, and rather than serving China’s narrow economic, political, and geopolitical interests. That’s the kind of thing that Japan needs to take a look at.

And also more important is something that Saori said, the political relationship between Japan and China, that has to improve. There is lack of trust between the two countries and Japan cannot join in the absence of mutual trust. So this bilateral relationship has to improve substantially. That would mean a lesser conflict on the (inaudible) issue and China’s behavior in the South China Sea, you know, islands or reefs. So I think these two are still going to be major issues. So we need to see significant improvement over the next several years.

MS. SOLÍS: Very interesting. So, I realized that the audience has been very patient and I have to turn soon to ask them to share with us the question they may have. I just want to also talk a little bit about future scenarios and where we’re going. What’s the road ahead? We talked about earlier that we don’t know yet exactly how far will China’s growing penchant for new institutions and so forth, where will these take us? We know that, for example, in the past Japan proposed an Asian monetary fund and that initiative went nowhere. Do you think that China could make proposals in these new areas, new types of Asian IMF? Where do you see China putting forward new initiatives in terms of international economic governance?

MASAHIRO KAWAI: Certainly China could make a proposal of a new Asian International Monetary Fund, AMF. This idea was proposed during the Asian financial crisis by Japan supported by ASEAN countries and Korea. And of course at that time the IMF said no, the United States said no, and because of the lack of support, clear support from China – China did not oppose then but Japan had to withdraw the idea. Now China could come and say that we are going to propose an AMF and if Japan is interested Japan could join, if the U.S. is interested the U.S. could join. China could make that sort of proposal.

But on the other hand there is growing project going on the Chennai Initiative and also the ASEAN Plus 3 Macroeconomic Research Office being established and serving as a secretariat for the Chennai Initiative. And China is playing a very important role as well as Japan, Korea, and ASEAN
countries. So I think if China makes that proposal China should also consult with other ASEAN 3 members because the Asian Monetary Fund cannot go independently of the Chennai Initiative and AMRO, the ASEAN Plus 3 Macroeconomic Research Office.

So China could make a proposal but my expectation is that other ASEAN Plus 3 members would say, well, the proposal should be made by all these countries, not China alone. So certainly I think that’s possible.

MS. KATADA: Just quickly, I think the AMF proposal and the AIIB has kind of a similarity but the context — similarity is that the U.S. had this very kind of negative reaction right away saying, no, no, no don’t challenge our established framework. But I think the difference is that at the time of AMF it was a zero sum game where if AMF is introduced there will be a moral hazard, you know, IMF’s authority will be challenged and so on, so they couldn’t kind of make sure that debtors will pay, not care what they owe. While AIIB and World Bank I think is a positive sum. They need infrastructure, you know $8 trillion infrastructure is needed in Asia, so yes, obviously governance is important but also the Fund itself would be added and that would be a good thing.

So in some ways this time I think China has an easier sell not only because China is a rising power, well, risen power, and also has a major economy, but because of the nature of the issue that they are tackling.

MR. PRASAD: As I think about China, Japan, and the U.S. I want to go back to my initial metaphor that China is an awkward adolescent getting used to adulthood. As a parent of a daughter who is attaining teenage years I can tell you that it’s a difficult adjustment for the adults as well in the room (laughter). In particular, Japan and the U.S., I think, are going to have to get used to treating China, and indeed other emerging market economies as adults who are equals at the table. And this is a very difficult challenge for me and for adults in general sensing that authority is not what it used to be, that we need to start treating our partners at least to some level, and that is not an easy adjustment to make and I think some of what we’ve seen in these reactions to the AIB and so forth reflects that.

Now, having said that I think the U.S. and some of its bilateral dialogues with China, with India, has started taking a different approach where it’s not so much lecturing about the U.S. being the epitome to which other countries should aspire but viewing it more as a collaborative relationship where
the U.S. does have some things to share with China and India and this is ultimately going to work well for all three countries.

But the domestic political circumstances do end up constraining both Japan and the U.S. in terms of providing the sort of leadership in a shifting world, and that I think is going to have a detrimental effect both in terms of the role that these two countries can play in the international economic order and frankly for the international economic order itself because it creates a lot of instability whereas these two pillars, I think, were very important.

I think Saori made this important point that as one thinks about the AIIB the TPP and so on the stakes for Japan are significantly higher. Although China owns a lot of U.S. Treasury securities the nature of American dependence on China is very different from the nature of Japanese dependence both political and economical in China. They are neighbors, they do have competing interests in the region both economic and geopolitical, so it’s going to be a relationship that has to be managed I think much more carefully.

But for China I think there are enough initiatives and new institutions on the table. The big issue now is whether they can be implemented well and whether China can in fact meet these standards that it aspires to and that the rest of the world is looking to and I think that is very much where the focus is right now rather than thinking about new proposals to put on the table. So for the short-term at least what I would anticipate seeing is not new big proposals from China but attempts to get these initial initiatives working in the right way and that I think is going to be interesting to watch and very important for the international economic order.

MS. SOLÍS: Frequently people have alluded to the fact that we may be heading towards a world in international economic governance where the emerging economies play a larger role. Just reflecting the realities of where we are at today. But this also brings a question as to whether China is in a league of its own or whether other emerging economies, the BRICS countries, can also become more active, aspire to a higher profile, have their own views of economic governance that may or may not match what China has in mind.

So India, for example, comes to mind. In the world of international trade I have to say India does not appear as (inaudible) ambitious. Frequently when India participates in a trade negotiation
that brings down sometimes the level of aspiration, if I may be as direct as that. But are there other emerging economies that will be stepping up to the plate? Can they provide public goods? Can they come up with new alternatives, or is it a China discussion?

DR. DOLLAR: I think China is in a league of its own and that it would create a certain amount of confusion talking about the BRICS because China is just so much bigger and has such global aspirations. India has to grow really, really well for 20 years to be where China is now. And I wish India well, I hope they do, and so 20 years from now we could certainly be looking at a very different situation. But I think for the next decade it’s really China that’s the emerging power.

And it is useful to put in the larger context because developing countries as a whole are increasing their share and these other countries we’re mentioning, they’re all increasing their shares, but they’re just going to be relatively small shares for the foreseeable future. So I really think it is accommodating China’s position in these institutions that’s really the key issue.

MASAHIRO KAWAI: I agree with David. On the other hand, there are other countries that may play an increasingly important role in their own regions. India’s role South Asia, hopefully Brazil, will be playing a more proactive role in Latin America. On the other hand, compared to AIIB the new development bank of BRICS in my view would be much less effective because it’s equally owned by the BRICS countries rather than predominantly owned by China. So AIIB would play a much more important role that the BRICS. But as I said, other countries would be playing increasingly important roles in their regions.

MS. SOLÍS: So let me ask a very big picture question. We talked about whether China is a revisionist or reformist power; we talked about whether established powers are making sufficient room to accommodate the change in relative capabilities or not in established Bretton Woods institutions but also having an open mind about new institutions. And I think when people discuss this they want to know if ahead of us we have a period of growing a strategic rivalry or whether we think that there could be successful communication, successful engagement, and therefore, that we can find a way to collaborate in the management of the world economy.

So what would be the markers to tell us where are we going? I know this is an extremely challenging question but I think it’s probably in the back of everybody’s minds here. We care about this
because what this may mean for the quality of governance in the future but also for the quality of interaction along the major powers in the world.

So where are we heading?

MR. LIEBERTHAL: I’ll take an initial stab (laughter).

MS. SOLÍS: Wise choice.

MR. LIEBERTHAL: Every time you comment, Mireya, now I have a much bigger question, your questions do indeed keep getting bigger but the first of those I thought was big enough at the start (laughter).

If you look at the U.S. and China we seek now to cooperate as much as we can on major global issues. Those are especially in areas now like climate change, nuclear nonproliferation; we are developing more cooperation in counterterrorism, in military to military relations, we are moving that forward. So when you talk about what the nature of the relationships will be in the future the economic side is a part of that but many of these other issues determine the degree of trust in the long term intentions of another country. My sense is at this point – this doesn’t fully deal with your question obviously, but as a starting point my sense is at this point that the U.S. and China are able to have considerable confidence in the agreements that they reach in a number of different areas. We understand each other pretty well. What we are very unclear about is long term intentions of the other country and so how much you can trust them strategically down the road.

And I think that’s a work in progress. There is no single item that is going to flip a switch on that shy of some huge escalatory event. Very likely this is going to be a matter of, as this whole conversation has suggested, we focused primarily on the central issues of this panel, is how do these institutions develop? How do we react over time? Do we build confidence or on balance are things going to move in a different direction.

One last comment I’d make is that -- I know this is somewhat outside the scope of this panel – I think one of the big issues that will affect thinking about China’s revisionism or not is going to be the one belt one road effort and how that plays out. And I’m frankly of -- I have more confidence in the AIIB than I do in the one belt one road.

MS. SOLÍS: Very good point. Saori and then Kawai-son.
MS. KATADA: I think the marker that you are looking for – and I don’t think I have the best answer, but my answer would be the level of interdependence. And interdependence does not only mean the economic interdependence, which is obviously a big major part among U.S., China, and Japan, and beyond, where the interdependence creates domestic support for more stable, more amicable, more kind of collaborative relationship with each other, that will change the domestic environment. And, again, Japan and China have such a large interdependence and Japan and China have to work on that, but I think that interdependence continues with student exchanges and everything else, I think that’s the marker of our being able to feel a little bit safe of the major clash kind of going forward. That would be my two cents.

MASAHIRO KAWAI: I think one of the most important determinants of whether we are going to have a collaborative international economic system including China is to what extend China can be successful in its economic reform. So we have to go back to the initial issue of this session. I think China is under transformation towards more consumption that services net and more market based economic system including financial market reform and financial market opening capital, capital account opening. I think if China clearly moves towards that direction in a visible way then the chance of having a more collaborative system would be there.

MS. SOLÍS: Excellent. Any other comments?

DR. DOLLAR: The leaders on the two sides, U.S. and China, leaders that for a long time said that the economic relationship was the foundation of the overall relationship, and I don’t think this is true anymore. I think the economic relationship is stagnating and that as Ken was intimating, I think the real positive area of U.S.-China relations is cooperation on global public goods like climate change and nonproliferation in Iran, these kinds of issues. And that’s positive but I worry that that can easily be kind of opportunistic and without that deeper economic integration that may not persist. So when you look for markers I would be looking for do we get a bilateral investment treaty between China and the United States, do we get TPP, does China eventually join TPP or negotiate some kind of free trade agreement with the U.S. I think without deeper economic institutional integration I think it’s going to be hard to advance all aspects of the relationship. And then the risks of conflict become much greater.
MS. SOLÍS: Great. So I think the audience has been extremely patient and I would like now to give them the opportunity to ask questions. We have hopefully some mics going around. I would like you to please identify yourself and be very concise in the question because I imagine that there are a number of people that have questions to ask.

So maybe these ladies. And I’m going to take two or three questions at a time.

MS. LEE: Thank you for the great panel. I’m Jennifer Lee with Hong Kong Phoenix TV. My question is regarding President Xi and President Obama’s meeting last week. If we read the fact sheet they released after the meeting we can find the economic relations is at a relatively longer length. Also on the international economic governance they also talk about many issues like G20, IMF, or World Bank and other banks, but I didn’t see any AIB mentioned in the fact sheet. So I wonder, after the meeting how would you foresee the collaboration between the United States and China on the economic issues, specifically on the international economic governance? Is it going to be more optimistic from your perspective? Thank you.

MS. SOLÍS: Thank you very much. And then there was another question from this lady?

MS. LIAO: Jessica Liao from (inaudible) University, Kuala Lumpur. I have a question for all the panelists, particularly for Dr. Dollar and Professor Lieberthal who have had personal interaction with a lot of Chinese officials. Taking from all the panelists’ discussion I think the contribution from China’s economic governance by providing new loans to particularly Southeast Asia really depends on the rule of conduct. And the rule of conduct really boiled down to the end is a political will. So Professor Lieberthal talked about a really important point on the last discussion is the difference between AIIB and the one belt one road. So just wondering what is the political consensus among the top leadership now in terms of its conduct? I know there are a lot of discussions and they come a long way. In the beginning when they provided AIIB to thinking about that might be an opportunity for us to promote export and so forth. And that idea was shut down after most of the major economies joined AIIB. In the past few decades like when they provided loans to Southeast Asia there are a lot of problems, especially human rights and environmental issues they run into. So I was wondering what is the political will that is actually there and what do they see themselves doing in terms of disciplining the conduct of loans?
MS. SOLÍS: Thank you very much. One last question from this gentleman on this round and then I’ll ask for answers from the panelists. This gentleman.

QUESTIONER: My name is (inaudible) and I’m from Bangladesh and I’m an author. I’ve travelled to China many, many times and have lot of known people there. If I would have talked to six illuminous people like you in 1 hour 40 minutes there would be Japan bash up and China and U.S. bash up. Only thing they love in America is McDonalds only. So I would like to say that the relationship with China that you discussed about I beg to disagree. These are aspirations, not realities. China wants to be a rule maker and not more a rule taker. Also, China is getting very aggressive with its hydro behavior; they already have set up four deep sea ports for military use in Indian Ocean, and –

MS. SOLÍS: Would you mind making a question?

QUESTIONER: -- and China has got no public opinion, it only has published opinion. So, when we talk about this interacting with China we should also remember that there is a dangerous (inaudible) of economy which is in China and this is the tale of growth of corruption and favoritism (inaudible) of politics into the economy which we may have to think about. Thank you very much.

MS. SOLÍS: Thank you very much. Reactions?

MR. PRASAD: Well, luckily, first, we don’t have to worry about favoritism in politics in the U.S. (laughter).

These are difficult issues. Everyone engaging with China certainly there are areas in which there are common interests between China and the U.S. and Japan as well, and then there are areas where there is inevitably going to be conflict especially when it comes to geopolitical issues, and China is trying to expand its influence. I think the key issue is how one can think about these many, many areas of common interests. I think that areas of economic common interest both the U.S. and the Chinese and Japanese economies can grow by collaborating with each other. And likewise if you think about climate change that is common interest. So how one balances those common interests with the inevitable conflicts I think is the key issues that leaders in all of these countries face. And that, as David pointed out, is going to be a work in progress and there is no way to reconcile some of those interests. But the question is whether one is going to let those areas of conflict supersede the areas where I think there can be some creative collaboration among the countries.
The signs are not entirely positive but as we’ve seen from the climate change agreement at least there is hope. But of course domestic economics and domestic politics as Kawai-son pointed out do intrude so even if there are aspirations to do things cooperatively at the international level there are domestic constraints as well that need to be dealt with. So it’s complex.

MS. SOLÍS: It is. So two more questions. We have time for two more questions. So these two gentlemen please.

MR. WINNS: Hi I’m Brock Winns with the Congressional Research Service. The panel mentioned that it was important from a U.S. perspective to bring China into a rules based economic system and I would say that some might argue that that has already been done to a large extent by China’s involvement in the WTO and I was wondering how successful you think that process has been and what role there is in the WTO for advancing that.

MR. HERWITZ: Thank you very much for a good presentation. I’m Elliott Hurwitz. I was a contractor for the World Bank for 20 years and a State Department official and Intelligence Committee official before that. China’s record in the past has not been very good in the environmental area although they have made a recent agreement. For example, they violated the World Bank three gorges dam requirements and so even though they aspire to lead the Asian International Development Bank or whatever it’s called, their environmental policy as recorded by the American Embassy in Beijing has not been good. So I would invite any of the panelists to comment on the prospects of Chinese environmental. They have violated the three gorges dam requirements of the World Bank in my time there.

MS. SOLÍS: Thank you very much.

So let me just briefly go back to the WTO question. I do think it has been a major success to bring China into the WTO. It has been a good situation for China and for the world. The problem is that the WTO actually now suffers from dysfunction in the negotiation area and when you think about how the world economy continues to be transformed, many of the rules negotiated in the WTO do not cover the newer areas, the global supply chain issues, for example. So the question we ask ourselves is where are the new rules going to come from. And that’s, I think, the main intention of the TPP and that’s why people talk about trying to create an incentive structure whereby China will think it’s in
its own interest to join the TPP and in that way also gain leverage in its own domestic reform. So it’s a question of adding to the WTO because unfortunately the WTO, the (inaudible) is into making any progress and has not been able for the past 20 years to generate membership-wide rules on trade and investment.

Any comments?

MASAHIRO KAWAI: Yes, just following up on your comment involving China within rules based international monetary system is absolutely needed. It’s been done but more needs to be done. The experience of the WTO shows that it’s been successful. China has been able to grow following the entry to the WTO and China knows it and the dispute settlement system of the WTO would subject China to an issue where China is accused for violating the WTO rules and China can bring other countries to the dispute settlement process. So this kind of rule is extremely useful and China has been learning this process.

China has been a member of the World Bank and ADB and China has been also learning how the World Bank works and ADB works. China’s main interest in getting loans from the World Bank and the ADB despite the fact that China has financial resources has been to learn from the World Bank and ADB on various issues for procurement, safeguards, environmental safeguards, other issues that would have to be dealt with in relation to infrastructure projects. So overall this process has been quite successful.

On the issue of the environmental protection and safeguards, I think it’s going to be a challenge. I think David has said so. It’s a challenge for China, international NGOs, civil society may be watching, and China would have to be conducting a lot of consultations with the local communities, international NGOs, and various other stakeholders. This is a new challenge for China, for its infrastructure project. So I, personally, want to continue to watch and many people will be watching how China would do in the AIIB project.

Domestically on domestic projects I wasn’t aware of the specific case of three gorges dam project by the World Bank and I don’t know the extent of the violation, maybe David knows, but I think looking forward everybody would be scrutinizing China and AIIB’s operations starting from next year.
DR. DOLLAR: Let me just add that China continues to be a large borrower from the World Bank and most of the focus in the program now is actually on environmental issues and certainly over the last decade or so China has had a very good track record of implementing these projects without any problems. The World Bank did not provide any financing to the three gorges dam.

MR. HERWITZ: In fact they denied it.

DR. DOLLAR: Right. Basically you can say that China didn’t want the World Bank involved and you’re right, they didn’t meet World Bank standards but the World Bank wasn’t involved at all so I just want to be clear about that. So there was no violation of a legal agreement in a sense because the World Bank was not involved. But lots of examples of World Bank projects, cleaning up rivers and lakes. The environmental picture in China is mixed. I mean, you read a lot of the negative stuff in American newspapers but there is also progress in cleaning up rivers and lakes. Some cities are improving their pollution, so it’s a mixed picture. But I think the technocrats developing AIB and they’ve got so many different countries involved now and President Xi actually said out loud that they are committed to meeting international standards in AIB operations. So I think let’s pitch in and help them succeed in that.

MS. SOLÍS: Great. So I think we’ve had an exhausted discussion. It’s been terrific but I think it’s time to wrap it up. Thank you so much. Please join me in thanking the panelists for sharing their expertise.

(Applause)

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