

THE BROOKINGS INSTITUTION

**Press Briefing: Fifth Meeting of the U.S.-China  
Strategic and Economic Dialogue**

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P R O C E E D I N G S

MR. SHEN: We can start. So, thank you for all those who have joined the briefing today. Just so you know, there will be a transcript and an audio and I can send it out to all of you afterwards. We'll probably get it within -- by the end of today.

Today we're joined by Ken Lieberthal, who is a Senior Fellow at the John Thornton China Center here at Brookings. He served as a Special Assistant to the President for National Security Affairs and Senior Director for Asia at the National Security Council during the Clinton Administration.

Mr. Lieberthal specializes in U.S. policy towards China, U.S.-China relations, cyber security issues between the two countries.

And we also have Eswar Prasad, who is a Senior Fellow at Brookings and he holds the New Century Chair for international trade and economics. He is also a professor at Cornell University. He was previously the head of the financial studies division

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and the china division at the IMF, and his expertise is macroeconomics, China's economy, emerging markets.

I would ask everyone to mute their lines until they need to ask a question, and so we can begin, and we'll start off with Ken Lieberthal.

MR. LIEBERTHAL: Thanks very much. Both Eswar and I will each roughly take five minutes to set a framework for your questions. I think that as we look at the S&ED, which will meet on July 10 and 11 with two days of preliminary meetings on July 8 and 9 for various working groups and that kind of thing, as we look at this annual meeting, we should see it the way the top leaders of both countries now view it, which is as a direct follow on to the Sunnyland Summit between Obama and Xi Jinping, which is to say they want to take the broad outlines and whatever momentum was developed there and try to sustain the momentum and begin to shape some practical outcomes.

I think neither side sees concrete deliverables as key to this particular meeting, but there will at least be an overall statement to

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highlight the scope of things addressed and if they can agree on some specifics, you can be sure they'll point to them.

This meeting, as you know, is divided into broadly economic and strategic tracks. The reality is a lot of issues like energy security, climate change and cyber security overlap those two, so there's a lot of kind of mixing and mingling in putting this thing together.

Eswar is going to cover the economic and trade issues. Let me focus on the other issues that will be highest on the agenda. I'll just give you a few points about each and happy to follow up on any ones you want to pursue in Q&A.

First, North Korea. The U.S. here is looking to further consolidate a tough Chinese line on the North Korean nuclear program. Things have been moving in what Washington would consider to be a good direction here. Clearly, the new Xi Jinping leadership in Beijing is very unhappy with North Korean policy viewing it as undermining China's own

interest in Northeast Asia.

But I think the bottom line is, China has moved from giving pure priority to stability in North Korea with de-nuclearization very much secondary, to a current position where they accord equal weight to de-nuclearization in North Korea and stability in North Korea. We, of course, want them to have de-nuclearization first and foremost. I don't think they're there yet. I think it's going to be hard to move them beyond their current position, but we'll see.

Second, on cyber security, the two sides have established a working group to report to the S&ED and hopefully to continue efforts beyond that. The U.S., in the cyber arena, is trying to draw a bright red line. Effectively the U.S. position is everyone conducts espionage. We don't object to Chinese espionage, they shouldn't object to ours.

But the U.S. does not do commercial espionage to benefit our own firms' competition position. The Chinese side does, and we insist that

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they stop.

President Obama really laid this out very fully for Xi Jinping at Sunnylands, in part, because frankly we weren't sure how much Xi really knows about what China is doing and how much he knows about the issue, in part to clarify what is of real concern to us and what is more just things governments do.

I think the Snowden revelations clearly give China an increased opportunity to muddy the waters in the discussion of this related to the S&ED, but at least now we're devoting serious time to this on both sides. The significant discussion of this will be -- forgive all the acronyms here -- but will be at the SSD, the Strategic Security Dialogue, which will be meeting for the third time next week.

The Strategic Security Dialogue is unique in that it is the only dialogue we have with the Chinese where we have both uniform military and top civilian officials in the room at the same time. Cyber security will be a major topic of the SSD this year and the SSD this year, unlike in the previous two

years, will actually spend quite a bit of time convening. There will be two hours before lunch and then a working lunch and then two hours after lunch, and that will occur, I believe, on July 9, the day before the formal S&ED meeting.

Fourth big issue will be climate change and clean energy, and I should say climate change, clean energy, and energy security. Again, we've established a working group with China. Secretary Kerry got agreement from the Chinese side to do that during his visit to Beijing about -- I've forgotten exactly, but roughly six weeks ago.

We may have an announcement of some new steps that the two sides have agreed to take. This working group, like the SSD, will convene separately before the S&ED convenes in Washington next week and then we'll report to a special meeting within the S&ED on the climate change and energy security issues. That special meeting will have at it, which is not typical of most parts of the S&ED, it will have at it, co-chairing it, all four of the co-chairs of the S&ED.

Secretaries Lu and Kerry and on the Chinese side, a man by the name of Wang Yang and the other gentleman is Yang Jiechi.

The big story here, I think, in this arena, in so far as there is one, is that the climate change issue has moved significantly up the Chinese agenda over the past year, and as you all know, it's also moved up President Obama's operational agenda as he's entered his second term.

So, both sides are looking for major projects to engage in and also to coordinate more effectively in their postures in multilateral international negotiations.

There are also going to be other non-economic and trade issues such as maritime security. I think they're going to be less prominent than the few that I've listed here.

Let me conclude with just a couple of broad summary comments. First, there are several things that are going to constrain the S&ED this time. I mean, if the question is, how big a deal is this and



what will it accomplish, I think the answer is probably less than one might have anticipated a year or two ago, and that's for two basic reasons, one, we have four new leaders convening -- co-convening this, and they do not have the same set of interests and scope of authority as their predecessors had. So, there's just some sorting out to do here. Their predecessors have gotten to know each other well; these folks are early days.

Secondly, the Chinese government is still sorting things out. They have had a massive turnover of leadership in their government this past March and by all accounts in dealing with them to set up the agenda and nail down things, the level of -- I hesitate to say disorganization, but the problems of coordination have been more severe than we're accustomed to, and we're accustomed to fairly severe problems of coordination on the Chinese side.

In addition, the operational priorities of the new leadership in China on many of these issues still are a work in progress, and so all of that

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combines to kind of limit, I think, what the S&ED will actually accomplish this time around.

One final comment, and here I think we see a good development, is, as you can see with the process of forming these working groups with the longer meeting of the Strategic Security Dialogue and so forth, the S&ED is beginning to become more of an ongoing process with concrete working capability and less of an annual event that involves hundreds of people for a day and a half or so and is more of a circus than a serious strategic initiative.

So, insofar as this becomes more regularized and there is more follow up and that kind of thing, I think that likely is all for the good for U.S.-China relations.

With that, let me turn it over to Eswar Prasad to pick up on the economic and trade issues.  
Eswar?

MR. PRASAD: Thank you, Ken. Hi, this is Eswar Prasad. Good morning, everybody. Thanks to the subtle distinctions in accents between Ken and myself,

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I suspect you won't have much trouble figuring out who's speaking, when.

There is an extensive agenda for the economics component of the forthcoming bilateral discussions and one positive issue is that many of the immediate flashpoints of tension between the two countries are in the realms of politics and security, which, at least in principle, should make for a more productive set of discussions on economic matters, although as Ken has pointed out, it's difficult to disentangle economics from security and especially cyber security issues. I will touch upon that as well.

So, in my brief remarks, I'd like to talk a little bit about the economic conjuncture in the two countries and what bearing that could have on the discussions, a few specific issues that the two sides are likely to focus on, and what we might expect out of the meetings.

So, first of all, the discussions will take place against a background of slowing growth in China

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and, by contrast, signs of a U.S. recovery, although still very tenuous, is at least beginning to firm up, so in some sense, the playing field is at least a little more level than it used to be about a year ago.

I suspect there will be considerable interest in both sides on what the two countries' central banks are doing. The Fed's hint of the forthcoming paper of its monetary operations has reduced capital flows into China and other emerging markets and it's had a negative effect on stock markets worldwide. So, at some level, this takes the pressure off China, but I suspect they will be very eager to hear more about what the Fed's plans might be because the Fed's intentions will have significant implications for China's capital flows, currency value, and stock market performance.

Across the Pacific, of course, the Peoples Bank of China, the PBOC's actions during the recent liquidity squeeze in China's financial system have received a lot of attention. My interpretation is that the fact that the PBOC hung tough, even while

markets seemed to be undergoing a fair degree of turmoil with interbank rates shooting up, that it signals that there is very significant support among the top leadership for financial sector and specifically banking reforms.

It will not be an easy process, but I view the signals as being potentially very positive ones.

So, the U.S. side will be key to get a clearer picture of China's reform intentions, especially plans to reform the currency regime and the financial system.

So, that's where the two economies stand and what I think they'll be keen to discuss now.

The specific discussions, I think, will focus on the sort of quid pro quo that Timothy Geithner has set out before one of the S&ED meetings a couple of years ago and those issues still remain very much the key ones. The U.S. will continue pushing for better access of U.S. corporations and financial institutions in China's markets, and also for better intellectual property protection.

And China, for its part, will be eager to get more clarity from the U.S. government about Chinese firms' access to investment opportunities in the U.S. as well as the U.S. technology, and this is where I think a lot of the discussions will be focused and they'll overlap with security issues as well.

We recently had the case where the U.S. has filed a case against Sinovel Wind Group, accusing them of stealing trade secrets and intellectual property, and I think those discussions will have a pretty hard edge to them because China is very interested in pursuing both investment opportunities and sourcing of technologies in the U.S. and the U.S., I think rightly so, is getting very concerned about the implications for U.S. manufacturing at a time when the U.S. manufacturing sector has slowly seen to be experiencing a revival.

The currency issue, I think, will come up and it will be the usual ritualistic elements of the U.S. pushing for faster movement on the currency regime towards making it more flexible and arguing

that it's important for China's own more balanced economic development and China, for its part, will say that it is making progress.

The reason this is less of a flashpoint than it used to be in the past, of course, is that both the trade surplus and current account surplus of China recorded last year was significantly lower than their peaks in 2007. And more importantly, from the looks of foreign exchange reserve numbers in 2012, China's F-Ex reserve accumulation which indicates the amount of exchange market intervention was only about \$131 billion, well below the levels in the previous years.

But in the first quarter of this year alone, China accumulated \$130 billion worth of F-EX reserves, about the same amount that it accumulated in all of 2012. Now, in the last few weeks, some of the pressure has come off and, as I mentioned earlier, capital inflows have eased up, but I think the U.S. will still point to those reserve accumulations suggesting that China should allow its currency to appreciate faster.

And I think the U.S. will continue pushing for much more rapid financial sector reforms, which, they will argue, are in China's interest. There, I think there will be a meeting of minds and I suppose they could offer some technical guidance on those issues.

So, overall, I see this as a potentially good time to make progress on a number of bilateral issues. And on the trade front, China has indicated some interest in joining the Trans-Pacific Partnership because it doesn't want TPP to end up being an end run around China, which I think there is a case given Japan's recent enthusiasm for it.

So, I think there is a productive basis for discussions. Like Ken, I do not expect any major deliverables, but I think the process is a very good one and significant progress could be made to these technical discussions on some issues of interest to both countries.

Thank you.

MR. SHEN: Okay. So, we'll now take

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questions. If you can unmute and ask a question and then mute again after your question is over? Any questions?

QUESTION: Yeah, hi. Tom Catan here from *The Wall Street Journal*. This question is for Ken. You know, you mentioned the impact of Snowden. I wonder if you could elaborate a little bit more on how he could potentially complicate the U.S.'s efforts to put cyber security at the heart of the bilateral relationship?

MR. LIEBERTHAL: Sure. Let me tell you, first of all, cybersecurity issues are very, very difficult to discuss in any case. This is a new space in international relations, even the vocabulary and that kind of stuff is not standardized and top leaders tend not to understand the issue in all of its technical detail. So, this is a hard issue to begin with.

I think the part of Snowden's revelations that are most damaging in our discussion of cyber security, is his making clear that we have gone well

beyond penetrating merely China's government and military networks, we've gotten into their universities, their research centers, and presumably, into major enterprises too.

And so, I think the distinction that we want to draw is still a valid distinction, which is that none of that is done to increase the competitiveness of American firms. I think a lot of it, insofar as we get into Chinese enterprises, is to ferret out violations (inaudible) requirements and that kind of thing, while the Chinese are using their commercial knowledge gain -- this is partly technology, but it's partly even big prices on projects, it is various kinds of plans that firms have, including their plans for expansion in China and so forth, and that they use those for direct competitive advantage.

So, I think we'll want to stay focused on that issue, but you can see in China, first of all, there is a popular perception that the U.S. effectively owns the Internet. Much of the infrastructure for the Internet is based in the U.S.

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Much of the software that's used globally, including in China, was developed in the U.S. And it appears, at a popular level in China, as if we are leveraging that advantage for much greater penetration of China than they have of us, and so who are we to be the demander here?

So, I think, at a minimum, this has reduced our ability to cast ourselves as the injured party. But I think the issue-- it's a valid one, it's just going to be a little tougher to get the Chinese to focus on that.

MR. SHEN: Any other questions?

QUESTION: Hi, this is Howard. Yes, my question is for Ken also. I didn't hear you mention anything about, you know, the territorial disputes in the South China Sea area, is that something that is going to come up, how will it come up? And I'm wondering, too, if you could clarify I'm not a specialist in this area you were talking about one reason that you didn't expect a

lot of, you know, progress at one thing, that there were four, you talked about four new leaders that were just kind of getting into this process.

And I was wondering if you could clarify that, what four leaders are you talking about there?

MR. LIEBERTHAL: Yeah, sure, absolutely. First, on the four new leaders, since that's very concrete. This is a dialogue that is the, say, strategic economic dialogue was set up in an unusual fashion. It is co-chaired on the U.S. side by our Secretaries of State and Treasury. Each co-chair is, by the way, not wearing the hat of being a cabinet secretary, but rather being especially designated by the President to run this dialogue, which gives a kind of higher status so they can, so their stature for this dialogue is actually above that of, say, the Secretary of

Energy, who will also participate in this, and other cabinet officers from the U.S. side.

On the Chinese side, it's headed by two people, roughly Vice Premier rank, one is a man by the name of Pong Yang, who, until last March, until this past March, just a couple months ago, was the top political official in Guangdong, and that's near Hong Kong, was just moved up to Beijing, he's a member of the Politburo. His responsibilities appear to be, have some trade aspects to them, but otherwise, on the domestic side, are more in areas like agriculture. His predecessor in this dialogue, a man by the name of Huang Qi Sheng, really focused on economic and financial issues, and had very extensive experience in dealing with Americans.

Huang Yuan is somewhat of a new entity for most American interlocutors, and he does not have the economic and finance portfolio

domestically, so it's kind of an odd fit, there. The other person on the Chinese side is Yang Jiechi, he is what's called a State Counselor, puts him above the Foreign Ministry, he is the former Foreign Minister of China, just became State Counselor in March. His background is really mostly on the United States, he's a U.S. specialist, very, very seasoned diplomat, he'll know his counterparts here well. But, again, he has not previously held this position, and his personal dealings with Secretary Kerry to date have been minimal.

So we've got four people here who have not dealt with each other within the S&ED, and all four are new to their current positions that have gotten them into the S&ED, so it's just going to take some time to build a sense of rapport, personal familiarity and full agreement on kind of what this platform should be used for and how to

manage it. So that's what I was talking about. Their predecessors, Hillary Clinton and Tim Geithner on our side, Huang Qi Sheng who I mentioned, a man by the name of Dai Bing Hua on the Chinese side got to know each other very well. They met several times during the year in various combinations and there were no surprises when they dealt with each other personally at the S&ED. This is just a clean slate, here, with all four having changed since the previous S&ED meeting.

On the South China Sea, I did mention that they will discuss other issues on the security side, maritime territorial issues will be among those, that certainly includes the South China Sea. We engage with the Chinese very regularly on the South China Sea issues, I don't expect anything new to happen, here. We will reiterate that we have no territorial ambitions there, we do not see ourselves as a mediator, but

we have serious interests in how these issues are handled, that they are peaceful and that all sides move toward a code of conduct in the area. And the Chinese, I'm sure, will repeat their well known talking points on this.

Kerry is just back from a meeting in Brunei where the Chinese Foreign Minister was, and the members of the Association of Southeast Asian Nations, and we all just went through this script there this past week, so I don't think that anything significant is going to happen on the South China Sea maritime disputes. But it certainly will be, everyone will run through their talking points on it during the course of the S&ED.

MR. SHEN: Thank you. Any more questions?

QUESTION: Hi. Yes, Paul Eckert at *Reuters*, thanks for this briefing. Directed to



Ken, I just want to touch on it a bit. I wonder if, given that Ken has been watching China for a long time, and also was in government during the Clinton administration, how he rates the S&ED as a vehicle, given that it didn't exist back in his time in the Clinton administration, and sometimes crises were hard to manage.

And the S&ED is now in year number five, is it moving in the right direction from being a sprawling kind of talking shop to more focused group that might actually produce, you know, concrete results, or at least results that governments can then work on going forward? JCCT for Commerce, and other venues for other projects, just a stand back look at this process that, essentially, two powers trying to get along, and how good they're doing at that.

MR. LIEBERTHAL: Very good question, Paul. First of all, keep in mind, in the Bush

administration, they developed the SED, the Strategic Economic Dialogue that, on our side, Hank Paulson ran with Huang Qi Shen on the Chinese side. I thought that was a very effective mechanism, and it went beyond economics, it certainly included energy related issues and a variety of other things. And we had, at a lower level, a diplomatic dialogue between state and the Chinese Ministry of Foreign Affairs, but that was at a deputy's level, not the cabinet level.

When President Obama came in and he wanted to elevate this, and retinize the interaction of economic and strategic issues, and so we insisted that the SED become an S&ED, Strategic and Economic Dialogue, that it be headed by two cabinet secretaries. Neither Secretary Clinton or Secretary Geithner, frankly, was willing to play second fiddle to the other, so we

had, so we established a co-chair thing, and pretty much insisted that the Chinese match that.

On the Chinese side, this is a very bad day. The Chinese, to my knowledge, had never had another kind of platform like this where two officials of the same rank co chaired the platform. The Chinese system just has no provision for making that work well, and I think the problems there quickly became evident. So this went from being a twice a year meeting in the Bush administration of the SED to a once a year meeting in the Obama administration. It expanded dramatically, several hundred people traveled to the other capitol for this, an absolutely jammed agenda with no clear follow along.

In other words, without working groups and that kind of thing to carry forward in any organic fashion what had been decided. So that's why I referred to it earlier as somewhat more of a

circus than a serious strategic dialogue. Circus sounds a little too pejorative, but the point is, it was an event rather than a process. And my feeling has been for quite a while, this needs to become more of a process. I think, just in the last few months, we have seen steps taken to begin to move it in that direction, so we have now several working groups on really key issues; cyber security, climate change, that kind of thing that are headed by high level officials on both sides that will meet periodically, that have developed a specific agenda for this S&ED.

And the thought is, we'll have to see whether this happens, but the thought is, the S&ED will then give those working groups direction for them to continue to work together to try to shape some issues and sharpen some opportunities for future cooperation. And I think the SSD, the Strategic Security Dialogue, which is now in its

third year frankly, in the first two years, this consisted on an hour to two hours of people reading talking points at each other across an array of issues.

This time around, it's about five and a half hours, including a working lunch, and the thought is that it, too, will meet after the S&ED. So it's not going to be just a one-off meeting each year in this broader event, it, too, will now become an ongoing dialogue that may actually spin off some things that will really affect our management of issues. So I think that the potential for the S&ED idea to move our relationship forward has grown somewhat as we see some signs that both sides are more serious about making this an operational process, rather than a one-off big ticket event every year.

But we'll have to see, you know, whether that potential is really developed now, or whether

it kind of fades in the coming year, is one of the things we ought to be watching.

MR. SHEN: Thank you. Any more questions for Ken or Eswar?

QUESTION: Yes. This is Marty Crutsinger with the AP. Could I follow up on that last answer? Could you discuss how China has molded this? My perception was that it was actually China that pressured to change it from a total focus on economics to a broader focus. Did China play any role in shaping how this process goes forward now?

MR. LIEBERTHAL: I think that, broadly, on a number of details, sure, the Chinese side puts up issues that they want to have discussed and ...

MR. CRUTSINGER: I mean, your answer seemed to suggest that China had no role in deciding how this was shaped. Weren't the Chinese

upset that Paulson came in and had this policy that totally focused on their currency and economic issues, and they wanted it changed, and the Obama administration decided to agree to some changes? Or is that perception wrong?

MR. LIEBERTHAL: I think the perception is wrong. First of all, the Chinese, I think, really welcomed the original SED, the Strategic Economic Dialogue. I would stress that that went far beyond currency issues. You know, Paulson personally has had a huge interest in China, going back to the Goldman Sachs days, knew the Chinese leaders, he's also very interested in clean energy and climate change issues. Again, his personal agenda. And he really sought to engage the Chinese on a wide array of issues that could affect future economic growth one way or another. And they, again, went well beyond treasury itself.

I think those meetings went fairly well, there was a significant focus on currency, but keep in mind, those were a few years when Chinese currency remained much weaker than market forces would have indicated, our trade deficit with China was soaring. The switch from the SED to the S&ED, combining the strategic and economic tracks came totally from the U.S. side. That really was a U.S. initiative, the Chinese were not happy about it, but signed on to it. And I think that it has, you know, I indicated what my views are on kind of how that has worked out. The addition of a sub dialogue, the so-called SSD, the Strategic Security Dialogue, the one that brings together military and civilian officials in the same room, again, was a U.S. initiative.

This does not fit in the Chinese system, it is very hard to find another instance in China where uniformed military and their foreign



ministry counterparts sit together in the same meeting. It's just not the way the system works, those two don't deal with each other directly very much at all. But we felt, and I think absolutely rightly, that there are a variety of issues involving space, involving cybersecurity, and a number of other things, where you have to have the military and civilian sides in the same room talking about the issues, or what we would term, Paul Mill issues.

China very reluctantly agreed to this. I think now it's developed to the point where they seem to be much more comfortable with it, and they can really become potentially a very serious platform. So these changes are really U.S. initiatives with China kind of taking them on board as necessary. The detailed agenda for each of these meetings, the Chinese have a number of things they want to raise and they want to talk

about, and we have our things that we want to raise and we want to talk about.

But, typically, in U.S.-China relations, the Chinese rarely take the initiative to indicate major changes or to suggest major changes in the way things are done, they assume the U.S. will take the initiative, we then wait a while for their response. And the U.S. taking the initiative puts it on the center of their agenda, they aren't bashful about coming back at you in response. But it's hard to think of areas where the Chinese themselves have taken the initiative to change a venue or change the way something big is done.

MR. CRUTSINGER: Could I get Eswar's thoughts on the evolving nature of this?

MR. PRASAD: I think Ken hits it right on the head that these meetings take a lot of pomp and circumstance, the more important work really

goes on behind the scenes. Now, the pomp and circumstance does have a useful purpose of focusing the mind, and I think, given the likely contentious nature of some of these issues that spans economic and politics and security, I think the S&ED as it is now structured may, in fact, play just the right combination of elements on both sides that are necessary to talk through these issues.

I think, in the early months of the SED, and subsequently the S&ED, there was a sense that expectations were not being met in terms of there being few deliverables, and I think that expectation now has, rightfully again, dampened, and these meetings are seen as part of a broader process. So although the pomp and circumstance sometimes can be a bit of a distraction, I think, if there was an offer from (inaudible) the background, the process can actually be really

helpful in terms of forging relationships.

Especially given the senior leadership on the Chinese side, I think it's a very good time to use the dialogue to build bridges at the senior levels, even while the more important work goes on behind the scenes.

MR. SHEN: Thank you. Any other questions?

QUESTION: Hi. My name is Kasia Klimasinska, I'm from *Bloomberg News*. Can I ask a currency question regarding China? My understanding is that, in April, China promised that the trading (inaudible) widened, and I'm not sure have they ever delivered on this promise. And, if not, is that something that the U.S. would push for? Thanks.

MR. PRASAD: I'm sorry, could you repeat what you said, what exactly they had promised to do?

MS. KLIMASINSKA: To widen the trading band?

MR. PRASAD: Oh, yes. There was an implicit promise they made, they never stated those things quite so specifically. They do talk about the move towards a more market-based exchange rate, and this was certainly an issue that the U.S. was pushing on, again, given the high level of reserve accumulation the first quarter of this year. But, once again, economic circumstances have sort of cut the legs out from under the U.S. arguments on that issue, because I suspect we're going to see the latest month's data much less currency intervention by China, much lower capital influence, and the expectations in the non deliverable forex in Hong Kong again suggests that the markets are expected to, indeed, to appreciate significantly.

So I suspect that, again, other than the ritualistic elements, there won't be very much to this. The U.S. side will probably continue to emphasize that exchange rate flexibility is really about getting China's growth balance right. So I suspect that the discussion of currency and the discussion of financial sector funds will be tied together very closely this time. Because, ultimately, that's where the Chinese government seems to be putting some of its emphasis in the short term. And if the financial system reforms can, in fact, start moving the Chinese growth patterns in the right direction, that, I think, will serve the U.S. a lot better.

So, to sum up, I think the currency issue will come up, but not with a great deal of stridency on the U.S. side, and I don't think the U.S. will be pushing for any specific commitments from the Chinese.

MR. LIEBERTHAL: If I could just add a technical footnote. I agree 100 percent with what Eswar just said. But on the issue of widening the trading band, that is different from letting the market simply determine the value of the RMB within that trading band, because every day, the Chinese set the value at the start of the day, and then the widened ban is simply how much it might move from that initial value each day. But they can set that value lower or higher.

So, in that way, they can still exercise a fair amount of arbitrary control over changes in the value of the RMB over time.

MR. SHEN: Okay. Any last questions?

QUESTION: Paul Eckert if I may again, a brief one. The intellectual property part of the debate, does that fall under cyber this time around, or economics, or both? It's a crosscutting issue, but I'm not clear on that.

MR. LIEBERTHAL: I think, inevitably, it's both, it certainly is a major element in the cyber side. The argument that President Obama made to President Xi at Sunnylands focused very much on the importance of innovation to the U.S. economy. That is our competitive advantage. That, if intellectual property is stolen and made available to competitors, it has a wide ranging set of ripple effects. It will diminish over time, the investment the U.S. firms make in high-tech innovation. Why invest if it's just going to be stolen from you? And, therefore, that's one of the consequences.

But if you just think about that consequence, that, over time, it will really diminish the capacity of the U.S. economy to remain on the cutting edge of global innovation. And, therefore, what the Chinese are doing strikes right at the heart of America's core economic



interest, and Obama will not sit idly by while that occurs. I mean, that was the nubbin of the argument, so you can be sure the IP side of the cyber security issue is something we will focus on like a laser beam.

MR. LIEBERTHAL: Eswar, I don't know whether you want to add to that.

MR. PRASAD: Yeah, Ken, I think you summed it up very nicely. Let me just add that the latest action against China will, I think, signal one thing very clearly, the U.S. is going to take a much harder line on intellectual property protection, especially when it comes to linking that issue with Chinese investments in the U.S., and I think the battle lines on that issue are very clearly being drawn. And there, the U.S. does have some degree of leverage over China, because, again, China remains very interested in

investment opportunities in the U.S. and U.S.  
technologies.

So I think the U.S. will make clear that  
it is drawing some lines in the sand and needs to  
see significant progress being made by the Chinese  
side on intellectual property protection before it  
makes it easier for China to invest in the U.S.

MR. SHEN: Okay. Any final questions  
from anyone? No? Okay. Thank you very much.  
Just so everyone knows, again, we will have an  
audio recording and a transcript, and I'll send  
that around to you guys, hopefully, by the end of  
the day. If not, then maybe not the 4th of July,  
but Friday. Thank you very much for joining.

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## CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

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