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P R O C E E D I N G S

MS. CHALEF: We'll go ahead and start. I just want to welcome you to this briefing regarding the upcoming G20 Summit. Thank you all who are here in the room.

And for those of you on the phone, thank you, as well. If you could remember to mute your line until you want to ask a question, we appreciate it. And we'll pause every now and then to check for questions on the phone.

We're joined today by Kemal Dervis, who's the Vice President and Director of the Global Economy and Development Program at Brookings. Kemal is formerly the head of the United Nations development program, and Minister of Economic Affairs for Turkey. He focuses here on global economics, emerging markets, as well as development in international institutions.

David Dollar is a Senior Fellow, recently joined Brookings in the Foreign Policy and Global Economy programs, and he's based within Brookings' John L. Thornton China Center. David, from 2009 to

2013 was the U.S. Treasury Department's economic and financial emissary in China. He also worked for 20 years at the World Bank, serving as country director for China and Mongolia from 2004 to 2009.

And Eswar Prasad is a Senior Fellow in Global Economy and Development, and the New Century Chair in International Trade and Economics. Previously, Eswar headed financial studies and the China divisions at the International Monetary Fund.

We'll start with a little bit of opening comments from each of the panelists, and then we'll open it up to your questions afterwards.

So -- Kemal, would you like to kick us off?

MR. DERVIŞ: Well, thanks for being here. And there are two occasions, really, one is that we are about two weeks before the G20 Summit in St. Petersburg, so that's always an important moment.

And then, second, we've also -- you know, we accompany the summit with a collection of contributions from G20 countries from the think-tank academic side. And this was just published yesterday, and I think it's a very good collection, including some central bank governors and very senior economists from the various countries. It focuses largely on monetary policy in central banks, as the focus of this particular G20.

So, very telegraphic -- and then I'll turn to my colleagues -- what do I see as the big issues? Not just me, but what I think most observers think the big issues for the G20 meeting are -- the first, of course, has to do with the reversing or slowly going back on the extraordinary and unusual monetary policies, the quantitative easing. And here, actually, there's a big difference still between the central banks in the U.S., Europe, and Japan. So I just want to kind of highlight that actually they're all three in a very different position. And then, of course, China, U.K., and there are others.

And in a sense, the U.S. is driving the whole process, and is also creating the nervousness because it is still the giant in financial markets.

But I think it's important to realize that all these countries are in somewhat different positions. The U.S. is mainly worried about how strong the recovery is. There is a recovery, but there's a lot of uncertainty on how much it actually depends on the monetary policy versus how much autonomy it has gained.

In Europe, you know, there are very, very slow signs of some recovery, but the major issue, still, for the Central Bank is kind of managing the euro zone, which gives it a very different dimension. And in Japan, it's almost the opposite of the U.S., because Japan is embarking on a new phase of expansion in monetary policy.

So I think that it's important to notice that difference.

The impact of the talk about tapering has actually been quite major, even without it happening. And nobody's sure whether it will start in September, or December. But the impact on emerging markets has been quite strong. And so that's a second topic I think one needs to discuss.

Some countries, there are other factors. I don't think one can link the whole issue of emerging market slowdown, cyclical slowdown, and difficulties in countries such as India or Indonesia, or Brazil, and others, you know, entirely just to the Fed issue, but it's a big variable, I think. How big? Well, one can discuss that.

I think another important link here is that development in China -- and, you know, we're lucky to have both David and Eswar, who are great specialists on China -- I mean, the slowdown is very relative, you know, when you think about it. I mean, it's from a long-term trend growth of around 9, 9-1/2 percent, to maybe around 7 now. And, you know, by any standard, 7 is not exactly a slow growth. But that difference seems to be important, given the new trade links that are quite strong between a lot of the emerging-market countries and China. So even a slowdown of 2, 3 percentage points in China, you know, has impact on quite a few of the exports from emerging markets, and many of them, raw materials, and primary products. But I think that's another variable that is making life somewhat more difficult for the emerging markets.

And I think linked to that debate is how large should the Fund be? As you know, there has been a whole expansion of Fund resources that has been extraordinary, through the NAB, and the extraordinary borrowing capacity of the Fund -- but the actual quotas haven't increase, because even the 2010 package is not yet in force, has not been, you know, agreed to. I mean, it has been agreed to, but it hasn't been ratified.

So the Fund has a quota capacity of about $250 billion, but an actual lending capacity now close to $1.2 trillion. Most of it is not permanent. And the question is, how permanent do you -- what is the size of the Fund that is reasonable for the next 5, 10 years? And I think there's a lot of debate there, and that will be issue which, certainly, the emerging markets will raise strongly, because they are in favor of making more permanent the Fund's lending capacity, whereas the advanced countries are much more cautious on that, much more conservative on that. So I think that's another major issue.

Then, finally, two more points which I think are going to be important -- one is the whole issue of investment financing, how to finance infrastructure and climate-related, energy-related investments. The needs are huge. As you know, this was one of the rationales for talking about the Briggs Bank. It hasn't gone very far, but there is a feeling in the emerging markets that there's a lot of need for medium and long-term investment financing. Not all of it can come -- most of it will come from the private sector, but not all of it, and so the need for multilateral lending and long-term resources to complement the private sector, with guarantees or with other instruments, whatever. And, in that sense, both -- well, a World Bank issue, but there is a demand for an increase in size of the regional banks and the World Bank -- which, again, the advanced countries are not very keen on. And, particularly here, the Europeans, I think, are the major kind of brake, because they realize that such an expansion would bring about the much talked about change in voting shares and quotas, and Europe that, of course, is resisting that the most.

And, finally, I think one issue that is gaining importance -- there will be a report to the G20 leaders in Moscow -- is on base erosion and profit shifting of taxes. It's not just the transparency and non-cooperative jurisdictions issue, which has been around for awhile, and where, you know, progress has been made -- slowly, but I think somewhat surely the system has changed. The information sharing has gained a lot of traction. But that's on tax evasion. The big issue that has come up in the G8 and, you know, which, for example, David Cameron was very strong on, is this whole issue of profit shifting of the base, and of legal avoidance of taxes by multinational corporations that erodes the base in the advanced countries particularly but, you know, depending on where you are, this is a very big problem or not so much of a problem.

But it's a major, major issue. And I predict that -- although I don't predict any major decision in St. Petersburg, I do think that it will gather steam because the amount of taxes that are shifted that way have become huge.

So, with that, maybe I'll turn first to Eswar, and then to David.

Eswar?

MR. PRASAD: Thank you, Kemal.

So, as with other G20 meetings, the Russian presidency has very ambitious objectives. These include the mantra of "balanced, strong, and sustained growth," but also a host of other longer-term issues, including financial regulatory reform, issues about the tax architecture, as Kemal has mentioned, reform of the international financial institutions. And, as has been the case with many past G20 meetings, I suspect that short-term events are going to overtake much of the discussions at the G20.

So, the big issue right now is there has been a substantial shift in growth momentum across the advanced and emerging market economies. The emerging market economies are looking somewhat weaker, relatively speaking, and the advanced economies are looking somewhat more stable, relatively speaking. But, again, as Kemal pointed out, this is largely relative, because the emerging markets still have better growth prospects, both in the short term and the long term.

But the shifting growth momentum has certainly created a different dynamic leading up to the Moscow meetings.

So, one of the key issues that I suspect will be debated -- which, again, feeds off what Kemal said -- is about the monetary policy stances in many of these economies. Because one thing that is common across the advanced economies and emerging markets is that monetary policy is still being used as a crutch to avoid taking the much more difficult fiscal and structural reforms that many of these countries need.

Now, of course, what reforms each country needs varies by country. As one goes down the list of advanced economies, there are different countries and different sets of reforms that one can point to. But, in every one of them, there is the sense that there is more of a focus on short-term fiscal austerity rather than taking care of the longer-term fiscal problems, and an avoidance of very difficult structural reforms, and a reliance on monetary policy.

The emerging markets are in a similar position. But in those economies, monetary policy is taking on an even greater burden. Monetary policy in many of these emerging market economies is taking on the burden of supporting growth, controlling inflation, and managing currency values.

So I suspect that the reliance on monetary policies, and the implications for capital flow volatility will remain a dominant theme at these meetings, with the emerging markets largely viewing monetary policy in advanced economies as causing problems for them, and the advanced economies are basically taking the position that the emerging markets are chronic complainers. And, in fact, this theme came up at a meeting of central bankers in Moscow a month ago. And, of course, things were quite different back then. But there was already a sense among the emerging markets that the big trouble is monetary policy stimulus could also have very adverse consequences on their economies -- and that has certainly proved to be the case over the last few weeks.

So that, I suspect, is going to be one of the key issues.

On some of the broader issues, there is, in fact, some degree of agreement, and I think one can see progress taking place, although very slowly and somewhat more in words than in actions. If one thinks about issues related to the tax architecture, there is fairly strong agreement -- among the G20 economies, at least -- that something needs to be done, and there is movement towards that goal.

Whether something concrete will come out of the Moscow meetings is still not clear. I suspect we will continue to get progress through words, some common guidelines, but nothing much more concrete.

In terms of financing for infrastructure and international financial institution reform -- again, there is a broad sense of agreement, but nothing very concrete in terms of what each country would like to have accomplished in the short term. So, my suspicion is that at the meeting of leaders in Moscow, what we will get is something very similar to previous communiqués that each of the G20 economies commits to doing the right thing domestically, but with few cognizance of the implications of its own policies for the rest of the world. And, at the same time, we will get, I think, fairly promising notions of agreement among the major economies about what needs to be done on tax architecture and financial institution reform.

And, finally, I think if one steps back again and thinks about the global economy, one very -- or potentially promising issue is that at least two of the major engines of growth, the U.S. and China, do seem to be stabilizing right now. Again, the signs are varied, and not entirely convincing, but I think the sense that these two economies might once again become -- they have been and, I think, will continue to be the main drivers of world growth -- I think is going to be the key issue.

But still, among the emerging markets, I think they're going to see more and more differentiation between countries like China, that continue to remain relatively stable in terms of their growth patterns, although slowing down to some extent, and countries like India, Indonesia, Turkey, that look a lot more volatile.

So I think this divergence among emerging markets is going to be another key theme of the meeting -- which is as good a segue as any to David.

MR. DOLLAR: Okay. Thanks.

Actually, I'm going to take off from Eswar's point that if you look at the recent history of the G20, there's a tendency to avoid difficult structural reforms, or to move slowly on the difficult structural reforms, and try to use the fiscal and monetary policy to make up for that.

All of these economies have reform agendas. You know, they are different, but every one that I'm aware of has an important reform agenda. And, in general, these reforms are, you know, good for yourself, and good for your neighbor, you know. So part of the importance of the G20 is if all of these economies pursue their reforms at the same time, you're going to get better results.

There's also a little bit of risk of free-riding, of course, because if other big economies are pursuing reform, that tends to have spillover benefit for countries that are lagging. So I personally think the main value of the G20 summit is an opportunity for these major economies to share their plans, and to exhort each other to follow through on structural reforms.

So what I'd like to do to complement what's been said is just touch briefly on the two biggest economies, the United States and China, and what are some of these important structural reforms?

I think, you know, the whole world is looking at the United States to increase its savings and improve its competitiveness. And one aspect of increasing its savings is bringing down its fiscal deficit and getting debt sustainability. Actually, there's been a lot of progress. U.S. fiscal deficit is coming down very rapidly and, in fact, many countries are now worried that it's coming down too rapidly. So the July finance ministers' communiqué emphasizes the importance of not overdoing austerity but, you know, keeping a focus on growth. So I think the developing world, in particular, is looking at the U.S. and worried perhaps that the U.S. is exiting too quickly from fiscal stimulus.

And certainly on the monetary side, as Kemal indicated, the developing countries are worried that as the Fed exits, you know, U.S. interest rates may rise too rapidly, and this could be disruptive for them. So I think, you know, the developing countries, the whole world, is looking to the United States to manage the exit from stimulus well.

And then there are important structural reforms that the U.S. could pursue that would provide a sounder foundation for U.S. growth. One issue is there's a lot of need to repair and rebuild infrastructure in the United States. And, you know, this is something the Chinese bring up a lot, that they see there's potential for more infrastructure investment in the U.S. Actually, they would -- many of their companies would like to be involved in this, in terms of financing.

Another important structural issue is immigration. The U.S. has a lot of -- there are particular shortages of certain types of skills in the U.S. economy. So, proper immigration reform could really help.

So, I think as the rest of the world looks at the United States' recovery, it's worried about too rapid withdrawal of fiscal and monetary stimulus. And it would like to see the United States move ahead on some of these structural reforms that would make the U.S. economy more competitive, and create a solid foundation for U.S. growth going forward.

Let me say a few words about China. China's situation is almost the reverse of the United States. You know, the United States needs to save more and become more competitive. China, in my view, needs to consume more. China has shifted from a very significant reliance on external demand -- you know, it's shifted away from that, so its external surplus has come down a lot, so you can say China's relying very much on domestic demand. But its investment rate has risen to about 50 percent of GDP. So, as its external surplus has come down, it's replaced that almost completely with investment. And when you invest 50 percent of GDP, you basically double your capital stock in about six years.

So the challenge China faces now, if they continue investing at that rate, there's very serious risk of overbuilding. The leadership's already worried about excess capacity in many sectors, and so they're trying to bring down the investment rate. And that's really what's behind the slowdown that we've seen so far in China's growth.

So they're trying to bring investment rate down, investment growth down, but not so much to really seriously disturb the growth rate. So they're really trying to walk a very fine line.

Now, as with the United States, there's a whole range of structural reforms that could help China make this transition. They have a household registration system that tends to limit the rural-urban migration. They're talking about reforming that. Financial liberalization could help with this transformation. A lot of their service sectors are relatively closed and oligopolized. You know, so they have an important structural reform agenda.

They have a Party plenum coming up in October, where there's an expectation that they'll roll out a lot of plans. So I think, you know, the G20 meeting will provide an opportunity for Xi and Obama to meet on the sidelines. A lot of what's valuable at these summits, you know, is the opportunity for these bilateral meetings.

And so the main point I want to put across is that if these two biggest economies in the world can pursue their complementary reforms, that will help their sustainable growth, but also be a very good foundation for the world economy.

Obviously, there are a lot of other important economies in the world that -- just in the interest of time, I've just singled out the two biggest.

MR. DERVIŞ: Let me just very telegraphically draw your attention to two of the quotes here, because I think we didn't -- I was supposed to cover it, but I forgot.

There is Europe, still. Europe has not -- I mean, it's fragmented, you know, but it's still there. And if you take it as a whole, it is as big as China and the U.S.

Now, Daniel Gros has a very interesting article which I highly recommend in the collection, but let me read one sentence here: "It cannot be in the long-run interest of the German economy to continue to accumulate very large current account surpluses when the rate of return on foreign investments is so low."

The German current-account surplus for the last 12 months is $250 billion -- larger, significantly larger than China, in absolute terms, and much larger in terms of ratio of GDP. But what one has to add to that are two facts: Northern Europe is running a current account surplus of $550 billion, larger than China ever did. And I think this is somehow not quite part of the consciousness of the debate -- okay? And Southern Europe, having to adjust with great austerity, is now no longer -- is actually beginning to have a small current account surplus.

So the euro zone, as a whole -- France is not included in the south and as a (inaudible) current account -- but the euro zone as a whole -- and, you know, to paraphrase, is looking more like Germany in terms of current account. And China, in some sense --

I mean, you know, in the sense that it's actually substracting, not only Germany, but the euro zone as a whole, is substracting demand from the world economy.

And couple with that, my dear friend Don Kohn, who's a great colleague at Brookings, but he has one very controversial statement, I think, which we highlighted in the list here, the last one on the list, which says: "Except for the feedback mechanism..." -- well, there is an "except" -- "...decisions to exit should not be keyed to the consequences for foreign markets and economies."

That's pretty strong. Basically, he says, you know, the Fed should do what it has to do for the U.S. economy and, you know, the Chinese should do what's good for the Chinese. And you could then say, well, what about the G20? And so there is this whole issue is how do you handle this?

When Paul Volcker raised interest rates in the early '80s to very high levels from negative real levels, it led to a complete catastrophe for emerging markets, and the debt crisis of the '80s. I mean, we're in a different world now. Emerging markets are much stronger than they were.

But I believe that central banks should cooperate, and there should be a sequencing, and that the G20 should facilitate that. But, as you can see from Don's quote, it's far from a generally agreed to position.

Sorry for coming in one more time.

MS. CHALEF: So, we'll go to your questions. For those on the phone, we'll get to you in a moment.

But, go ahead.

MS. YUKHANANOV: Hello. I was going to actually follow up on that point, in terms of what can the U.S. specifically do, or should do. I mean, IMF keeps talking about effective communication, and I don't think the Fed would disagree with any of that.

So, I guess if you could maybe be a bit more specific. I mean, what would the emerging markets want from key -- beyond what the Fed is already inclined to do anyway, for the U.S. economy? I mean, I don't think they want it to be disruptive or anything like that. So, what are people asking?

MS. CHALEF: And just to say, if you could all talk a little louder, because we are recording this for a transcript.

Thank you.

MR. DERVIŞ: Well, I mean, I also -- Eswar, particularly, has worked a lot on that, but David also.

But I would think that, given the interdependencies in the global economy, I think it is -- I agree, you know, with Don's statement, because he says "except for the feedback mechanism." There is a feedback, there is a spillover, and the IMF is working more and more.

So, yes, every central bank has its own mandate, which is a national mandate. No central bank has a mandate to worry about what's going to happen in financial markets, you know, across the globe.

But, given that there are spillovers and feedbacks which are quite important, it would seem to me that monetary policy should have a global dimension, and whatever tapering or expansion in Japan, or whatever, happens, should be put in a global framework, not just looking at the individual economy concerned, but -- well, that's a very major part, of course, of the job -- but also what spillover effects it will have, and how these spillover effects will feed back onto the economy in question.

So I would think that the G20 should promote that. And it was promoted for fiscal policy. When the crisis hit in London, there was a lot of talk about, you know, fiscal coordination. And I do believe, both on the up -- I mean, on the expansionary side as well as the tapering side, certainly, the emerging markets, I think, would welcome analysis of the feedback mechanisms as one of the variables that would impact decision-making of the rich countries' central banks.

But, I don't know -- my colleagues, Brookings, everybody has their opinions.

MR. PRASAD: And not necessarily the same ones.

So, it is a curious situation, because the emerging markets were complaining about the Fed's actions early on, and now they're complaining about the Fed taking the reverse actions. And, certainly, the advanced economy central bankers have noted this apparent inconsistency in the emerging market perceptions.

But, again, the concern that the emerging markets have is twofold. One is that the advanced economies continue to rely more on monetary policy rather than the other policies they should be undertaking and monetary policy has spillovers. So, the fact that these economies continue to work on the one policy that has very significant spillovers, I think, is part of the complaint.

And the second issue is related to the capital flow volatility which at least some emerging markets feel is coming because of sort of unclear signals that they feel were sent to the markets about the speed with which, at the time, the speed with which the Fed would taper -- which led to more capital flow volatility than if there was a more gradual tapering, consistent with the U.S. economic recovery.

So, this is why we heard a lot from the emerging markets about communication strategy. But the reality is that there isn't much that can be done. Because if the U.S. economy recovers -- as Kemal pointed out -- the Fed does have in its mandate to do the right thing for the U.S. economy.

So I think these tensions are going to remain. We've seen them play out in different ways, and I suspect we're going to see them at some level in the Moscow meetings, as well, especially because many emerging markets right now are under enormous pressure.

MR. DOLLAR: I don't feel that we need to all comment on each question.

MS. CHALEF: Okay, just wanted to check.

Lesley?

MS. CLARK: Yes, I just wanted to ask -- given that the summit, so far, has been sort of overshadowed, at least in the U.S., by the President is not going to meet in Moscow with President Putin, sort of what is Obama's, what is President Obama's challenge in this meeting? And what sort of messages are you expecting him to want to deliver?

MR. DERVIŞ: Well, we're not, definitely not going into Russian-U.S. relations in this --

MS. CLARK: Right. Right.

MR. DERVIŞ: But, David, why don't you --

MS. CLARK: But on the underlying parts of the G20.

MR. DOLLAR: Right. So, I think the -- you know, from the United States point of view, if the United States successfully can increase in saving its competitiveness, you know, this will go a lot more smoothly if the rest of the world cooperates, you know. And I emphasized China, but I agree with Kemal, Europe is very important, you know. So if Europe's building, euro zone's building a very large overall current account surplus.

And then, frankly, there's always the risk that China's current account surplus will rise again in the future. You know, they've built up all this capacity. They're not moving that quickly on structural reforms that would increase consumption.

So I think, from the U.S. point of view, there's a risk, you know, that the rest of the world will not be cooperating, in a sense.

So, I would encourage Obama to, you know, try to get that message across to key leaders, you know, that we really need complementary structural adjustment in the world economy.

MR. PRASAD: Yes, I think pretty much sums it up. What Obama is going to be taking to the Moscow meetings is the sense that we, the U.S., are finally getting it together. Now it's the time for the rest of the world -- China, Europe, and other countries -- to get it together.

MR. DERVIŞ: Well, I would -- I mean, I'm not a China, particularly, a China expert. I'm here with two of the greatest experts. But, I mean, again, what we have to put things in -- I mean, China is still growing at 7 percent. So that is not, by any means, a minor kind of achievement. The difference is there, but I don't know -- my question there is could it go down to 5?

MR. DOLLAR: Yes -- no, it could. Their own leaders are very worried. You know, as I said, you're doubling the capital stock in six years, so, you know -- just think about doubling the whole Chinese capital stock in the next six years. There's not going to be demand to use that.

So the leaders know that, so they're trying to reduce the growth rate of investment. But, you know, that's half of GDP, so they don't want to have too much effect.

So, I think they're walking a knife edge. So far, they're doing a good job, macroeconomically.

MR. DERVIŞ: Right. I think the management has been pretty good, overall.

MS. CHALEF: Anyone on the phone with a question?

(Pause)

MR. DERVIŞ: We've lost the phone?

MS. CHALEF: No, no -- they're there.

Question?

SPEAKER: Sure. You talked about how there's been this over reliance on monetary policy as a crutch, instead of some of these longer-term structural reforms.

Can you talk about what some of the specific structural reforms that the U.S. would need to do to put itself in a better long-term position? And then how that might differ for some of the other advanced economies, or other emerging economies.

MR. DOLLAR: Well, I'm happy to start off, because I mentioned a couple. But let me mention something I didn't say before, because I think it's, you know, it's kind of a sensitive and difficult issue, is the issue of entitlement reform.

And I pointed out, the U.S. fiscal deficit is on a very good trajectory. It's dropping very rapidly. And, you know, many macroeconomists think it's dropping too rapidly. So, the U.S. fiscal situation, out three to five years, looks very good. And, you know, for that time period, the U.S. is definitely stabilizing debt-to-GDP, perhaps bringing it down. But then go out 10 years, and the current parameters of the entitlement programs, you know, will definitely create a very significant fiscal issue.

Now, I tend to agree with the analysts who are saying it doesn't have to be solved -- you know, it doesn't have to be solved today in the sense of cuts in entitlements and/or revenue increases today. But, personally, you know, as a U.S. citizen, I would prefer that we reach an agreement relatively soon on how we're going to change those parameters, even if, say, some of the entitlement changes or revenue enhancements don't kick in for a few years. I think it would do a lot for the markets if there was a sense that there's a long-term fiscal plan for the U.S.

So I think that's an important issue. And I know a lot of emerging markets are looking at the U.S. and are very concerned about this.

And then I won't repeat at length, but I actually think immigration reform -- immigrants tend to be more entrepreneurial than the native-born population, and we're missing skills in a lot of different areas. So I actually think immigration reform could be very, very powerful.

And then I mentioned -- I don't know if you consider infrastructure a "structural" reform, but there are potentially things we could do in terms of public-private financing, and regulatory reform that would encourage more infrastructure investment.

So you can definitely see developing countries looking at the United States, hoping it makes changes, you know, that will lead to a more sustainable growth pattern.

MR. DERVIŞ: Any word on India, maybe -- so much in the news?

MR. PRASAD: Yes, I think, starting with what David said, I think the crux of the issue in the advanced economies is that the focus on short-term fiscal austerity is detracting from productivity and growth-enhancing expenditures. So I think in the long run it complicates the fiscal position that David was talking about, that nothing is being done about the longer-term entitlement issues, specifically in the U.S., and in some of the other economies, as well. The long-term issues are, in some sense, going to become worse because of the short-term policies.

Among the emerging markets, I think the unfavorable external environment has very clearly exposed the vulnerabilities of economies like India, Indonesia, Brazil, and a whole lot of others. And many of these economies have twin vulnerabilities right now: large budget deficits, and current account deficits.

And again, if one looks at an economy like India, India has managed to benefit from a spurt of reform in the 1990s that kept growth pretty strong over the last decade and hid a lot of these problems. But I think the chickens are finally coming home to roost.

And, again, the reform agenda has been clear for a long time. What needs to be done is to improve the financial system, take care of infrastructure investment, which is particularly important for India, which has a capital deficiency relative to a country like China.

The fiscal problem is a huge one, and little has been done. And in the last two or three months, the policies seem to be more tilted towards redistribution, especially with the national elections coming up next month -- I'm sorry, next year. So there is a sense that the reform momentum has sort of shifted, downshifted, and in the lead-up to the national elections, that we won't see major reforms that India really needs. And I think that nervousness is what is leading to the plight that India is in right now.

And in many of the other emerging markets, I think the situation is similar. There is a sense that the governments relaxed a bit in relatively good times and are unable to take the reforms now that are necessary to keep these economies in stable shape.

MR. DERVIŞ: I mean, I would add again one word on Europe and on Germany, in Daniel's analysis in the volume, collection, you have. You know, he has a very interesting point he makes. Germans have always saved more than they've invested, you know. And particularly after the euro was created, that became even stronger.

Germany saves -- one-quarter of total German savings are in the form of its current account surplus -- okay? One-quarter, much larger than China ever has been. And what is so interesting is that the return Germany is getting on that quarter is close to zero because, you know, it's not in the form of investments, it's basically running up huge balances at the European Central Bank. And the European Central Bank pays zero on those balances. So it's a very strange situation where, you know, Germany is kind of saving that much, but not really -- on a big portion of that saving, getting very little return. It's kind of almost like the opposite of -- similar, but opposite of China, in the sense that China is risking now to get a much lower return on its capital investment inside China -- right? -- whereas Germany is having the problem of not enough investment in Germany. And there are some -- the latest news yesterday was construction was picking up. So it may be going in the right -- but accumulating a lot of financial balances with zero return on them. So I think that's another interesting point to make.

And I'm always a little bit surprised that, given the size of the German economy, it's less in the news than it should be -- particularly, after all, there are German elections, you know, in four weeks. So there should be more of a debate. But for some reason, there isn't.

MR. PRASAD: Kemal is single-handedly trying to change that.

MR. DERVIŞ: I can't do that single-handedly.

MR. LEE: If I could just follow up on the monetary policy again -- I mean, given that the central banks are supposed to be independent, and that's often stressed, autonomy from the Fed, and so forth -- what can we realistically expect the G20 leaders to say that would -- I mean, what would be, what would constitute, you know, progress, or what you would consider a strong, really, statement or action? What can they really do about this situation?

As you've said, the central banks that won't pursue what's in their national interest, with some thinking about the spillover. But, in reality, that, you know, even the White House is -- while they're independent, they do what their mandate is.

MR. PRASAD: I think the crux of the problem, again, is the excessive reliance on monetary policy. So if you go down the list of countries, and think about what each central bank should be doing, and the environment it would like to operate, every central bank, as you've correctly pointed out, has in its mandate only domestic objectives, and they already have too many mandates as it is.

But the problem that every central bank faces is that monetary policy is having to make up for the deficiencies of other policies. So, in the U.S., they're getting the contours of fiscal consolidation exactly reversed relative to what I think is needed, so monetary policy has to step into the breach to support short-term growth.

If you think about a country like India, going to another example, monetary policy is having to make up for the lack of good supply-side policies, and lack of effective policies. So at least at the central bankers meeting that was had, this was the refrain: that we're doing all we can, but unless other policies are pulling in the same direction, not only are they not going to be effective, but it is going to have very large spillover effects.

So what the G20 could, in principle, do is commit to a better mix of policies, because I think that is the only way out.

MS. CHALEF: Are there any questions on the phone?

(Pause)

MS. CHALEF: Okay, any questions in the room?

Anna?

MS YUKHANANOV: A quick question just to follow up on Germany, since you're talking about it.

I mean, there's also this issue of culture, and how that influences saving. You know, if you talk to the U.S., they're always saying Germany needs to consume more. But then you go talk to Germans, and they're like, "What are we going to buy? We don't need anything." You know.

So, how -- I mean, how do you tell Germany -- I mean, the U.S. has been telling them for several years now at G20s, you need to reduce you current account surplus?

And, you know, there are small changes, but I guess -- do you see any kind of major thing, this is what they should do? I mean, invest more in Southern Europe. I don't know -- what do you think?

MR. DERVIŞ: Well, you know, as I've pointed out, the return that Germany is actually getting on its substantial savings is quite low when you factor in, you know, the current account surplus component of it. And there is the need -- I mean, Germany is doing well, and I wouldn't say that German infrastructure is weak, but a lot could be done there.

I do believe that the correct part of the German message and policy has been: Look, we can't -- countries cannot just run large fiscal deficits forever and accumulate debt to reach 90, 100, 120 percent of GDP, and we have to have some discipline in fiscal policy and all. And I agree with that. And, in a way, setting the example is a good thing. Because, you know, if you do it, then others are more likely to follow.

Germany, I think, also has been, in a sense, both clever and lucky to have a product mix that was very appropriate to this decade's demand pattern in the world -- you know, emphasizing capital goods, and things that are in high demand in, you know, rapidly growing emerging markets.

Having said all that, I do believe that it's an issue if Northern Europe continues to have between $500 and $600 billion current account surpluses -- and, you know, with Germany the major player, but others, too, in Northern Europe -- and we have this strange situation where unemployment in the euro zone is above 12 percent now -- okay? -- so much higher than in the U.S., for example -- and yet the fiscal policy is restrictive, growth is very weak, and there is current account space for the euro zone. I mean, if the euro zone was running a deficit, you could say, wait a minute, they can't stimulate because they have a foreign deficit. But the euro zone now is having a $250 billion surplus, so it doesn't seem to make sense for the euro zone to have very austerity-focused policies, you know, while they're running a large current account surplus and have huge unemployment.

The problem here, of course, is the internal dynamics of the euro zone -- okay? If it was one country, it would be a no-brainer. You'd just expand fiscal policy, and try to fight unemployment. But in this case, there are distributional aspects here, and that's what's blocking it.

And I think unless they can resolve these internal euro zone distributional issues, and architectural issues, we're going to have a continuing problem in the euro zone, which has impact on the rest of the world economy. Because a $250 billion Northern -- German or euro zone surplus is not in the interest of the rest of the world.

MR. LEDERMAN : We haven't talked a lot of the tax avoidance issue that was really big at the G8, and the OECD plan. Do you expect that to come up in a prominent way at the G20?

MR. DERVIŞ: Yes, it will come up. There is a report to the G20 on this. I don't think any decisions will be made. There is a lot more preparatory work to be done. But I do believe that there is an increasing consensus -- just as the consensus that had emerged on transparency and tax evasion, and the need for information exchange -- that you cannot have a world economy where the legal system as a whole in the world economy, in individual countries, allows very profitable and very large multinational corporations to pay minimal taxes by profit-shifting -- legally profit -- they're not doing anything illegal, but they're legally profit-shifting.

Because, you know, there are fiscal issues, there are social issues all over the world. There are difficult entitlement issues, health financing issues, education issues, infrastructure issues, and some of that, these demands have to be met by public revenue. And if, increasingly, you have a world economy where multinational, very highly profitable firms can avoid to pay taxes, I think you have a big problem.

So I think this problem, while nothing will "happen," if you like, in St. Petersburg as a decision, I think it will be a major issue for the G20 and for the world economy as a whole to come.

MS. CHALEF: Any other questions?

Okay -- one last one? And if you could speak up.

MS. YUKHANANOV : Yes -- about the -- you mentioned a bit about the prospect for IMF, World Bank reform, and I was wondering, first, if you could elaborate why emerging markets want a bigger IMF. Is it to help countries like India in the current situation, or are they worried about stability overall?

And then, how do the diverging growth prospects right now, with emerging markets slowing down, play into the urgency of reforming IMF, World Bank.

MR. DERVIŞ: Why don't we have Eswar address that?

MR. PRASAD: The bigger concern right now for the emerging markets is about capital flow volatility. And I think there is a sense that the present structure of the international financial institutions is not conducive to more cooperation across countries. And in the absence of that cooperation, it's harder to discipline capital flows.

The emerging markets have for a long time felt that the IMF, in particular, is sort of stacked against them, and largely takes care of the interests of the advanced economies. And what happened in the last three or four years has been seen by them as sort of evidence of that -- that the IMF has lent out a lot of money and, as they see it, not followed some of its own procedures consistently when lending to the Europeans.

So the sense that the IMF is still in the hands of the advanced economies is very much prevalent. And I think this has implications especially for the long term, because after the financial crisis, and after this recent episode of volatility, I think when financial markets settle down, the emerging markets are going to go back to looking to self-insure by building up reserves, simply because they realize that there is a lot more volatility ahead, and they cannot entirely count on the IMF.

The governance reforms therefore become very important, because unless the promised reforms are not [sic] delivered on, it's going to be much harder for the IMF to credibly tell the emerging markets that, look, we are on your side as much as we are on the side of the advanced economies. And the advanced economies recognize this, as well, that the imbalances are going to persist unless the IMF can be a credible player.

So I think most countries do want it to happen, but not at their own expense. That's the case for the Europeans. And the U.S., of course, would like it to happen, but I think the political stalemate here is making it difficult for it to happen.

So, again, it's something that most people want, but actually getting it done I think is going to be somewhat complicated because of internal political dynamics in each of these countries.

MR. DOLLAR: Can I just add that, you know, the quota increase agreed to in 2010 would increase the weight of developing countries -- you know, China would move to number 3, Brazil, Russia, India, China would all be in the top 10. So, you know, and there may be a relatively small increment, but it kind of ratifies a process that will eventually lead to greater weight in the IMF for these economies if they continue to grow faster than the developed world, which is what we expect.

So the Chinese care about this a lot. You know, even if this first move is somewhat symbolic, you know, the Chinese feel very strongly that the emerging markets should have greater say in the international financial institutions in order for them to have continuing legitimacy. And then, as Eswar said, you know, the U.S. Congress, you know, has to vote the additional money from the U.S. side, and so far that's been a difficult process.

MR. LEE: Just to follow up on China, quickly -- apart from what you said, that, you know, in terms of China wanting the U.S. to increase infrastructure, focus on infrastructure, what do you see as Beijing's agenda for this particular G20? What will it really seek to do? I know it's dealing with Japan's currency depreciation, and there are regional and a number of other issues, but I'm just wondering, from China's perspective, what will it really strive to accomplish here?

MR. DOLLAR: Yes, I would say in the sort of three main objectives, you know, for the meeting, in each one, China has a particular interest. So let me take them in reverse order.

You know, one is the international financial architecture where, as I just said, the Chinese feel very strongly that the developed countries, the U.S. in particular, should follow through on its commitment. That may be hard to do in the next two weeks, but they'd like to use the meeting, you know, to continue to create peer pressure for the United States to do the right thing.

And then in terms of financial stability, we haven't said too much, but the Chinese are concerned that some of the developed countries are not moving quickly to implement Basel III, you know, which is an important regulatory agreement at the Financial Stability Board.

And then, you know, the first issue is given some nice politically correct name like "sustainable growth," you know, or "sustainable inclusive growth," and there, it's a lot of the issues we've been discussing that the Chinese would like to see the U.S., in particular, but definitely also Japan and Germany, you know, managing their macroeconomic policies in a way to avoid negative spillovers on the emerging world.

And then I tried to emphasize, the Chinese really would like to see the U.S. follow through on structural reforms, because they think the long-term health of the world economy depends very much on the U.S. continuing to do well. So a lot of the discussions between the two sides are about the structural reform agenda.

MR. LEE: Well, the Chinese must be getting worried about the U.S. interest rates shooting up in the last two months. They've got a lot of treasury and securities, and sitting on things, and they can't, obviously, dump them without causing some -- a shake-up in the markets. So, this must be a --

MR. DOLLAR: Yes -- I honestly don't think their concern is about sort of the short-term valuation fluctuations, it's that, you know, too rapid a rise in U.S. interest rates is going to have a negative effect on -- not so much on China directly, but on the emerging world in merchant markets, and China is a major exporter to those markets.

MS. CHALEF: Thank you all. Thank you, Kemal, David, and Eswar. I appreciate it. And we'll send around a transcript, probably on Monday, of the discussion here.

So, thanks everyone. Appreciate it.

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