



**Project on New Frameworks for Addressing Global Challenges
in International Finance, Energy Security and Climate Change:
Cooperation among the United States, Russia, China and India**

*Carnegie Corporation of New York
Financial Services Volunteer Corps*

Rapporteur's Report on the First Symposium of the Project¹

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The first symposium of the Financial Services Volunteer Corps (FSVC)/Carnegie Corporation of New York *Project on New Frameworks for Addressing Global Challenges in International Finance, Energy Security and Climate Change: Cooperation among the United States, Russia, China and India* took place in Hong Kong during June 13-15, 2014. One of the main goals of the new FSVC/Carnegie effort is to continue to provide a forum for open international and cross-sectoral dialogue among leading experts from each of the four countries, and at a time when international tensions appear to be growing. The Hong Kong symposium built on the most recent FSVC/Carnegie symposia in New Delhi (November 2012) and Beijing (June 2013), and brought fresh insights to the analysis of chronic global problems as well as recent events.

Themes

The Hong Kong symposium took place at a time when the international system is experiencing significant stress. The search for new frameworks and models for addressing a variety of urgent challenges is ongoing; yet, so far, no stable model has presented itself or been developed. The United States, Russia, China and India, four of the leading nations in the world, are also ones that, arguably increasingly, find it difficult to cooperate with each other. Yet, they are often the principal sources of a significant number of problems globally (e.g., all four are major emitters of pollutants contributing to climate change) and, due to their size and global influence, they are also countries that are indispensable for solving these problems.

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The relative economic and military weight of these four countries varies, even as they are all powers to be reckoned with. The United States is still the largest economy and the most powerful nation as measured by military power; Russia has been its historical antagonist and is the largest country in the world by territory; China is the United States' nearest economic challenger and competitor; and India will soon overtake China as the world's largest nation by population.

The challenges and trends facing most countries today are global in scope and impact. At the same time, the defining trend of the previous 50 years -- globalization -- is under review and stress, as national identities and interests appear to take center stage once again in many areas of the world. The tension behind these two realities animated much of the discussions at this year's symposium.

The Hong Kong symposium started with the observation that multiple assumptions that broadly underpinned global governance and represented consensus among major international actors since the end of the Cold War no longer seemed to apply in June 2014. There is, in fact, an ongoing and possibly accelerating change in the fundamental intellectual assumptions underpinning the modern world. The optimistic and rational underpinnings of the post-Cold War world are now being severely tested and challenged. Among these assumptions, the leading ones postulate that:

(1) Growing economic interdependence will prevent conflict and lead to positive spillover.

Counterpoint: Tensions now often rise among highly interdependent states and economies.

(2) Globalization is a fact, not a choice.

Counterpoint: In fact, there is resistance to globalization in many countries. For instance, in Europe, there is resistance to further integrating the European Union. In many countries, there is also increasing resistance to immigration, one of the key elements of a globalizing world.

(3) Ideology has faded.

Counterpoint: Much of the change in the world today is driven by ideology and, in some instances, religion, one of the oldest potential sources of conflict in the world.

(4) Technocratic solutions, empiricism and knowledge are the key to good policy and are the foundation of the modern world.

Counterpoint: In much of the world today, there is growing disagreement about basic facts behind certain situations or phenomena, with debate around climate change being one of the primary examples of such controversy. In many countries, including the United States, there are leading figures who deny that climate change exists despite overwhelming scientific evidence to the contrary. In other countries, for instance in

Russia, climate change may be recognized as a reality, but is seen as neither a threat nor a policy priority.

(5) *There is a single global community of people, all of whom comprise the “international community.”*

Counterpoint: The concept of “localism” is growing stronger in many countries. Rather than seeing the world in terms of a global identity or aiming for a common good, many people, including policy-makers, are reverting to their local or national identity, often seeing the world in exclusive and competitive terms. The growing issue of scarcity may in part be driving this trend. By 2050, the world’s population is estimated to reach 9.6 billion, and it is not clear how the world will be able to ensure adequate living standards for all.

These assumptions are being challenged today with a resurgence of older, local identities, and the new world that is emerging appears to be less predictable.

Building on discussions at the previous symposia, the participants also observed that multiple gaps continue to exist between the problems the world faces and the tools available to assess and address them. Specifically, there are gaps in knowledge, policy, leadership and institutions.

As a result of these gaps, there are difficulties in the world as a whole, and in individual countries, in dealing with challenges as they increase in both complexity and intensity. Many threats and challenges are not only global in scope, but also present a potentially existential threat. For a global society to endure, these threats and challenges must be addressed effectively by either containing them or solving them.

Some of the main discussions at the symposium in Hong Kong centered on the new dynamics in the international arena. Participants agreed that geopolitical risks have increased globally over the previous twelve months, and noted the following trends:

(1) Competitive multilateral institution building, which indicates growing competition in the international system. Rather than turning to existing institutions or seeking global solutions, states and regional powers are seeking to form their own regional-level international organizations. These organizations are often seen as a tool for larger powers to impose their will on smaller ones in a particular region. In comparison, some of the major international institutions, including the United Nations and particularly the UN Security Council, are often deemed ineffective.

(2) The intractable nature, combined with global importance, of problems originating from an arc of territory extending from Northern India to North Africa. There is growing instability, in particular, in the Islamic world, as evidenced by the rapid and extensive territorial gains made by the Islamic State of Iraq and Syria (ISIS), gains which were occurring at the time of the symposium.

(3) Continued deterioration of the global climate, with numerous new reports and studies confirming the wide-ranging consequences of current climate trends. According to many scientists, some of these trends are now irreversible. The challenge is not whether the world, and the four countries in particular, will have to manage the consequences of catastrophic climate change, but rather how and when they will have to do so.

(4) Rapid growth in modern technologies, leading to disruptive innovation across societies and economic sectors. Cyber-security is an increasingly pressing issue at a time when multiple governments, major companies and media sites are under constant attack by hackers. It can be expected that a cyber-attack by one country against another will cause major disruptions at some point. In another realm, the use of unmanned drones is likely to prove a challenge in the future as well.

While some themes in Hong Kong overlapped with those discussed in both New Delhi in 2012 and Beijing in 2013, many new ones were developed in Hong Kong. Several themes also assumed a more prominent place in the discussions than was previously the case, including:

(1) The overall geopolitical situation has worsened in late 2013 and the first half of 2014. Geopolitical risk has risen globally. Since the Beijing symposium in June 2013, there has been a significant deterioration in a number of key bilateral relationships. For instance, the relationships between China and the United States; the United States (and the European Union) and Russia; and China and Japan, have all worsened.

On the other hand, there has been some improvement in the relationships between Russia and China, and India and China. Overall, however, the world scene appears to be more tense and less stable than just one year ago.

(2) The relationship between Russia and the West has worsened. While this trend has been discussed in past symposia, most participants seemed surprised and alarmed by the near-collapse in the relationship between Russia and the rest of the world. As one participant observed, the entire structure for interaction between, for instance, the European Union and Russia, built over several decades, has collapsed in the space of a few weeks. Both domestic policies inside Russia and its conflict with Ukraine have altered the international dynamic significantly.

At the same time, there was no expectation that this trend can be reversed. Russia is one of the countries that, at least for the moment, has embraced local, nationalist identities. This trend, however, runs contrary to the interests of Russia's internationally-exposed and interdependent economy.

The downing of a Malaysian Airlines jet over pro-Russian rebel territory in Ukraine occurred subsequent to the Hong Kong symposium, but the incident indicates that the conflict is spreading and is further isolating Russia internationally.

(3) There is conflict, or at least tension, between the need for international, multilateral solutions and a tendency for the world to become increasingly localized or regionalized. The

effectiveness of international decision-making is decreasing precisely at a time when more rapid, coordinated and effective action is needed. This trend is worrying.

(4) The current world is not multi-polar; there are no clearly defined powers that can divide and manage the world among them. While this situation can be deemed “more democratic”, it also increases instability. It is increasingly difficult to imagine a new "concert" of nations, along the 19th century model of international relations.

(5) There are numerous narratives in the current world. Some countries, such as the United States, are seen as presenting or defending an established view of the world. Other countries increasingly strive to present an alternative vision. For instance, Russia now aims to advance a different set of values and narratives which it sees as "traditional," promoting itself as a challenger to the United States and the West more broadly.

There is a deficit of coherent policy narratives and worldviews, however, that prove workable for multiple countries and societies.

The role of the media in shaping a specific set of concepts and narratives that tend to generate more tension within and between countries, particularly in the United States, Russia and China, was also discussed. Furthermore, social media is changing the way people identify themselves, and relate to each other and their surroundings on a daily basis, a factor that has not yet been sufficiently understood or addressed by policy-makers.

(6) Corruption is seen as pervasive, in both institutionalized and illegal forms, and was deemed by some participants as the principal economic and policy problem in many countries. In vastly different ways, it is present in all four countries of the project, and it is distorting governmental policy- and decision-making processes. While in Russia, China and India, corruption is more traditional rent-seeking by government elites, in the United States, it is systemic, institutionalized and in effect “legalized” corruption. In a first instance, corruption in the U.S. is manifested by the system of campaign financing and the power of special interest lobbyists in Washington, D.C.

(7) Youth unemployment and the problematic demographic, income and opportunity dynamics in all four countries are looming issues. Growing income inequality and inequality of opportunity create a sense of frustration in many countries, especially among the young. This frustration can feed radicalization and breed instability, in addition to not taking advantage of the capacities and promise of a younger generation.

Country Discussion

Most of the points mentioned above were noted during discussions of individual countries. Overall, general observations on Russia and the United States tended to be pessimistic; assessments of China were mixed; while the Indian situation gave some reason for optimism.

The United States

In the international arena, the United States, in the words of one participant, is being visited by sins of the past. Some examples include:

- (a) The U.S.-Russia relationship is largely ruined, in some part due to the United States engaging insufficiently with Russia and operating under the influence of residual Cold War thinking.
- (b) Having contributed significantly to the destabilization of Iraq and Syria, the United States is now struggling to find an appropriate response in both countries to new, dramatic challenges. The Islamist conquest of large parts of Iraq and Syria has already taken place. This, if left unchecked, could grow into an existential threat to all the countries of the Middle East.
- (c) Climate change is being felt in the United States in a wide variety of ways, with growing public awareness of the phenomenon. The United States is one of the leading contributors to global climate change, and one that is still struggling to find a political response to the challenge.

The U.S. Government continues to be largely paralyzed by partisan gridlock, to the detriment of policy-making and coherent action in multiple areas of concern. It is not clear how this situation will be corrected either as a result of mid-term elections in November 2014 or the presidential elections in 2016.

Russia

Trends in Russia are mostly negative, and participants have generally expressed pessimism about the direction in which the country is heading.

One major factor contributing to this pessimism is the conflict in Ukraine. No fast resolution to this conflict is likely. The conflict continues to put the very existence of Ukraine in doubt, while also exerting considerable pressure on Russia's government and economy. Broadly perceived as the aggressor by the West, Russia is now operating under increasingly heavy economic sanctions; more sanctions can be expected.

These sanctions are unprecedented and significant when taking into account the fact that Russia is one of top ten economies in the world, deeply integrated in some areas of the global economy. Although dismissed by some in Russia as ineffective, the sanctions are having the following effects:

- (a) Contributing to and accelerating capital flight;
- (b) Significantly increasing the borrowing costs for most of Russia's major industrial enterprises and banks;
- (c) Increasing risk premiums;
- (d) Growing reputational damage; and

(e) Halting Russia's global economic integration.

Cumulatively, the sanctions are likely to cause serious negative consequences for Russia's economy, which has already been slowing down due to numerous factors, many of them political. The lack of rule of law and protection of property rights, however, will continue to have an even greater effect on the growth of the economy and level of investment in Russia.

In addition, the Ukrainian crisis has posed a major challenge to the overall European security architecture. It is likely that a comprehensive reevaluation of security and military planning is underway in Brussels, Berlin and many other capitals of Europe as well as globally.

There is a growing personalization of Russian politics, while the quality of the country's governance has deteriorated significantly.

China

Similarly, China is facing the consequences of previous bad decisions. In particular, it has engaged in massive over-construction, which now poses a large threat to the Chinese economy. The central government in Beijing aims to manage the looming economic problems, but the result has been a liquidity crunch which is slowing down the Chinese economy.

There is growing awareness that double-digit growth is not likely to return, and that a new model of growth is needed. This new model would rely on greater domestic demand, high value-added manufacturing and services, and less carbon-intensive growth. There is cautious optimism that China's model for economic success can evolve based on its considerable spending on research and development, increases in innovation, growing rates of domestic consumption and an increase in the number of graduates from institutions of higher education.

At the same time, there is growing social discontent against corruption as well as over environmental problems and deteriorating standards for safety and quality (for instance, the contamination of food and water).

President Xi has consolidated his power successfully and is seen as an able and decisive manager of the state. The wide-ranging anti-corruption campaign he unleashed has the effect of both strengthening his own position and attempting to solve a serious problem affecting China's governance.

Regarding foreign policy, China has been more assertive in the past year, particularly with regard to territorial disputes with Japan and Vietnam. The search for sources of energy supply is a key driving force behind its foreign policy, which has also led to vast investment projects in Africa. In general, however, China's foreign policy has remained conservative, particularly in light of its growing economic power and the size of its population.

India

Discussion of India focused on the ramifications of the election of Narendra Modi as Prime Minister. Modi assumed this office in late May 2014, only two weeks prior to the Hong Kong symposium. There seemed to be cautious optimism about the likely consequences of Modi's election.

Modi inherits an economy that has grown only about 5% in 2013, and is likely to grow at about the same rate in 2014. This level of growth is very low for India. In particular, there has been no growth in the manufacturing sector. Within state banks, there is an increasing problem of non-performing assets. One of Modi's biggest challenges will be renewing and investing in India's infrastructure, particularly in the cities, and finding investors to help finance infrastructure projects.

The election has dramatically changed the political situation in India. Modi ran a presidential-style campaign, promising less government and more development. His party, the Bharatiya Janata Party (BJP), has an outright majority in the Indian Parliament. This is the first time a single party has had full control of the Indian legislature in 30 years.

In terms of Prime Minister Modi's foreign policy stance, it was noted that he does not have extensive experience in foreign policy and has not traveled much outside of India. His negotiating style overall appears to be:

- (a) Bargain from strength;
- (b) Relatively more prone to walk away from negotiations;
- (c) Comfortable with coercive diplomacy; and
- (d) Espousing a paternalistic attitude.

Modi also appears to be a pragmatic policy-maker, focused on challenges within India but conscious of the need for a positive international environment, particularly with neighboring countries. Overall, a more pragmatic government can be expected in India, with a likely upside benefit for India's economy.

Additional discussion: Iran

During the discussions, the group focused in particular on the ongoing negotiations with Iran. Iran is a pivotal state in the increasingly unstable Middle East, and the success of negotiations is important. The discussion on the ongoing P5+1 negotiations with Iran identified three major concerns:

1. Any agreement will have to be accompanied by assurances that the international community, and the United States in particular, will not attempt to force a regime change in Iran and accepts that Iran has a legitimate government. Iran has indicated that words alone cannot convey credible reassurance on this point. However, the United States so far has not advanced more concrete forms of reassurance.

2. The current approach for imposing restraint on Iran's enrichment activities includes limitations on gas centrifuge capability, which Iran is unlikely to accept. Iran has indicated that it would accept limits on the accumulation of enriched uranium product (in amount and in form) so that its capabilities remain perpetually below the threshold for the production of highly-enriched uranium. The P5+1 parties, however, do not appear to be pursuing this approach.
3. The P5+1 reliance on coercive pressure to force Iranian compliance has become a compounding issue in Iran. Iran is far more likely to accept restraint if given a positive incentive to do so, and the mere removal of sanctions will not be considered a sufficient incentive. To draft a sustainable agreement, the international community will need to support Iran's development of legitimate fuel cycle capacity and not merely refrain from interfering with it.

It was also noted that, while a deal with Iran is within reach, there is a danger that the U.S. Congress could sabotage an agreement, due to partisan considerations.

The Global Financial Sector

The financial sector and global economy are still experiencing multiple problems. The recovery from the Great Recession continues to be slow and uncertain. Gains in the stock markets, for instance, do not solve persistent problems with unemployment and growing inequality. There is a perception that the recovery has benefitted only the more affluent members of society, and left many others behind.

At least five major risks to the world economy were identified:

1. Geopolitics;
2. Shifting growth models;
3. Radical financial regulation and financial experimentation;
4. Forgetting the lessons of the Great Recession; and
5. Corruption.

At the same time, anxiety about unemployment, for instance, is fuelling anti-globalization sentiment in many countries. In particular, global competition for jobs is creating a backlash, especially in times of economic hardship.

One area for potential international cooperation, particularly between the United States and China, is infrastructure development. In Africa, both countries could partner, rather than compete, on infrastructure projects. China's recent interventions in Africa have so far been viewed as controversial, but very effective at delivering projects. The United States' interventions in Africa over a period of decades have been seen as mostly altruistic but relatively ineffective. The combination of Chinese effectiveness at mobilizing capital and delivering infrastructure projects, and the U.S.'s more favorable reputation in Africa, could help create jobs and result in projects of substantial value for all parties involved.

Another challenge is technological innovation, which threatens many jobs and entire industries. Adjusting to technological change in the modern world often means adopting new ways of doing business and eliminating entire categories of jobs. The world may need to shift to new concepts of work and leisure in order to be able to handle technological change. New sources of economic growth must be found, which not only increase productivity but also create jobs.

BRICS – Brazil, Russia, India, China and South Africa, or the leading emerging economies – can no longer be put together automatically into one group, as their development trajectories have diverged significantly. A new possible grouping is MINTs – Mexico, Indonesia, Nigeria and Turkey – although this grouping can also be seen as too heterogeneous.

Regarding the financial sector in particular, the participants observed that there is still no internationally-agreed mechanism for resolving systemically important institutions in distress. At the same time, the perception exists that some institutions within the financial and banking sector are again accumulating risk, which makes forward thinking on ways to address possible crises even more important.

Energy and Climate Change

In the realm of energy, the world will have to continue to confront twin crises: the developing climate change crisis and the air pollution crisis. A new international industry centered on energy infrastructure with dedicated public-private financing will need to be created.

There are six basic ways to generate energy in the world today: coal, gas, oil, hydro, renewables and nuclear. In order not to compound the air pollution crisis or the climate change crisis, and to provide enough energy for the world's growing population, a significant shift toward nuclear energy has to occur.

At the same time, such an expansion of nuclear energy creates safety concerns that can only be addressed effectively on an international basis. New international regimes enabling countries to develop nuclear energy capability without acquiring the capacity to develop nuclear weapons need to be developed. These have to focus on the reliability of supply, and control must be globalized. If the United States, Russia and China could agree to cooperate on supply, this could de-politicize the issue and build confidence in a globalized control system. In the current political environment, however, this type of agreement is highly unlikely.

The impact of energy and climate change on domestic and foreign policy was also noted by several participants. China's foreign policy is driven in large part by its search for new sources of energy. Strategic decisions about energy in Russia appear to be highly personalized, with no discernible long-term strategy. Furthermore, Russia has leveraged its role as an energy supplier to cut off or threaten to cut off supplies to neighboring countries that do not align themselves with Russia.

Possible Triggers of Next Crises

1. An accumulation of new risks in the financial sector could lead to another financial meltdown, probably within one systemic institution or market, but with a risk of contagion. This could come either from unseen pockets of risk in Western economies or from imbalances in emerging market economies.
2. Use of a drone by a non-state actor, especially a terrorist organization, against a civilian aircraft, or a similar scenario, could provoke a severe reaction from the affected countries.
3. Failure of negotiations with Iran could further destabilize the Middle East.
4. Internal instability in some countries could rise due to unemployment, particularly among young men, or other economic considerations.
5. Large-scale, climate-related disruptions could threaten domestic capabilities and the mechanisms for managing international crises.

In addition to these triggers, it was noted that various crises will likely emerge at the local or regional levels. A fundamental question in this current international geopolitical environment is how to prevent these regional crises – such as Ukraine – from becoming global conflicts.

Policy Recommendations

1. Focus on preventing, rather than responding, to crises;
2. De-link issues in the global arena, in order not to prevent cooperation in one area because of problems in other areas;
3. Build coalitions to address clear, technical challenges. Global coalitions are the only way to address and resolve some issues;
4. Re-invigorate large multilateral institutions to enable them to implement effectively, and to counter the emergence of new competitive multilateral institutions;
5. Harmonize and facilitate trade, including by removing it, as much as possible, from the political realm; and
6. Prioritize the fight against corruption, in both its legal and illegal forms, to prevent the promotion of vested interests in policy development and decision-making.

Concluding Observations

The FSVC/Carnegie symposium in Hong Kong provided a unique opportunity for leading experts from the United States, Russia, China and India to discuss an international environment that is undergoing rapid and, at times, disturbing change. The presence of leading experts and “rising young stars” provided a dynamic forum for the symposium’s discussions. The strong representation of experts from Russia at this year’s symposium was particularly welcomed as they offered candid and fresh insights into recent events, including the conflict in Ukraine.

While several themes dominated the symposium, concern over a perceived lack of leadership in tackling increasingly complex global problems was pervasive. With the United States currently withdrawing from its role as leader in the international arena, there appears to be no engagement from other parties to replace the U.S. in that role and a general lack of collective responsibility. More worrisome still is the growing tension between major powers. This tension is not likely to result in a major war, but this should not be the threshold at which the bar is set. In addition to old, familiar problems, new ones are arising, yet collective action remains elusive.

In this new emerging global mood of anxiety and distrust, the symposium provided a forum in which to exchange ideas openly and discuss potential areas of cooperation. General consensus at the symposium was that major crises are inevitable, and that all four countries will have to work with each other to solve them. Participants discussed potential avenues for cooperation, and how to share insights from the symposium with policy- and decision-makers in their respective countries. The Hong Kong forum provided an all-too-rare glimpse of what is possible when experts from the four countries are invited to engage with each other in an atmosphere that encourages constructive and open dialogue.