



**Project on Future Framework for International Governance:
Contributions of 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 Project

New Delhi, India

November 30-December 2, 2012

The first symposium of the Financial Services Volunteer Corps (FSVC) / Carnegie Corporation of New York project on *Future Framework for International Governance: Contributions of the United States, Russia, China and India* took place in New Delhi, India, on November 30-December 2, 2012.

The symposium focused on the major concerns facing the four countries--the United States, China, India and Russia--as well as the global system as a whole. The participants probed the challenges facing each of the four countries, and addressed developments in the global banking/financial and energy sectors. One of the key goals of the discussion was to find common themes linking the situations in the four countries, and defining the current environment internationally. This search for commonalities proved to be a fruitful way to frame the conversations.

Organizers of the symposium succeeded in bringing a number of new participants to the discussions. The United States, China, India and Russia were represented both by established specialists and long-term participants in the FSVC/Carnegie projects and by some new voices in these countries' expert and policy communities, and in the Carnegie effort. The exchange of views was lively and dynamic.

Thematic Conclusions

The key challenges facing the world today are global, and much that defines the policy environment in every one of the four countries can be found across nations. A number of major themes emerged during the discussions in New Delhi. These themes increasingly provided structure for the discussion at the symposium, as participants shared insights and made new connections. The themes presented below were thought to be particularly important and relevant to the global policy environment at the end of 2012 and beyond, affecting the focal countries of the symposium as well as the European Union and countries outside the scope of this project.

1. The current global moment is one of punctuated equilibrium in human development. A term borrowed from evolutionary biology, “punctuated equilibrium” denotes a period of rapid change and evolution, leading to heightened uncertainty.

2. Policies adopted ten or fifteen years ago (or even earlier) have crucial importance, and often unexpected consequences, today. Some examples of consequences include demographic changes in China, financial system issues in the United States and the EU, and the current economic slowdown in India. This underlines the pivotal importance of decisions being made today.

3. Because of the particular sensitivity of the current moment in global political, economic and social history and the urgency of challenges facing all four countries, and the world generally, “muddling through” is not an option.

4. Most key issues facing the world today can only be solved internationally and multilaterally. This trend has been developing over decades and is an important indication and corollary of globalization. The world has now reached a point where most challenges cannot be addressed effectively and lastingly on the national level. Some examples of major transnational issues include:

- a. nuclear issues, including nuclear policing;
- b. climate change;
- c. pandemics;
- d. financial and banking system functioning and regulation;
- e. trade; and
- f. intellectual property.

5. There will be new crises, be they in the climate, energy or financial domain. Humanity cannot prevent crises, and it cannot predict them with any certainty. The question is thus not whether but when a crisis will hit – and, most importantly, how can the world, and individual countries, best prepare for new destructive crises.

6. Income inequality has increased dramatically in all four countries as well as globally. While inequality among countries has decreased, which is a positive development, at the household level inequality has increased across the world. Interestingly, in some countries inequality appears to increase because of lack of market forces (for instance, in China and Russia), while in others inequality may increase because of relatively unregulated market forces (for instance, in the United States). Whatever the cause, inequality is a growing problem in most societies and can become a structural challenge to social stability and development.

7. In all of the countries at the core of the project, there is a growing sense that the younger generations are falling behind. There is a lack of prospects and of opportunity for young people. This is evident not only in the United States, China, India and Russia, but also in Europe and the Middle East. Although the reasons for this vary, the effects are often similar: a growing pessimism and a heightened danger of social

instability going forward. Structurally, the world needs to find a productive way to use the energies of its young. Otherwise, potential for crises increases.

8. Corruption is a signal problem in China, India and Russia. It links directly to the issues of economic development, rule of law, and inequality, often distorting a country's economy, and exacerbating or retarding the finding of solutions to existing problems. Corruption undermines the legitimacy of governments, and has to be an area of intense focus for leadership in all three countries. International solutions to the problem of corruption are elusive, but international pressure can be helpful to some extent.

9. To address the challenges of an interdependent world, current international institutions are increasingly not sufficiently agile, responsive or effective. Some new mandates are needed. In particular, there is a need to develop institutions that handle information that is particularly sensitive to national authorities. Looking forward, this is important, for instance, for a globalized energy sector, in particular nuclear energy; the global stock of nuclear materials should be catalogued and monitored. It is also crucial for responsible handling of global health concerns, in anticipation of likely pandemics.

10. An additional aspect of the problem of international institutional deficit is the emerging but still underdeveloped international regime for dealing with systemically important financial institutions. In such regimes, information sharing would once again be sensitive, challenging and crucial. Although there are some international regulatory, or rule-setting, bodies in the financial sector, national regulators are still loath to share most information about domestic financial institutions.

11. Today there are increasing needs in an era of diminishing resources. In many countries, for instance the United States, India and Russia, infrastructure is aging. While significant investment is needed urgently to upgrade existing infrastructure and to build new components – for instance, to deal with effects of climate change or to be able to take advantage of opportunities presented by new technologies – resources for doing so are lacking. Similarly, both China and especially India are experiencing significant population growth, while their economies are slowing down and their governments already may have difficulties meeting the demands of their populations.

12. The rule of law is a requirement for successful and orderly resolution or management of most challenges facing the world today, and most countries internally. New rules, institutions and structures that are required can only be set up and made to operate successfully if laws and regulations can be trusted, respected, and enforced equitably and justly.

13. All of these challenges are made more acute by a leadership deficit on the national and international levels. Visionary leadership is in short supply even as it is urgently needed. Populations of most countries are increasingly disappointed in and mistrustful of their leaders, which inhibits effective policy making and urgent action, and often paralyzes key national and international institutions.

Country discussion

The world is still struggling with the aftermath of the Great Recession. The tail of this crisis is very long. Although it has hit the Western developed world the hardest, emerging markets have not “decoupled” from the West and have also suffered. The crisis has coincided with increasing global awareness of major new challenges, in particular, climate change and the increased likelihood of more frequent catastrophic weather events.

The United States

In the United States, the crisis is still broadly felt despite some positive news. The country is suffering from low growth and rising inequality, which fuels social resentment. The banking and financial system is not functioning properly, as it does not focus on banking, or turning people’s savings to productive uses. Long-term issues are also considerable and seemingly intractable, although public awareness of them has increased: the country has yet to come to a consensus on how to battle the twin crises of the ballooning fiscal deficit and unsustainable entitlement programs, while also being faced with the problem of aging, stressed and insufficient infrastructure.

The crisis, however, demonstrated that the United States, of all its Western peers, has the most resilient and dynamic private economy. It is able to adjust to challenges and to reengineer itself, even when government action is not present. The United States has also shown some ability to adjust socially, with views on a range of issues changing. The political system has been slower to react, although some crucial domestic political decisions have been taken, and probably helped the country to weather the crisis. In November 2012, the US electorate reelected President Barack Obama to a second term in office. The first item on his agenda was the resolution of the so-called “fiscal cliff,” which, if not solved, has the potential to push the United States back into a recession.

Emerging markets

Emerging markets overall have posted lower growth than expected. Although their performance is quite impressive by Western standards, all of the major emerging markets have slowed down, affected to differing extents by destruction of Western demand. The relative importance of the BRICs (Brazil, Russia, India and China) has increased, as has that of some of their peers. It appears, though, that emerging markets collectively are not yet ready to assume the mantle of global leadership and responsibility. While China is the second most powerful country in the world by many measures, including economic performance, and while its regional assertiveness and global economic clout have grown, it has not yet developed as a true global leader on many policy issues.

Some major positive conclusions came out of the crisis:

1. One key observation is that there has been no wholesale rejection of the global open economic model. Although criticism of globalization and attendant forces has risen in many parts of the world, probably most starkly in Europe, the global economy is here to stay.

2. The global system in many ways worked, with both national and international institutions doing their best to halt the spread of the crisis. Even so, it was shown that international institutions are not fully capable of dealing with a global crisis of such magnitude effectively.

3. Some international institutions have been adjusted to work better and to reflect the growing importance and weight of the emerging market countries on the world stage. For example, the G8 became the G20; the Basel Committee on Banking Supervision was expanded from 13 to 27 countries; and all the BRICs are on track to be among the top-10 shareholders in the International Monetary Fund (IMF).

China

In late 2012, China has been going through a leadership transition, which has allowed for reinvigorated discussion of challenges facing the country during the next ten years, the typical term of office for the country's leaders. Participants in the New Delhi symposium noted that over the past ten years, China has benefited from previous reforms and initiatives, without coming up with new reforms. Now, new positive action is needed. A key question is whether structural obstacles to resolving the issues that defeated the previous generation of leaders will also prove to be overwhelming for the new leadership.

In the words of one participant, the outgoing President Hu did not bring new accountability but greatly increased China's wealth. The incoming President Xi has already showed he cares, but now he needs to get rid of corruption and increase the security of society in all respects.

There is a slowdown in the Chinese economy. Although rates of growth are very high by Western standards, and are expected to be about 8% in 2013, they are lower than previously. This may both reflect structural problems of the Chinese economy and exacerbate problems in the Chinese polity. One concern is that slower growth will make corruption and high social inequality even more visible, leading to tensions and discontent in society at large.

Among the main problems in China, participants named social inequality, environmental degradation, corruption, and lack of opportunity for the young. An additional concern is the growing demographic imbalance, with the long-standing "one child policy" leading to a decrease in work-age population supporting growing numbers of the elderly.

Non-performing loans (NPLs) are a hidden problem of the Chinese economy, the extent of which is not fully known. It is exacerbated by the complex and murky relationships between state-owned enterprises (SOEs), state-owned banks, local governments and the central government in Beijing. There are fears of high levels of indebtedness across many regions and sectors, and of several asset bubbles, most notably in real estate.

One key challenge of the Chinese economy is to change labor-intensive production into technology- and innovation-intensive economic activity. This can be difficult, with hundreds of millions of people likely to continue to leave rural areas for the cities. Another challenge is to reorient the economy towards domestic consumption.

In order to deal with the challenges, China needs to shift its economy from being dominated by state-owned enterprises (SOEs) to a more private economy. To do that, both individuals and private businesses need to be empowered.

Many of the problems and much of what has to be done will raise the issue of the degree of fragility of the Chinese system of government. If existing problems are not resolved and if the negative trends are not addressed, the Communist Party of China may not be in power for much longer.

India

India lately has lost some of its dynamism and demonstrated sluggish GDP growth and high inflation. One of the main reasons for its slowdown is the loss of export markets and capital inflows due to the global economic turbulence. However, domestically its politics are seen as broadly dysfunctional, while its economy is largely inward-looking.

India's financial sector weathered the crisis relatively well. This is largely due to prudent regulation by the Reserve Bank of India (RBI), the country's central bank. Speculation by financial institutions was not permitted, and the banking system has been well-capitalized. While some regulation came at the cost of innovation in financial services, overall the RBI, in its capacity as banking regulator, helped India preserve its financial stability during the global financial crisis.

Now there is a need for deep structural reforms. The current government, in power since 2004, has been largely passive and reactive. India has benefitted from reform plans and actions of the previous governments. The administration of Prime Minister Manmohan Singh, however, has done little. No major changes can be expected until the elections of 2014.

The political system drives the country's economy. This is often problematic, as Indian politics are complicated and fractious, with power divided between the central government and governments in 27 states, many of which yield significant power. There is an ongoing standoff between the center and the states. Political leadership does not

show ideological commitment to reform. There is also an endemic problem of corruption.

The challenges that India faces are acute. There is a lack of investment in infrastructure. Labor laws are antiquated, with the country still following statutes that have been on the books since the 1940s. The need to move people from the agricultural sector to the manufacturing sector is urgent. India has an abundance of low-cost labor; however, manufacturing jobs that are now leaving China tend not to go to India but rather to other countries, such as Bangladesh. This is largely a function of India's outdated labor laws. As a result, India has moved from an agricultural to a service economy, skipping the manufacturing stage. In a country with a vast and mostly poor population, however, this is untenable. Skilled workers need to manage unskilled workers, rather than other skilled workers, which is the case at present.

On the positive side, India has a vibrant civil society and a strong investigative press, both of which serve as a check on government, politicians and to some extent corruption. The new middle class is showing signs of activism, and has organized to protest practical problems, and corruption in particular. When allowed, Indian business can be effective and competitive. There is also significant innovation in the financial and banking sector, which is focused productively on increasing financial inclusion across the myriad of the country's villages and on introducing new technologies to make inclusion possible.

Russia

In Russia, the return of President Vladimir Putin dominated the life of the country in 2012. While it represents continuity, the return of Putin to the presidency has increased tensions in society. It is assumed now that the status quo is not sustainable over the long term.

The return of Putin to his third term in office, after serving for one term as a powerful prime minister, has provoked an outpouring of discontent from the urban middle classes, leading to more than a year of protests, primarily in Moscow. At the same time, there are signs that the "Putin consensus" has frayed. The Putin consensus denotes an implicit deal between the political regime and the people of Russia: while economic development continues and the standard of living increases for everyone, power is monopolized by a small group of people around the president. However, a combination of economic slowdown and the manner in which President Putin decided to regain the presidency has led to more people turning against the status quo. As a result, tensions within both the elite and the country appear to be increasing.

In the economy, growth has fallen. Russia continues to be overwhelmingly dependent on exporting its energy resources, while suffering from extremely low productivity. Levels of corruption are very high and growing, while much of the Soviet legacy, for instance in infrastructure, has been depleted and requires urgent improvements.

The Russian government is officially committed to a strategic plan to make Moscow an International Financial Center (MIFC). A number of new laws, rules and regulations that may make Russia a more attractive place for investors and a better managed financial location have been promulgated, or are planned, under this banner. However, several participants in the symposium voiced significant skepticism about the likelihood that the MIFC could be successful. Consistent reform, transparency and accountability are all necessary for the MIFC to be plausible, and all are lacking.

More broadly, observers inside and outside of Russia comment, and commented during the New Delhi meeting, about a worrying lack of commitment to good governance and the rule of law throughout Russia's governing elite, and even the country's society.

Thus, the key challenge for Russia is governance. Should it find leadership and societal resources and political will to continue with a reformist agenda, it could leverage its natural advantages into development. The issues the country faces, however, will be increasingly political. The first months of Putin's third presidential term saw a broad tightening of numerous norms and laws, with the apparent goal of making political opposition activities more difficult. At the same time, there is some talk of returning some more democratic forms of governance, such as elections of governors and senators. It is too early to tell whether this, as well as anti-corruption initiatives, will yield some positive results.

Sector discussion

Financial Sector Issues

1. Although there is a change in the structural position of reserve currencies, the appearance of major new currencies has been problematic. The RMB is probably moving in the direction of becoming a reserve currency, but it will take some time. Lack of transparency and strict capital controls in many countries are major stumbling blocks. Transparency, for instance, is the key issue for the Russian Ruble, while capital controls limit the potential of the Indian Rupee. Overall, in current market conditions, it is difficult to diversify out of the US dollar.

2. One of the major problems in the global financial sector post-crisis is the so-called "too big to fail problem." How can future bailouts be prevented if the world--or national regulators--cannot prevent future crises? The social costs of failure of a major transnational financial institution can be immense. In fact, it is better to replace the term "too big to fail" with "too interconnected to fail."

One answer is that the goal should be a dedicated effort to mitigate the risks and costs of failure of a major international financial institution. This will have to be done on an international level, by bringing together best practices and multilateral partners to come up with workable solutions. Dealing with the failure of a "too interconnected to

fail” institution would require sharing sensitive information, and the necessary global institutions to facilitate and oversee such sharing do not yet exist.

Climate and Energy Issues

There is general agreement in the scientific community that climate change is real, and is moving faster than was broadly expected. Failures to adapt to climate change, possibly as a result of large-scale climate-related natural disasters, are likely to occur over the next ten years. This will present unprecedented challenges to individual societies and to the global community as a whole.

To mitigate climate change, humankind will have to adapt new energy technologies very rapidly. At the current moment, there is no detailed and practical energy policy in the United States or most other countries. This will have to change.

Most alternative energy sources are developing slowly and are still far from being cost-effective. Most renewable sources of energy are not reliable and are costly to store. In this situation, and in the absence of new scientific breakthroughs, the most likely path for the world to take is to become more reliant on nuclear technology for the generation of power.

Several trends generally make it a tenable as well as relatively secure option. Security of nuclear plants has been increasing, in part reflecting adjustments after the 9/11 attacks. In the wake of the Fukushima earthquake and tsunami disaster in Japan, safety precautions internationally have also been amplified. At present, a lot of countries are upgrading their existing facilities, renewing extant licenses, and commissioning new plants.

There is some hope for new scientific breakthroughs that could change the global energy equation. Such breakthroughs, whether they will make renewable technologies more practicable or will find how to use methane hydrates for power generation, will be slow to arrive and cannot be predicted with certainty. The challenges the world faces are already here, and need to be addressed now.

The symposium in New Delhi has extended the long record of high-level dynamic and productive discussions organized by FSVC and the Carnegie Corporation of New York. The world of late 2012 is one of profound change and significant turmoil. The ability of FSVC and the Carnegie Corporation to bring together influential specialists from key countries of the world is more valuable than ever. Building networks of communication that will persist beyond the meetings is one of the goals of the project, and one that has been accomplished in New Delhi. Most importantly, by openly and directly discussing a wide range of pressing international and national concerns and challenges, the New Delhi symposium has contributed to building trust and understanding among experts and opinion-makers from numerous countries, an

achievement of particular significance as the world continues to grapple with the difficult realities of the 21st century.