UNEDITED TRANSCRIPT

2018 US-China Forum — China's Role in Global Finance and Trade Growth

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MICHELLE CARUSO-CABRERA: So glad to see you all here, and thank you for those kind remarks. And could I re-emphasize how great it is that so many of the panelists traveled from Beijing and from China to join us? Because we shouldn't be talking about each other or at each other, but we should be talking with each other, and that is certainly the goal of this US-China Forum. Good morning, and welcome back to day two. This panel is "China's Role in Global Finance and Trade Growth."

On the far end, Lars Peter Hansen is the David Rockefeller Distinguished Service Professor in Economics, University of Chicago. Also a winner of the Nobel Prize, this very small club, even though here at the University of Chicago it tends to be big. Raghuram Rajan is the Katherine Dusak Miller Distinguished Service Professor of Finance, Booth School of Business, University of Chicago. Just flew in from talks at the IMF and former head of the Central Bank of India. Wang Yanzhi is the Executive Director of the Board of Directors and President of the Silk Road Fund. And once again, in particular, thank you so much--

WANG YANZHI: My great pleasure.--

MICHELLE CARUSO-CABRERA: --for traveling from Beijing. We really appreciate it that you've made the long trip here. So the topic is, as I've talked about, China's role in global finance and trade growth. That's a broad topic. We're going to start a little bit more narrowly, because of your specialty. I'd like to start with the guest from Beijing, first of all, to be polite and also to hear from you, but also because you have this great specialty. We talked so much yesterday about the Belt and Road Initiative, and you are in charge of the Silk Road Fund, which is about investments in the Belt and Road Initiative. Could you just tell us a little bit about the fund, and how connected is it to the Chinese government?

WANG YANZHI: The Silk Road Fund-- first, thank you very much. Great pleasure for me to come here. The Silk Road Fund was set up four years ago. At that time, China launched its initiative-- Belt and Road Initiative. Two important institutions were set up. The AIIB, which is quite well-known. Another one is the Silk Road Fund. We kept ourselves low-key. We classify ourselves as a medium-long-term equity investor. So we do direct overseas investment. The reason to set up a new financial institution.

The background for the thinking-- there was already or there are already enough financial institutions why China is to set up a new one. The thinking is that the long-term-- medium, long-term investors are not that so many, especially in China. There are a lot of financial institutions who do short-term investment.

Well, the economies, especially those less developed economies, require a long-term fund for investment. So that's the theory behind setting up this new fund. We have four investors. They are SOEs. So we are SOEs working independently.

The area for us to make investments are very broad, in the areas of power, resource related, infrastructure is very important, and also in areas of promoting economic connectivity. So we do a lot of investment for the long term. That's the uniqueness for us.

We do investment based on the market terms. So yesterday, there was a lot of talk about China's financing in the Belt and Road-- along this Belt and Road Initiative. That was really something new for me.

But we work on the market teams. We work with partners in other countries. So that's what we are doing. I stop here right now, yeah.

MICHELLE CARUSO-CABRERA: So if you're just joining us today, SOE is a State-Owned Enterprise. So you've got four state-owned enterprises that are investing in you. On CNBC, I'd ask, what's your AUM? What's your Assets Under Management? How much money are you investing, managing on behalf of these institutions?

WANG YANZHI: When the company was set up, we have 40 billion US dollars capital. And last year, there was injunction of, in addition this $40 billion US dollars, we have 100 billion RMB, which is local currency. So we have a two-tier capital.

But the capital is on call basis, which means we first have a project that are acceptable for us. And then we will call our shareholders to put their money in. So that's the size [INAUDIBLE].

MICHELLE CARUSO-CABRERA: By the way, I forgot to mention. If you have questions, there's going to be people walking around with cards. You can write them down. They'll bring them to the front row, and we'll be taking questions towards the end of the panel.

One final question to you before I move on to the other panelists. There'll be more. Don't worry.

But you highlighted what was a lot of the discussion yesterday-- the criticisms coming out, debt trap diplomacy, economic imperialism. I gather you would disagree. But tell me, what would you say to folks?

We spent a lot of time on the Sri Lankan port that got taken over because Sri Lanka couldn't pay the bills. And so therefore, the collateralized asset was seized. Are we making too much of that? What?

WANG YANZHI: Well, I gave the example what we did in Pakistan. We have hydropower projects. Hydropower-- we team up with China Three Gorges, who built the gorges. They have the capacity to do the project.

MICHELLE CARUSO-CABRERA: The company.

WANG YANZHI: The company.

MICHELLE CARUSO-CABRERA: Yeah, mm-hm.

WANG YANZHI: And also with IFC, the world bank affiliate. We set up a company, and we put our capital in. And we start that project.

We talk with the Pakistan Electricity Authority, agreed to build this power. And the Pakistan Electricity Authority agreed to purchase once the project finished a given level of tariffs. So that is the project.

The Silk Road Fund is minority shareholder. And at right now, the Three Gorges is the biggest shareholder. But once the project's built in, after, say, 20 or less than 30 years, the project will be transferred to the Pakistan government or electricity authorities.

So that's the way we work. And we put our own capital in. We have debt financing from banks.

The banks would do this based on the financial considerations-- can we finish our project on time? Can we repay the debt? If we don't repay it, our shareholders will pull our money to return to the banks.

Can the Pakistan Electricity Authorities pay their tariffs on time? So this is sort of issues. We don't create a debt at the national level. We create debt at the project level, which we bill the authorities.

There's no-- I mean, yesterday they talk about debt trap. I really don't know where this concept come out. In my project, there's no such things. Direct investment actually reduce the debt level of Pakistan.

MICHELLE CARUSO-CABRERA: Yeah, so I think when people talk about debt-trap diplomacy, there's this insinuation that, for example, the loans were designed to be onerous, unpayable, and therefore, China by design gets this asset. And that was always their intention. And you're saying, no, that always it's an economic--

WANG YANZHI: I really don't know if there is a financial institution-- a bank-- who work in that way, who live in that way.

MICHELLE CARUSO-CABRERA: I mean, they shouldn't in theory, right? But--

WANG YANZHI: In theory, in practice, I have never seen a fund-- a bank-- live in that way or make a living in that way. I mean, that's--

MICHELLE CARUSO-CABRERA: No, they would generally fail if they-- [CHUCKLES] right, exactly. Professor Hansen, you travel to China frequently. If we can move to the broader topic at hand about China's role when it comes to trade and global finance, your immediate observations to help us set the stage.

LARS PETER HANSEN: Sure. Well, a couple observations come to mind. When I go to China, I'm often asked this question about when will the Chinese economy overtake the US economy and the like? And it's almost like a zero-sum mentality. I find that a very boring question. I'm much more--

MICHELLE CARUSO-CABRERA: Boring.

LARS PETER HANSEN: Boring. I'm much more interested in questions about what are the mutual economic gains between the potential out there between the two countries. And I find that a much more interesting conversation. There's two challenges there that I find intriguing. And one is the future of economic growth-- I think it's true in the US, it's certainly true in China-- comes through nurturing new businesses, building new enterprises, and promoting new ideas.

The standard banking sector has been notoriously poor at identifying such and making such investments. It's made the so-called shadow banking activities all the more critical in China in order to try to nurture this new growth. There's shadow banking challenges in the US as well.

But I think there's some special challenges coming out of China because of this. And given the perceived need to regulate shadow banking, how do you regulate it in ways that you don't also squash the potentially very productive investment? And so I find that a fascinating challenge going forward and one that's interesting to see how it plays out.

The other thing that really stands out is China's advances in so-called fintech financial technologies. We look at the payment systems which they put in place. I think that this is, in part, a reaction to the sluggishness of the state-owned banking sector.

They kind of jumped over the whole credit card system, and they've got this incredibly impressive internet exchange system in place. It's now leading to peer-to-peer lending and the like. Those have been fascinating evolutions and advances.

Of course, anytime you see such advances, there's interesting questions that go along with them. There's now concerns about how you regulate things like the peer-to-peer lending in productive ways. There's issues about how do you produce and kind of assess credit worthiness.

So big companies can do this on their own because they've got their own data sets, which they can draw upon. But to what extent do governments have to be involved in this? And this raises fastening questions about privacy.

So part of credit evaluations now include things like assessing social networks. And it's kind of my observation of innovators is they're not always the most socially connected people. And so I worry about there's being a technology out there that could be abused by bad governments-- in the US, in China, or in the future-- that's a major invasion of privacy because of these internet advances.

And I'm not sure how to wrestle with that one. I think that's a challenge in China. I think it's a challenge worldwide.

MICHELLE Yeah, the big trade-off between efficiency and privacy and what it can lead to. We discuss it so

CARUSO-CABRERA: much here in the United States as well. Professor Rajan-- I interviewed Professor Rajan about a year ago, was it, at the-- there was a different panel at the Booth School.

And you thought the most important thing to bring up was what is the state of the Chinese economy, and what does it mean for the global economy? Do you want to elaborate? I mean, you think a lot about this issue.

RAGHURAM G. RAJAN: Sure. Let me start first by agreeing with Mr. Wang that I don't think these situations where countries get into trouble because of the debt they've taken on is designed. I don't think any Chinese lender would think that's the way to get influence and win hearts and so on. I think what is happening is there is the occasional mistake-- projects that essentially are not commercially viable, that have been financed.

And it's happened since time immemorial, especially with large infrastructure projects. And so then we have to figure out how to restructure them, how to put them back on track. And some of them are white elephants which will never see the light of day.

I think one of the concerns there is this, are the negotiations being done in a way that brings in more of the commercial aspect, especially from the countryside? And I think that's a learning process. As we go along, we'll figure out how to do more of it.

Certainly, the multilateral institutions-- the World Bank, the IFC, et cetera-- have had 60, 70 years of experience trying to do this. And there is still the occasional failure. So I think when China starts and there are these issues, we shouldn't be quick to rush to judgment, saying this is because of debt imperialism or something like that. At the same time, I think it would be really very good for both sides to have more transparency on the process of negotiation, et cetera, so that the immediate conclusion is not from the countryside, our guys sold out because there were lots of underhand transactions that were done, and from the rest of the world that this is China trying to sneak in through the debt door to get a competitive advantage. So I think there's learning in this process that can take place.

I think China is undergoing a transformation. And you must have heard about that yesterday also in a big way. And as Lars pointed out, a big part of that is the financial sector.

But I think it's important to understand why the dynamics are so different in China. What is happening, to my mind, is a transformation on the industrial side to far less dependence on subsidized inputs, on cheap credit, on cheap resources, et cetera, and on the household side, a movement to far less repression. One example for you is household deposits in the banking system were historically compensated at very low rates.

MICHELLE CARUSO-CABRERA: You're talking about financial repression.

RAGHURAM G. RAJAN: Financial repression.

MICHELLE CARUSO-CABRERA: And this is a reference to oftentimes when banks or governments keep interest rates low, et cetera. Uh-huh.

RAGHURAM G. RAJAN: Absolutely. They keep interest rates low so that they can provide cheap credit to industry. Industry gets cheap credit, utilizes it in investments, and it comes back to the household over time in the form of more jobs, over time higher productivity, et cetera. But for a while, the household is repressed with low interest rates.

It's repressed in a way with lower than marginal product wages. This is the reserve army of people as they move from agriculture into industry. Because there's so many of them, you can afford to pay them lower wages.

Now, over time, that's made up because as you grow faster, these wages go at a fast pace. And people get rich very quickly. China has become very rich, very quickly. But it has done that on the basis of what the West would call distorted prices. But it's been a very effective way.

Now, the prices are coming more back to normal. Now, as they come to normal, you have to change the method of allocation. The allocation can no longer be centralized.

You build this. He builds that. We build these extremely long bridges because they're needed. We build these railway lines because they're needed.

You reach the point where you have to figure out whether it's needed or not because not everything is needed anymore. Infrastructure becomes much harder to build once you are more developed. What is the additional road you need to build and where?

That's where China is now, I think, is certainly on the building, which is why they're changing their model from an emphasis of investment-led growth to more consumption-led growth to more market-led growth. And here is the big question for China. Can it allow the various markets to allocate resources in the way that it needs now, now that it's reaching closer to the frontier?

And the problem, to some extent, is that many Western countries have done this but have done this without the additional constraint that China has, which is it wants the party in charge. And I think those two are something that we've never seen before-- having a dominant, centralized sort of political structure with a market allocating resources.

MICHELLE CARUSO-CABRERA: Economic freedom versus political freedom is another way that it's sometimes phrased.

RAGHURAM G. RAJAN: That's another way of--

MICHELLE CARUSO-CABRERA: Can they be separate?

RAGHURAM G. RAJAN: --putting it. And let me sort of throw up one reason. Markets go up and down.

MICHELLE CARUSO-CABRERA: They sure do.

RAGHURAM G. RAJAN: And when they go down, it's because the market has figured out that it was getting it wrong. And it's telling you that, you know, rethink. Now, can a system which is more centralized allow that fluctuation?

I throw this out as a question because as you see, the last few days when the Chinese market was down, people were saying, when is the state going to intervene? When are they going to come in to bail us out? And to some extent, this is not far from a issue that has been raised time and again about centralized economies, what Janos Kornai called the soft budget constraint, that they are tempted to come in to bail out.

And in that case, can you allow the market full freedom? Because the market is always betting they will come in. And then it distorts decisions. So that--

MICHELLE CARUSO-CABRERA: And you have moral hazard, basically.

RAGHURAM G. RAJAN: Yep, moral hazard big time.

MICHELLE CARUSO-CABRERA: Moral hazard is a concept in insurance where when you insure something, people are more likely to do it because they know that they're going to get the insurance, right? You can actually engender more risky behavior because the person thinks, well, I'm insured for that. So why not go for it, right? If they're going to bail out the stock market, why not invest in it is the general concept.

So there's a lot to unpack there. There's some overlap between what Professor Hansen said, talking about the financial system, and the state-owned banks, and maybe not being so good at allocating capital. Mr. Wang, do you want to weigh in on-- I saw you nodding your head when Professor Hansen was talking about the shadow banking system and what was happening there. Did you have some observations that you wanted to add to that?

WANG YANZHI: We had a private chat before we came on this.

MICHELLE CARUSO-CABRERA: Uh-huh. Tell us. Tell us everything.

WANG YANZHI: About the shadow banking, and it's much more related with, as Professor said, the efficiency of state-owned banks. Can they provide efficient financing support to the people where they really need, or to enterprises which they really need? If they work less efficiently, someone would show up.

This is shadow banking who do. And I think that's the forces of market economy, even working in China. If the state-owned company is not doing well, someone will show up.

MICHELLE That's the shadow banking system to fill the need.

CARUSO-CABRERA:

WANG YANZHI: Right. And also, the regulators always slow a step backward. When they realize this issue, they come out. So when they try to bring the shadow banking within the framework of supervision, it's very likely their way they will kill this shadow banking-- make the more efficient work less or not longer working, or rely on those SOEs who do less efficient works.

So this is a issue. That's why I talked to the professor. China is very interested-- and this is really beyond what I'm doing now.

You have a different institutional arrangement. But we embrace the theory of market economy, which is very new, how the system could work-- different system but market economy. This is a lot of area that certainly Professor can do the research.

MICHELLE CARUSO-CABRERA: You were here yesterday. I would describe yesterday as a lot of people saying, China should be a market economy. Why isn't it a market economy yet? We've been waiting for China to be a market economy. What is taking so long?

I mean, there were all layers of that. I mean, there was a lot of skepticism about Belt and Road yesterday, even from economists here who I would associate with the Democratic Party, who believe in, to some degree, Keynesian spending, et cetera, but were very skeptical about the level of spending on Belt and Road. I mean, a lot of the Chinese participants yesterday basically said, we're working on it. We're getting there. Be patient.

You want to add anything to that? Or are we--

WANG YANZHI: Well, yesterday's discussions were really very high quality. Professor Huang from Beijing University has given a lot of interesting points. China has overgone in the last 40 years tremendous changes. They are a lot of changes which I don't think the West really understand the fundamental changes.

But 40 years now, the US [? trade ?] is not happy. It's not going like us, like US, right? I'm not sure the US really understand if China is really like US it's the good thing or bad thing. That's one issue.

And this certainly brought a very legitimate concern, I mean, for inside, outside people in China. Over the past 40 years or over the last 20 years, China worked under the rule of WTO.

China has benefited a lot from this globalization.

Should China make some change because you're no longer in the past, so you should do some change? In which way? I mean, these are legitimate questions, even for the people who are living in China.

There is a much need for further reform in SOE sector. I'm also pretty sure the role of government is also an issue if you want to move further with the system. But the difficulties right now really over the 40 years of reform are definitely already established there based on what we have, the interest. So you are touching more deep-rooted issues.

Should government like to change its role? In which ways change? How SOE behave? Is the market disciplined to supervise their behave?

This is a lot of issues related with China's institutional arrangement. We do overseas investment. We have to do based on the market economy, or we have to behave in the market way because our partners are from different countries. They work in different ways.

And it works very well with us, I mean throughout our last three years' investment. We always team up with local partners, with international partners. And there's one phenomenon I don't think people actually realize. We go in the Belt and Road, together with the US firms, because my investment, a lot of services are provided by US firms in the area of law, in area of financial services, in area of tax policies.

So we work actually together. In the service sector, it's the US firms that are working with us. We work together in the Belt and Road Initiative.

MICHELLE CARUSO-CABRERA: I meant to ask earlier if you could give us some sense of performance. Do you have any stats you can tell us or any insight you can give us based on the investments you've made so far--how they're doing? I mean, as we sit here and wonder about the ability of SOEs to actually perform well, you're running one. How's it going?

WANG YANZHI: We had, over the last three years, total 27 transactions. Two already existed. So existing, 25.

MICHELLE CARUSO-CABRERA: You've exited already.

WANG YANZHI: We've exited two already. We have investment in Russia, in Middle East, in Europe, in Southeast Asia. That is Pakistan is one of the projects we mentioned.

It has been, I mean, better than we had expected, let me say, thanks to God. I mean, doing the direct investment is sometimes you have to rely to some extent the element of luck. You have a good luck, you make a right-time investment, so you do well. But also--

MICHELLE CARUSO-CABRERA: There's a saying in this country. I'd rather be lucky than good. [CHUCKLES]

WANG YANZHI: Also, I have to thank my team. They work very hard.

MICHELLE CARUSO-CABRERA: Yeah, yeah.

WANG YANZHI: And also, I have to thank China, this Belt and Road Initiative. It is well received-- you may disagree with me-- in less developed countries. In developed countries, or developing economies-- US and EU area in general-- it depends whom you ask. It is very well received. That's why we can do much better at this.

MICHELLE CARUSO-CABRERA: But generally, the transactions are going well. I mean, have you had any defaults? Or have you had to do any restructurings on any of them?

WANG YANZHI: So far, no. I cannot say in the future. But when you select the project, the financial consideration is the most important for us.

We do the long-term investment. Can the project itself go through the cycle? There is up and down. Can you go through?

There is also the political risk-- if the government change, as you mentioned. Sri Lanka is one of the case. If the government change, is that project still relevant to society?

So the project itself has to be fitting the need of the society where you go. So even the government change, the people still need that project. So that's a selection of the project itself.

Financially sound, sustainable is critical to us. This is nothing to do with the ownership. SOE or private, you have to do that. I think this is the first important principle.

And also, you have to choose the right partner. Local partner is important. The ownership-- the project is theirs, not mine. I'm making--

MICHELLE CARUSO-CABRERA: You're the finance guy, mm-hm.

WANG YANZHI: And also, for us, the success so far we have done, we tried to work together with third party, together with the local partner in this area. I think multilateral financial institutions and US firms-- actually, we had the platform the GE we do together in the third countries. This is great. I mean, that's why I say, it depends whom you ask. I think that the way, yeah.

MICHELLE CARUSO-CABRERA: Professor Rajan, I see you nodding your head.

RAGHURAM G. RAJAN: Well, I think the new institutions that China has set up-- AIIB, for example, the new development bank in partnership with the BRICs countries-- these are actually creating new ways of financing investment, cutting through some of the bureaucracy that has developed in some of the old multilateral institutions. So I hear good things about the way they're evaluating projects, the way they're going into it. And I think it's high time we had some competition for the multilateral institutions from elsewhere, which weren't dominated by the same set of countries and shareholders.

That said, I think in the longer run, it would be good to have some sort of a global architecture into which these new institutions sort of fit in because there are places where competition can be bad. And there are places where competition can be good. One example that the IMF has talked about is when multiple agencies lend to the same country, and the left hand doesn't know what the right hand is doing. The country gets overindebted quickly, not because of anybody's intent but because we don't have a good sense of what the overall structure is. So there may be some advantage to trying to have an overall envelope, to have a platform for each country which all these institutions sort of subscribe to so that there is a sense of this is what's going into the country, this is how its development is being managed, especially for the least developed countries that have modest capabilities at that level.

So I think it's very good news that China has set up these institutions. I think it's financing that is very important, that has sort of slowed down over the last few years, especially in the infrastructure area. But I think we need to figure out a way to sort of make it most effective. And I think thinking about that makes sense.

MICHELLE CARUSO-CABRERA: Professor Hansen, anything you want to add to this?

LARS PETER HANSEN: Yeah. So observations in various different economies is that infrastructure investment always seems like a wonderful idea. I was struck in the US economy after it had a financial crisis, in which we wanted to rush out a bunch of fiscal spending [INAUDIBLE]. We were remarkably poorly set up in order to infrastructure investments in smart ways.

I think it's an important challenge to figure out what is a smart infrastructure investment. And it kind of has this appeal to it. But are these going to be projects that are in China's interest? Are they in the foreign countries' interest?

How do we balance off the social value of them and the like? I think that's a very hard assessment to be making. And the more that that's done in a centralized way, the more concerned I am that you might have the less-than-successful outcomes out of them.

But, of course, I'm open to the idea of China investing in the rest of the world in order to make things better for everybody concerned. Structuring incentives, I think, is quite challenging.

MICHELLE CARUSO-CABRERA: Everywhere in the world.

LARS PETER HANSEN: Yeah.

MICHELLE CARUSO-CABRERA: Right? I mean, down to the local municipality here in Illinois even, right?

LARS PETER HANSEN: Right.

MICHELLE CARUSO-CABRERA: Professor Rajan, you highlighted whether or not there should be a wider platform in terms of knowing what the left hand versus the right hand is doing. China has grown so much. And its economy is now so big. And because of its lending, we're now on the verge of something that hasn't happened in modern economic history, which is that we might end up with an IMF bailout, for example, that involves Chinese lending.

RAGHURAM G. RAJAN: Yeah.

MICHELLE CARUSO-CABRERA: Or there's going to be some kind of international debt restructuring that involves Chinese lending. It's the first time we may see this. I've covered debt restructurings for a long time at CNBC, whether it was private sector General Motors, the Greek thing that went on forever.

And people are just-- they're not antagonistic about it. They're just very curious, like what's this going to be like, you know? And part of any kind of debt restructuring is all the people who are owed money demand-- they want to say, OK, what's the total debt out here? Because if we're going to restructure it, we need to know how much there is, so we can come up with a better structure where all of us can get paid back at least some of what we lent, maybe not all of it.

You know, we want to avoid the tuna boat situation down in Africa, for example. If you don't know what I'm talking about, Google it. And what are you thinking about? I mean, how cognizant are the multilateral institutions of the world think about that?

RAGHURAM G. RAJAN: So our system was set up immediately after the war, the Second World War. The US was the most powerful country in the world. And it set up a system which was actually based on your growth is good for us.

MICHELLE CARUSO-CABRERA: Mm-hm.

RAGHURAM G. RAJAN: However, that system had a central place for the United States. It was a system set up by the United States, with extraordinary powers for the United States, which it did not exercise for the most part. So for example, in the IMF, it's the only country which has a veto, right. But it's got that, and nobody objects because it's not used that often.

It's respected. Everybody knows the US can veto decisions. But they don't get there. And the

US rarely threatens to use it, right?

MICHELLE CARUSO-CABRERA: Don't you think there's probably a lot of self-censorship on the part of--

RAGHURAM G. RAJAN: Exactly.

MICHELLE CARUSO-CABRERA: --the other participants?

RAGHURAM G. RAJAN: There is some of that. But it hasn't reached the point where people say, we don't like this hegemon. We want to overthrow the hegemon. However, in the IMF Article of Association, there is a clause which says, the headquarters of the IMF will be in the country with the largest quota, which happens to be in the United States, which is why the headquarters of the IMF is in Washington.

But by all parameters, China is becoming the largest country, right, soon-- certainly within our lifetimes. Whether it's in the next 10 years, we have to see. It's becoming more of a market economy, with the financial sector increasing, et cetera, which means that by rights, the quotas will have to adjust such that it becomes the single largest quota holder. All the rights that the US has will transfer to China.

Is that a reasonable thing to happen? Well, the structure of the system was set up post-World War II, when we had a single hegemon. It's not a structure which is meant for a multipolar world, where there are multiple players of similar size, and economies are more broad based.

So we have to change the system in such a way we can accommodate this multipolar world. It has to become much more democratic, much less hegemonic. As it was set up earlier. However, what we have right now is a resistance to change on the part of the old powers. And to some extent, I think the new powers are setting up their own institutions rather than changing the existing institutions. As I said, this creates problems because when you have to get together to solve a problem, you have very different institutions that are not on the same page.

Now, when we have a new great game being played out in Africa, everybody is trying to get influence because this is the continent of the future, this creates problems of indebtedness, et cetera. What do we do to solve this? I think we have to get together on the same page. And this requires change on all sides.

I think from the old powers, they have to allow place for the new powers in a much more substantial way than in the past. How are we going to do this in an era of populist nationalism? I don't know.

It's going to make it harder, but it has to be done. Otherwise, the old institutions will lose relevance. And we need coordination of this more integrated world in order to make the kinds of decisions which are more welfare maximizing in these countries.

MICHELLE CARUSO-CABRERA: I take your point about the current administration, which I think is what you're talking about on [INAUDIBLE].

RAGHURAM G. RAJAN: I think more broadly then, that Europe is also an issue. But--

MICHELLE CARUSO-CABRERA: Yeah, for sure. But I'm not sure under President Obama they were going to be willing to give up--

RAGHURAM G. RAJAN: For sure.

MICHELLE CARUSO-CABRERA: --IMF power at this point.

RAGHURAM G. RAJAN: I think this exacerbates things a little bit. But the problems are historical. No existing power wants to give up any of-- Belgium doesn't want to give up its quote in the IMF, right?

MICHELLE CARUSO-CABRERA: Right.

RAGHURAM G. It's so out of whack with this Belgium size. But it doesn't want to give up its quota. So I think

RAJAN: there's a larger problem. But the reality is if we don't change, those institutions will steadily lose influence. And new institutions will come up.

MICHELLE CARUSO-CABRERA: Professor Hansen, what do you think are the prospects for China's future role in global finance in trade?

LARS PETER HANSEN: So China's already demonstrated an amazing ability to innovate in some important ways when it comes to, say, financial technology and the like. Part of this is adaptation to some of the institutional weaknesses of the Chinese economy. But there's been major advances there.

You know, we keep on talking about this transitional market economy. And we had the discussion yesterday about do you do this fast or slow, and that China's decision has been to do it somewhat gradually. And is that good or bad?

I worry very much that that process is going to plateau. And the transition is not going to go all the way. We're now thinking when we see some of these financial challenges facing China, we will go and reform the state-owned banks and get them to behave better and the like.

And I think external private-sector competition is really critical here. And how that plays out, I think, is quite important in terms of China's future. Is it going to be really solved by just doing better monitoring of the existing state-owned system? Or is it really going to open up even more opportunities for private-sector competition?

And to me, that's a very important question. I don't have a crystal ball to predict how the politics are going to work out for that. But I think it's critical to China's future.

MICHELLE CARUSO-CABRERA: Speaks to the tension that Professor Rajan was talking about earlier about-- I oversimplify because I'm a journalist-- economic freedom. And is it ultimately good for democratic freedom? You know, we had a guest on once who quote 38 Special, which is a rock and roll band.

And they have a very famous song-- hold on loosely, but don't let go. If you cling too tightly, you lose control, right, that there's this-- that can you take the mental leap to say, the more dynamic this economy becomes, the more economic freedom that there is? Do we actually retain more power as a result, right? I mean, am I close there in to the kind of tension that we're thinking about here?

RAGHURAM G. RAJAN: Absolutely. I want to echo what I heard, which was with power comes responsibility. And I think the problem is being responsible for the market. If you are held responsible for the market--

MICHELLE CARUSO-CABRERA: Good luck.

RAGHURAM G. RAJAN: --you tend to do a lot of stuff which is problematic. You have to have the ability to say, that's doing its own thing. I'm taking care of this side. That takes care of economic allocation, et cetera. If it penalizes you, if it dumps on your stock price, that's not my fault.

But the more you sort of intervene and say, I am in this private company, I'm here, I'm there, I'm managing the economy, the more you take responsibility for outcomes. And then you can't blame the market. So that's my-- I mean, you said it perfectly with that verse.

That's precisely the point. The more close you get, the more you get pulled up and down by the market, the more to show you're in control, you've got to do this stuff to smooth it. And then the market is no longer functioning as you would want it.

And that's, to my mind, the greater problem than, you know, you need political freedom to innovate and all that. I think maybe, maybe not. But I think really, it's the separation between market and state, which becomes much harder when you have an infallible party which takes full responsibility for everything.

MICHELLE CARUSO-CABRERA: Mr. Wang, I don't want to ignore you. But I also don't want to push you into something that's outside the scope of what you came here to talk about. And you want to weigh in here on this kind of weighty discussion?

WANG YANZHI: Yeah, yeah. From my own perspective, the future role of China in the global finance, I take the establishment of AIIB as one example. Something related to Professor Rajan just said-- the multilateral institutions.

You have World Bank. You have regional multilateral financial institutions-- ADB, in different region, they also have. But why the AIIB still has a role, still need, when the China decide to sign up AIIB, it is welcome, at least in some certain countries? Because the current multilateral development institutions is no longer functioning in an efficient way or in some way as people wished.

The rich country reluctant to give money to financial institution, to multilateral institutions. They don't have enough money to support the poorer countries. And also, the multilateral financial institutions has become more complicated in whatever the criteria set up by the major shareholder, which the less-developed countries really cannot bear that criteria.

So it's not qualified to get the loan. So that's the way the AIIB has a role. This is one way I think China played a role.

And another aspect, as Chinese economy grow, Chinese enterprises has the wish to go international market, as of right now, because in the past, the enterprises doesn't matter, SOE or private. They feel already very crowded in China. So they have wish to go outside.

When the enterprise go outside, the financial system will also help them to go outside. This trend will continue, sometimes faster, sometimes slow. So I think China's role in the future will grow in global finance.

MICHELLE CARUSO-CABRERA: The currency is managed. We're right now wondering, are we going to see it 7 to the dollar. Good idea? Bad idea?

Talking about things that these multilateral institutions require, the IMF is, of course, always pushing-- not originally, right? It was Milton Friedman who actually, when he wrote, "currency should float," everybody thought it was a heretical idea. But now, of course, you know, the US government wants to demand that China let its currency float. What's your predictions about where that's going? And is it a good idea to maintain it right now-- their walled capital account-- as we worry about whether or not there's stability there, Professor Rajan?

RAGHURAM G. RAJAN: I think the Chinese inclusion in the SDR basket and the--

MICHELLE CARUSO-CABRERA: The SDR basket is the IMF--

RAGHURAM G. RAJAN: The IMF's--

MICHELLE --unit of money.

CARUSO-CABRERA:

RAGHURAM G. RAJAN: --set of reserved currencies that make up the IMF's unit, the SDR. I think China did a number of things in that process. And now, certainly, there is far more flexibility to the renminbi.

I think the fact that the renminbi has depreciated in the last few months should not be necessarily attributed to active intervention to depreciate it, but rather is, you know, you apply trade sanctions on a country. What happens? You know, the currency sort of adjusts to that fact to some extent.

And so I think it's much more market driven than in the past. I think going forward, in China's goal of making the renminbi more of a reserve currency, they are working in fairly effective ways in trying to deepen their financial markets and allow the inflow and outflow of foreign exchange of capital into their markets and out of their markets. Ultimately, having strong financial markets, strong trade will allow more of the trade to be denominated in the renminbi and serve to make the renminbi more of a reserve currency that's used. I think there's a well-structured plan towards that.

I think, to some extent, the crucial part is what Lars pointed out-- making the financial system more transparent and able to absorb and allow inflows and outflows of capital. And that's work in progress as the financial system is being cleaned up, as the sovereign-- all these wealth funds, et cetera, are being restructured at the various financial institutions. That's a process. But my sense is at the end of it, we will see a renminbi which is much more used in international transactions.

MICHELLE CARUSO-CABRERA: Professor Hansen, I saw you nodding your head a couple times. No?

LARS PETER HANSEN: I'm fine.

MICHELLE CARUSO-CABRERA: You're fine. Professor Rajan-- five minutes to Q&A, by the way. If you've got questions, fill out the cards. They'll be brought up here up front. In about five minutes, we're going to start taking questions from the audience. If the currency were allowed to float, where do you think it would be?

RAGHURAM G. RAJAN: It is, to my mind-- I mean, what they might control is the amount of daily movement. But to the extent we don't see a large change in reserves in either direction in a sustained way, it would suggest there's no target in mind. They're not moving it in a particular direction. I would say, whatever's happening to the renminbi in the last few months is perfectly natural. There is no sense-- I mean--

MICHELLE CARUSO-CABRERA: I guess just would it be beyond 7 by now? I mean, would it be weaker? Would it be stronger? Would it be much weaker?

RAGHURAM G. RAJAN: I think most people think it's fairly weak at 7.

MICHELLE CARUSO-CABRERA: Mm-hm.

RAGHURAM G. RAJAN: But of course, if your biggest trading partner is threatening to impose a 25% tariff on you, you naturally weaken to offset some of the effects of the tariff. So there may be some management. But I don't think you need to point to very active management to explain why it is here.

And I think to some extent, the Chinese don't see the renminbi as a one-way street anymore. It used to be that the only way for the renminbi was appreciation.

MICHELLE CARUSO-CABRERA: Yes.

RAGHURAM G. RAJAN: What happened in '15 and '16 was the possibility of depreciation, which is why they don't-- and they intervened at that point not to prevent further depreciation, including imposing certain capital controls. So I don't think there is a sense anymore that it's a one-way street and that the Chinese are basically preventing it from getting stronger. I think they work both ways.

MICHELLE CARUSO-CABRERA: Any of you have any strong opinion on the use of tariffs to try to effect change in Chinese behavior? Considering what exports are to the Chinese economy, what trade is to the Chinese economy, putting aside which is the classic thinking about tariffs, which is they're generally bad, they raise prices, trade wars are not good, what we know about the Chinese economy-- are they useful to effect change? Or just in general, what do you think of the imposition of tariffs? Jump ball, as we say in basketball.

LARS PETER HANSEN: So I would like to see the US lead by example and work with a carrot instead of the stick. Of course, there are issues about intellectual property rights and the like associated with China and what's the best way to address them. I'm quite concerned that if we go kind of product by product, country by country, try to work out-- start imposing tariffs, this could magically end in a good place, where everyone decides to remove them. It could leave us stalemated for a long time in a bad place. And I guess I would prefer to see a different approach to this than the current one.

MICHELLE CARUSO-CABRERA: But any ideas in terms of--

LARS PETER HANSEN: Lead by example.

MICHELLE CARUSO-CABRERA: Mm-hm. Professor Rajan?

RAGHURAM G. RAJAN: I was trying to avoid--

MICHELLE CARUSO-CABRERA: [CHUCKLES]

RAGHURAM G. RAJAN: Look, I mean, I very much think that we are risking a recovery, which was, you know, reasonable-- not great but reasonable.

MICHELLE CARUSO-CABRERA: Here in the US.

RAGHURAM G. Across the world.

RAJAN:

MICHELLE CARUSO-CABRERA: OK.

RAGHURAM G. RAJAN: I think the problem with tariffs is the great uncertainty they create, because if they were permanent, you would know, OK, let me invest in these places to substitute. But they're temporary, or at least you hope they're temporary. And then you don't know how long, whether you move production or not.

And that puts a dampener on investment, both in this country, as well as elsewhere in the world. And one of the good things about this recovery was investment was finally picking up. So I think in the short-term effects, it's been quite problematic.

Now, as we heard from the consul general, maybe there's good news on the way, that there is a discussion going on. Maybe there is a resolution. Of course, we are four days before the midterm election. And I don't know how much to believe any news that I hear at this point.

MICHELLE CARUSO-CABRERA: Because it's driven by political calculations for getting out the vote, as opposed to--

RAGHURAM G. RAJAN: I don't want to make an allegation. I'm just saying, I don't know how much to believe it.

MICHELLE CARUSO-CABRERA: Right. No, no, no.

RAGHURAM G. RAJAN: But the longer term is, I think to Lars' point, the example this sets for the rest of the world is perhaps the most detrimental problem. I see in India all those guys who have been advocating tariffs for the last 30 or 40 years coming out of the closet now and saying, see, the US does it. You've been saying we should bring down tariffs, be a more open economy. You know, the guys that you are using as examples are now going the other way. What leg do you have to stand on?

And I have to say, look, I wasn't pleading the US's case. I was saying what made the most sense for us in India. But you've basically undercut a whole sort of set of people who've been saying, you know, see, the US is so successful. Follow them.

MICHELLE CARUSO-CABRERA: But they don't understand the nuance of the we want reciprocity. The US government says, we want reciprocity. They've got very high tariffs. We have much lower tariffs. And until they lower their tariffs, then we're going to raise our tariffs to meet--

RAGHURAM G. RAJAN: See, but this is the game these guys have been playing for so long, right? These guys have been saying, oh, we are a poor country. We need high tariffs to protect us because they've got so many advantages.

MICHELLE CARUSO-CABRERA: Right.

RAGHURAM G. RAJAN: And plus, they really subsidize their farmers. Therefore, we need agricultural subsidies. We need tariffs. So all these contingent statements-- we need tariffs because of this, we need tariffs because of that-- is what these guys have been saying for so many years. When the US starts saying it, they've got a champion.

MICHELLE CARUSO-CABRERA: Anything you want to say about tariffs? I bet you don't like them.

WANG YANZHI: Yeah. So my answer is [INAUDIBLE]. But let me say in this issue, the US was not happy. I mean, using this tariff is-- so, too, is good or bad. I think you know. This great university, you know that.

Several claims-- one is the surplus with China-- trade surplus China. I think China will run current account deficit very soon. It's only the issue that China with US has some surplus. So Chinese policymakers is confronting a different challenge as well for them.

So the second US claim-- not second, third-- but this is forced transfer of technology, right? And there was the issue talk a lot yesterday. I think the issue they miss-- first, if you force someone against their willing, this is not right.

But a lot of transfer of technology take place at a fair price. Nobody asks that transfer at what cost, what price. We had investment-- this is really my experience-- involved transfer of technology.

We had some investment in Europe. And the authorities in the country says, one type of technology or the production you must promise continue in this country. You should not move that back to China.

We agreed because they have that advantage. They have the laboratory. They have staff.

They have people-- scientists-- working. We want them to work. So we own that technology, but we want to keep that in Europe.

But there's another type of technology they have, but they don't have market. So they agree this technology can be transferred back to China. And someone is going to buy that at the fair price that we agree. So this is really a market practice. Transfer of technology is a market practice.

We have another experience, not in my company but in my previous career. Quite a number of Western companies make investment not with cash but with technology, because that technology, they have more advanced one. Someone, they can be transferred to the developing countries instead of cash.

So when people talk about this transfer you claim unfair, you better think about what price that was. If someone doing or government doing some unfair-- that's a different issue you can talk. But in reality, transfer of technology is part of business.

MICHELLE CARUSO-CABRERA: Questions from the audience. "The capital control measures currently in place-- are they a sustainable tool of the Chinese government and the People's Bank of China?" I'm looking at you, Professor Rajan. [CHUCKLES]

RAGHURAM G. RAJAN: Look--

MICHELLE CARUSO-CABRERA: Does everybody understand what this means? I'm sorry to interrupt you just as you were about to-- so there's a walled capital account in China, right. They have very strict rules about how much money can leave the country, et cetera. And it's not a free float of capital at this point.

And there's lots of criticism that it should be. But then, of course, if there's ever a major crisis in China, people say, well, at least they have a walled-off capital account. So that way, it doesn't necessarily affect the rest of the world.

RAGHURAM G. RAJAN: Well, first, there are ways that capital flows out. And you just have to see the amount of houses bought in Vancouver by Chinese citizens--

MICHELLE CARUSO-CABRERA: 57th Street in New York City.

RAGHURAM G. RAJAN: Yeah-- to understand that capital is flowing out. There are ways around. And that's always been the issue with capital controls-- how effective are they?

I think they're not ineffective. I think some of the controls that China put in place when its reserves were plummeting very fast were effective in perhaps stabilizing. Of course, they did many other things that improved confidence in the Chinese economy at that time.

Longer term, I think to the point of making the renminbi a reserve currency and freely used, I think free-floating capital would be necessary. But I think the lessons we've learned over the years is first fix your financial markets. Slowly bring in more capital, let more capital out. It's a process, rather than a one-time big bang. And when you do that, eventually you reach the goal of full openness.

So I think the Chinese authorities are trying to figure out how to do it and our managing that process. I think the direction is towards more capital openness. And I think they're doing the right thing.

MICHELLE CARUSO-CABRERA: You know, you only have to look at Turkey and Argentina to know that a country is going to have very, very strong controls internally, right? Or else they become subject to capital flight. That becomes very, very painful, requires an IMF bailout.

We have a question for you, Mr. Wang. "Do the four investors-- the SOEs in the Silk Road Fund-- expect a market return on their investments?"

WANG YANZHI: Oh, we do. It's a pretty clear answer. We make investment. We want a return.

But I think the difference for us is we can stay for longer time-- longer period of time. But the return is very important for us. We normally are a minority shareholder.

We have another partner. This return we set up together. So we share that return. It's market based.

MICHELLE CARUSO-CABRERA: Do you have a number in mind that you think about? I mean, depending on which part of Wall Street certain people work in, you'll hear some of them say, I don't get out of bed before a 30% return, you know? [CHUCKLES]

WANG YANZHI: You know, this is correct. The world has a lot of liquidity. There's no shortage of liquidity.

The matter is that liquidity will not go into the infrastructure [INAUDIBLE] because low return, longer period.

MICHELLE CARUSO-CABRERA: Right.

WANG YANZHI: Private money would not be happy with that longer 10 years. No, they only stay five years, most three years-- shorter the better. But this is the gap [INAUDIBLE].

MICHELLE CARUSO-CABRERA: And that's why there's no private investors in this fund then.

WANG YANZHI: Yeah, yep, yep.

MICHELLE CARUSO-CABRERA: Because that was the second question from this-- Professor Hansen.

LARS PETER HANSEN: So am I allowed to criticize the question?

MICHELLE CARUSO-CABRERA: Go ahead.

LARS PETER HANSEN: So it's my understanding that infrastructure investment is often justified by some type of social externality. And that's the reason why we want governments to do it instead of the private sector to do it. And so maybe we should be looking beyond just the market return to the social return off of it. And maybe there's a wedge between the two. I think that's often the most compelling cases for the government involvement in infrastructure investment.

MICHELLE CARUSO-CABRERA: Social externality being a social benefit--

LARS PETER HANSEN: A social benefit.

MICHELLE CARUSO-CABRERA: --in other words.

LARS PETER HANSEN: That it isn't nationally internalized by the market.

MICHELLE CARUSO-CABRERA: OK. While we're on Belt and Road, "Is it possible to make information about each Belt and Road project-- the balance sheet, the benefits, the shareholders, and the nature of the claims-- publicly available on a periodic basis? It would make it transparent and be useful information to all concerned."

WANG YANZHI: We have a website. Whenever we finish a transaction, we make announcement. How detailed is a different story because financial data is agreed by players.

If you go to public, yeah, to what extent in detail? This is really a commercial business. So what we are doing, we are very transparent, which country we go, what project we do.

The information itself is really commercial. So you have to follow the practice.

MICHELLE CARUSO-CABRERA: Now, I guess in the US, we would think, OK, a private equity investment. You're not going to get a lot of detail. That's a private transaction.

But the minute the US taxpayer dollar is involved, everything becomes transparent, right? So that's the way we bifurcate the world. But obviously, your world is very different.

WANG YANZHI: We are not public company. But we have to report to our shareholders.

MICHELLE CARUSO-CABRERA: But you have public money, right? I mean--

WANG YANZHI: That's right.

MICHELLE CARUSO-CABRERA: --an SOE is--

WANG YANZHI: The shareholders take care of their money. So we have to report in to them what we've done, what is the financial situation of that project. So we do, but not in the way as a public company do. If you're public listed, you have a rule. You have to go transparent.

RAGHURAM G. RAJAN: In some of these transactions, it's also the other side, which is the public side. And so, I mean, some of what is being asked for is from that side. What did you agree to? What were the concessions and how to make it public?

So I think making those public would reduce the temperature around these sort of transactions. And so people know that it's a broadly level playing field that we're going into. And some of the concerns come from suspicions that this is not so well structured. And it'd be nice to alleviate that by making the details.

And I think it's equally the responsibility of the other side. But how to work these in such a way that it can be done? Sometimes the other side says don't reveal. Well, that's when you have to figure out do you really want to get into that?

MICHELLE CARUSO-CABRERA: Last question-- what should I have asked you or did you expect me to ask you? Or final thoughts-- what's the biggest takeaway the audience should leave with from today?

[CHUCKLING]

LARS PETER HANSEN: I think China's a fascinating economy with lots of potentially exciting opportunities. I think it's also attached to a fair bit of uncertainty going forward. So it'll be fascinating as an economist to watch it evolve.

RAGHURAM G. RAJAN: Look, I think we heard it again and again. And I think we should remember this. It's been 40 years since China started on this really fascinating road.

And we have to think about all the issues we're dealing with today in the context of it's just been 40 years. And therefore, a lot of structures will develop over time. A lot of changes will take place hopefully all of them in the right direction.

But sometimes we demand of this country what we would demand of countries that have 200 years to develop their structures. I mean, of course, China is a very old country. But in terms of this economic development, and then the associated sort of development of other structures, it's been a very, very short time.

MICHELLE CARUSO-CABRERA: Mr. Wang.

WANG YANZHI: Well, I would say-- [CHUCKLES] probably you would laugh at me-- Belt and Road Initiative is a good initiative. Give them some time. Let them work out.

MICHELLE CARUSO-CABRERA: Thank you for coming so far for this. And we really appreciate your participation and your frank responses. And also, of course, to our esteemed members of the panel from the University of Chicago as well. So thank you very much.

This concludes our discussion. We would like to extend a thanks to everybody joining us today. We're going to take a brief break, and we're going to see you back for our next conversation, "Chinese Leadership in Global Clean Energy Investment-- Green Finance, Sustainable Infrastructure Development." We're going to start promptly in 15 minutes.

[APPLAUSE]