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**PRESS BRIEFING:  
THE WORLD ECONOMIC SUMMIT**

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H. ANDREW SCHWARTZ: Good morning and welcome to CSIS, the Center for Strategic and International Studies. It's great to see all of you back from the campaign trail who have been out there slogging it out, and I'm very happy to say that we'll be hosting a lot of policy briefings in the next several months. This is the first of many. You know, we have, of course, the World Economic Summit this week, and it's exciting for us because we get to unveil to you our new business chair, Steve Schrage, who is here, and Steve's going to lead off.

Steve came to us from many positions in the Bush administration and in Congress, on Capitol Hill, and most recently Steve was a trade and economic advisor to Governor Mitt Romney during Mitt Romney's campaign. Steve has a load of experience in these issues, as do the rest of our panel. You know, we're very blessed to have Charles Freeman here, former assistant USTR for China. Grant Aldonas, who of course was undersecretary of commerce, and Dr. Simon Serfaty, who all of you know, a prolific author and scholar.

This is really a dream team for us, and I hope that – and judging by this turnout, you guys think so too. So without further ado, I'll pass it to Steve Schrage, and we'll get going. Thanks for coming.

STEVE SCHRAGE: Well, thank you, Andrew. As Andrew mentioned, I'm going to kick this off and then turn it over to some of our specific advisors and top experts on different areas.

I think maybe the most useful way to start off is to talk about what the summit is probably not going to be, which a lot of the talk early on was this idea of a Bretton Woods II, a new Bretton Woods, and at first blush that might seem like something appealing. You know, we've had a real breakdown in business government understanding. You've got national governments struggling with transnational economic challenges. You've got really 1930s-'40s era institutions, in some cases, dealing with these, so why not have a new Bretton Woods – and I think there's a growing sentiment that we need to restructure the system.

I think there's two core problems with viewing this upcoming meeting in that context, both of which have to do with timing, first of all with crisis timing. You know, Bretton Woods was after the dust had long settled on the Great Depression – you know, had gone years into planning, weeks of meetings. This is weeks after, you know, the initial hit, and I'd say we're in the beginning or, at best, the end of the beginning of the current crisis. So having some broad restructuring at this point would kind of be like in the middle of a five-alarm fire calling together the fire chiefs and trying to restructure the fire department. And you could also do more harm than good, kind of in the idea of the

Hippocratic Oath, you know, above all, do no harm. Rushing into major surgery before we really have a firm understanding and shared understanding of where to go can cause major problems, and a lot of economists would say the Great Depression was really sparked by the protectionist measures and intervening in the markets afterwards that really caused it to spiral out of control.

I think the administration recognizes this, and especially because of the second point, which is their lame duck status. There's a lot of uncertainty – you know, they're launching this but who's going to carry it out? How is the Obama administration going to come into this? And there's also some lame duck issues in terms of some of the other governments around the table.

So recognizing this, the administration has crafted a proposal which I think has got some – you know, it's an accomplishment to get the heads of state and the finance ministers around the table to launch something, but there's very limited ambitions in terms of actual policy change that are going to come out this weekend. But I would contrast that with they have very bold visions of what they hope this will eventually lead to, though a lot of it's going to be out of their hands.

In terms of what they're looking at on the 15<sup>th</sup>, they're looking at three key areas, the first of which are kind of a common understanding of the causes of the crisis; second, looking at what's been done so far in terms of freeing up liquidity, and the overall themes they're running through here are going to be, you know, supportive, continuing open markets, standing by the developing world, and also not overregulation. These may be controversial in terms of the discussions with some of the other leaders who have posed this is a real challenge to fundamental U.S.-style capitalism, but I think these are things they can negotiate out and will really affect the language of the final statements.

The third piece is really the meat of it, and that's the way forward. The things they're talking about are four key areas: transparency, enhancing sound regulation, promoting integrity of the market, combating fraudulent areas, and then reinforcing international cooperation. And I think these are all very good things; you know, I think everyone can agree on that. The real meat is going to hit when the rubber hits the road down the line, and they're going to have to define different things. In the short term they're looking at things like expanding developing country cooperation, things like the Financial Stability Forum. They're looking at things like global accounting principles and credit default swap markets. That's going to be much more difficult, but that's not going to be the substance probably of what happens in this meeting. That's going to be punted to the next administration, the next team to go forward.

Even longer term we have even broader challenges, like restructuring the international financial institutions, doing pro-cyclical and counter-cyclical efforts. Those are huge endeavors. And they're boldly envisioning this, but again, that's not what's going to happen here. One thing that Grant will be able to go into more depth about is they had hoped to use this to kind of breathe new life into the Doha round negotiations

and get modalities going forward. From everything I've heard, that has kind of been a nonstarter internationally, so I don't expect much on that.

But on the bottom line, looking at what to look at, at this meeting, again, not much in the short term, and there's a limited marginal upside from this. I think the markets have kind of discounted it from coming together. There is a huge potential downside if there is disruption, disunity. The markets are very jittery right now. If the see the Europeans and the United States can't agree on a way forward, it could have a really devastating short-term effect. I don't think that's going to happen, but there's three things to watch for that this panel can address very well.

First of all is European disunity, which Simon can talk about – how are Sarkozy's visions consistent with those of Gordon Brown's? They had trouble getting together to a common strategy on Friday. And they all agree they want to go somewhere really bold, but I don't know if they agree exactly where that's going to be, other than they want the IMF central to this because of the European strong presence there.

The second piece is the G-20. I don't think it was a mistake that the G-20 was picked because Gordon Brown and the U.K. – which has very similar market views in general to the United States – will be leading that next year. But as we saw from the G-20 meeting on Saturday, there's broad agreement they want to play more of a role in these institutions but less of an agreement on how exactly that's going to happen. And that may run them headlong into the Europeans who have a disproportionate influence in many of these institutions based on their history from the 1940s.

And then finally, the last piece, and really kind of the underlying lynchpin of this all, is how is this going to lock in the Obama administration and how are they going to react to this? People are talking about having a follow-on summit in 100 days, in the first quarter, now is the terminology I'm hearing, of the administration. How is the Obama administration going to react to that while it's setting up its new transition team and getting everything in place? It has this broad new agenda; is it going to want to be dealing with restructuring the global financial system? Those are going to be tough challenges that we're going to have to figure out in the short term.

And in the long term, again, there's grand ambitions, if they can get through all that, to where it goes. And in closing I'd say it's a lot – well, it's difficult to launch these things; it's a lot harder to land them, like a super jumbo jet, you know – and you've seen this I think somewhat in Doha, maybe in the Annapolis conference also. You can gather everyone around a table and say these grand principles of where you want to go, but actually coming to a conclusion and agreeing on something is more difficult. So we're watching this very closely and I think we've got a great team that can discuss some of the ins and outs of the specifics here today. So thank you very much.

MR. SCHWARTZ: Charles?

CHARLES FREEMAN: I'm just going to be very brief, and if there's questions specific to issues that I focus on, particularly China, I'll save that for Q&A.

Just to pick up on a couple things that Steve talked about, I think – the primary issue here is I think that from the initial very grand ambitions that some, particularly Sarkozy and others had for this weekend, it's been dumbed down significantly, and I think that's probably a good thing because, to be candid, there was a bit of a fire drill, in effect, that, you know, actually sober thought probably isn't compatible with. So I think it's – the fact that people now have relatively reduced ambitions is probably a good thing, and a recognition that this is a process and not an event is a good thing. And, frankly, given the market's reaction to this, I think – you know, the fact that people are coming in here with some very basic ideas about what they want to accomplish is also a good thing.

There are some things to watch for, though. There is still an element of not triumphalism, but at least a desire to vent at the United States for creating this crisis, and a desire by Russia and some others to at least speak out against the American style of capitalism and American greed, all things that created this crisis. And if there are – if there is significant relatively public angst that comes out of it, and disunion between the parties at this event, I think that will be – that markets will react very, very badly to that.

So, really, as Steve said, I mean, it's do no wrong, and one of the first things that they could do wrong is publicly point fingers and lay blame. That probably wouldn't be a good sign for anybody.

The other thing to think about is, is this really the right group to be getting together to solve the crisis or focus on banking? There are some key players that are not here: Switzerland, a big player in banking; Spain, a big player in banking, not here. So the question is, ultimately is this right gang to be dealing with the issue and coming to some final conclusion, perhaps not at this meeting but over the course of events I think is going to be key.

Clearly there is going to be an effort to use this forum and succeeding forums to restructure the global financial architecture in ways that reduces, quote, "U.S. dominance," end quote, in that. And whether or not Europe comes to the fore and European-style regulation becomes more prominent in that is one question, but really the role of Asia and particularly China is the thing to be keying in on.

China, as you know, launched a fairly significant stimulus package to try to stimulate domestic growth, something that has been greeted very positively by everyone concerned. The specifics are not exactly as clear about what's in that stimulus package, how much is being spent and by whom – what's new versus what had already been in the pipeline – but clearly, China had said at the outset that their role in this process of restoring market confidence was to help be an engine for global growth, and the stimulus – \$586 billion of it – is one good sign that they're going to do it.

I would anticipate that – and having talked to friends from the Chinese government, I would anticipate that they are – they are talking about just wanting to be at the table and how it's very important that they're at the table. I would anticipate that they are going to be much more than at the table long term, that the process of restructuring whatever global architecture will exist a year from now, two years from now, however long the process takes, China will have a significant say in what that looks like at the end of the day.

I'll stop there and turn it over to Simon.

MR. SCHWARTZ: Dr. Serfaty.

SIMON SERFATY: I have to be brief, which is highly unusual, actually. (Laughter.) There have been references to BWI, BWII. BWI was based on the *pas de deux* between the U.S. and the U.K., called the ballet if you wish – 42 states that truly didn't have much to say and much to do.

Your position, BWII, is based on the very significant central dialogue between the U.S. and the EU, but this time a dialogue that is taking place and will be taking place with 18 – 19, actually, other states, many of which may have a more significant influence on the conversation, if you will, than either the U.S. and the EU. And as Charles said, in the specific case of China the distinction is quite important.

I'll make three general observations very quickly to explain how the dialogue between the U.S. and EU is, and actually to inform about the state of the partnership, the state of the union, and the state of mind that is conditioning the meeting this weekend.

With regard to the state of partnership – that is to say, the relationship in this case not between the U.S. and individual European states, but between the U.S. and the European Union. The reaction to the election of Obama was just euphoric. I noticed a piece in the *Washington Post* that surprised me yesterday, pointing to racist reactions in Europe to Obama's election on the basis of an 80-year-old journalist, Polish, *de passé* politician, and some Austrian who nobody has heard about, and I thought that, frankly, the conclusions that we reached about the European reaction were just misleading. The reaction has been euphoric.

But the partnership is in a good shape because Bush has made it so. I think we should not neglect the extent to which the relationship between America and Europe has dramatically improved from Bush to Bush over the past two years and has set the stage, in fact, for this set of decisions that will be made by Obama in the next few months on the basis of a legacy that has significantly improved relative to the past several years. On that basis, there will not be a kind of blame game over the weekend. Even though the Europeans believe that this crisis originated in the United States, they will nonetheless work hard on making things fall short of whatever failure might otherwise have been contemplated. And that is the first point I wanted to make.

With regard to the state of the union, the response of the 27 members of the union, in my mind, exceeded expectations. There was a tough start, but in the end the members of the union were able to reach together a shared position, not a common position and not a solid, lasting consensus, but a consensus that will enable them to come to repeat to the meeting with a shared position, including the Spaniards, incidentally, who were given the second seat that France had access to, which shows the extent to which the representation within the G-20 is just not well thought through, if one state can actually have two seats.

That has been made possible by the ebullient part of the – (unintelligible) – and Sarkozy to work together on those issues, thereby compelling, in a sense, Merkel to follow suit. Merkel does not want to be isolated, really, in this context, and she agreed to enter into that shared position, even though on the occasion she did not agree with specifics of that position. And that will become evident, I think, as Merkel might find in President Bush an ally of the notion that the members will be divided over those who want the kind of loose, soft agreement on behalf of cooperation and consultation – nothing too dramatic, nothing conclusive – and those who wish to have a hard agreement that defines very clearly intrusive rules of behavior that are not going to be acceptable on this side of the Atlantic, irrespective of who is president, and that the Germans are not going to be able to adopt for a while. So I think that the fact the EU, in my judgment, will have been able to assume, for a moment at least, a leadership role in that process is encouraging but it is not definite.

The G-20 meeting, from that standpoint, the state of the union, serves as an interesting test for issues that transcend the union. I think that the discussion that has taken place over the past few months might point to an interest on the part of a majority – an overwhelming majority of the members – to move toward the “E” of EMU. That is to say, to see whether the improvements they have made in the direction of a military union can also be extended to economic union, and I think some steps can be expected in that regard later, in 2009. And it will also be a test of the ability on the part of the Obama administration to work out the strategic partnership with the EU of the wide range of issues that would include not only the reform of the financial system, but some specific issues such as, indeed, Afghanistan, which is a test for the EU no less than it is a test for NATO.

Whether these tests can be met remains to be seen simply because this may not be the most propitious moment to set up a kind of mid-term test, a final exam for the union. For one, it is the fact of the German elections in September of '09 which will make it very difficult for Merkel to do what the German people does not want for her to do. Two is the European election in June of next year. Again, that is going to raise a variety of questions that need to be examined.

Finally, with regard to the statement that relates to what will happen at the meeting over the weekend, this has already been covered in a sense. There is no doubt that the European expectations are much too high. I thought that Charles put it very well when he said that this is a process; it is not an end game. And Sarkozy has made it sound as if this is an end game that they're going to sit together and we'll produce a new

system. There were two years of preparations for Bretton Woods I, not to mention the war before and the aftermath of the Depression, and this is not going to be done from one day to the other. So the expectations are much, much too high and the five principles that have been put forward by the Europeans will not get much support, with one exception, and I'll come back to that.

There is also a timing that is exaggerated, not in terms of doing something over the weekend, but coming back 100 days from this weekend to make sure that in fact the president of the United States has heard what was said to him by the Europeans and others and is able to deliver – well, 100 days from now will be 30 days into the Obama administration, and it is remarkable that those guys would think that Obama will be so much focused on this issue that he will be able to respond to those requests.

A deliverable that might be at least agreed upon theoretically, which has not been mentioned, relates to the IMF and the enhanced role of the IMF. The only problem with that is that it would take a heck of a lot of money. There are \$250 billion worth of resources at the IMF; 100 billion only are usable. The IMF would probably need 10 times that amount – that is to say 1 trillion – to be able to do the job that is going to be allocated to it. Who is going to give the money is an interesting dilemma. The Europeans will not – and I'm satisfied that the U.S. will not finance it in any case to make it available. Maybe the Chinese will. They are the new Germany of 2010.

So that's what I wanted to say. Expectations are, in a sense, too high. Let's take our time. The meeting is a good thing to be held, but there will be others.

GRANT ALDONAS: Well, I have to say I feel better listening to you guys. I'm an optimist by nature, but right now things are unremittingly bleak. I'm supposed to say a few words about the financial crisis, the summit, and globalization, and I think the best thing I can say is the last round of globalization ended with a shot fired by a Serbian anarchist and this time it's a bond salesman on Wall Street.

We're at a point where there is a severe depression ahead of us, and it is largely one that will grind away at most of the progress that has been made toward trade and investment liberalization over the last 40 years. And I think everything I see out there right now is that politicians, both in the United States and elsewhere aren't taking this, frankly, seriously enough. And the best indicator that the summit on the 15<sup>th</sup> won't produce anything is to remember that Franklin Roosevelt was never at Bretton Woods. (Laughter.) It involved an awful lot of finance ministers and their staffs, putting together the details of a package that really came, as everybody has said, after an enormous amount of work over a period, first coming out of the Depression, thinking about what we had done in terms of the trading system as well as the financial system, and then the results of World War II.

It was a unique moment where you could bring countries together, precisely because of the crisis that the war represented, and because of the United States' dominance. And that simply doesn't exist at this point. It's a much more fracturous

environment in terms of trying to build this coalition. That was demonstrated this past weekend at the G-20 finance ministers meeting where the goal was to provide a fairly detailed framework of the work plan of this process. And I would have greater confidence if in fact they produced a detailed framework. In fact they didn't. There was a good deal of rhetoric from President Lulu, just to offer some perspective, suggesting that this was all a result of laissez faire economics, which is a startling statement for anybody who understands the depth of government intervention in our mortgage market, in our securities market. The idea that this was a product of lax regulation – (chuckles) – to be honest, rather than insufficient liberalization as a part of this process is stunning, but nonetheless, that's the mood.

And the reason I'm so pessimistic about this is you have to see this against the backdrop of real antipathy toward globalization, which is not just an economic matter. This goes to deep issues of personal identity and questions of who decides your economic future? What are the forces that are shaping your livelihood and your family's wellbeing, and a complete lack of faith not only in domestic institutions to address this, but particularly in international institutions.

So you're now going to bring the world leaders together to try and fashion some sort of solution under the white-hot glare of summitry, and that usually spells disaster. So I have, unfortunately, a pretty negative view of this. Now, that's only compounded by my negative view of the United States government's role in this, which, as near as I can tell on the financial side, was the equivalent of walking into a crowded theater and yelling, "Fire!" and then pointing to a blocked exit. If you think about the asset plan that was originally brooded about by the Treasury secretary, you'll notice that it's fallen to the wayside at we've made progress through this, and instead we've opted for recapitalizing banks – indeed, banks like Wells Fargo that didn't need the capital.

So we're in a situation where there is a reason to lack faith in some of the decisions that have been made, and the markets are reading that, and you can see that descending, not only through the financial markets but – this is the really troubling aspect of it is that you're starting to see it for very small business people in places like where I'm from, and Minneapolis, Cleveland, Atlanta, all that sort of stuff – this is a set of conscious choices where you could have stemmed the tide in the financial industry by understanding that investment banks in New York play a much less significant role in the case of the United States economy than they ever did before. You could have cauterized this wound at that point. Instead, in some respects, by walking into that crowded theater and yelling, "Fire!" you've allowed it now to metastasize into the rest of the economy. Consumers have pulled back despite the most significant tax cut that's been given in the last eight years, is the recent decrease in the price of gasoline. The reality is there's just not a lot on the table that gives you a ray of hope.

So, having said that, where are the possibilities? Well, the irony is, is that in the worst of all possible worlds people actually start to look around for serious solutions, and what's interesting about this is that greater liberalization of the rules on exchange rates, certainly greater exchange rate flexibility, certainly liberalization of our financial markets

subject to the appropriate fiduciary and oversight rules, all of that is a better solution to this particular circumstance. Think about it this way: If the United States had less antipathy toward foreign investment in its financial sector, we would have seen institutions with stronger balance sheets coming to the rescue of individual banks. You saw it with the Saudi investors in the case of Citi. You saw it with Warren Buffet in the case of Goldman Sachs.

The irony is in the circumstance, the market was rewarding those companies that had prepared best and were prepared to survive best in the circumstance. And instead what we've done with respect to government policy, and is now rolling out into the international stage, is the idea that government intervention is going to be the solution to this. So that's the sort of optimistic note for the day.

(Laughter.)

MR. SCHWARTZ: Great. With that we'll open it up for questions. And if you could please, you know, state your name when called on and your news organization, that would be helpful. We'll go to the back. Carlos?

Q: Cesar (sp) actually.

MR. SCHWARTZ: Cesar, I'm sorry.

Q: No problem, Andrew. I have two questions, if I may. One, on this issue of the IMF – I mean, Strauss-Kahn last weekend indicated that he wanted more money. I mean, is this going to happen? I guess they are looking to China and Japan and the oil-producing countries, and I wonder if they are going to – at least China and the oil-producing countries are going to ask for more voice in the IMF in exchange for this.

And the second question is on the issue of the group. I mean, the G-20, it seems to me that they called on this group because they didn't have any other, and, you know, perhaps this is sort of the end of the G-7, G-8 grouping. And at the same time, you know, in the G-20 you have Argentina and Mexico, and perhaps they shouldn't be on the table for these things. Thank you.

MR. SERFATY: As I said, much more money will be needed, and if that money were ever to be made available, those states that are emerging economies, so called, would want a comparable say within the institution, which calls therefore for a reform of the IMF, even before the money is delivered. Under such circumstances, you don't pay until you've been satisfied, and the reform of the fund therefore would add time to this process that we envision.

And it would be, in my judgment, and some on this panel would know better – the amount of additional money has been said to be about one-thousand-billion dollars, from some experts. So that's a good point. And G-20 is a large group, it is not a homogenous group, and some single issues that will be part of the process probably ought to be

debated within smaller groups of members that are immediately relevant to the issue. There should not be a constant meeting of 20 or 21. That, in my mind, will hamper the ability to come to consensus – (inaudible).

MR. SCHWARTZ: John?

Q: My thoughts are on why Obama is hanging back, not attending. Is he simply doing it to avoid taking responsibility for this until he absolutely has to? Does he risk anything by doing that? Second, does the lame duck status of Bush and the president-elect status of Obama leave the U.S. vulnerable because there's a leadership vacuum? And then third would just be, how do you guys expect Obama to respond to this going forward once he's in office?

MR. SCHRAGE: I think you raised some key points. I think this puts Obama and a new administration in a very difficult position. I don't think they can really jump in and fully engage. I think that would be problematic as well. And I do think, as you mentioned, the lame duck status of the Bush administration, as I mentioned at the beginning, makes it very difficult for hard, substantive reforms, which is why I think the administration has, as Charles mentioned and I touched on at the beginning, looked at this more as launching a process as opposed to determining where that process goes. It's really going to be up to the next administration to figure, do they breathe life into this? Does this go forward? Do they take it in a different direction?

But as I mentioned earlier, a lot of the decisions can lock things in – the point about the G-20, for example. You know, if you've got that large group, it makes it exponentially harder to negotiate, even things in the G-8, versus a larger and diverse group. And there's been a lot of "G's" thrown out there. You know, people have talked about a G-2, a G-8, a G-20. It really shows a kind of a system in flux, and people have talked kind of about a unipolar or bipolar or multipolar world. I think in the end it's going to have to be – get kind of off this idea of multipolar and more multi-tiered and multidimensional in terms of there's going to be different groups you're going to have to have at different times working on different issues, and how do you build that kind of flexible architecture?

But no shortage of challenges for the Obama administration coming in. Is reworking the financial architecture going to be one of their top priorities in their first year? You know, this may force them to have to make that decision very soon.

MR. FREEMAN: Okay, just to follow up, there is nothing positive that can come out of this meeting. It can only go badly. So if you're Obama, you want your fingerprints nowhere near this thing. You'll take up the process when it's launched and more stable down the road, but, you know, he said there's only one president and he's pretty glad it ain't him right now.

MR. ALDONAS: Yeah, I was just going to say I was talking to a friend in the banking business yesterday who said Obama's voting "present." (Laughter.) But in fairness –

MR. SERFATY: And that's nonpartisan.

MR. ALDONAS: That's completely nonpartisan. He's a Democrat, like most bankers on Wall Street, I've got to be clear. But the interesting thing in this instance is that he actually is being active; it just doesn't happen to be on this front. On the other hand, it's not something that should make us optimistic because his first salvo really is to provide assistance to the U.S. auto industry. It's very hard to square that with the idea of the continuing open trading environment trying to press for the right things that would help solve the economic or financial crisis globally.

So in one sense, he is deeply engaged. He is engaged on a set of issues which confirm the idea that the United States, as well as a lot of other players, are thinking domestically first. I think certainly China's efforts at stimulus is directed at China's domestic situation much more than it is an act of collaboration globally. But for those of us who think that it's very important to have that collaboration globally to try and find a way out of this mess, that's not a good signal because the debate we're going to have in Congress if there is a lame duck is going to be very much about assistance to our auto industry rather than the broader effects of the financial crisis, the lessons to be drawn and the things we ought to do.

How does he do going forward? I've got to say, this is not his strength, and when I see him having – every time he speaks about the economy to have a phalanx of economists behind him, it doesn't give me great confidence. On the other hand, I'd know that some of the people involved in the Obama administration are very solid. Dan Tarullo, a good example, just came out with a new book about international financial regulation that provides a good roadmap about the direction we ought to be going.

So I think we've got to give them a chance to sort of get their feet, get things organized and then get involved. I think he's better off focused on that process rather than this summit for starters, because I know there's really solid people involved. But it's not his strength, and the first salvo is one that's focused on things that are probably bad for our economy, certainly bad for the taxpayer, but also not leading us toward the right solution globally.

MR. SERFATY: Let me just add that those questions were well answered in full, three question, but there was a fourth question which would have been noted as significant. Why did the Europeans ask Bush for the meeting to be held and why did Bush say yes? And that reflects in part Europeans' assumption that they could work with Bush more effectively on this particular issue at this time than they might be able to do with his successor. And second, on the part of the Bush that there was indeed enough cohesiveness now with the Europeans as partners of choice as well as enough urgency in the issue to attempt to score something before leaving.

Q: So I'd like to actually follow on that. Two questions. First, I'd like for you to think about this summit from President Bush's perspective. This is the end of his term. It's kind of his exit from the world stage. What is the upside of this summit for him and what's the downside? And then if you could just expand a little bit on why did President Bush agree to this, and is it an attempt in a way by Europeans to set the table for the Obama administration, to use this interregnum to try to box in Obama? Especially the first on Bush – the upside and the downside.

MR. ALDONAS: Well, the upside is we're not talking about Iraq. (Laughter.) We're seized with an issue that sort of overshadows some of the other failures of the administration on the foreign policy front. And so you're in a situation where, thankfully from his perspective, he has an opportunity to do something constructive on the world stage and is taking action. I've got to give him credit for that.

In terms of downside, the downside risk is this – is much less than people had expected it to be. Even the early conversations with people inside the administration suggests that we've come way down from that. And going back to the last question, John's question, was sort of the – does the lame duck status affect this? Yes, of course it does. Everybody understands that it's overshadowed by who's coming next.

So in one sense there's an upside, that he can show real leadership under the circumstances. On the other hand, his effectiveness is limited by his status.

Q: (Inaudible) – but if I can just ask you to address the issue of are the Europeans trying to use this period in time to set the table for the Obama administration to sort of extract what they can out of Bush and box Obama in?

MR. SERFATY: No, I don't think so. I'm much more focused on the interest in engaging Bush. Remember that in 2004, in the early summer of 2004, Bush did attempt to engage the Europeans. We essentially said, no, we will wait for the election because we expect a new president after November of 2004 and in January of 2005. This is not to set up. There was a sense of urgency, growing urgency. There was an opportunity to assert some kind of leadership. Sarkozy has never been known as a man of lengthy reflection. (Laughter.) He's rather reactive. And they did think that they might be able to come to a deal with this administration fairly quickly. And based on, as I said before, the transformation from Bush to Bush in 2007, 2008, on a number of specifications.

MR. SCHWARTZ: David?

Q: Yes. David Jackson, USA Today. Among the foreign leaders who are coming, who should we keep our eye on specifically and what are those people looking for out of this conference?

MR. ALDONAS: My personal favorite is President Lula and what he's looking for is a platform. His perspective about economics and Brazil's role in the world is

what's paramount in his concern and always has been. I mean even in the context of the WTO negotiations. The guys – (inaudible) – in the foreign ministry have always been more concerned about Brazil's status than they have about the outcome commercially. And we're going to see that rollout here. I mean, this is someone who very much wants not only to be a leader on the world stage, but also for Brazil to play a much more significant role as a part of the process. And I think that's key because, given his background, he has legitimate criticisms of the way economic fortunes have played out in the Brazilian structure. That has given him a perspective on economics from the left. He feels that's vindicated in this context by what's happening in the United States. He sees an opportunity to provide a very different vision of what the world economy and the world economic architecture – whose interest it ought to serve. So I'd be looking hard at the role he plays.

MR. FREEMAN: Just want to watch the Russians carefully. Remember Medvedev in his state of the union essentially had launched into a screed against the United States for creating both the financial crisis and the crisis in Georgia. So measure – watching the tenor there is going to be real interesting.

The Chinese are going to be very cautious. I mean, there's a hundred people coming in here with President Hu. They're taking this very seriously. But there's also doing this in the context, they're preparing for the bilateral strategic economic dialogue, and they don't know what they want out of this process yet other than to be at the table yet. And they're certainly not going to – I mean, the Chinese are preaching caution, caution, caution, stability, stability, stability. And they've got a lot of bucks here, and anything that's going to send the markets one way or the other just can only hurt them, so they're going to keep as calm as possible.

MR. SCHRAGE: And all the Europeans, too, I think, again, the danger is, as you've all mentioned, any one player in the G-20 could use this as a platform to get on the world stage and kind of disrupt things. I think the Europeans have less of an incentive to do that, though they may in the longer term because they want to institutionalize this process. They want to kind of lock this in so that it can be legacy for them down the road, whereas some of the other leaders may – like Lula and others, may see this as an opportunity where they're at the world stage to disrupt things. I think the Europeans want to make sure it's locked in going forward, and to some degree locks the Obama administration to at least addressing it over the next –

Q: But Sarkozy has been pretty outspoken about changing the financial architecture. How much do you think he'll push that at this deal? And what about Merkel?

MR. SERFATY: He will push it up to a point, but my pick would have been Merkel because Merkel faces the most awkward position in a sense. She has entered into this kind of EU-shared position. She has bought into it. She's part of it. She could have in many ways blocked it. She chose not to do it. But in her heart she is with Bush on this. She's closer to the U.S. position than to the European position, and how she plays it

out during the meeting in the context of what she says and other related matters will be the most difficult thing.

Sarkozy will be very careful, mind you. What he says on the other side of the Atlantic may not be what he will be saying here, because he has achieved something remarkable, a newly-developed new intimacy, bilateral intimacy between Washington and Paris, which is unprecedented really. And he has already worked on developing and preserving that intimacy with the new president. He views himself pretty much the way Obama views himself as well – as uncharacteristic, if you will, of the state over which he presides. So he'll be very careful.

MR. SCHWARTZ: Simon, do you think that there will be a synergy between Sarkozy and President Elect Obama in the way that Tony Blair and Bill Clinton had – (off mike).

MR. SERFATY: Well, that is surely what he hopes for. But he will lose a significant platform next year when the Czechs and the Swedes take over the presidency of the EU. And whereas he has been very effective, in my judgment, over the past couple of years both in terms of domestic and foreign policies, he has a tendency on occasion to overdo it, and this may hurt, but he will be working on this. And there are lots of names being mentioned for the new administration who have always been sympathetic to the French positions on a number of foreign policy and security issues.

MR. FREEMAN: The Chinese are looking for – what they really want ultimately is an early warning system. I mean, they felt – they were surprised a little bit at what came down. So ultimately, they want whatever architecture to come up with to be – to have the early warning system. I'm not sure that includes government-sponsored or multilateral-sponsored rating agencies or otherwise, but I do think that that's – ultimately they want more foreseeability, and ironically transparency, as part of the process.

Q: (Off mike.)

MR. FREEMAN: The Chinese are cautious in their approach to this just because they're trying to get a feel for the situation. This is the way they always are in international organizations. I have a suspicion that ultimately they will arrive at a position because others will be granting them favor and others will be getting out of their way in trying to promote Chinese involvement, that they arrive at a leadership – a relatively leadership position within whatever architecture ultimately emerges. But I don't think that's because they will elbow their way to the front of the queue.

MR. ALDONAS: Could I just add to that? I mean it's interesting with China because you have to see it in the context of this is an economy on the financial side that's just beginning to use the price of money as a tool to manage its own affairs, and in that context it is leaning on the international system, and in some respects free-riding on the international system up to this point. It's a big step to say suddenly you're going to assume responsibility for that system when you're still working out the inner workings of

what you're doing on the financial side in your own economy. And so in my own view, it's too much to ask, honestly, I think at this stage. What people are going to be looking at the Chinese for is a source of cash, and in this instance we'd be wise to try and make sure that we're as inviting to that as possible.

Q: (Off mike.)

MR. FREEMAN: You know, it's a good question. I mean the Chinese are much more comfortable in bilateral situations than they are in multilateral situations. They don't – they're not that anxious for others to tell them what to do. So I would not be surprised if their first instincts were to try to avoid some very, very broad regulatory approach that the Europeans might be pushing for. But again, do they – what do they want ultimately? They want as much foreseeability and transparency in the system as possible. If that suggests that more regulations, more broad global supervision is helpful, I think they'll go for it.

Q: (Off mike.)

MR. SCHRAGE: No. And I think it was more of the intent of the administration, as I think you can see in the closing days of the Bush administration, they really see this trade as a potential legacy and a key thing that they want to leave behind. In Doha what they had been talking about were modalities, which are kind of a pathway forward of how you might kind of get Doha back on the rails. I don't think – I think they've got pretty firm resistance on that, and I don't think it's feasible – in large part a lot of the development economies, particularly India's upcoming election, really complicate that process. And the Obama administration may need to fundamentally rethink overall trade strategy and how that goes forward, because we do seem to be really at a point where it's off the rails. And you do see the Bush administration pushing these things. The Colombia Free Trade Agreement, whether that was part of this quid pro quo or not, you do see that they are pushing that, Panama FTA, Korea, very aggressively over the last several months but don't seem to be getting any traction. So I am fairly pessimistic in terms of Grant's terminology in terms of where this may go.

And Grant, I'd like to hear you thoughts on this as well.

MR. FREEMAN: Doha's dead. And I mean it's just not – it's not even a remote possibility at this point. There's a lot of things you could do with the trading system. What's curious about this is that you really don't have people trying to use the trading system as a way of galvanizing collaboration. To be blunt, it's the one process internationally that's actually worked well over the last 20, 30 years. And the inability to understand the nexus between the trading systems and the thing you're trying to achieve, as well as what kind of impetus that would provide at a point where the world economy is heading for nadir – and I don't mean Ralph in that case – is really remarkable, but you don't see it.

You don't really see Lemee (ph) trying to use this as a moment to drive this process forward, and that's something which I know Catherine (sp) and I were part of when we were at USTR ages ago when we were kids. People understood there was a moment to use a crisis like this as an opportunity to drive the trade agenda, and that just seems, frankly, lost as part of the – I think Steve's right about the Indian elections. It goes back to a point I was making earlier, Doug, about the broader populist trend, which is not just a phenomenon in the United States that this antipathy toward globalization, it's certainly shaping up so it'll affect the Indian election, may push it to the BJP rather than Congress, in which case you can forget about trade liberalization inside the WTO for a very long time. So we're really at this sort of moment where you would expect that leaders would reach for this as a tool in their toolkit, which has actually been pretty effective in the past, but there's been no instinct to do that.

So in this context of the summit, the most they're hoping for now is sort of a commitment against acts of protectionism. And that of course, Doug, I think you need to read against the backdrop of an initiative by Nancy Pelosi and Harry Reid and certainly President-Elect Obama to provide massive subsidies to the auto industry in the United States, all of which are deeply inconsistent with the international trading regime. So you have these tugs against what should be the right course in this context, and I don't see that ending in favor of providing a greater stimulus for Doha.

MR. FREEMAN: I just want to follow up quickly with that. I am not as pessimistic as Grant that we're about to approach a severe depression, but I do think the lesson we learned and was – at the end of the last severe depression that we had was that we really needed liberalized trade to help us get us out. And the fact that Doha is not even a whisper at this thing, other than I think the Bush administration had kind of the right instinct, but the fact that it was – it's immediately pulled off the table suggests that maybe we're going to need to learn that lesson the hard way.

MR. SCHRAGE: And just to add to that, because I agree with everything that Dave said, it's really phenomenal. When you look at trade, it's been such an amazing engine of growth – some of the most unprecedented growth in human history coming out of the Great Depression. But this way forward is really – we've kind of run into a brick wall, backed up, and keep on running into the same brick wall over Doha. And it may be an opportunity for the Obama administration – (inaudible) – to really rethink how we go about this. Do we need to regroup with a smaller group? Do we need to look at some of the more crosscutting issues? I mean tariffs have come dramatically. Do we need to look at things like services liberalization, by protecting intellectual property, the things that are kind of the modern-day equivalent of the challenges we faced in '45 or '47 when the GATT/WTO system was built up. So I think there's going to be an opportunity for a fundamental rethinking of how we approach these problems. I hope we seize that opportunity.

MR. ALDONAS: Yeah, me too. I just think it's ironic, Steve, that lo and behold we have a strategic pause in trade. (Laughter.) Unfortunately, it's coming at exactly the wrong time.

MR. SCHWARTZ: We'll be selling "Doha is Dead" t-shirts. (Laughter.) Plenty available.

Q: Yeah. One week after this meeting in Washington – (off mike). Is that likely to be just an afterthought this year or is there a role – we've been talking about revealing trade on a regional – (off mike). Is there a role in these regional groupings – albeit this is a big regional grouping – but is there a role for these – (off mike) – in dealing with – (off mike)?

MR. ALDONAS: The answer would be yes if what you could do is get the kind of commitment in APEC that I think President Bush wants out of the G-20 summit. I mean if you have the countries in the Asia Pacific make that commitment that they're going to resist protection, if nobody's going to take that set of measures, that actually could be very important. Because in truth, the world's economic future revolves on an axis that runs through North Asia to India at this point, and under those circumstances having a commitment by those governments towards a greater liberalization, certainly resisting protectionist pressures, actually would be a very positive signal in that context. I don't think that's on the agenda right now, but it should be.

MR. SCHRAGE: And I think one of the problems – I agree with Grant – this is a huge opportunity for some of the regional things. The original kind of game plan going back to the nineties and the Clinton administration and the Bush, first was that originally you would have all these regional groupings that you'd integrate at a regional level, and then eventually you would marry these all together in kind of a new system. But they've run into brick walls regionally, some of our own making in terms of like the Egypt FTA, the plug getting pulled on that, and the MEFTA strategy, but also Brazil playing a very non-constructive role at times in the FTAA. So that's where – I mean, ideally you would love to have these regional things formed together.

If they're not, I think this is where we may need some really new thinking about how do we structure around kind of these roadblocks we've hit in this regional strategy that we've been pursuing for quite some time but hasn't gained a lot of traction.

MR. SCHWARTZ: In the back.

Q: Steve Lavene (sp) with Business Week. I just wanted to ask whoever wanted to reply, the FT has a headline today that the agenda's going to be uniting on a stimulus. Just comment, agree, disagree.

MR. ALDONAS: Globally? I mean it's fascinating to me that people think that the stimulus would work under this circumstance. I mean that's is pure Keynesianism, right? We're going to plump up demand under the circumstances. And it ignores the fact that what we're about to face is severe deflationary pressures. And demand management isn't the answer under those circumstances.

The irony is that we're resorting to tools that in many respects failed to pull us out of a downward spiral throughout the 1930s, created very negative repercussions in terms of the ability of investors to even understand what was going on in the market and make a bet in the marketplace. So the irony of that statement is that it's moving in exactly the wrong direction in terms of the focus of what you need to do.

And it's one of those circumstances where – what government always should do is describe the shape of the racetrack and then let everybody figure out how fast they want to go. And at this point you have an awful lot of people through things like priming the pump with stimulus and stuff like that, that want to encourage people to go faster. Doesn't work that way. That's not how individuals make decisions in the market. You look at the banks and their response to the quote, unquote, bailout. What did they do? Well, they started to look after their assets. They didn't lend. You don't see that money coming back into the market that was pushed out through the initial window. There's just not appreciation that these ideas like an economic stimulus is going to make a difference.

To-wit: Let me just make a point about that in our own domestic context. Think about what cutting – I mean this very seriously – cutting gasoline prices, for people on the low end in the United States, guess what, they don't pay taxes, so a tax cut stimulus, even pushing a check out to them, is not as helpful as gasoline prices dropping by 60 percent, given how they've got to get around, get their kids to school, get to work, all the rest of that kind of stuff. That's already happened. You already have that stimulus in the market. And yet we're continuing to see that downward spiral. It would lead you to question whether the idea of stimulus is a good idea.

MR. SCHRAGE: And just to add on that, the stimulus package I think as we've seen in the tarp (?) in some sense are the easy solutions to go for. It's very appealing to politicians. You've got a big pool of money. You can hand this stuff out. And the question is – it's easy to start. The question is, where does it stop? And I think we're seeing that now. Originally it was financial institutions, banks, investment banks. Now insurance companies, now the automakers. Where do you draw the line in terms of where that goes and piling debt on future generations in terms of making it out of there?

And what's always gotten us out, and Grant's talked about some of this environment, has been productivity growth. Dynamic new industries coming in, in America and being developed. And how do we make sure that if we're going to be doing these major fiscal stimuluses or quote, unquote, "bailout plans," how do we get a return on investment? How are we putting money into things that are going to yield productivity and yield growth, and aren't just going to be like pouring water on sand and piling up debt without really building a foundation for us growing out of this, which is eventually what's got to happen.

MR. FREEMAN: What's the quote, we're all Keynesians now? (Laughter.)

I mean, what's really interesting is that you've got the Chinese government coming here very actively pushing the United States to come up with a real stimulus

package for the domestic economy, which I find absolutely fascinating. I mean, you look at the roots of this crisis, I mean it's got to be underscored here – there's a lot of talk about the failure of markets and all this other stuff, and we need more regulation. Without focusing on the fact that what created the bubble was massive intervention in the housing market and the United States government effectively granting consumers the right to spend much more than they could possibly ever pay back. That's not market activity. That's intervention. That's excessive regulation. So I mean we're getting into a question of – and everybody is sort of – the initial reaction is, we've got to have more market intervention, we've got to have more government spending. As Grant said, we've seen this movie before, and it was black and white.

Q: Yes. Daniel Wrench (ph) with Channel News Asia. You're talking about the idea that the stimulus – the idea of stimulus is not a good idea at the moment. But there was mention, Grant, I think you said, that we need Chinese cash. And that was slightly humorously done, but in a sense is China and India still growing economies? Are they actually the economic stimulus that the global economy still needs?

MR. ALDONAS: Well, I shouldn't be quite so glib, and I suffer from that unfortunately. But what I really mean by that is enterprise by enterprise, bank by bank, what you need to see is someone with a stronger balance sheet come in and shore up your operations. Now, that probably means a takeover at some point. But that's how we got out of the Texas savings and loan crisis. It's what we do every time we get into a banking crisis. You've got to find somebody with a stronger balance sheet. You're going to see consolidation as a part of this process. The role the Chinese can play constructively, if we will allow them to, is actually enterprise by enterprise sorting out through the detritus of a financial disaster, you know, where the solid money is.

Q: Is that Detroitus or detritus?

MR. ALDONAS: Yeah. Detroitus. (Laughter.) But I want them to behave in our market just the way Warren Buffet does. You want to reward the people who have good economic prospects, at which point the economy starts to come around. What I don't want is massive borrowing by our government, which induces the same sort of flaccidity in our economic policy, the lack of discipline in our economic policy. That would be a mistake.

And in some respects, the profligacy of a stimulus package simply amplifies the mistakes that we've made. We're trying to save people from an awful lot of bad decisions. And under these circumstances – I want to be clear. I'm not – I don't want to be curmudgeonly about the market, that it's all got to be laissez-faire. I actually think that intervention would help, but intervention would help most if what it was doing was helping people with their mortgages so that – and the insurance of their funds so that they knew that they could stay in the marketplace and have some confidence. The idea that we would have saved Dick Fold (ph) from his own doubling down on real estate investments at Lehman Brothers is foolish. It was the right choice to let it go.

So under these circumstances, I want the Chinese to come and behave in this market the way I would expect them to, to generate a high return on their investment, look for the positive assets, but not to be lending money as part of a broader economic stimulus approach.

MR. SCHRAGE: And just to clarify too, it's not – I'm not opposed to all kind of stimulus overall. It's just a question of how is it thought about strategically, how is it thought about an investment for long term that's going to generate productivity growth – and Larry Summers and others have written about this too – as opposed to a political process which is there's always going to be politics in this, but how do we make sure that it's as strategically targeted and not just opening the floodgates to pet projects and earmarks and whatever else going forward.

MR. FREEMAN: Just one last word. If you were the Chinese, would you actually buy in this marketplace? How do you price assets when there's so much money going around? I mean, there's no – it's really – what's the market? What are things worth?

MR. SCHWARTZ: Do we have time for just a couple more?

Q: Thank you. (Inaudible) – from 21<sup>st</sup> Century Business Herald, a Chinese paper.

So if I may, I have two questions. One, what are the concrete inputs that U.S. government is looking from China to provide over this conference or the following working group meetings?

Two, regarding the refund of IMF, how soon and how much will China provide funding, and what – under what kind of conditions? Do you know anything about discussion? Like to what stage is the discussion so far between IMF and Chinese government? Thank you.

MR. FREEMAN: I don't know the answer to the latter. I know that the initial reactions from the Chinese government were not particularly positive to injecting a huge amount into IMF, and one can understand that. I mean, Gordon Brown came out very forcefully and said, what we need is the Chinese to put \$2 trillion or something like that in the IMF, and I think was pretty quickly rebuffed.

On the first question, what does the United States government want the Chinese to do? I think the United States government is very anxious that the Chinese government not do anything precipitous with respect to the assets it already holds of agency and treasury debt. There's been a lot of discussion about – and I know David McCormick and Hank Paulson are spending a lot of time on the phone with counterparts in China both at the People's Bank and elsewhere and higher trying to make sure that there is continued Chinese faith, to the extent we can call it that, in U.S. institutions like in treasuries and the agencies.

Just I mean as an aside, it's kind of interesting. I mean the Chinese are playing – are trying to do the right thing with respect to the United States, trying not to move money out of the marketplace in ways that are going to – that would reduce whatever market respect there is for these assets. But they're also not being so faithful in the long-term sanctity of treasuries or assets that they're not playing a little close to the vest. If you look, for example, of Chinese holdings in the agencies, what they've done is they've actually – they've kept things there but they've – they've kept the money there but they've largely put it in two-year bonds as opposed to ten-year bonds.

Now, ten-year bonds are of course are what drive mortgage prices in the United States. So the Chinese, because they hold such a huge pot of these assets – and that's where everybody sort of flock to the Chinese position. So everybody's going into these short-term assets ignoring the longer-term assets, which of course drives yields through the roof for ten-year bonds, which of course makes mortgage prices higher, which effectively will reduce – will lower U.S. housing prices. So – and there's a bit of a double-edged sword there obviously.

MR. ALDONAS: If I could just add on that point. What's interesting about it is that the Chinese can't move out of our market. You have to appreciate that with all that money you need a market that is so deep and so liquid to invest so that you don't move prices. And you can't take \$2 trillion that's in the mattress in China and invest it in Italian railway bonds without moving the market. And so that money is going to be in the United States.

I think Charles' point is exactly right. What you want to see is the mix of what China does with the investments. Are they sorting through finding specific companies to invest in? If it's the CIC, are they going to the longer yields in treasuries? Which I agree with Charles would suggest that there is greater confidence that mortgages – or rather home prices have hit bottom and are starting back up. I mean the Chinese government are very shrewd in how they're investing. But I'd be very surprised if they move out of the market because they can't. There's no other place to invest, is the irony. There's no market that's deep enough and liquid enough to handle the volume of what the Chinese have to invest.

So it's the mix that matters. And actually I think could be a good leading indicator, as Charles was pointing out, of when we've actually hit bottom in the mortgage market and things start to move in the right direction.

Q: (Off mike.)

MR. ALDONAS: I'd be very surprised if they do. I mean, this is staged – (inaudible) – at this point. You would expect that most of the deal has been cooked by the finance ministers meeting in Sao Paulo, which is why earlier I alluded to the fact that it largely ended in failure, to come up with a detailed framework for this meeting. So your expectations for the summit would be very low because the deal hasn't been cooked.

Now, you have some unique personalities like Sarkozy who could make a real difference in the event – Lulu too, who I don't actually expect to be unconstructive as a part of this process. I think he will create a role for himself on the world stage by being constructive under these circumstances. But the interesting thing is, there's going to be a lot less discussion of those sorts of practical issues than probably should be on the table, and what it reflects is I think what everybody said, there's really insufficient preparation at this point to come – to suggest we can get something broad, positive and incredibly detailed about the direction of the world economy coming out of the summit.

Q: (Off mike.)

MR. ALDONAS: Yes, because he's the decider.

(Laughter.)

Q: Still? Is he still?

MR. ALDONAS: Yeah, he is. And I mean you have to appreciate, the Treasury still has enormous resources to try and effect the outcome of this, and it – you – even when things are going negatively in the U.S. economy, people underestimate the basic power of this \$14 trillion juggernaut where people still got to get up and go to work every day, right. And so – those who still have jobs.

But the point is, is that under those circumstances, what Bush and the Treasury do makes a huge difference under these circumstances. So he still has that power as any executive would. The real question is, does he have willing partners on the other side that are willing to move in a positive direction. Not so clear that anyone's outlined that positive direction, but the failure last weekend in Sao Paulo wouldn't suggest that people have coalesced around what the right course would be. If they had, I think Bush could make a real difference.

MR. SCHWARTZ: Great. With that, thank you for coming to CSIS today for this briefing. A transcript will be available later today at [www.csis.org](http://www.csis.org), and I will also be mailing out individual copies to those who have participated today. So thanks very much for coming.

(END)