DOLLAR & SENSE: THE BROOKINGS TRADE PODCAST

“The imperative of US-China dialogue on global issues”

Washington, D.C.
July 17, 2023

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Episode Summary:

U.S. Treasury Secretary Janet Yellen recently visited China and met with senior Chinese economic and political officials. Mark Sobel, U.S. chairman of the Official Monetary and Financial Institutions Forum, reflects on her trip, and says U.S.-China dialogue on economic and other global issues is imperative. “I believe that if the world’s two largest economies … aren’t talking,” Sobel says, “whether they agree or not, that’s a very bad thing for themselves and the world.”

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DOLLAR: Hi, I'm David Dollar, host of the Brookings trade podcast *Dollar and Sense*. Today, we're going to talk about Secretary Yellen's trip to Beijing. My guest is Mark Sobel, U.S. chair of the Official Monetary and Financial Institutions Forum, which is a London-based think tank. And Mark worked many years for the Treasury Department, and he and I worked together in the Treasury Department. So, welcome to the show, Mark.

SOBEL: Thank you for having me.

DOLLAR: So, let's start with the big picture. You were involved in many visits like this during your long time at Treasury. What's your overall impression of Secretary Yellen's visit to Beijing? Were there any specific outcomes in terms of policy changes on either side?

SOBEL: Well, thank you again for having me, David. I think that Secretary Yellen's trip was successful. She effectively conveyed the administration's points. I think she succeeded in her two main objectives, meeting key officials in Beijing and establishing dialog. So, regarding new faces, David, as you know, Chinese and U.S. financial officials could always meet quietly at the G20 meetings, IMF-World Bank meetings, or the Financial Stability Board. That was hard during the pandemic because the Chinese weren't traveling.

But there are many key players above the central bank and the finance ministry that don't travel or often interact that frequently with U.S. officials. So, notably, Yellen was able to meet the new vice premier, He Lifeng, who replaced Liu He. She was able to meet the premier, and I know she met Pan Gongsheng, who appears to be headed towards running the central bank.

In terms of dialogue, let me digress for a second. So, as you know, Secretary Snow began interacting heavily with China, and then Hank Paulson really amped that up of creating the strategic economic dialogue. And the dialogue continued just as heavily when Tim Geithner and Jack Lew were secretaries of the Treasury. You were our Treasury financial attaché in Beijing for many of those years. And plus, many of us in Washington interacted heavily with China on exchange rate issues, bilaterally, or we did so through the G20. Bob Dohner and I were able to just email our contacts in China in that period.

So, that dialogue came crashing down during the Trump administration, and it hadn't picked up under the Biden administration until now due to the fraught relationship and the pandemic.

I also want to say that I think given Janet Yellen's background as an extraordinary academic, Fed chair, and a technically oriented thought leader—to say nothing of Treasury's favorable relationship over time with Chinese financial authorities—there was really no better person to carry U.S. economic messages to Beijing. So, I'm one, and I have a feeling you are as well, I believe that if the world's two economies, largest economies, comprising 40% of global GDP, aren't talking whether they agree or not, that's a very bad thing for themselves and the world. I believe her trip will kickstart a resumption of dialog. It’s not going to be anywhere near as intense as beforehand, but it’s still progress.

But let me be clear—I don’t want to be Pollyannish. Not only are there huge tensions on the military, the defense side, there are big problems on the economic side. And economic relations cannot be divorced from national security considerations. China perceives the U.S. as resenting and trying to contain China’s rise, economic rise. China sees harsh political rhetoric across the U.S. spectrum, proliferating sanctions, semiconductor actions, CFIUS sanctions. They know the administration is working on outward-bound investment restrictions. They see de-risking as code for telling foreign firms and supply chains to leave China.

The U.S. has, in addition to its national security and human rights concerns, legitimate worries about forced technology transfers, IPR theft, disregard for property rights.

So, neither side is standing idly by. Beyond the tensions in the overall economic relationship, there are important substantive topics for them to discuss, such as macroeconomics, exchange rates, emerging market and developing country debt, global governance. We can come back to those. But in any case, the overall relationship concerns have not gone away. Yellen’s trip hasn’t changed that reality, so at least both sides are beginning to talk. But the fundamental, fraught dynamic remains in place.

DOLLAR: So, Mark, you’ve talked a little bit about some of the extreme measures or let’s just call them measures, that the U.S. has in place on the technology side. And I think Secretary Yellen in public and probably in private is telling the Chinese that these are narrowly targeted to national security issues or technologies with national security implications. They’re not meant to keep China down. That’s one of her main points in her public statements. Is that a fair description of the Biden administration policies that these various restrictions are narrowly targeted? And then you touched a little on this, but I’m interested in how the Chinese see this. Do they find that a credible message coming from Secretary Yellen?

SOBEL: I think you’ve characterized Yellen’s message quite accurately and clearly. I’m not a tech expert, I barely know how to turn my computer on. But I’d say that whether our restrictions are narrow or not, I don’t think the Chinese buy our narrative that they are narrow for one second.

So, regarding the expected executive order on outbound investments, various reporting suggests it will focus on advanced semiconductors and also perhaps quantum computing, artificial intelligence. There’s talk about whether it will be based on the notification process.

When some people speak about a narrow targeting of tech and trade restrictions, it’s often suggested the U.S. is focusing on applications with military significance. I’d guess, though, that applications with military significance may also have commercial and broader dual use applicability. So, the dividing lines are blurred. There are firms on the entities list that engender controversy. Also, TikTok might be an example in the Chinese minds that the U.S. isn’t narrowly targeting. Similarly, Huawei, though, that’s obviously much more controversial. And then, I see reports that Congress wants to restrict Chinese land purchases in the U.S., presumably because they may be near military bases, but whatnot.

So, the bottom line, I don't really feel I'm able to judge whether the restrictions are bearing being narrowly targeted. Regardless, and you've alluded to this, the definition of narrow may be in the eye of the beholder. This is a complicated question. My sense is the Chinese don't think the yard is small or the fence is high.

DOLLAR: I would characterize the official Chinese position as the following way, that the U.S. is trying to have these various national security restrictions we were just discussing, but also wants to cooperate with China on various global issues. And I hear Chinese officials saying that they resist this approach, that if the U.S. is imposing harsh economic and technology measures against China, then it's hard for China to cooperate on other issues. That's kind of the official line.

But it strikes me that we see some movement, actually, on a number of important global issues despite that Chinese rhetoric. And so, I want to bring up one that I know you understand well, which is the debt problems of developing countries. IMF estimates that about half of low income countries are at risk of debt distress, and China is the largest official bilateral creditor for this group of countries.

So, one of the issues presumably we're engaging China on is debt relief for these countries that have unsustainable debts. And it seems like recently there was a breakthrough on Zambia with a debt rescheduling agreement and a new IMF program. So, I want to ask you about that Zambia deal. Is China being cooperative? And do we see this as essentially a precedent that will lead to other reschedulings for low income countries? Is this an area where U.S. and China are actually working together reasonably well?

SOBEL: Great question. Let me just start off with the uber picture that you painted. I just want to underscore my very firm belief that it's imperative that the U.S. and China cooperate on global issues. How our two economies do will affect the entire world. Global climate can't be effectively tackled without U.S.-China cooperation. Ditto pandemic preparedness and others. So, I think this is just absolutely imperative that both sides work together.

Okay, turning to debt. Actually, the IMF estimates about 60% or two-thirds of low-income countries face debt distress. And in addition to low-income countries, there are some others such as Sri Lanka, Pakistan, and even Suriname, that face significant Chinese debt issues. As you mentioned, China is often the dominant bilateral official creditor in these cases.

So, the advanced economies in the past tackled unsustainable debt in the Paris Club. And some 15 years ago or so, we just wrote it all off. Now, China is not a Paris Club member despite strong efforts to bring it in, particularly in 2016 when China was the G20 chair. It is an observer in the Paris Club. But to create a Paris Club-like framework hoping to facilitate Chinese inclusion in debt deals and write-downs, the G20 created the so-called Common Framework, and it's a document that allowed a lot of wiggle room. But the potential for Paris Club-like solutions is there.

For its part, China wonders why it should provide deep debt relief and not just work ad hoc with distressed countries when it's a dominant creditor, not a Paris Club member. And it prefers deferrals, rollovers, and extensions, and doesn't want to take haircuts. And China, to be fair, is like any other creditor in not wanting to lose money.

And there are a lot of added complications. Are the Chinese Export-Import Bank and the Chinese Development Bank private lenders or official lenders? Does the government of China even know the true extent of Chinese lending, given the role of state commercial banks and companies? Does it even know what the terms are? Does it know what collateralization exist in those in those loan documents?

So, Chad, Zambia, Ethiopia, and more recently Ghana signed up for debt treatment under the framework. There were huge delays in getting financing assurances for IMF programs to go forward for Chad and Zambia. And then further reviews on IMF programs have been linked to progress on debt treatment. Chad moved forward after years, but again, the debt to Chad was mainly with the private entity, and when oil prices jumped, a deal was concluded because it didn't provide debt relief. Ethiopia's fighting a civil war. Ghana's come along later.

So, Zambia has been front and center. Again, the IMF staff agreed on a program in principle with Zambia in December 2021. Financing assurances were only secured in July 2022, allowing the program to be approved in August of 2022. In June this year, June of '23 as you suggested, a restructuring deal was reached with the bilateral creditors. A deal still has not been reached with private creditors, and that's going to open up a whole can of worms with respect to comparability of treatment.

The deal to restructure 6.3 billion, according to reports, provides a 1% interest rate on restructured loans till 2037. The rate will increase under a baseline to 2.5% and an upside scenario to 4% depending on future performance. If the lower base case prevails, some net present value relief will be afforded, though much less it seems than the Paris Club had typically provided, and perhaps not enough to meaningfully impact Zambia's debt burden in the sense of getting it out of the debt overhang. And the extent of relief in the upside case, which will be determined whether the upside case or the base case in a few years, is much less clear.

I'd say progress is being made. There's still far to go. There is huge international pressure on China over Zambia. China's premier was going to President Macron's summit for a new global financing pact, and that was the action forcing event. We haven't seen the agreement translated into a memorandum of understanding so far. Again, there's the private sector deal also to be hammered out.

So, whether this will translate readily into more deals has yet to be seen. I'm keeping my fingers crossed. I'll be watching Sri Lanka. I'm hopeful and think that progress will be slowly made because it simply has to be made. And the reality is the low-income countries are stressed and they simply can't afford to and they won't be able to repay.

DOLLAR: Okay, thanks, Mark. That was very helpful. And it seems to me it's something of a mixed picture. There's some progress, but it's not clear exactly how much debt relief really is going to be there for Zambia and how well this is going to translate to other countries. So, we're making some progress. It's not completely grim, but it's certainly not impressive cooperation among the major economies.

SOBEL: Not yet. Jury's out.

DOLLAR: Let's talk a little bit about the exchange rate. When you and I were working for Treasury, this was a constant issue between the United States and China. It's been less of an issue in recent years. But in fact, since the Fed started raising interest rates, we've seen quite a bit of depreciation of the Chinese currency. So, is this an issue for the U.S. economy? Is this something to worry about and something that Treasury likely discussed with Chinese officials during the Yellen visit?

SOBEL: Well, yes, as you said, exchange rate issues have been a hardy perennial between the U.S. and China and one that's shaped a good bit of both of our careers. So, the RMB's down about 4% this year and closer to 7 relative to a strong point, I think on a trade weighted basis is down around 2% or so.

What's going on? As you said, it's first and foremost, it's a story about relative monetary policy divergence. The Fed's been hiking rates, U.S. rates across the board have risen. On China's side, heady hopes about a Chinese rebound this year with his pandemic reopening are being dashed. And China's economy faces headwinds from housing and high indebtedness, among other issues. In part because of the high indebtedness and wishing to avoid a surge in leverage, the authorities have been unwilling to put the macroeconomic pedal to the metal as they did after the global financial crisis. Monetary policy has been slightly eased. That's weight on the RMB.

Many macro economists would say China should use fiscal stimulus to support the economy. But again, given high public debt, concerns about contingent liabilities, and the like, the authorities have not significantly been willing to do so, at least up till now.

I'd also note that capital inflow into China has really tapered off. Our friend at the Institute for International Finance, Robin Brooks, produces wonderful charts on this, which show that since around the time of the start of Russia's barbaric war against Ukraine, China has been flat in terms of receiving inflows. There's indications exporters are holding on to their dollars longer and the like.

China has acted to restrain the RMB's depreciation. It's used its traditional tools such as higher fixings in the market spot rate, guidance to banks, it's cut deposit rates on dollars. The central bank has not intervened, though, to prop up the RMB. I have to also say that RMB management in China is very untransparent and opaque.

Now, is this a problem for the U.S.? you ask. So, China has a humongous trade surplus—it's about 4% of GDP in general at this point. And when you think that China is like an $18 trillion economy, that's one hell of a big nominal figure. It's current account surplus, more around 2% of GDP right now, less of an eye popping figure. And frankly, it's below the Treasury threshold for evaluating designation on that criteria.

Our bilateral trade deficit is humongous. It's significantly down this year. And while economists don't care much about bilateral deficits, U.S. politicians do when they're big and when they come from China.

So, I could imagine there will be U.S. concerns—I'm sure Janet Yellen spoke to them about this—particularly in a world of low global growth there could be concerns China will turn to exports to support flagging domestic demand rather than boosting fiscal support, and that will have the effect of absorbing demand from the rest of the world. Concerns would be the case even if the RMB's weakness is being importantly driven by dollar developments. You and I both know that protectionist pressures can flow from such scenarios, let alone given the already fraught U.S.-China background.

So, that's my take, David. You are the master on Chinese macro developments. I hope I got that right or I pass muster in your eyes.

DOLLAR: That was excellent, Mark. Yeah, I definitely agree with you. Yeah, it certainly would be helpful if China would do a little bit more on the fiscal stimulus side, particularly oriented toward consumption rather than counting on further depreciation of the currency to stimulate exports. But as you say, they've been resisting the depreciation. Some of that is clearly market driven. Not clear they can really do that much about it.

Let me ask you about a related issue: relative roles of the dollar and the Chinese yuan. So, the market has been basically pushing the Chinese currency value down. But China continues to talk, or maybe it's fair to say they complain about dollar dominance. They talk about developing alternative systems and shifting out of dollars toward other types of reserve assets. And there's obviously talk about the Chinese yuan emerging as an important reserve currency. Do you see that happening? Is the dollar primacy threatened in any way?

SOBEL: Let me start with some data. Some measures of the RMB's global financing role put it around 3% or under. Eyeballing a wide range of metrics, the dollar is around 60%, the euro 20%, sterling and the yen 5%, the Australian and the Canadian dollars and Swiss francs account for a small rising bit. There have been stepped up central bank purchases of gold. I should say, this 60% figure for the dollar has been around for decades. Goes up and down, but not a bad number.

So, to answer your China question, what are the prospects? Let me let me start off with why is the dollar the world's financing and reserve currency? So, it's not a declaration of God or the U.S. Congress. The markets chose the dollar because of the size of the U.S. economy, open, deep, and liquid capital markets, currency convertibility, a wide array of debt instruments in which to invest, and good rule of law. U.S. financial institutions are the strongest in the world. They dominate the global financial system. They have established financial networks to transact global business. So, if it ain't broke, why fix it? Our macro policies are not going to win any beauty contests, but we also are not going to be competing in the most ugly contest.

So, I should add that I also believe that the dollar's global role is a net plus for the U.S., but not an exorbitant privilege. And that though it gives people like me an opportunity to talk about something, we talk too much about this topic.

So, one facet that I want to mention is that over the past decades what's emerged is the U.S. ability to use the dollar for geopolitical leverage through financial sanctions. So, I believe that if the U.S. deploys financial sanctions on a multilateral and judicious basis, there shouldn't be significant fallout. But I also think if the U.S. goes overboard and is abusive in the use of especially bilateral sanctions, financial sanctions, let alone with extraterritoriality, that could erode and hasten a less prominent global role for the dollar.

Regardless, surely if you're Chinese or a Mideastern fund, you've taken note of what happened with the blocking of the Russian oligarch and central bank assets.

So, let's contrast that with China. The RMB is not convertible. There are capital controls. Financial markets are evolving, but they're still heavily influenced by the government. And I doubt there's all that much global confidence in China's rule of law given President Xi's rectification campaign. And the "no limits partnership" with Putin isn't going to help, especially, as I mentioned earlier, the capital flows have abated since the start of Russia's war with Ukraine.

So, all that said, putting it together, I can see room for the RMB's role to increase somewhat, perhaps a bit in reaction to the use of financial sanctions, perhaps a bit in response to the increased use of the RMD for trade settlements. And as China hesitantly liberalizes its financial system.

Now, is a heightened RMB role a worry for the U.S.? I believe that it's not. The chief potential danger in my mind to the U.S. dollar's global role is the United States of America. If we preserve the characteristics I mentioned earlier and don't abuse the use of financial sanctions, I think the dollar's dominant role, whatever the number is associated with that, it'll remain intact even if it lessens. Doing that and not messing up should be our focus. And if others open up, adopt the characteristics I mentioned above for themselves to a greater extent, and they rely more on domestic demand, the world economy might be on a sounder footing.

DOLLAR: Last question, Mark. Let's go big picture again. China has started some new institutions like the Asian Infrastructure Investment Bank, and the BRICS Bank, and it's got this Belt and Road Initiative. So, one line of argumentation is China's trying to create an alternative set of institutions to replace the essentially U.S.-dominated global institutions. But another school of thought is that it's really important to enmesh China in the existing institutions: IMF, World Bank, et cetera. So, what is your take on that tension?

SOBEL: Great question to wrap up on. As you said, there's a lot of talk these days about blocs, fragmentation, deglobalization and the like. I'm not naïve. As I mentioned earlier, national security concerns are going to triumph over liberal commerce and all of us sin to a varying degree.

But the world has benefited tremendously in the past decades from openness and globalization. There's going to be some fragmentation, there's going to be some reorientation of supply chains, et cetera—that is baked in the cake. But do we want the world to split into U.S.- and Chinese-led economic blocs, so to speak? The rest of the world doesn't want to be caught between two blocs per se. I don't think the

U.S. either should want two blocs. There's plenty of nonthreatening business to be done with China. That's good for American consumers.

I worked a lot on IMF issues in my career, as you know. The People's Bank of China represents China in the IMF. The PBOC has an extremely talented staff. They're often educated in the U.S. They work very well with the IMF. China has no interest in financial instability abroad. So, it's IMF voting power's around 6%. I think China's global GDP share is somewhere around 18%. So, China should be number two, whatever, whatever its voting share, it should be number two in the IMF.

I'm not naive. The administration isn't likely going to support that any time soon, given U.S.-China tensions, obvious congressional reactions. Europe's not going to want to cede voting power to China because then it would lose. And frankly, in my view, China should start behaving far more responsibly on low-income country and emerging market debt before its role in international economic financial institutions would be stepped up.

But not supporting an increase in China's share, even if it's a difficult thing for the U.S. to do, isn't going to help keep China closer to global economic institutions. Now the NBBs also need to mobilize massive amounts to finance global climate change. And that's not going to be possible without U.S.-Chinese cooperation.

So, my bottom line: I think doing what we can to tie China into global economic institutions can benefit the U.S. and China and is a good thing to the extent possible to prevent a greater drift into regionalism and blocs.

DOLLAR: I would describe that, Mark, as engagement with eyes wide open, which I agree with your perspective. I'm David Dollar and I've been talking to Mark Sobel. We used Janet Yellen's visit to Beijing as a jumping off point to discuss a range of U.S.-China economic issues and some global financial issues more generally. So, thank you very much, Mark.

SOBEL: Great pleasure to be with you.

DOLLAR: Thank you all for listening. We release new episodes of *Dollar and Sense* every other week. So, if you haven't already, follow us wherever you get podcasts and stay tuned.

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Until next time, I'm David Dollar and this has been *Dollar and Sense*.