

DECEMBER 2021

Perspectives on the Global Economic Order in 2021

A U.S.-China Essay Collection

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A Joint Report of the CSIS Economics Program and the Shanghai Institutes for International Studies

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About SIIS

Founded in 1960, the Shanghai Institutes for International Studies (SIIS) is a government-affiliated high-caliber think tank dedicated to informing government decision-making by conducting policy-oriented studies in world politics, economics, foreign policy, and international security. SIIS maintains intensive and extensive exchanges and cooperation with research institutions at home and abroad, bolstering China's international influence and soft power.

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Preface

BY MATTHEW P. GOODMAN AND CHEN DONGXIAO

For many years, the Center for Strategic and International Studies (CSIS) and the Shanghai Institutes for International Studies (SIIS) have had a broad and productive relationship exploring critical issues in the U.S.-China relationship and in global affairs. Since 2015, we have cohosted the U.S.-China Dialogue on the Global Economic Order, a track 1.5 dialogue that has sought to build mutual trust, enhance communication, identify issues, and propose solutions. The series of semiannual workshops, alternating between China and the United States, has covered a wide range of topics, including trade, investment, finance, and technology. The dialogue has drawn scholars, former policymakers, and current officials from the United States and China across a wide range of institutions and disciplines.

This volume consists of a series of parallel essays on the global economic order by U.S. and Chinese scholars who have participated in our dialogue. It complements similar volumes published in 2017 and 2019.¹ The value of this text is found not only in the ideas presented by the essayists but also in the opportunity to “listen” to each other as we manage our differences and seek a shared reform agenda for the global economic order.

1 Matthew P. Goodman et al., *Parallel Perspectives on the Global Economic Order: A U.S.-China Essay Collection* (CSIS: Washington, DC, September 2017), www.csis.org/analysis/parallel-perspectives-global-economic-order; and Matthew P. Goodman and Chen Dongxiao et al., *Perspectives on the Global Economic Order in 2019: A U.S.-China Essay Collection* (CSIS: Washington, DC, October 2019), www.csis.org/analysis/perspectives-global-economic-order-2019.

U.S.-China Cooperation on Financial Issues

BY MARK SOBEL

A senior level Biden administration official recently suggested that the future dominant paradigm between the United States and China would be competition and that the era of engagement had come to an end.²

The U.S. relationship with China is complex, multifaceted, and, as former secretary of the treasury Hank Paulson said, the “defining geopolitical issue of this century.”³

The United States will surely look disapprovingly at China’s growing authoritarianism and economic statism. It will also view with disdain China’s rising militarism in the South China Sea, its treatment of Uighurs in Xinjiang, the suppression of democracy in Hong Kong, and many other facets of Chinese behavior. Indeed, going forward, there will be plentiful avenues for strategic competition.

But the United States and China are the world’s two largest and most dominant economic powerhouses. Their economic and financial footprints overlap across the globe. Together, they share many common interests in managing the global economic and financial system in a manner that

2 Noa Ronkin, “White House Top Asia Policy Officials Discuss U.S. China Strategy at APARC’s Oksenberg Conference,” Stanford Freeman Spogli Institute for International Studies, May 27, 2021, <https://fsi.stanford.edu/news/white-house-top-asia-policy-officials-discuss-us-china-strategy-aparc%E2%80%99s-oksenberg-conference>.

3 “OMFIF interview with Hank Paulson,” YouTube video, posted by OMFIF, June 29, 2020, 45:08, <https://www.youtube.com/watch?v=3ka5IxPp3AE>.

promotes prosperity and stability for themselves and the world. To do so in a sound and responsible way, they must strategically engage.

Over the years, the U.S. Treasury Department—as well as the U.S. Federal Reserve and financial regulators—have engaged well with the People’s Bank of China (PBOC). The latter is staffed with many talented economists, who are often trained in U.S. universities and have a favorable understanding of the United States. Technical-level discussions may have diminished in the past several years, but the Treasury Department and PBOC still interact in the Group of 20 (G20), the International Monetary Fund (IMF), and the Financial Stability Board. Plus, even under the Trump administration, they certainly knew how to find one another for discussions—such as through the Phase 1 currency understandings.⁴ The Treasury Department also has strengthened its ties over time with China’s Ministry of Finance, especially during the years of strategic economic dialogues. The ministry is more modern and internationalized compared to a decade ago.

There are many areas of overlap. For example:

- The United States and China account for more than 40 percent of global GDP using market exchange rates.⁵ The United States is now strongly recovering from the pandemic’s hit to activity.⁶ Whether the United States faces transitory or more lasting inflation, and associated Federal Reserve policy, will be a key determinant of global financial market developments. U.S. fiscal management will impact whether support for the U.S. and global economies is prematurely withdrawn. China closed its economy early last year to overcome the pandemic, accepting a sharp temporary plunge in activity.⁷ Overall, Chinese leverage is high.⁸ After China’s reopening, authorities have pursued restrained fiscal and monetary policies, wishing to avoid an excessive build up in debt and an associated elevation in financial risks as well as to steer clear of following major advanced economies into unconventional monetary policy. Excessive restraint could limit Chinese and global growth, while a further unsustainable increase in leverage would create further financial risks for China, which could spill over globally. U.S. and Chinese macroeconomic policies and their consequences for the world are ripe for discussion.
- Currency issues also require engagement and cooperation. The dollar is a floating currency. Policy mixes at home and foreign currency practices can impact whether the dollar’s value is in line or highly overvalued. U.S. monetary policies and dollar movements can impact whether the renminbi moves up or down and also drives global capital flows. In the past, China ran massive current account

4 Virgil Bisio et al., *The U.S.-China ‘Phase One’ Deal: A Backgrounder* (Washington, DC: U.S.-China Economic and Security Review Commission, February 2020), <https://www.uscc.gov/sites/default/files/2020-02/U.S.-China%20Trade%20Deal%20Issue%20Brief.pdf>.

5 World Bank, *Gross Domestic Product 2020* (Washington, DC: 2021), <https://databank.worldbank.org/data/download/GDP.pdf>.

6 Patti Domm, “The U.S. Economy Is Bigger than It Was Pre-Pandemic, but Covid Could Still Decide What Happens Next,” CNBC, July 29, 2021, <https://www.cnbc.com/2021/07/29/the-us-economy-is-bigger-than-it-was-pre-pandemic-but-covid-could-still-decide-what-happens-next.html>.

7 Lyric Li and Eva Dou, “China’s Economic Growth Eases as Recovery Levels off after Covid-19 Pandemic,” *Washington Post*, July 15, 2021, <https://www.washingtonpost.com/world/2021/07/14/china-economy-slowdown-covid/>.

8 Ma Guonan, “China’s High and Rising Corporate Debt,” *Merics*, August 22, 2019, <https://merics.org/en/report/chinas-high-and-rising-corporate-debt>.

surpluses and intervened heavily in markets, creating the prospect for boom and bust cycles in China.⁹ It also stoked global protectionism, especially in the United States amid charges of currency “manipulation” or “undervaluation.” China’s current account surpluses have decreased sharply since the global financial crisis—though the pandemic has bumped the surplus up a bit—and intervention has largely ended.¹⁰ China’s gradual financial opening may be attracting flows that might have gone to other emerging markets. The renminbi’s valuation remains a key issue, as it can impact not only trade with the United States but with Europe and third-country trade around the globe. Rightly or wrongly, China’s enormous bilateral trade surplus with the United States will remain a potential flashpoint.

- China and the United States must cooperate on the global financial regulatory agenda. Major U.S. banks are globally active, and China’s large banks are likely to become increasingly so in the future. Global financial stability requires that the large systemically important banks follow similar and sound high-quality standards to avoid a race to the bottom. The United States and China also face issues with large scale non-bank activities, in which less regulated non-banks can take advantage of lower standards, gaps, and regulatory arbitrage, creating financial risks. Excess credit to housing sectors has frequently triggered financial stress and lower growth in many countries, an issue now potentially confronting China in light of the problems facing Evergrande and other firms. Accordingly, there is a need for the United States and China to cooperate closely in the Financial Stability Board and Bank of International Settlements to ensure all banks follow sound capitalization and liquidity management practices, restrain leverage, and limit the risks from “shadow” banks.
- One increasingly important area of the global financial regulatory agenda involves addressing climate finance risks. Financial institutions face a critical transition and physical risks that can impact portfolios and weaken financial stability. There is substantial work underway, including with the United States and China, through the Task Force on Climate-related Financial Disclosures and the Network for Greening of the Financial System.¹¹ Environmental, social, and governance investing and the need to develop taxonomies to avoid greenwashing are increasingly critical. The United States and China are currently co-chairing a G20 Sustainable Finance Working Group.

These are but a few areas where U.S.-China economic and financial cooperation are essential. Other areas are important as well, though they may give rise to friction.

A critical area is developing-country debt. Several decades ago, the major advanced economies began a process of eliminating official bilateral debts for debt-distressed countries through international initiatives such as the enhanced Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative. They organized their relief efforts through the so-called Paris Club. Now, the bulk of official bilateral debt is owed to non-traditional creditors, of which China is the largest. China is not a member of the Paris Club

9 “China May Soon Run Its First Annual Current-Account Deficit in Decades,” *The Economist*, March 16, 2019, <http://www.economist.com/leaders/2019/03/16/china-may-soon-run-its-first-annual-current-account-deficit-in-decades>.

10 *Ibid.*; and Michael Nienaber and Rene Wagner, “China Overtakes Germany with Largest Current Account Surplus-Ifo,” *Reuters*, January 21, 2021, <https://www.reuters.com/article/us-germany-trade-ifo-idUSKBN29Q332>.

11 “Task Force on Climate-related Financial Disclosures,” Financial Stability Board, Task Force on Climate-related Financial Disclosures, n.d., <https://www.fsb-tcfd.org/>; and “Network for Greening the Financial System,” Network of Central Banks and Supervisors for Greening the Financial System, n.d., <https://www.ngfs.net/en>.

and does not follow its conventions.

Debt distress is an increasing challenge for low-income countries, especially as the pandemic reduced tourism and remittance inflows and hurt commodity prices.¹² Such economic losses hurt budgets and the ability to fund social protections.

In many cases, low-income country debt is now unsustainable and needs to be written down. Much credit has been extended in past years as part of China's Belt and Road Initiative. The G20 has pushed forward with the "Common Framework" to allow official write-downs of unsustainable debt, but it is decidedly a work in progress.¹³ The framework's language leaves much room for interpretation. China has been hesitant to write down unsustainable debt and to acknowledge that obviously official debt should not be categorized as private debt; instead, it sought to roll over and extend loans without a reduction in their value.¹⁴ The United States should and will continue to press China to write down unsustainable debt. It should also press China to enhance the transparency of China's credits, at a minimum providing full information to international financial institutions.

Digital currency is another area receiving much international attention and in which China is a leader. While the motivation for a Chinese central bank digital currency is largely domestic, aimed at reasserting control over Chinese payments networks, some see this development as the beginning of a challenge to the dollar. While that claim is fanciful, it still points to frictions between the United States and China over the management of the international monetary system. Chinese concerns over past excessively unilateral use of financial sanctions reinforce China's concerns about the dollar's predominant global role.

The United States and China have much to gain from engaging in dialogue on economic and financial issues, and the rest of the world has a vital interest in them doing so. One should not be Pollyannaish; the discussions may often be frank, candid, and involve tensions and strong differences of views. Still, the United States and China must find ways to work together on economic and financial issues, especially where their interests strongly overlap or are shared.

In a well-crafted speech in early April, Secretary of the Treasury Janet Yellen underscored U.S. interest in a stable, growing world economy that benefits the United States, the need for a more inclusive global economy that aligns with U.S. values, and that no country will be successful if it advances alone or in isolation.¹⁵ As she sagely observed: "We will cooperate with willing partners to protect and enforce a rules-based order. Our economic relationship with China, like our broader relationship with China, will be competitive where it should be, collaborative where it can be, and adversarial where it must be."

12 Homi Kharas and Megan Dooley, "Debt Distress and Development Distress: Twin Crises of 2021," Brookings, March 17, 2021, <https://www.brookings.edu/research/debt-distress-and-development-distress-twin-crises-of-2021/>.

13 "Common Framework for Debt Treatments beyond the DSSI," G20 Saudi Arabia, November 2020, https://clubdeparis.org/sites/default/files/annex_common_framework_for_debt_treatments_beyond_the_dssi.pdf.

14 Martin Chorzempa and Adnan Mazarei, *Improving China's Participation in Resolving Developing-Country Debt Problems* (Washington, DC: Peterson Institute for International Economics, May 2021), <https://www.piie.com/sites/default/files/documents/pb21-10.pdf>.

15 "Remarks by Secretary of the Treasury Janet L. Yellen on International Priorities to The Chicago Council on Global Affairs," U.S. Department of the Treasury, April 5, 2021, <https://home.treasury.gov/news/press-releases/jy0101>.

Reforming the IMF to Better Serve Post-Pandemic Needs

BY XIONG AIZONG

The International Monetary Fund (IMF) provided prompt, integrated action plans for its members to help them cope with liquidity shortages after the onset of the Covid-19 pandemic. The IMF aided low-income and emerging market economies through its rapid-disbursing facilities, scaling up from \$50 billion to \$100 billion.¹⁶ The Fund also established a Short-term Liquidity Line to provide swap-like liquidity support for its members in a special balance-of-payments need. It also provided the Catastrophe Containment and Relief Trust (CCRT) for eligible countries to pay debt service owed to the IMF and free up resources to better cope with the pandemic. By the end of May 2021, the IMF had provided financial support of more than \$100 billion for its 84 members through lending instruments and debt reduction or exemption of \$700 million for 29 countries through CCRT.¹⁷

The IMF had taken active actions to replenish resources before the pandemic as a buffer for the later eruption of the crisis. In January 2020, the IMF Executive Board approved a doubling of the New Arrangements to Borrow to 364.7 billion Special Drawing Rights (SDRs, the IMF's unit of account) from

16 "IMF Makes Available \$50 Billion to Help Address Coronavirus," IMF, March 4, 2020, <https://www.imf.org/en/News/Articles/2020/03/04/sp030420-imf-makes-available-50-billion-to-help-address-coronavirus>; and "IMF Executive Board Approves Proposals to Enhance the Fund's Emergency Financing Toolkit to US\$100 Billion," IMF, April 9, 2020, <https://www.imf.org/en/News/Articles/2020/04/09/pr20143-imf-executive-board-approves-proposals-enhance-emergency-financing-toolkit-us-billion>.

17 "IMF Financing and Debt Service Relief," IMF, n.d., <https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker>.

SDR 182.4 billion for a new period extending from 2021 to 2025.¹⁸ In March 2020, the Executive Board also approved a framework for a new round of bilateral borrowing, under which the IMF entered into bilateral borrowing arrangements with 41 creditors for a total of SDR 135 billion.¹⁹ However, the IMF’s most important financing source of quota did not increase.

In February 2020, the Board of Governors adopted a resolution concluding the 15th General Review of Quotas, with no increase in quotas.²⁰

The IMF’s current total financing resources, amounting to SDR 973 billion, translate into a capacity for lending of about SDR 707 billion (around \$1 trillion) for its members.²¹ Quotas are the IMF’s main source of financing, which can provide lending of SDR 316 billion, while New Arrangements to Borrow and Bilateral Borrowing Arrangements serve as second and third lines of defense, which can provide lending of SDR 285 billion and SDR 106 billion, respectively. As of June 18, 2021, total lending commitments in the General Resource Account of the IMF amounted to SDR 183.1 billion, and the Forward Commitment Capacity (FCC) was SDR 155 billion, both of which had mainly been financed by quotas (Table 1).²²

Table 1: Weekly Report on Key Financial Statistics (as of June 18, 2021, in billions of SDR)	
1. Total Lending Commitments	183.1
1.1 Undrawing Lending Commitments	93.1
1.2 Credit Outstanding	89.9
1.2.1 Financed by Quota Resources	84.9
1.2.2 Financed by Borrowed Resources	5.0
2. Forward Commitment Capacity	155.0
2.1 From Quota Resources	155.0
2.2 From New Arrangements to Borrow Resources	-
2.3 From Bilateral Borrowed Resources	-
3. Unactivated Borrowed Resources	386.6
3.1 New Arrangements to Borrow	280.3
3.2 Bilateral Borrowing Agreements	106.3
4. Total GRA Resources	724.7

Source: IMF Finances.

18 “IMF Executive Board Approves Decisions to Implement a Package on Resources and Governance Reform,” IMF, January 17, 2020, <https://www.imf.org/en/News/Articles/2020/01/17/pr2010-nab-and-quota-imf-executive-board-approves-package-resources-governance-reform>.

19 “IMF Concludes Steps to Maintain its Lending Capacity,” IMF, January 8, 2021, <https://www.imf.org/en/News/Articles/2021/01/08/pr214-imf-concludes-steps-to-maintain-its-lending-capacity>.

20 “IMF Board of Governors Approves a Resolution on Quota Reviews,” IMF, February 13, 2020, <https://www.imf.org/en/News/Articles/2020/02/13/pr2050-imf-board-of-governors-approves-a-resolution-on-quota-reviews>.

21 “Where the IMF Gets Its Money,” IMF, n.d., <https://www.imf.org/en/About/Factsheets/Where-the-IMF-Gets-Its-Money>.

22 The IMF’s one-year Forward Commitment Capacity (FCC) is a measure of the resources available to the IMF

Facing the global public health and economic turmoil amid the Covid-19 pandemic, the IMF should take the following measures to better serve the needs of its members in the future.

1. Help members better cope with the pandemic.

It remains the IMF's top priority to ease liquidity shortages for its members during the pandemic, particularly for developing countries. The pandemic has had disproportionate impacts on both emerging market and developing economies (EMDEs) and advanced economies (AEs). IMF chief economist Gita Gopinath said that projected GDP per capita losses will average around 6 percent over 2020–24 in EMDEs (excluding China) and around 2 percent in AEs.²³

Apart from providing more support within its existing lending frameworks for EMDEs, the IMF has recently put more focus on discussing a new round of general SDR reallocation and how to use the SDRs. Since the eruption of the pandemic, the international community has repeatedly called on the IMF to reallocate the SDRs—as it did after the eruption of the global financial crisis in 2009—to help its members address the global liquidity shortage.²⁴ Luckily, despite their slow pace, the Executive Board discussed a new SDR allocation of \$650 billion in March 2021, and major IMF members reached preliminary consensus on it.²⁵ In August 2021, the Board of Governors approved a general allocation of SDRs equivalent to \$650 billion.²⁶ The new allocation will help ease liquidity shortages in developing countries. Statistics show that \$275 billion of the new SDR allocation will go to EMDEs and \$27.6 billion will go to 74 low-income countries.

Meanwhile, the international community has been discussing how to further expand the use of existing or newly allocated SDRs. Countries, especially those with excess SDRs, can collect their unused SDRs and put them under the management of the IMF. There are three possible ways to use those SDRs: (1) increasing the Poverty Reduction and Growth Trust to scale up external financing accessible to low-

for new financial commitments.

- 23 “Remarks by IMF Chief Economist Gita Gopinath at the 3rd APEC Structural Reform Ministerial Meeting,” IMF, June 16, 2021, <https://www.imf.org/en/News/Articles/2021/06/16/sp06162021-gita-gopinath-remarks-at-apec-ministerial-meeting>.
- 24 The United Nations Conference on Trade and Development (UNCTAD) recommended the IMF for a SDR allocation of \$3–5 trillion. Kevin P. Gallagher and Edwin M. Truman et al. recommended the IMF for a SDR allocation of at least \$500 billion. UNCTAD, *The Covid-19 Shock to Developing Countries: Towards a ‘Whatever It Takes’ Programme for the Two-thirds of the World’s Population Being Left Behind* (Geneva: March 2020), https://unctad.org/system/files/official-document/gds_tdr2019_covid2_en.pdf; Kevin P. Gallagher, José Antonio Ocampo, and Ulrich Volz, “It’s time for a major issuance of the IMF’s Special Drawing Rights,” *Financial Times*, March 20, 2020, <https://www.ft.com/content/43a67e06-bbeb-4bea-8939-bc29ca785b0e>; and Edwin M. Truman, “The IMF will need more resources to fight the COVID-19 pandemic,” Peterson Institute for International Economics, March 29, 2020, <https://www.piie.com/blogs/realtime-economic-issues-watch/imf-will-need-more-resources-fight-covid-19-pandemic>.
- 25 “IMF Executive Directors Discuss a New SDR Allocation of US\$650 Billion to Boost Reserves, Help Global Recovery from COVID-19,” IMF, March 23, 2021, <https://www.imf.org/en/News/Articles/2021/03/23/pr2177-imf-execdir-discuss-new-sdr-allocation-us-650b-boost-reserves-help-global-recovery-covid19>.
- 26 “IMF Governors Approve a Historic US\$650 Billion SDR Allocation of Special Drawing Rights,” IMF, August 2, 2021, <https://www.imf.org/en/News/Articles/2021/07/30/pr21235-imf-governors-approve-a-historic-us-650-billion-sdr-allocation-of-special-drawing-rights>.

income countries; (2) increasing CCRT to strengthen debt reduction and exemption for low-income countries; and (3) establishing new trusts to satisfy other financing needs of low-income countries.

2. Further increase the IMF's resources.

The IMF's credit outstanding has increased continually since the outbreak of the pandemic. Apart from quotas, the IMF has also activated New Arrangements to Borrow to provide lending support for its members. Now the one-year FCC has hit a 10-year low. If the borrowing demand further increases, the FCC will continue to drop and the IMF would have to activate Bilateral Borrowing Arrangements.²⁷ In this situation, it is essential to further replenish the resources available to the IMF.

Quota of the IMF should be further increased. The IMF is a quota-based organization, but quota currently only accounts for 49 percent of all IMF resources and 44.7 percent of the its lending capacity. Such low ratios are not in line with the role of quota as the most important source of financing for the IMF. The quota should be gradually increased, and while it should ensure that the IMF's lending capacity is not weakened, its dependence on multilateral and bilateral borrowing should be gradually reduced.

The IMF can consider making use of the securities market to finance more resources. Some regional financial arrangements, such as the European Stability Mechanism and the Latin American Reserves Fund, have also financed on the securities market. In October 2018, the G20 Eminent Persons Group suggested that the IMF could issue highly rated securities on global capital markets to promptly mobilize the needed resources upon eruption of major systemic crises.²⁸ Moreover, it also suggested that the IMF make use of SDRs as capital to establish a Special Purpose Vehicle to issue securities to finance. For example, in 2010, the IMF proposed that after the reallocation of SDRs in 2009, developed economies can use their SDRs as capital to establish the Green Fund to help cope with climate change challenges.²⁹ Against the backdrop of the pandemic, countries, especially developed economies, can use their existing or newly allocated SDRs as capital to set up special purpose entities managed by the IMF to support their anti-pandemic and economic recovery.

3. Promote the IMF's governance structure reform.

The disproportionate representation of EMDEs should be further addressed. The gap between the global output proportion of EMDEs and their quota proportion in the IMF should be narrowed down. The 16th General Review of Quotas should be concluded on time. While the quota structure reform is being promoted, the scale of quotas should be gradually expanded and the IMF's reliance on temporary resources should be reduced. The current quota formula should be reformed, and, in particular, the weight of GDP in the formula should be raised. Special attention should be paid to the voices and quotas of the poorest and smallest members to prevent their interests from being damaged during the process of governance structure reform. The IMF's recruitment processes should be reformed to promote open and merit-based selection of the managing director. A more democratic governance

27 According to the IMF, Bilateral Borrowing Agreements will be activated only if the modified FCC is below SDR 100 billion.

28 G20 Eminent Persons Group, Making the Global Financial System Work for All (G20, October 2018), <https://www.globalfinancialgovernance.org/>.

29 Hugh Bredenkamp and Catherine Pattillo, "Financing the Response to Climate Change," IMF, IMF Staff Position Note, SPN10/06, March 25, 2010, <https://www.imf.org/external/pubs/cat/longres.aspx?sk=23725.0>.

structure should be established to continually promote participation of EMDEs in IMF decisionmaking and rule setting.

How Can China and the United States Work Together for the IMF?

First of all, China and the United States should strengthen support for the IMF. While maintaining the central position of the IMF in the Global Financial Safety Net, both countries should support and encourage the Fund to strengthen cooperation and coordination with other financial safety nets and continue to promote the IMF's active role in international macroeconomic policy coordination to facilitate global economic growth and financial market stability.

Second, China and the United States should expand the use of SDRs. Based on the new round of SDR allocation, both countries should communicate on the use of SDRs—including about the form in which IMF members channel SDRs and the purpose of the use of SDRs—in order to better help low-income countries achieve economic recovery.

Finally, China and the United States should ensure that the IMF's resources are adequate in the long run. Both countries should lift the ratio of quota resources in the IMF's total resources and gradually reduce reliance on borrowing resources to meet the expectations of all parties for the Fund as a quota-based organization. China and the United States should complete the IMF's 16th General Review of Quotas and reform the quota formula to make the IMF's quota structure more consistent with the realities of the world economic landscape.

Working to Avoid the Kindleberger Trap

China-U.S. Collaboration on Development Finance

BY KEVIN P. GALLAGHER

When it comes to the provision of global public goods, the two largest and most systemically connected countries in the world must work in parallel at minimum and together at optimum in order to achieve and maintain a more equal, stable, and sustainable global economy. This is not to ignore the fact that the two countries have legitimate grievances with each other. Rather, it is important to stress that as hard as the two countries need to work on their differences on one track, each has a global and self-interested responsibility to provide public goods on another track. At the core of such an agenda should be a stepwise mobilization of public development finance aligned with the Sustainable Development Goals (SDGs) and the Paris Agreement.

In his classic work *The World in Depression* (1986), Charles Kindleberger outlined how the Great Depression became globalized and the seeds of World War II were sewn in 1933 when the two largest economies failed to come together at the London Economic Conference to provide five essential public goods for the world economy.³⁰ Those key public goods included fostering a stable global exchange rate system, having sovereign lenders of last resort, maintaining open markets during recessions, providing long-term development finance, and coordinating across nations on macroeconomic policies. It took a global depression and global conflict to rectify that failure in 1944 through the establishment of the current economic order. Once again, the order is under great strain and is in desperate need of leadership and cooperation. The world must avoid a “Kindleberger Trap,” whereby world powers fail to

30 Charles Poor Kindleberger, *The World in Depression, 1929-1939: 40th Anniversary of a Classic in Economic History* (Berkeley: University of California Press, 2013), 40.

work together to provide global public goods.

This essay focuses on the urgent need for a stepwise increase in long-term development finance and the role that China and the United States can play alone, in parallel, and together. Kindleberger recognized that private markets fall short in providing long-run counter-cyclical financing and that public financial entities need to be established and coordinated on a global scale. The International Bank for Reconstruction and Development (the lending arm of the World Bank) was established to play that role at the historic Bretton Woods summit in 1944, followed by hundreds of regional, sub-regional, and national development banks across the world.

Unfortunately, the scale, composition, and efficacy of development finance has not kept pace with the size of the world economy and the growing set of issues that the world's nations have prioritized. While differences in accounting methods vary, there is a consensus that at minimum an additional 2 percent of GDP needs to be mobilized on an annual basis from now until 2030 in order to meet global climate and development goals. Such goals are not arbitrary. If such financing is not mobilized and put to good use, the economic costs of inaction from climate and social shocks will be severe.³¹

Despite some significant advances, the community of nations was falling far short of these goals even before Covid-19 shocked the world economy. Efforts to use public development finance to attract private sector financing showed little signs of success, and rising debt levels were limiting the ability of nations to put capital to productive use. The Covid-19 crisis worsened those prospects, pushing even more countries into debt distress. There is a debate about whether a global debt crisis is looming, but there is widespread acknowledgement that the growing debt overhang will make it impossible for the world's nations to mobilize the necessary resources to meet shared climate and development goals without new financing and more careful use of subsequent funds. Therefore, it is paramount that a stepwise mobilization of capital is harnessed alongside meaningful levels of debt relief for emerging market and developing countries.

Lead by Example

China and the United States should act unilaterally, in parallel, and together on these fronts. Unilaterally, each country should lead by example. To this end, China has already made incredible contributions. The China Development Bank and the Export Import Bank of China were fueled with stepwise increases in capital following the global financial crisis. The two institutions provided just as much financing to sovereign governments between 2008 and 2019 (over \$400 billion) as the World Bank did during the same period.³² Moreover, China has set up a network of global and regional funds such as the Silk Road Fund and the China-Africa Development Fund. New research has shown that

31 Amar Bhattacharya et al., *Aligning G20 Infrastructure Investment with Climate Goals & the 2030 Agenda* (Washington, DC: Foundations 20 Platform, June 2019), https://wwwFOUNDATIONS-20.org/wp-content/uploads/2019/06/F20-report-to-the-G20-2019_Infrastrucutre-Investment.pdf; and Amar Bhattacharya et al., *Climate Action to Unlock the Inclusive Growth Story of the 21st Century* (Washington, DC: IMF, May 26, 2021), <https://www.imf.org/en/Publications/WP/Issues/2021/05/26/Climate-Action-to-Unlock-the-Inclusive-Growth-Story-of-the-21st-Century-50219>.

32 Rebecca Ray et al., "Geolocated Dataset of Chinese Overseas Development Finance," *Nature*, September 20, 2021, <https://www.nature.com/articles/s41597-021-01021-7>.

this financing is already significantly associated with economic growth, and the World Bank estimates that the potential growth impacts of development finance and the Belt Road Initiative are three times the size of the potential growth impacts of the failed Trans-Pacific Partnership.³³ China has also led in the creation of new development banks such as the Asian Infrastructure Investment Bank and the New Development Bank, which are widely recognized as being among the most innovative multilateral development banks (MDBs).

While China deserves great praise for mobilizing the lion's share of new development finance so far in the twenty-first century, there is room for improvement with respect to the pattern of growth that is fostered through such financing. To be sure, Chinese development finance is associated with economic growth, giving developing countries more choices and thus agency when seeking development finance, and has been focused on sectors such as energy and infrastructure, which Western-led development finance institutions largely abandoned decades ago. However, Chinese development finance (not unlike its Western counterparts) has also been shown to be associated with debt distress, carbon-intensive economic activity, biodiversity risk, and social conflict.³⁴ To lead by example, China will need to get its massive new financial flows into alignment with the SDGs and the Paris Agreement.

The United States has trailed in comparison when it comes to new development finance in the twenty-first century but has shown signs of improvement over the past few years. After a closure for political reasons, the United States recently reinvigorated its Export-Import Bank. More significantly, the United States has established the Development Finance Corporation (DFC) with an investment cap double that of the Overseas Private Investment Corporation, the DFC's predecessor, though the lending limit is still just \$60 billion. As the largest shareholder at the World Bank Group, the United States also played a role in modest increases in the base capital of the World Bank and International Finance Corporation in the wake of the global financial crisis.

As in the case of China, however, the performance of U.S. and U.S.-led development finance has been lacking. The DFC got off to a shaky start, becoming enmeshed in accusations of cronyism, as well as financing carbon-intensive activity and imposing conditionalities for privatization and for blocking Chinese technology. Recent executive orders and new leadership under the Biden administration pledge to straighten the course of the DFC to be a leader in green and inclusive development finance. The World Bank has provided counter-cyclical finance but remains elusive in generating economic growth in host countries. The World Bank and other U.S.-led MDBs have also fallen short in changing the structure of member economies, leaving them vulnerable to external shocks, the resource curse, and beyond. Finally, in the absence of significant new increases in base capital, the U.S.-led development finance institutions have shifted their business model to use development finance to leverage private sector finance. Unfortunately, this strategy has had very limited success, and when private sector finance is crowded in, it involves socializing the risks of such finance and privatizing the

33 Axel Dreher et al., "Aid, China, and Growth: Evidence from a New Global Development Finance Dataset," *American Economic Journal: Economic Policy* 13, no. 2 (May 2021): 135–74, doi:10.1257/pol.20180631; and World Bank, *Belt and Road Economics: Opportunities and Risks of Transport Corridors* (Washington, DC: World Bank, 2019), <https://www.worldbank.org/en/topic/regional-integration/publication/belt-and-road-economics-opportunities-and-risks-of-transport-corridors>.

34 Hongbo Yang et al., "Risks to global biodiversity and Indigenous lands from China's overseas development finance," *Nature Ecology and Evolution* 5 (2021): 1520–1529, doi:10.1038/s41559-021-01541-w.

benefits, thus leaving host countries in a worsened debt position. To lead by example in development finance, the United States will need to increase the scale of its bilateral development finance institutions and show that the United States can provide financing that is aligned with the SDGs and the Paris Agreement.

Parallel Partnerships

In terms of parallel action, China and the United States can build on examples such as the China-U.S. climate agreement. There, recognizing the common but differentiated responsibilities of each country, the two countries acted in parallel to curb carbon dioxide emissions such that it created the opportunity for a global climate agreement. In addition to taking parallel action on increasing the scale and composition of development finance, the two countries could phase out development finance that is detrimental to development goals and work in parallel on debt relief.

Arguably, China has the most vibrant public sector in the world economy, and the United States has the most vibrant private sector. Acting in parallel, the two nations can leverage their respective strengths toward the common goals of phasing out fossil fuel financing and providing debt relief for emerging market and developing nations so they can mobilize finance for development over the next decade.

It is now widely recognized that in order to realize collective climate and development goals, economies will have to transition away from fossil fuels by mid-century. The first step in such a transition is widely seen to be phasing out coal-fired power plants. Indeed, Chinese industrial policy in solar, wind, and electric battery manufacturing in effect subsidized global clean technology learning to the point where clean technology is at price parity with fossil fuels, especially coal, which is now increasingly seen as a “stranded asset” in the world economy. Also to China’s credit, it has pledged a coal phaseout on the mainland over time. However, to some degree, China (like Japan and South Korea) has eased its domestic adjustment for coal-fired power through financing the construction of coal plants overseas. Indeed, before China announced it would also halt overseas coal finance, it was the largest public financier of overseas coal plants in the world economy.

Yet between 2013 and 2018, China made up only 17 percent of total overseas coal finance and even less of the total share of overseas coal plants in the pipeline.³⁵ (The United States and G7 nations have pledged and largely delivered, with the exception of Japan, on phasing out public overseas coal financing, yet private firms in these countries, such as Vanguard, BlackRock, Capital Group, and State Street, are among the largest financiers of overseas coal finance.) Recognizing their common but differentiated strengths and responsibilities, China announced it would phase out overseas public finance in the coal sector at the United Nations General Assembly in October 2021. While the Western pledges only pertain to public finance institutions such as development banks and export credit agencies, China’s pledge also includes commercial banks. Indeed, just days after the China’s UN pledge, the Bank of China announced it would no longer finance overseas coal as well.

35 Xinyue Ma and Kevin P. Gallagher, “Who Funds Overseas Coal Plants? The Need for Transparency and Accountability,” Global Development Policy Center, Boston University, Global China Initiative Policy Brief 8, https://www.bu.edu/gdp/files/2021/07/GCI_PB_008_FIN-1.pdf.

In essence, while China was the last major public financier of overseas coal plants, it was the first to pledge to prohibit commercial finance for such uses. It is now the West's turn to follow suit, and the United States could work to phase out private financing for coal. In each case, however, simply cutting off coal finance will not be aligned with development goals. Behind every stranded asset is a stranded community, stranded workers, stranded contracts, and stranded entrepreneurs. In some countries, coal is so systemic that it is central to fiscal stability and the balance of payments. Therefore, it is imperative that in addition to simply exiting from coal, financial flows should be shifted to cleaner energy technologies and toward adjustment assistance to help affected communities become part of new dynamic industries.

Emerging market and development countries will also need significant debt relief. The largest share of emerging market and developing country debt is held by private bondholders that, according to the International Monetary Fund, “surged” into emerging market and developing countries as a result of quantitative easing in the United States. Official bilateral public finance is also a major component of emerging market and developing country debt, with China as the largest official bilateral financier, especially in lower-income countries. Without comprehensive debt relief, emerging market and developing countries will not be able to mobilize the capital necessary to mount a recovery from the Covid-19 crisis, nor meet climate and development goals for 2030.

G20 debt relief efforts in the Covid-19 era have been plagued by the fact that they only pertain to the poorest countries of the world and that coordination among the Paris Club, China, private bondholders and commercial banks, and international financial institutions has been severely lacking. Each actor is rationally, reluctant to engage in restructuring because if all creditors do not act in unison, debt relief from one creditor will be used to finance other creditors rather than enabling debtor countries to respond to the Covid-19 virus and mount a green and inclusive recovery. If Chinese creditors and private bondholders were aligned in these efforts—and all countries experiencing debt distress were included in debt relief schemes—such efforts would work more effectively. If China required its state-owned financiers to meaningfully engage in debt relief and the United States required bondholders registered in the United States to engage, the two countries could act in parallel to unlock the gridlock on global debt relief. As part of such a scheme, a recent proposal argues that the World Bank could provide guarantees to creditors for the newly restructured bonds as long as host countries commit to aligning some newfound fiscal or policy space with the SDGs and Paris Agreement.³⁶

Multilateral Cooperation

It would be ideal, for example, for the DFC and the China Development Bank to co-finance projects around the world that are aligned with the SDGs and the Paris Agreement. China has the edge on capital and infrastructure know-how; the United States has long histories in the developing world,

36 Ulrich Volz et al., *Debt Relief for a Green and Inclusive Recovery: Securing Private-Sector Participation and Creating Policy Space for Sustainable Development* (Berlin, London, and Boston: Heinrich-Böll-Stiftung SOAS, University of London, and Boston University, 2021), <https://www.bu.edu/gdp/2021/06/28/debt-relief-for-a-green-inclusive-recovery-securing-private-sector-participation-and-policy-space-for-sustainable-development/>; and Ulrich Volz et al., *Debt Relief for a Green and Inclusive Recovery: A Proposal* (Berlin, London, and Boston: Heinrich-Böll-Stiftung, SOAS, University of London, and Boston University, 2020), <https://drgr.org/files/2021/06/DRGR-Report-2021-Securing-Private-Sector-Participation.pdf>.

experience with due diligence, and the ability to provide credit enhancement to host countries when blended with Chinese finance due to the better credit ratings enjoyed by U.S.-led institutions. While economically optimal, such acts of direct collaboration may not be politically feasible currently. However, given that the United States and China are both members of all but a few major MDBs, they can build on joint work and collaborate within the MDBs.

There are several examples where the United States and China have collaborated through the MDBs that can be built upon. The International Finance Corporation's China-Mexico Fund, started in 2014 with \$1.2 billion in capital, and the IDB Invest-administered China Co-Financing Fund for Latin America and the Caribbean contributed 13 percent of a \$75 billion IDB package for the Solem solar photovoltaic plant in Mexico. These are examples of key ways that blending Chinese capital and technological prowess with MDB technical expertise and creditworthiness can provide lower-cost financing for projects aligned with the SDGs and Paris Agreement.³⁷ There are numerous examples of collaborations between the World Bank and the Asia Infrastructure Investment Bank as well.

While working unilaterally toward common goals, in parallel and together, the United States and China will also foster healthy competition. In the end, new financing will be decided on by emerging market and developing countries. The United States and China will create more choice for those nations, and the same nations will play a role in steering the supply of development finance through the nature of their demand. Both countries will need to show that they are for providing public goods through development financing rather than using development finance to act against one other.

37 Margaret Myers and Kevin P. Gallagher, *Scaling Back: Chinese Development Finance in LAC* (Washington, DC: Inter-American Dialogue, 2020), <https://www.thedialogue.org/analysis/scaling-back-chinese-development-finance-in-lac-2019/>.

Debt Transparency Agenda and the Way Forward

BY YE YU

Driven by the quantitative monetary policy of developed economies after the 2008 global financial crisis, financial globalization further expanded to every corner of the world and increased access to more diversified and sophisticated financing instruments for the poorest countries. With the combination of macroeconomic policies tightening and the unexpected impact of Covid-19 on the world economy, today's global debt boom risks turning into another round of debt bust. Sovereign debt sustainability has therefore become an important concern of global development governance.

Sovereign debt transparency is an old issue, but it is gaining new and heightened attention as the developing world accumulates new debt pressure. The German G20 presidency approved the Operational Guidelines for Sustainable Financing (“G20 Guidelines”) in 2017 with a focus on debt transparency. With the support of the World Bank and International Monetary Fund (IMF), the Japanese G20 presidency further endorsed the diagnostic tools for member countries’ self-check on overseas lending. As part of this G20 process, the Institute of International Finance (IIF) published the Voluntary Principles for Debt Transparency (“IIF Principles”) in June 2019. The International Development Association (IDA), the soft-loan window of the World Bank, made debt transparency one of the key priorities for its nineteenth replenishment period during the fiscal years of 2021 to 2023.³⁸

38 International Development Association, Sustainable Development Finance Policy of the IDA (Washington, DC: April 2020), <https://documents1.worldbank.org/curated/en/967661593111569878/pdf/Sustainable-Development-Finance-Policy-of-the-International-Development-Association.pdf>.

Compared to the existing sovereign debt data standards, these newly launched initiatives call for “full transparency” of each debt transaction, with a focus on loans and their contractual terms. According to the IMF and World Bank, “full transparency” means “publication of the size and terms of the loan, the collateral arrangements that are being used and the amount of collateral provided.”³⁹ New measures were also taken to oblige creditors to reconcile the debt data with debtor countries and voluntarily disclose all their lending to sovereign entities. Both new lending and the past debt restructuring events should be published.

The Covid-19 outbreak led to the launch of the G20 Debt Service Suspension Initiative (DSSI) for the 73 poorest countries in April 2020 and the Common Framework on debt treatment beyond the DSSI in November 2020, which prioritize debt transparency management as a policy condition. The G7 countries strongly supported this agenda.⁴⁰ As an important milestone, the World Bank started to publish the DSSI countries’ long-term public and publicly guaranteed external debt stocks and projected debt service due, disaggregated by creditor type.⁴¹

Although the most prominent hidden debt of Mozambique that was finally exposed by the country’s default in 2016 originated from European banks, Credit Suisse, and Russia’s VTB bank, the debt transparency agenda is largely stereotyped as a “China issue.”⁴² The Belt and Road Initiative (BRI) has been criticized as an “opaque” project by Western media and politicians. Research products that try to estimate Chinese overseas lending always sell very well. One study published in 2019 argues that 50 percent of Chinese overseas lending is hidden, which caused wide debates and questioning. The latest widely noted study, “How China Lends,” published by AidData in collaboration with several other academic institutions, provides a detailed anatomy of their contractual terms. It concludes that Chinese official lenders are largely commercial and introduce stricter non-disclosure clauses for their contracts than Western ones.⁴³

The focus reflects the political influence of the size of the Chinese economy and its overseas financing. More fundamentally, it reflects disputes over the legitimacy of Chinese development financing as a more commercial type of loan. Morris, Parks, and Gardner from the Center for Global Development studied Chinese lending terms compared with the World Bank, calling for more attention to the terms of Chinese lending rather than its size.⁴⁴ The G20 guidelines also indicate that the full debt transparency

39 IMF and the World Bank, *G20 Operational Guidelines for Sustainable Financing-Diagnostic Tool* (Washington, DC: IMF and World Bank, November 2019), <https://www.imf.org/external/np/g20/pdf/2019/111519.pdf>.

40 “Statement of the G7 Finance Ministers on Debt Transparency and Sustainability,” U.S. Department of the Treasury, June 3, 2020, <https://home.treasury.gov/news/press-releases/sm1023>.

41 “COVID 19: Debt Service Suspension Initiative,” World Bank, September 17, 2021, <https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative>.

42 Fiona Robertson, “How to stop Africa’s new rising debt from turning into a tragedy,” Devex, January 24, 2018, <https://www.devex.com/news/opinion-how-to-stop-africa-s-new-rising-debt-from-turning-into-a-tragedy-91921>.

43 Anna Gelpern et al., *How China Lends: A Rare Look into 100 Debt Contracts with Foreign Governments* (Washington, DC: AidData at William & Mary, the Kiel Institute for the World Economy, Center for Global Development and the Peterson Institute for International Economics, March 2021), <https://www.cgdev.org/publication/how-china-lends-rare-look-into-100-debt-contracts-foreign-governments>.

44 Scott Morris, Brad Parks, and Alysha Gardner, *Chinese and World Bank Lending Terms: A Systematic*

requirement serves to reduce the cost of sovereign borrowing. Traditional creditors have been calling for China to provide international development aid based on the principle of “fair burden sharing.” But the two sides share different views on the definition of that principle: while China still insists on its status as a developing country with common but differentiated responsibilities, the traditional creditors consider China as a developed country that should shoulder the same level of responsibilities.

China is responding to the international concerns that the BRI lacks clarity. In 2018, President Xi Jinping said the BRI's next stage should evolve like Chinese painting from Xieyi, the freehand brushwork that generalizes shapes and exaggerates forms, to Gongbi, the more realistic, meticulous style characterized by close attention to detail and fine brushwork.⁴⁵ China committed to “revise and improve the statistical indicator system of foreign aid, and develop a modern statistical information system for foreign assistance” in January 2021, a significant breakthrough.⁴⁶ This is part of broader Chinese efforts to modernize its fiscal management and national governance. China joined in the IMF's Special Data Dissemination Standards reporting in 2015, which was considered the “statistical access to WTO.”⁴⁷ China further joined in the Bank of International Settlement's Locational Banking Statistics at the end of 2016, for which Chinese authorities are proud of indicating “international recognition of Chinese Balance of Payment (BOP) statistical data quality and improvement of data transparency.”⁴⁸ These are just examples indicating why China is still a developing country in terms of market system and statistical capacity building and how it is making efforts at home. They are all very relevant in improving information sharing about Chinese overseas lending. China has also participated in the Paris Forum since 2013 and the Paris Club meeting as an observer since 2016. China was very quick in endorsing the G20 DSSI and the Common Framework, which are pilots for G20 emerging economies to coordinate with the Paris Club on sovereign debt treatment in the poorest countries and represent significant progress on transparency.

Transparency is a statistical challenge for all when more diversified creditors emerge and more complicated financing instruments are used. It is not limited to debt instruments either. A typical example is that the private sector arms of multilateral development banks are increasingly investing in financial intermediaries for the sake of risk mitigation, as many of the financial intermediaries are endorsed by developing countries' governments. Civil society organizations have raised serious concerns about their transparency, as it is very difficult to know where the money ultimately goes.

Comparison Across 157 Countries and 15 Years (Washington, DC: Center for Global Development, April 2020), <https://www.cgdev.org/publication/chinese-and-world-bank-lending-terms-systematic-comparison>.

45 Huang Yue and Zhang Minyan, “Xi Jinping Calls for the Joint Building of BRI to Develop from ‘Grand Xieyi’ to ‘Gongbi’ [黄玥、张敏彦, “共建‘一带一路’, 习近平提出从‘大写意’到‘工笔画’”, 新华网, 2018年8月28日。],” Xinhua, August 28, 2018, <https://china.huanqiu.com/article/9CaKrnKbYpw>.

46 “White paper on China's International Development Cooperation in the New Era,” State Council Information Office of China, January 2021, http://english.www.gov.cn/archive/whitepaper/202101/10/content_WS5ffa6bbbc6d0f72576943922.html.

47 “Significance of Chinese adoption of the IMF's SDDS [“中国采纳国际货币基金组织数据公布特殊标准的意义”, 新华社, 2015年10月8日。],” Xinhua, October 8, 2015, http://www.gov.cn/zhengce/2015-10/08/content_2943333.htm.

48 “BIS announces Chinese formally joining in its Locational Banking Statistics [“国际清算银行宣布我国正式加入国际银行业统计”, 国家外汇管理局, 2016年12月13日。],” State Administration of Foreign Exchange, December 13, 2016, <http://www.safe.gov.cn/safe/2016/1213/6697.html>.

The International Finance Corporation has made important pledges on this, but any debt transparency agenda needs to be comprehensive and patient.⁴⁹

What kind of transparency is optimal remains a question. The G7 finance ministers commit to publish their creditor portfolios on a loan-by-loan basis for future direct lending by the end of 2021 and urge all G20 members to do the same.⁵⁰ Looking at the reality, official creditors of G7 countries have published their lists of projects, but very few of them have fulfilled the “full transparency” requirements of the G20 Guidelines and the IIF Principles (i.e., disclosing all terms of their lending contracts). Non-transparency is a norm in the development financing world.⁵¹ This is understandable, especially for the more commercially oriented development financing institutions. There is a Chinese saying that “if the water is too clear, there will be no fish.” As the G20 Guidelines state, information sharing is a “means” aiming to “enhance access to sound financing for development,” but too much transparency regulation will be a burden for both creditors and debtors and may lead to less development financing. More empirical cost-benefit analysis of the debt transparency agenda needs to be conducted. A more tailored and incremental approach might be more appropriate. More robust rules may be applied to official development aid, while the development financing institutions subject to commercial banking regulations may be allowed more flexibility in terms of frequency, scope, or details in information disclosure.

Last but not the least, the politics needs to be right for the debt transparency agenda to work. This is especially true for any regulations on creditor countries. Weaponization of the debt transparency issue will be very destructive. All the major debt transparency initiatives mentioned earlier in this paper, whether for public or private creditors, lack participation of emerging economies. The new data repository for private creditors to report their sovereign lending activities is going to be hosted by the Organization for Economic Cooperation and Development (OECD). Emerging economies and their entities need more ownership in these decisions since these countries are not members of the OECD. Both traditional and emerging creditors should work together with international financial institutions to help debtor countries build their capacities since major responsibility for debt sustainability management lies with the borrower.

49 Mcintosh Toby, “World Bank Agrees to Transparency for Loans by Financial Intermediaries,” *Eyes on Global Transparency*, April 9, 2020, <https://eyeonglobaltransparency.net/2020/04/09/world-bank-agrees-to-transparency-for-loans-by-financial-intermediaries/>.

50 “G7 Finance Ministers and Central Bank Governors Communiqué,” HM Treasury, June 5, 2021, <https://www.gov.uk/government/publications/g7-finance-ministers-meeting-june-2021-communication>.

51 Gelpern et al., *How China Lends*.

Returning to the Bretton Woods

Emphasis on Stability May Offer a Path Forward

BY MARY E. LOVELY

The international economic order envisioned at Bretton Woods was based upon consensual decisionmaking and cooperation in trade relations. Today, commitment to that vision is tested by a lingering U.S.-China trade war and a breakdown in the world's ability to resolve trade disputes. Rising tensions between the United States and the People's Republic of China impede progress toward meeting common challenges, including updating trade rules, mitigating climate change, and regulating emerging technologies. It is the relationship between these two countries that will determine whether the Bretton Woods imperatives fit twenty-first-century geopolitical competition.

U.S.-China dialogue continues at many levels of government and civil society, but bilateral communication is increasingly strained by conflictual policy choices and hostile rhetoric. Despite proliferating signs of disintegration, U.S. and Chinese officials and colleagues must tap into opportunities to jointly imagine a new equilibrium for the relationship—one with less integration and more regulation of cross-border flows, almost surely, but also one with greater stability. To move the relationship toward this new equilibrium, dialogue should begin to outline possible resolutions to the U.S.-China trade war while setting the stage for more difficult negotiations over the creation of new rules for data and technology flows.

Resolving the trade war will not be easy, despite its obviously negative impact on both the U.S. and Chinese economies. Each side clings to tariffs as evidence of resolve in confronting the other's economic aggression. Since the end of 2019, each country has levied average duties of roughly 20 percent on imports from the other. U.S. tariffs and Chinese counter-tariffs continue to cover more than 50 percent of bilateral trade.

The trade war has outlived its usefulness. No serious progress is being made on resolution of the core issues that ignited the series of tit-for-tat tariff rounds—the belief that China routinely and systematically engages in theft of American intellectual property and technology. Instead of finding ways to resolve this fundamental issue, each side sleepwalks toward the inevitable failure of China to meet the unrealistic purchasing targets set in the January 2020 Phase 1 agreement.⁵² By the end of 2021, the best-case scenario will be one where the two sides use the pandemic as a reason to kick the can further down the road.

Both countries can certainly do better than that. With dialogue and resolve, the U.S.-China trade war can be scaled back and adapted to address the core issues that fueled it. Recognition that neither side gains from tariffs on products with mature technologies may open a path to negotiation and scaling back of the current tariff burden. A mutual and proportional rollback in levies is in each country's self-interest. Both sides could agree that remaining tariffs would stay in place while talks on the so-called "structural issues" continue, with the goal of finding ways to accommodate the intellectual property rights and national security concerns of both countries.

While scaling back the tariffs may seem unrealistic as new areas of conflict emerge, the current trajectory of bilateral relations is not sustainable. The United States adds new names to its lists of sanctioned individuals and entities while China adopts a new law blocking those sanctions. Multinational companies search for resilient and sustainable supply chains while struggling to understand the policy risks of their investments and financing activities. Commercial, educational, and scientific links between Chinese and U.S. citizens remain disrupted by the pandemic and clouded by long-term uncertainty.

Perhaps progress can be made by returning to the Bretton Woods emphasis on the creation of rules and procedures that advance stability rather than integration. Containing, if not fully resolving, the trade war can provide an opening for broader discussions between the United States and China on addressing each side's need for greater security than is possible with the current level of integration. The objective of such discussions should be the creation of rules and procedures for more limited openness—"conscious decoupling" as some call it—and reduction in the scope for mutually harmful practices. Recognizing that flows of data and technology between the two countries will necessarily be constrained, negotiations should focus on creation of new rules for information exchange. For example, what protocols can be developed to allow for trade in data-intensive services? What procedures are required to permit continued cross-border investment flows?

While rules for securing data flows eventually must be multilateralized, arrangements accepted by both China and the United States—key nodes in global information technology supply chains—will necessarily provide a framework for wider discussions. As noted by Chen Dongxiao in a 2019 essay concerned with joint action for global stability, "As two leading forces propelling global science and

52 In the Phase 1 deal, China agreed to expand purchases of certain U.S. goods and services by a combined \$200 billion for the two-year period from January 1, 2020, through December 31, 2021, above 2017 baseline levels. As reported by Bown (2021), through May 2021, China's purchases of all covered products reached 69 percent (Chinese imports) or 62 percent (U.S. exports) of the year-to-date target. "US-China phase one tracker: China's purchases of US goods (As of September 2021)," Peterson Institute for International Economics, October 27, 2021, <https://www.piie.com/research/piie-charts/us-china-phase-one-tracker-chinas-purchases-us-goods>.

technology advance, Beijing and Washington share the responsibility of helping foster international consensus on a new balance between advancing human knowledge through science and technology cooperation on the one hand and safeguarding national security on the other.⁵³ Such a consensus will necessarily include safeguards that recognize the extent to which the two countries have already pulled back from past levels of integration. It will extend such safeguards to new realms, such as cross-border stock exchange listings, while taking deliberate action to minimize the cost of disintegration.

Beliefs that fueled more than 20 years of deeper integration of the U.S. and Chinese economies—faith in the wisdom of deregulation, gains from freer trade, and spillovers from shared access to scientific information and new technologies—are now subject to revision. Rising economic inequality, impending climate crises, and national security concerns have reduced the salience of trade liberalization and dispute settlement. Each country stands on the cusp of multiple scientific and technological revolutions with inadequate understanding of the social and economic changes they portend. The wisdom of Bretton Woods, that cooperation for stability is a worthy objective, may help forge a way forward.

53 Chen Dongxiao, “Sino-U.S. Joint Action for Stabilizing the World Economy: Common Interests and Shared Responsibilities,” in *Perspectives on the Global Economic Order in 2019: A U.S.-China Essay Collection*, edited by Matthew P. Goodman and Chen Dongxiao (Washington, DC: CSIS and SIIS, 2019), October 2019, https://csis-website-prod.s3.amazonaws.com/s3fs-public/publication/191008_PerspectivesGlobalEconomicOrder2019.pdf.

The New Developed-developing Contradiction and WTO Reform

BY WANG ZHONGMEI

The New Developed-Developing Contradiction

Since 2000, in the generally observed dynamic changes in world production and trade, the substantive requests of developing countries have also undergone corresponding changes. They demanded to climb to the upper reaches of the global value chain to obtain greater added value, especially to increase the proportion of service trade. According to Lin Yifu, “the industries of developing countries are in the lower position in the world industrial chain. The economic development of developing countries is within the world industrial chain, along the existing industrial steps with different capital and technology intensiveness, and can’t leap over the process of continuous escalation from low to high.”⁵⁴

On the other hand, the developed countries have paid more and more attention to the problems of deindustrialization and industrial hollowing.⁵⁵ After the 2008 financial crisis, the “anti-globalization” view on trade deficits and the loss of job opportunities began to appear in the political circles and media in some developed countries. In the past, traditional trade policies that focused on promoting free trade, protecting foreign investment, and reducing the impact of exchange rates have gradually

54 Lin Yifu, “The tide phenomenon and the reconstruction of the macroeconomic theory of developing countries,” *Economic Research* 1 (2007).

55 Richard Baldwin and Toshihiro Okubo, “GVC journeys: Industrialisation and Deindustrialisation in the Age of the Second Unbundling,” November 9, 2018, http://www7.econ.hit-u.ac.jp/cces/trade_conference_2018/paper/richard_baldwin.PDF.

been replaced in developed countries by new trade policies that protect domestic producers, strictly screen foreign investment, and relocate or reshore production lines.⁵⁶

The United States under the Trump administration is the most representative example of this phenomenon. From widely implemented unilateralism to trade wars to pair-finding negotiations, the purpose was to try to recover lost comparative advantage in the trade of goods and to consolidate and expand the advantages in service trade. In short, developing countries are trying to climb up the value chain while developed countries are deliberately restraining and retarding the transfer of capital, technology, and trade especially, retaining firm control of core technology and containing potential competitors.

The implication of the developed-developing contradiction has evolved into a new reading, one that is completely different from 50 years ago.⁵⁷ Today, conflicts between the transfer of manufacturing and the prevention of transfer, between the development of domestic service industry and the request of liberalizing service trade, and between the efforts to catch up with innovation capability and to restrain technological cooperation and spillover effects reflect a new world economic policy pattern characterized by technological divide and gaps between global value chain positions.

Call for a Balanced Design within the WTO

In 2008, the U.S. subprime mortgage crisis triggered a financial crisis in developed countries, which first impacted the multilateral financial system centered around the International Monetary Fund (IMF) and World Bank. The widespread rise of trade protectionism has also affected the multilateral trade governance system, with the World Trade Organization (WTO) at its core. Like the IMF, the WTO is also trying to establish a rule-based governance model.⁵⁸ Unlike the IMF, the key to attracting member participation in the WTO is continuous liberalization, which is achieved by member-driven negotiation rounds. If this negotiation round is in trouble and the core members gradually lose control or interests in the scope, agenda, and possible results of the negotiation, the WTO is more likely than the IMF to fall into a crisis of survival.⁵⁹

The global production network based on the global value chain has gone beyond the scope of pure trade and has penetrated the borders of various countries through cross-border investment, services, and knowledge flows. The economic governance model required by the global value chain is no longer just tariff reduction, non-tariff barrier reduction, or exchange rate coordination. It requires a higher degree of unified governance, including the overall coordination of domestic economic policies, in

56 See Oluwafemi Mimiko, “The Politics of Global Economic Relations and International Business,” in *Globalization*, edited by Toyin Falola and Emily Brownell (Durham, NC: Carolina Academic Press, 2012).

57 See Kunibert Raffer and Hans Wolfgang Singer, *The Economic North-South Divide: Six Decades of Unequal Development* (Cheltenham, UK: Edward Elgar Publishing, 2001), 2–7.

58 See John Langmore and Shaun Fitzgerald, “Global Economic Governance,” in *Handbook on International Political Economy*, edited by Ralph Pettman (Singapore: World Scientific Publishing, 2012).

59 University of Warwick, *The Multilateral Trade Regime: Which Way Forward?* (Coventry, UK: The Warwick Commission, 2007), <https://warwick.ac.uk/research/warwickcommission/worldtrade/report/contents.pdf>.

order to achieve more efficient resources allocation and fair competition.⁶⁰ The increase in the depth of global governance also means the further transfer of national economic sovereignty and a rebalance of members' rights and obligations.

For example, the reform plan of special and differential treatment clauses proposed by developed countries is extremely shocking for developing countries. It is equivalent to invalidating more than 140 special and differential treatments automatically granted and returning to the authorization mode before the Tokyo Round in 1979. This is almost impossible to accept for developing countries. Self-declaration is still necessary, since no objective standards would be accepted by all the members on how to judge which member is a developing country. The proposed solutions go to the issue-based approaches taken by the Ottawa Group.⁶¹ Negotiating the differentiation principles for individual issue areas, rather than blanket privileges, offers much more room for compromise, even it is much more complex, as forms of differentiation have to be agreed upon on a case-by-case basis.

In past decades, as revealed in the Doha round, the differentiation of interests inside the developed and developing camps also became much more complicated. In order to alleviate the substantive contradictions, both camps' demands must be responded to and coordinated. Therefore, on the basis of retaining the existing universally applicable principles of special and differential treatment, and based on new issues, a possible solution might be to impose certain requirements on the level of commitment of different categories of countries, or various countries can actively choose specific categories of special and differential treatment.

Approaches Responding to the Varied Requests

With regard to WTO reform, the proposals put forward by all parties also clearly show that the two sides have distinct camps. Generally speaking, the developed countries represented by the United States, Europe, and Japan have more consistent demands. Since 2017, several statements jointly issued by the trade ministers of the United States, Europe, and Japan have specifically raised the issue of fair trade, believing that non-market economy, state-owned enterprises, state subsidies, and forced technology transfer all increase the unfair competitive advantage of certain countries. They call for the control and reduction of these unfair competitive advantages under the multilateral framework.

By comparison, the position statement issued by the Ministry of Commerce of China in November 2018 stated that WTO reform should address the long-term and serious distortions caused by excessive agricultural subsidies by developed members to international agricultural product trade and correct the abuse of trade remedy measures, especially the "surrogate country" approach in anti-dumping investigations. China pointed out, at the same time, that reforms should promote WTO rules to keep pace with the times, covering topics that reflect the economic reality of the twenty-first century, such as investment facilitation, e-commerce, and protection of small, medium, and micro enterprises.

60 Richard Baldwin, *Globalisation: the great unbundling (s)* (Geneva: Economic Council of Finland, September 2006), [http://appli8.hec.fr/map/files/globalisationthegreatunbundling\(s\).pdf](http://appli8.hec.fr/map/files/globalisationthegreatunbundling(s).pdf).

61 "Ottawa Group and WTO Reform," Government of Canada, n.d., <https://www.canada.ca/en/global-affairs/news/2019/05/ottawa-group-and-wto-reform.html>.

Overall, the requests of the major members of the WTO are no longer focused on tariffs and border measures but on the impact of domestic policies and measures on trade. Whether it is the leveling playing field that developed countries are concerned about, the capacity to benefit fairly that developing countries are concerned about, or the innovation, investment, service trade, and support of small and medium enterprises that both camps are concerned about, the issues exceed the traditional WTO trade governance framework. The new requirements for the scope and depth of governance of the WTO also grows out of the expanded global value chains in the twenty-first century.⁶²

In future WTO negotiations, issues such as reduction of subsidies, rules of origin, high value-added products, e-commerce, cross-border service trade, biomedicine, and other issues that the core members on both sides are concerned about will possibly be the first to reach a compromise because this is also relevant to the future industrial chain. As for issues such as non-market economy status, state-owned enterprises, and labor and environmental standards, where the two sides have large divides, a certain compromise may only be achieved through more flexible and elaborately designed rules and regulations.

The year 2021 marks the twentieth anniversary of China's accession to the WTO and also the turning point where the United States declared a return to the multilateral system. Even without an alleviation of the conflicts between these two largest powers, there is still much room for cooperation and joint efforts. For example, this could include restoring the functioning of the WTO Appellate Body, restarting plurilateral negotiation in environmental products, and finding varied and coordinated approaches to digital trade facilitation. More optimistically, from fisheries subsidies to agricultural products, from on-border issues to behind-border ones, the hope of updating existing agreements for a broader and deeper WTO rule system remains. What is the way forward? It depends on these two largest members' confidence in multilateralism and their willingness to contribute to it.

62 Richard Baldwin, *WTO 2.0: Global governance of supply-chain trade* (Washington DC: Center for Economic Policy Research, December 2012), http://www.cepr.org/sites/default/files/policy_insights/PolicyInsight64.pdf.

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