The Fifth US-China Strategic Economic Dialogue and Action to Combat the Global Financial Crisis

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I. Fifth round of the US-China Strategic Economic Dialogue

The fifth round of the US-China Strategic Economic Dialogue (SED V), held in Beijing on 4-5 December, was the final round to be held during the Bush presidency, the first having been held in December 2006 as a result of an agreement between President George W. Bush and President Hu Jintao. There was considerable interest in the agenda because of the global financial crisis, which has intensified since the collapse of Lehman Brothers in September.

The Joint US-China Fact Sheet released after the meeting identified five areas where the two countries agreed to cooperate: (1) macroeconomic cooperation and financial services, (2) cooperation on energy and the environment, (3) trade and investment, (4) food and product safety, and (5) international economic cooperation. China's Ministry of Foreign Affairs released a Chinese version, while the two sides agreed on a number of important measures to stabilize financial markets and combat the global financial crisis.

II. Agreement on important measures to stabilize financial markets and combat the global financial crisis

1. Agreement between US Export-Import Bank and Export-Import Bank of China to make available resources for trade financing facilities

The two governments agreed that the US Export-Import Bank would provide additional resources of $12 billion, and the Export-Import Bank of China additional resources of up to $8 billion, if needed, to assist in the financing of the export of US and Chinese goods and services. It is envisaged that these additional facilities will also be used to maintain trade with emerging and developing economies affected by the global financial crisis. The two sides also agreed that these facilities would be increased to $38 billion by 2009.

As of 2007, China was the US's third-largest export market in monetary terms, while the US was China's second-largest export market. Trade between the two countries therefore has a considerable impact on global trade. With global trade expected to continue to decline in 2009, the creation of these additional facilities is also likely to attract attention as bilateral action to combat the global financial crisis.

2. Restrictions on financing by foreign incorporated banks in China to be eased

The Chinese government agreed to allow foreign incorporated banks in China to trade bonds in the interbank market, whether for their customers or their own accounts, on the same basis as Chinese-invested banks. It also agreed that, in exceptional circumstances, qualified foreign banks would be allowed to increase their liquidity through either guarantees or foreign currency loans from overseas affiliates on a temporary basis, notwithstanding the (State Administration of Foreign Exchange's) short-term quotas (i.e., of 12 months or less) on external debt.

The latter (liquidity-increasing) measure is intended to combat the global financial crisis. After March 2007, the Chinese authorities reduced the amount of external debt that financial institutions in China were allowed to incur. This was to prevent inflows of (especially, short-term) foreign capital from exerting upward pressure on the renminbi and creating surplus liquidity. These restrictions on external debt were enforced on (the branches and subsidiaries of) foreign incorporated banks with particular rigor, and these were encouraged to borrow foreign currency from other banks on the domestic foreign exchange market in China rather than from overseas sources. Since the collapse of Lehman Brothers in September, however, foreign incorporated banks in China have faced a credit crunch of their own as they have found it increasingly difficult to obtain funds. Therefore the decision by the Chinese authorities as part of SED V to make it easier for foreign incorporated banks in China to obtain funds from their parent banks should ease this credit crunch as well as the credit crunch faced by foreign incorporated companies in China that have borrowed from these banks.

3. Widening membership of the Financial Stability Forum

Both governments agreed to support extending membership of the Financial Stability Forum (FSF) to China and other important emerging market economies. Similarly, they agreed that representation in international financial institutions should be adjusted to better reflect changing economic weights in the world economy.

The FSF was established by the G7 in 1999 to promote international cooperation in and the exchange of information on regulating and monitoring financial markets in order to make them more stable. It will be interesting to see what signals China will send from the FSF and international financial institutions such as International Monetary Fund (IMF) as emerging market economies are given a greater say in their decision-making processes.

4. Foreign direct investment in the US

The US reaffirmed that it welcomes foreign investment, including in its financial sector and commercially-oriented investments made through China's foreign exchange reserves and sovereign wealth fund, and its commitments to: (1) the open and nondiscriminatory principles for recipients of sovereign wealth fund investment identified by the Organization for Economic Cooperation and Development; (2) apply the same regulatory standards to all applications made by Chinese banks, securities and fund management companies as they apply to US or other foreign financial institutions in like circumstances; (3) process expeditiously Chinese financial institutions' applications; and (4) ensure that the Committee on Foreign Investment in the United States (CFIUS) process accords consistent and fair treatment of all foreign investment without prejudice to the place of origin. At SED IV (in June 2008) the two sides agreed to begin negotiations on a bilateral investment treaty and have thus far met three times for that purpose.

Via its foreign reserves China is the world's largest holder of US Treasury and agency bonds but is concerned that a rapid appreciation of the renminbi could reduce the value of its holdings of these and other assets. Similarly, there have been reports that China Investment Corporation (CIC), China's sovereign wealth fund, has now racked up an unrealized loss on its stakes in the US investment group Blackstone LP and investment bank Morgan Stanley. While the (separate) fact sheet on SED V released by the US Treasury mentions that the US representatives expressed their concerns about the renminbi's exchange rate, it has been reported in the press that the two sides also discussed China's concerns about protecting the value of its holdings of US assets. However, there is no mention at all of the renminbi's exchange rate in the Joint US-China Fact Sheet.

III. Prospects for US-China Strategic Economic Dialogue

Although China' special representative at the meeting (and therefore counterpart to US Treasury Secretary Henry Paulson), Vice Premier Wang Qishan, who also attended SED IV, is a major figure in Chinese financial circles, having previously served as deputy governor of the People's Bank of China, as well as being an old acquaintance of Mr Paulson's, there does not appear to have been much discussion or any particular agreement this time on opening up China's financial markets-unlike at previous such meetings. Nevertheless, the fact that the two sides agreed to conduct technical cooperation on the preferential tax treatment of defined contribution pension plans may mark an important development in the reform of China's pension system.

President Barack Obama appointed the former New York Federal Reserve Bank Governor Timothy Geithner as his treasury secretary in January 2009. As well as doing an MA in Far Eastern Studies, Mr Geithner has worked at the US Embassy in Tokyo. In addition, he is a well known figure in financial circles both in the US and other countries, having been involved in the US response to the Asian Financial Crisis after he joined the US Treasury as well as in its response to the current global financial crisis. We will follow with interest what happens to Mr Geithner, who is well acquainted with both Asian financial markets and market participants, in his new role and what happens to the US-China Strategic Economic Dialogue. We would expect both countries to wish to continue the dialogue in some shape or form in the pursuit of their mutual interest.