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Chairman Huizenga, Ranking Member Moore, and Members of the Subcommittee, thank you for inviting me to testify today on China's recent initiatives in the area of international development financing, and their significance for the global economy and for U.S. interests.

My name is Patrick Chovanec and I am the chief strategist and a managing director at Silvercrest Asset Management, based in New York, which manages $19 billion on behalf of families and institutions, invested in U.S. markets and abroad.. I am also an Adjunct Professor at Columbia University's School of International and Public Affairs, where I teach on U.S.-China relations. Until I moved back home to the U.S. two years ago, I worked for over decade in China as an investment professional and, later, as an Associate Professor of Practice at Tsinghua University in Beijing, where I taught in their business school. During that time, I also served as chairman of the Public Policy Development Committee for the American Chamber of Commerce in China.

Earlier this year, the United States was blindsided by the decision of several of our longtime friends and trading partners to join the new Asian Infrastructure Investment Bank (AIIB), an initiative promoted by the People's Republic of China that the Administration had quietly – and sometimes not so quietly – opposed. The U.S. set itself up for a very public rebuff that was completely unnecessary, both because blanket opposition to China playing a more prominent creditor role was untenable, and because the U.S. did little to pinpoint and clarify its more legitimate causes for concern.

For more than a decade, until just the past year or so, China was the recipient of large inflows of foreign currency, because of the large trade surpluses it runs, and the huge amount of foreign investment pouring into the country. To keep its own currency from rising, China's central bank purchased this foreign currency and kept it as reserves, investing much of it in U.S. Treasuries. The RMB it printed to buy all this foreign currency was initially frozen in China's banking system, then – in the wake of the 2008 global financial crisis – was released to fund a huge credit and investment boom that boosted GDP, but ended up creating a dangerous amount of industrial overcapacity, which is now becoming a big drag on China's economy.

So China has two challenges: what to do with all the foreign currency reserves it has piled up, and what to do with all the excess industrial capacity it has built.

The move to invest more of China's accumulated savings abroad, or at least in something more productive than U.S. Treasuries, did not begin with AIIB, the New Development (or "BRICS") Bank (NDB), or President Xi Jinping's "One Belt One Road" (OBOR) initiative. China Investment Corporation (CIC), the country's sovereign wealth fund, was set up in 2007 with $200 billion from China's foreign exchange reserves, to invest in companies and projects that would hopefully earn a higher return. As early as 2009, two of China's largest policy banks, China Development Bank and China Export-Import Bank, together surpassed the World Bank in the amount of money they lent (over $110 billion) to developing countries.

In contrast, China will contribute only a portion of of AIIB's initial capitalization of $50 billion and NDB's $100 billion, and not all at once, although presumably other Chinese banks could lend more money to projects that AIIB or NDB seed. China has pledged another $40 billion to create the Silk Road Fund, which will help finance OBOR-related projects. Altogether, however, China has only begun to deploy a fraction of its $3.5 trillion foreign currency stash.

Despite talk of China having a "master plan," the motivation for these initiatives are varied, and sometimes conflicting. Possible motivations include:

1. Finding better uses for China's foreign exchange reserves. In other words, earning a higher return on the foreign claims the government, in effect, borrowed from the Chinese economy, by investing them in something besides low-yielding Treasuries and negative-yielding German Bunds. That means making disciplined investment decisions with an eye towards getting your money back and then some, charging enough to cover the risk of losses along the way. It also means investing with the U.S. dollars or other foreign currencies in China's reserves, not in RMB. This was the rationale for setting up CIC, and remains an important motivation for opening up additional channels for investing Chinese capital abroad.

2. Driving Chinese growth, and absorbing China's overcapacity. By financing projects abroad, China can create business opportunities for Chinese construction contractors, equipment manufacturers, and materials suppliers, and even overseas employment opportunities for Chinese laborers. One of the criticisms of past development lending by China Development Bank and China Export-Import Bank is that they do not abide by OECD guidelines that bar the offer of preferential financing terms to win contracts and, in effect, "buy" business. The temptation to subsidize bids using cut-rate credit has grown all the greater as China's economy slows, and once-thriving industries find themselves simultaneously facing massive debt loads, shrinking domestic demand, and yawning overcapacity. One oft-expressed hope is that the projects sponsored by AIIB, NDB, and OBOR will absorb that overcapacity. In fact, however, most analysts estimate that the demand generated would barely make a dent in China's overcapacity problem.

Using cheap credit, often to high-risk borrowers, to prop up struggling industries at home is obviously at odds with the goal of earning higher returns on China's foreign exchange holdings. The temptation to cut corners on good governance, and count the costs later, is clear. So is the incentive to lend or invest in Chinese RMB, so the money can make an easy round-trip back to China in the form of demand, but at the cost of leaving China's foreign currency holdings untouched and underutilized. The strategy of "buying growth" is not without significant drawbacks.

3. Securing access to natural resources. Relative to its population and the size of its industrial economy, China is poor in many mineral resources and in arable land. One rationale often given for Chinese outbound investment, including development finance, is to ensure sufficient supplies of food and raw materials. This rationale, however, may have lost some of its logic over the past year, in the wake of a sharp decline in commodity prices, caused in large part by China's own falling demand.

4. Enhancing China's "soft power" abroad. Clearly one motivation behind China's development financing initiatives is to win friends and influence people in strategic regions like Southeast Asia, Africa, Central Asia, and Latin America. Certainly Chinese money has been welcomed in many places with open arms, and has raised China's profile. Letting politics dictate investment decisions, however, can come at a high cost. China Development Bank's estimated $37 billion in development loans to Venezuela, for instance, could not be repaid on schedule and recently had to be "restructured," at an undisclosed loss. The political opposition in Venezuela has hinted they might refuse to pay China back at all, if they came to power.

When loans and investments go sour, the good will initially generated can easily turn to bad. It's worth recalling that the term "gunboat diplomacy" originated in the 19th Century when creditor nations, including the U.S., literally sent gunboats to collect on unpaid debts, and protect their citizens working abroad. Today, China lacks the force projection capability to engage in "gunboat diplomacy," but one can readily imagine a world in which China has the means and the motive to protect its new interests abroad, and the complications that might pose for U.S. foreign policy.

5. Rivaling the World Bank and Asian Development Bank. Closely related to China's desire to expand its influence abroad is the idea that China might wish to supplant the "Bretton Woods" system, including the IMF and World Bank, with a new global architecture of its own. The AIIB, in particular, was seen by many as a bid to eclipse the Asian Development Bank (ADB), where Japan has the largest number of voting shares. Ironically, the rush by so many countries to join AIIB has somewhat diluted China's dominance over the institution. That would be all the more true if Japan – or even the U.S. – decided to join. In any case, China does not need to form new multilateral institutions in order to deploy its own overflowing stockpiles of capital abroad. Aside from the prestige gained, it may even find them a hindrance to its own objectives.

6. Establishing China's RMB as the world's top currency. Much has been made of China's desire to establish its own currency, the RMB, as an international reserve currency, potentially eclipsing the dollar. Rarely is it recognized – by experts either inside or outside of China – that such a role would require a dramatic change in China's relationship with the rest of the global economy. Rather than importing foreign currency by running trade surpluses and sucking in foreign capital, China would need to became a currency exporter, supplying RMB to the world either by running trade deficits or channeling its own capital abroad. This means turning China's own development model on its head, something it's not clear the Chinese have seriously wrapped their minds around.

If they do want to supply the world with RMB, investing a lot more money abroad is certainly one way to do it – with two caveats. First, with China holding $3.5 trillion in reserves, it makes little sense to lend or invest in RMB when it has more foreign currency than it knows what to do with. It makes far more sense for China to re-export a large part of this stockpile before it begins exporting its own currency.

Second, China's recent development financing initiatives – AIIB, NDB, the Silk Road Fund, etc. – do seem to paint a picture of a China determined to replicate, consciously or unconsciously, the model of Britain in the 19th Century, and the United States in the early 20th Century. Both countries ran chronic trade surpluses and recycled the proceeds in the form of capital outflows. This made sense in the context of a world economy, in both cases, that was fundamentally supply-constrained. Britain was the world's first and only industrial country, leaving huge space for other countries to catch up. Later, the rest of the world needed the United States to help it rebuild from two devastating world wars. There was a need and a place for both countries to function as a supplier of goods and capital.

At the moment, today's global economy is fundamentally demand-constrained. Many commentators say there is a need for more infrastructure finance in Asia and elsewhere, which the Chinese can help to provide. But the real problem isn't lack of capital; the world is awash in savings, to the point where investors have been actually paying the Germans to borrow their money. What is lacking are credible projects that stand a decent chance of earning a positive return, because it's not clear the customers will be there. What the world, and the United States, needs from China isn't a supplier of goods and capital, it's demand – and not just intermediate demand that goes into building out more supply, but final, end-user demand. Rather than rebalancing its economy to deliver that consumer demand, China appears to be trying to prop up its export-led growth model. But this time, instead of building excessive capacity at home, it is hoping to build even more excess capacity abroad. I do not believe this model, which might have made sense in the past, can work today. To the contrary, it will only exacerbate the imbalances that are already weighing down the global economy.

So what does all this mean for the United States and the multilateral development institutions it has helped to create and sponsor over the years? Should we be

alarmed, encouraged, or simply unconcerned? What, if anything, should we do about China's recent initiatives? Our response should have four elements:

1. Think. The U.S. is never going to be able to tell China what to do with its own money. The question is not whether China will continue being a creditor country, but what form that will take. China has many conflicting motivations and objectives in pursuing these latest initiatives. The U.S. needs to distinguish, in our own minds, between those that are problematic, such as China "buying" business or extending its influence abroad at the expense of sound financial and economic management, and ones we can live with or even assist, for our common good.

2. Monitor. The decision of so many friends to "defect" and join the AIIB may prove a blessing in disguise. Left to their own devices, China Development Bank and China Export-Import Bank have already deployed development funds in ways that raise serious concerns. The presence of so many new partners gives them and us a window into China's activities, and a way to press for more transparency and better governance. With this is mind, the U.S. should consider applying for observer status at AIIB, NDB, and similar Chinese-sponsored platforms.

3. Communicate. China rebalancing its economy and deploying its savings in ways that boost global demand, rather than add to the global supply glut, is good for China and good for the United States and the world economy. Yet at no point did the U.S. formulate, much less persuasively articulate, this idea as it related to the objectives of the AIIB and its participants. Instead of explaining why more Chinese funding for building infrastructure in Asia was not really the solution, whereas spurring more Chinese consumer demand to generate better returns on such projects could be, we rather lamely appeared as though we were opposing for selfish and petty reasons, standing in the way of what everyone, including, ourselves, unquestioningly accepted was a good thing.

4. Lead. "You can't beat something with nothing." If the U.S. has problems with the economic path China is proposing to other countries, and is willing to put its own money behind, then we had better be ready to offer a compelling alternative. TPP is a start, but only a start. The topic of international finance may seem arcane, but it lies at the heart of our relationship with China and our competition with China for global influence. A proactive agenda that reflects our values and our interests needs to be at the heart of our foreign policy, just as it was with Bretton Woods and the Marshall Plan at the end of World War II.

Thank you, and I'm happy to answer any questions.