Testimony of the Honorable Marshall Billingslea
Before the Subcommittee on National Security, Illicit Finance, and International Financial Institutions
of the House Committee on Financial Services
June 7, 2023

Chairman Luetkemeyer, Ranking Member Beatty, it is a pleasure to appear before your Committee today to discuss how best to preserve the U.S. dollar's role as the global reserve currency, and to maximize the advantages that conveys in the national security space.

In recent months there has been an uptick in talk about "de-dollarization," much of it driven by foreign autocrats and leaders with interests that conflict with the United States; a prime example of this is Brazil's newly re-elected President, Lula da Silva, who has repeatedly called on developing countries to replace the dollar with other currencies.

At the outset I must say that – to paraphrase Mark Twain – reports of the dollar's demise are an exaggeration.

I hold the view, shared by many others, that there is little chance the dollar will be supplanted by some other currency any time soon. It is true that over the past twenty years the dollar's share of official foreign exchange reserves has decreased, from 78 percent down to around 58 percent. But it still overmatches all other reserve currencies, with the euro accounting for just 19 percent, and the Japanese yen for 5 percent. The Chinese yuan is just 2 percent, and nearly a third of that is held by Russia, which cannot now easily access Western "hard" currencies. In other words, the shift away from the dollar has been into dozens of smaller, Western currencies, not towards a single emerging competitor.

Moreover, according to the Bank of International Settlements, the dollar is still involved in 88 percent of all global trade transactions. Compare that to 7 percent for the yuan.

At its core, the reason the dollar remains so prominent is because ultimately the international monetary system wants safe, stable assets. Our country provides that in ways others cannot. We have a relatively open economy that remains the world's strongest, at one quarter of the global Gross Domestic Product (GDP). We allow the dollar to float and do not manipulate our currency the way some countries do, such as Communist China. Nor do we impose the kind of capital controls that China does, which restrict the outflow of currency and raise doubts about the convertibility of the yuan. Our Federal Reserve system is transparent, we also have a strong, deep Treasury market and – with a few odd exceptions – we have never defaulted on our debt.

As a result, our national currency is at the heart of global trade and the functioning of the international financial system. This is very much in our national security interest because, among other things, it enables the US to employ a wide range of financial and economic tools against bad actors. It also enables us to deter third parties from helping these actors evade our sanctions by holding their access to the dollar at risk, should they do so.

However, we nevertheless should remind ourselves that in the 16th century, the Spanish silver dollar was dominant, followed by Dutch florins in the 17th, and the pound sterling in the 18th centuries. The link between a nation's currency being the favored unit of trade account and that nation's relative political dominance on the global stage is clear.

And that is why leaders such as Lula, Putin, and Xi all aspire to undercut the role of the dollar as the global reserve currency, just as much as they aspire to erode the international security framework that we so painstakingly constructed after the Second World War. Ultimately, they see it as a way of displacing the United States as leader of the free world. In the nearer term, they see it as a way of eroding our ability to use finance as tool for safeguarding our national security.

In this respect, Xi Jinping poses the most serious threat. He has dictatorial control of Communist China, having purged all his main rivals – many under the guise of anti-corruption investigations. Xi has a vision of China as the dominant Middle Kingdom on earth, to which all other nations ultimately will pay tribute, and some cultures, such as the Uyghurs, enslaved and eradicated. To that end, he has overseen a massive expansion in Chinese military capabilities, launched an unprecedented nuclear weapons build up to rival the United States (and Russia), and is ominously threatening invasion of democratic Taiwan.

It therefore should come as no surprise that he, via the People's Bank of China (PBOC), would like to undercut the dollar and establish the renminbi/yuan as a true international currency. It also should not be surprising that the Communist Party is taking active steps to "sanctions proof" China's economy to the best of their ability, learning several lessons from the international sanctions that have been applied on Russia after its further invasion of Ukraine.

In March of 2018, Russia began dumping ownership in US Treasury bonds, from $96 billion down to $15 billion. Russia also began buying large amounts of gold, becoming the fifth largest owner in the world (with 2,300 tons). We saw this happening at the Treasury. I cannot say that they were doing this back then in preparation for further aggression against Ukraine, but I can say they were doing this to lessen their exposure to US sanctions, and to give themselves a way of transacting with a commodity that is hard to trace.

Indeed, over the past year we have seen Russian entities conducting gold denominated transactions through Dubai and Turkey as a way of getting around sanctions.

China is now embarking on its own gold buying spree. I have not yet seen the data for May, but April marked the sixth straight month of Chinese expansion in its gold reserves, with the stockpile reaching over 2000 tons. At least, those are the official figures. I suspect the number is in fact far higher, and that they are concealing amounts generated by Chinese gold mining around the world; China is the world's largest gold producer and half of that is state-owned. China is also the world's largest gold importer, much of it not declared. At a minimum, the PRC is building up a war chest with assets that will be harder to touch through financial sanctions. But if China begins to back yuan contracts with gold, it also may remove a major impediment to the yuan being able to challenge the dollar by resolving concerns over convertibility.

This bears watching.

Last year China was also reducing its holdings in US Treasuries. 2022 marked the second largest decrease on record, with a drop of ~$174 billion, and China stood at the lowest level since 2010. But it seems to have reversed course this past March, perhaps temporarily. So far, while reducing its exposure, China has not yet moved decisively away from dollar debt the way Russia did. In fact, it seems that between 50-60 percent of China's foreign exchange reserves are still in dollar-denominated assets, though China considers the exact composition to be a state secret. This also bears close watching because a significant sell-off may be a leading indicator of planned Chinese aggression.

Perhaps one area where Xi Jinping may be more sanguine over his ability to withstand US financial and economic measures, in event of conflict, is the sheer size of China's financial sector.

One of the first things that the Biden Administration did in the wake of Russian aggression was to start sanctioning Russian banks, albeit in a piecemeal fashion. But it is one thing to de-SWIFT banks in an economy smaller than that of Texas. It is quite another to try to do that to banks in China. In 2022, Russia had just one bank in the top 100 globally, ranked by total assets (at number 65). China today has 20, including the four largest. These four alone have nearly $20 trillion in assets, which is more than one sixth of the total amount held by all 100 of the world's largest banks.

That is why many within the US Treasury would contend, as they did when I was there, that certain Chinese banks are just too big to sanction. For this reason, and to ensure that we could sanction Chinese banks, if necessary, we need to take immediate steps to reduce both the direct and indirect exposure of our financial institutions and our investors. According to the Atlantic Council, Communist China has up to $5.8 trillion in liabilities to Western investors, or assets in China belonging to them. In comparison, China has around $3.4 trillion in international assets that could be targeted by Western sanctions. In other words, China could potentially hit back as hard as we can.

The market is already starting to react to the geopolitical tension caused by Chinese military provocations and bellicose rhetoric towards Taiwan, and is moving in the right direction. For instance, yesterday Sequoia Capital – a major technology startup investor – announced that it would be splitting away its Chinese business. Indeed, many other venture capital firms have started scaling back their investments in China. Additionally, since April, Chinese companies have lost around $540 billion in stock value. Most of the major Chinese indexes, like the Nasdaq Golden Dragon China Index (which follows New York-listed Chinese companies) are down between 3 to 6.5 percent, and the yuan has dropped 2 percent.

As the Atlantic Council pointed out, of the $5.8 trillion in Western investment that China can hold at risk, roughly half of it is in the form of dollar or euro denominated external debt, including some Chinese government bonds. Just as Russia decided to default or defer payment on its debts, China could do likewise. This could cause serious harm to some of our pension and investment funds. We need to look at ways to encourage portfolio managers to recognize this very real risk, and to take steps to mitigate it now – not after conflict is imminent.

We have also seen three of the biggest US banks trim their exposure to China by more than $9 billion between 2022 and the start of 2023. This is another area where Federal action will be helpful. To encourage further reduction, and to build a hedge against reciprocal sanctions, US financial institutions with significant China exposure should face increased capital requirements. We need to ensure that our largest banks can withstand the systemic shocks to the banking system that a sanctions war would entail.

Finally, China has built up mammoth forex reserves – more than $3.2 trillion as of April. In comparison, Russia had built up reserves of $630 billion before it attacked Ukraine. Even with half of its assets frozen overseas, the Russian Central Bank has been able keep the Russian economy functioning and its war machine going. The People's Bank of China will certainly not repeat Russia's mistake of leaving assets where they can be frozen. So, consider then what the People's

Bank of China will be able to do, in terms of sustaining its economy in the face of Western financial pressure.

China continues to run a significant current accounts surplus, exporting far more than they import. In 2022, the PRC shipped out nearly $3.6 trillion in goods, which was seven percent more than 2021. Of that amount, approximately $583 billion was sold to the United States. That is $148 billion more than when President Biden took office, a 34 percent increase over 2020. While it may be impossible to push China into a trade deficit, we at least need to reduce the size of its surplus. The larger that surplus, the larger China's foreign exchange reserves become, and the more prolonged will be its ability blunt the effect of Western sanctions in event of a Taiwan invasion.

In conclusion, because of the dollar's continued dominance as the global reserve currency, we do have enormous leverage over Communist China in the event of hostilities. But because of trade and investment decisions made over the past several decades, we face an adversary that not only is now the world's second largest economy, but which has a financial system that will be resilient in the face of sanctions. Just how resilient will depend upon what steps we take, starting now.