

## Interview – Daniel McDowell

Written by E-International Relations

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Daniel McDowell is an Associate Professor of Political Science at the Maxwell School of Citizenship and Public Affairs at Syracuse University and a 2021-22 Wilson Center China Fellow. His work focuses on the international politics of money and finance, with a focus on the role of the United States and China in these arenas. His first book, *Brother, Can You Spare a Billion? The United States, the IMF, and the International Lender of Last Resort* was published in 2017. His second book, *Bucking the Buck: US Financial Sanctions and the International Backlash Against the Dollar*, is forthcoming with Oxford University Press.

### **Where do you see the most exciting research and debates happening in your field?**

I am most drawn to work being done at the nexus of security and international political economy. Those two IR subfields sort of diverged at the end of the Cold War. There have of course been people like Dan Drezner, Carla Norrlöf, Paul Poast, and others who continued working in that overlapping area, but overall, I think it was neglected. I think we are now in an exciting place where walls of separation are breaking down.

Though it is not the only piece of work that illustrates this shift, Henry Farrell and Abraham Newman's International Security paper and broader research program on "Weaponized Interdependence" is a splendid example of the changing landscape. Their work reframed how we should think about economic globalization. Markets cannot escape today's geopolitical realities like intensifying strategic competition between the US and China and the return of existential security concerns to the European continent. Fifteen years ago, most of our theories on trade, finance, and investment reduced matters to domestic political battles between interest groups with competing policy preferences. There was a much smaller role for international politics in those models. And, when international politics did enter the picture, matters of security were rarely centre stage. It is not that those models were necessarily wrong, rather they were reflective of a different moment in time when strategic and security matters objectively mattered less in the forming of foreign economic policy. But the world is changing, and so the questions we ask and the models we build need to adapt, and that is what is happening—and that makes this an especially interesting time to be doing work in IPE.

### **How has the way you understand the world changed over time, and what (or who) prompted the most significant shifts in your thinking?**

I started my PhD work in 2006 and finished it in 2012. The Global Financial Crisis erupted right in the middle of that formative period of my intellectual life. It completely reoriented my interests and shaped the research questions I began to work on. The crisis shined a light on the centrality of the US financial system, the dollar, and the Federal Reserve in the world economy. These were now undeniable and unavoidable facts that I had to deal with, even though they were not topics I entered graduate school to study. Ultimately the crisis led directly to my first book.

Homing in on issues of international currencies and finance early in my career required me to address questions of power and US-China competition sooner than I would have had I decided to study trade or other topics in IPE. So, while the answer may seem a bit simplistic, the financial crisis had a more significant impact on my interests and thinking than anything else I can think of.

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### **What are the political risks that sanctioning regimes can have on the global status of the US dollar? What steps should the US be taking to maintain its economic status and international political influence?**

This question is the subject of my second book *Bucking the Buck: US Financial Sanctions and the International Backlash Against the Dollar*. The book's premise is that the more the United States uses dollar dominance as a coercive tool of foreign policy, the more that political risk concerns enter the thinking of sanctioned governments or those that fear they may be sanctioned in the future. Despite the dollar's overwhelming economic appeal, sanctions can tarnish the dollar's shine as an international currency due to political concerns, and those political risk considerations can push states to introduce what I call "anti-dollar policies." As the name implies, these steps seek to reduce an economy's reliance on the dollar as an investment and cross-border payments currency. In the book, I show that sanctions are linked to the introduction of anti-dollar policies. In some cases, sanctions correlate with actual de-dollarization, where economies successfully reduce their reliance on the dollar.

The book is clear that this is not a story about the dollar losing its status as the top international currency. There is no evidence to suggest that sanctions are going to bring about a transition at the top of the global currency hierarchy, though they may shape it at the margins. What is on the table, however, is the future effectiveness of US financial sanctions as a coercive tool. As more states' efforts to circumvent the dollar system and greater coordination among anti-dollar states emerge, the United States will find it more difficult to impose the economic costs it has grown used to inflicting at the stroke of the president's pen.

I am not arguing that the United States should cease using financial sanctions. What is the point of preserving a weapon if the only way to maintain it is to not use it? Rather, I want to suggest that US policymakers can be more circumspect in their decision to use dollar dominance as a weapon. For example, they need not reach for financial sanctions every time there is democratic backsliding in a country over here or a human rights violation in a country over there. There are other tools in the toolkit that can be used to respond to events like those that do not require politicizing the dollar system. The goal ought to be to preserve the potency of financial sanctions for those events that pose the gravest threats to the interests of the United States and its allies and the stability of the post-war order.

### **In the context of competition between international currencies, what is the role of Central Banks in supporting hegemonic efforts by governments?**

At the most basic economic level, central banks issuing international currencies (or issuing currencies that aspire to achieve international status) need to focus on what I call the "two Cs": first, to cultivate market confidence in the currency's stable value over time and, second, to help develop and sustain market systems that enhance the convenience of using the currency for cross-border activities.

On the issue of convenience, here is where China scores particularly poorly. Beijing's financial policies limit the usefulness of the renminbi. Relative to the dollar or other major currencies like the euro, yen, and pound sterling, it is quite an inconvenient currency in which to invest and transact. The People's Bank of China is working on ways to improve this by, for instance, creating the Cross-Border Interbank Payment System (CIPS) which in time could enhance the convenience of international renminbi-based transactions. But at the moment, the system still has an exceptionally long way to go.

Beyond the "two Cs", how central banks respond to crises can shape attitudes toward their currencies. For example, the Federal Reserve has stepped in to function as the world economy's international lender of last resort twice in the last 15 years, first in 2008-9 and then again in the spring of 2020 when markets crashed as the realities of the COVID-19 pandemic were sinking in. These moves have enhanced the dollar's international appeal by assuring foreign banks, businesses, and governments that the Fed is standing by to stabilize global dollar funding markets when they seize up.

### **What is the future for the international status of other currencies like the Euro and the Renminbi? Can global recovery and growth benefit from competition between currencies?**

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Presently, the euro and the renminbi are both facing some challenges. The euro has fallen to parity with the dollar for the first time in decades as concerns about energy and security abound following Putin's war in Ukraine. China's economy continues to struggle under Covid Zero, and Xi's economic policies have hurt foreign investor interest in Chinese assets. The dollar looks quite good, by comparison. But currencies go through periods of strength and weakness, and these conditions are bound to change. I expect that the renminbi's international role will continue to rise slowly in the coming decade, but I would not expect it to compete with the euro for second place, let alone the dollar, in any of the major roles (reserves, trade settlement, FX markets).

The Europeans have recently called for greater "strategic autonomy" from the US, including the dollar, which led to some of the most ambitious talks about the euro in years. And yet the war in Ukraine has only drawn Europe and the United States closer together. Strategic autonomy seems a long way off. I expect the euro to continue playing a secondary role to the dollar but not lose its hold on the number two spot.

Certainly, greater competition between currencies can generate economic benefits. Intra-eurozone trade is more efficient because settlement relies on the common currency, not a third-party currency like the dollar. China could benefit from greater use of the renminbi in trade settlement, as it would better insulate its firms from FX risk and provide business opportunities for Chinese banks.

### **How do you interpret relations between US and China in terms of international trade and finance? What effects does their competition have on the global economy and growth?**

Trade relations between the world's two biggest economies remain at a 21st century low. The Biden Administration has not prioritized US-China trade and so the two powers basically remain fixed in the same trade Cold War that began in 2018. The future is bleak as the US and China are increasingly head-to-head competing for global export market share in high-tech manufacturing. Trade in services is also fraught due to privacy and security concerns surrounding personal user data. It is not a pretty picture.

In finance, competition is less pronounced. Chinese financial markets are big, but they remain very closed relative to the US. China's currency is still a bit player. China is concerned about US financial sanctions capabilities, and so Beijing has become more interested in insulating itself from such risks. Economic policy has not entirely caught up with concerns, but that may change. I will be keenly watching how China's financial relations with Russia evolve as the Ukrainian conflict drags on, for example. I expect we will see increased tension between Washington and Beijing on this front over the next few years.

### **How significant is the role of blockchains in the global economy?**

If the last six months have taught observers of finance anything, I would hope it has taught them that Bitcoin (and other cryptocurrencies) are not peer competitors to state-backed legal tender. They remain speculative assets that reflect moods of hype and panic among a narrow subset of financial investors and do not have much use beyond generating lots of stories in the financial press.

### **How can governments and Central Banks tackle the issue of digital currencies?**

My sense of central bank digital currencies (CBDCs) is that, if they take hold, their most significant impact will be at the level of the consumer. The digital renminbi has received a lot of hype as a potential threat to the dollar, but the PBOC's former chair recently explained that the development of the digital currency is mostly about improving and streamlining consumer-merchant exchange.

CBDCs are also talked about as a way to create a more equitable financial system. If individuals can have digital wallets with the Fed, for example, it would help millions of "unbanked" Americans have access to financial services. Of course, the loser in that scenario would be commercial banks, as they would likely suffer a diminished role as financial mediators. The point here is that most of the issues related to CBDC that are on my radar tend to be domestic in nature. There is a role for politics, but less so at the international level.

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### **Did international organizations like the IMF and the World Bank act satisfactorily in response to the Covid-19 pandemic?**

If the pandemic laid bare anything, it was that developing and emerging economies do not have anywhere near the level of fiscal space that the US, Europe, and Japan have. The massive spending packages implemented in the developed world, mostly funded through issuing debt at incredibly low-interest rates, outstrip anything that the rest of the world could offer.

Still, the IMF and World Bank responded quite admirably to the pandemic challenges facing the developing world, in my view. The institutions learned from past crises. More financing was made available on-demand with little to no conditionality to member countries facing an unprecedented economic shock. In general, these institutions performed their functions by providing countercyclical lending to economies less equipped to get that funding through private channels alone.

This does not mean the institutions did not make any mistakes, but relative to past crises, I would give them a solid grade. The next few years, however, may prove trickier as interest rates rise in the major economies and developing countries dig out of the debt, they have piled up over the past two years. If I had to guess, navigating the aftermath of the pandemic will be a greater challenge for the IMF and the World Bank than the initial response.

### **What is the most important advice you could give to young scholars of International Political Economy and International Relations?**

There are many well-worn research topics in IPE and IR more generally. There is splendid work being done in these areas, and you can obviously contribute to developed debates through empirical or theoretical innovation. But there is also something to be said for striking out on a new path. So much of my research has been influenced by events unfolding in the world. Governments are always adapting and innovating in the face of a changing world. Closely follow the news in your topic area. You can find inspiration there to build on. There is risk in this approach because events can change dramatically before a project is finished, but there are also great upsides. The subject you study stays fresh, and that keeps you on your toes. It can also keep you motivated in year two or year three of a long project because you are not just looking backwards into history, but you have to keep pace with the present with an eye turned toward the future.

Second, and relatedly, become an expert on something that most people are not experts on in the field. Obviously, methods training is more important than ever, and this should be a priority for any young scholar. But you also need to know something about something. Do not just stick to the IR literature on your topic. Read extensively outside of our field. If what you are studying has to do with international law, you should be reading work by international lawyers and really getting to know the nuances of the legal system as it relates to your subject. If what you are studying has to do with international finance, then you need to be reading reports from the industry. There are many ways to add value to the IR literature. Being able to make complex topics from outside the field more accessible, interesting, and relevant to other scholars inside the field is one such way.