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China's Monetary Power: Internationalization of the Renminbi

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This paper sheds light on the Chinese government's recent efforts to internationalize the Renminbi (RMB). China's standing as the world's second largest economy and its more than $3.9 trillion in foreign exchange reserves could greatly leverage China's monetary power. As the United States has become heavily dependent on Chinese financial support in the wake of the recent financial crisis, China has sought to exploit this financial advantage. China may seek to influence decision-making on matters relating to future reorganization of the international monetary system. Were the RMB to become a global currency, the status of the dollar as the world's top currency would be undermined and US hegemony in the international political economy potentially challenged. However, the intent of Chinese policy-makers is not to replace the top currency status of the United States, but rather to increase Chinese policy autonomy. Since internationalization of the RMB requires a massive financial liberalization of China's domestic economy and further might threaten the vested interests of domestic groups, China has pursued internationalization of the RMB by a two-track global and regional strategy in a gradual manner.

Key words: *monetary power, Renminbi, Yuan, currency politics, internationalization, China.*

Signaled by Chinese Central Bank Governor Zhou Xiaochuan's criticism of the current dollar-dominated international monetary system and his proposal of an alternative reserve currency,[1] the Renminbi (RMB) has been seriously discussed as a possible means of international transaction as well as an alternative reserve currency. China's status as the world's largest creditor and its holding of more than $3.9 trillion in foreign exchange reserves in 2014 make a plausible case for the internationalization of the RMB in the near future. As an engine of world economic

1. Zhou Xiaochuan, "Reform the International Monetary System," *BIS Review*, 41 (2009), pp. 1–3.

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growth, China's continuing economic success, when contrasted with the enduring financial crisis in the rest of the world, strengthens its call for internationalization of the RMB. As the United States has become heavily dependent on Chinese financial support in the wake of the recent financial crisis, China has sought to exploit this financial advantage. China wants a seat at the table in any discussions about future reorganization of the international monetary system.

Were the RMB to become a global currency, the status of the dollar as the world's top currency would be undermined and US hegemony in the international political economy potentially challenged. Within the context of a globalizing world, the monetary power of a country is arguably a more effective means of persuasion than military power. For several decades since World War II, the dollar's status as the top international currency has promoted the US goal of a liberal world economic order. Although the dollar's status has become vulnerable in the face of the United States' chronic trade and budget deficits that sometimes constrain its ability to espouse a liberal world economic order, the United States and other members of the Group of Seven nonetheless have muddled through international monetary management. However, the United States subprime mortgage crisis rekindled the issue of confidence in the dollar, strengthening the argument for the RMB as an alternative global reserve currency. In order to gain key currency status in the global economy, the RMB would require a guarantee of international convertibility, to be perceived as an attractive investment, and to function as a store of value based on stable macroeconomic conditions. Although the Chinese government has taken only a small step toward internationalizing the RMB, some pundits are predicting that the RMB will eventually challenge the dominance of the dollar.[2]

In order to shed light on the Chinese government's efforts to internationalize the RMB, this paper investigates the following research questions. How might China pursue the internationalization of the RMB, and in what political economic contexts? Given the outmoded state of its financial market system, what policy dilemmas might China face? Would internationalization of the RMB elevate China's role in the global financial system? The paper is organized into five sections. Following the introduction, the second section reviews a theoretical framework of monetary power. The third section analyzes the major concerns about China's authority to pursue internationalization of the RMB and the influence of contending domestic institutions and groups that would be involved in such a decision. The fourth

2. Melissa Murphy and Wen Jin Yuan, "Is China Ready to Challenge the Dollar?: Internationalization of the Renminbi and Its Implications for the United States," A Report of the CSIS Freeman Chair in China Studies (Washington, D.C.: Center for Strategic & International Studies, 2009); Arvind Subramanian and Martin Kessler, "The Renminbi Bloc Is Here: Asia Down, Rest of the World to Go?" Working Paper, WP12–19 (Washington, D.C.: Peterson Institute for International Economics, 2013); Carolyn Cohn, "China's Yuan Might Ultimately Challenge Dollar: ECB's Mersch," *Reuters* (26 February 2014), at <http://www.reuters.com/article/2014/02/26/us-ecb-mersch-idUSBREA1P0XM20140226> (searched date: 10 March 2014).

section examines China's strategies and related anticipated challenges. The paper concludes with an evaluation of the prospects of internationalization of the RMB.

Power of Money: A Theoretical Framework for Analysis

Since Robert A. Dahl defined the concept of power as the ability to get another actor "to do something he would not otherwise do,"[3] several international political economy scholars have conceptualized various aspects of monetary power.[4] In his seminal work analyzing international monetary relations, Benjamin J. Cohen coined the concepts of "structural power" and "process power."[5] Susan Strange further clarified two types of power as "relational power" and "structural power." Relational power could be applied to a relationship involving two or three international actors, while structural power could affect a broader domain. Structural power is "the power to shape and determine the structures of the global political economy."[6] Joseph S. Nye Jr. created the concept of "soft power"[7] as persuading or influencing other actors through culture and ideas instead of the use of threat or force. The soft power concept provides an additional way to understand the attractiveness of a specific currency as a means of attaining monetary power. In the world economy, most countries prefer key currencies, such as the dollar and euro, because business actors prefer these currencies as a medium of exchange in international trade. Technically, the status of key currency depends not only on a country's macroeconomic stability, but also on its political stability and its possessing high social value.

In addition to these power concepts, what is the source of monetary power? According to Strange, four structural power resources arise from the areas of "security, system of production of goods and services, the structure of finance and credit, and knowledge."[8] Cohen proposed that the sources of monetary power are based on the three areas of "international liquidity," "owned reserves," and

3. Robert A. Dahl, *Modern Political Analysis* (Englewood Cliffs: Prentice-Hall, 1963), p. 50.
4. Benjamin J. Cohen, *Organizing the World's Money: The Political Economy of International Monetary Relations* (New York: Basic Books, 1977); Susan Strange, *State and Markets: An Introduction to International Political Economy* (New York: Basil Blackwell, 1988); Jonathan Kirshner, *Currency and Coercion: The Political Economy of International Monetary Power* (Princeton: Princeton University Press, 1995); David M. Andrews, ed., *International Monetary Power* (Ithaca: Cornell University Press, 2006).
5. Benjamin J. Cohen, *op. cit.*, pp. 53–77; see Eric Helleiner, "Below the State: Micro-Level Monetary Power," in David M. Andrews, ed., *International Monetary Power* (Ithaca: Cornell University Press, 2006), pp. 24–25.
6. Susan Strange, *op. cit.*, pp. 24–25.
7. Joseph S. Nye Jr, *The Paradox of American Power: Why the World's Only Superpower Can't Go It Alone* (New York: Oxford University Press, 2002), p. 8.
8. Susan Strange, "The Persistence Myths of Lost Hegemony," *International Organization*, 41-4 (Autumn 1987), p. 565.

"borrowing capacity."[9] We therefore should investigate the specific conditions under which a country wields monetary power, toward whom, and by what means. Cohen's "autonomy and influence" as two different elements of power are useful in analyzing how monetary power is wielded.[10] These two domains of power resemble spears and shields on an ancient battlefield. Power as influence implies the ability to control other actors, while power as a form of autonomy is the ability of a nation to defend itself against the influence of other actors. In reality, no individual economic system can be completely insulated from international markets. How much monetary power a country might reasonably expect to wield in relationship to other countries is an issue worth exploring, given the interconnected nature of the world. For example, under the Bretton Woods monetary regime, the United States became the highest monetary power by exploiting its status as holder of the world's top currency in the international political economy. In the wake of the collapse of the Bretton Woods regime, the United States, suffering from the Triffin Dilemma, has experienced a relative decline in its hegemonic monetary power. The injection of massive financial capital into ailing Wall Street firms and the big three automobile companies in order to resuscitate the economy undermined the status of the US dollar. The United States was subsequently forced to seek financial support from China, a developing country. China's massive purchase of US Treasury bills helped the United States to finance global debts.

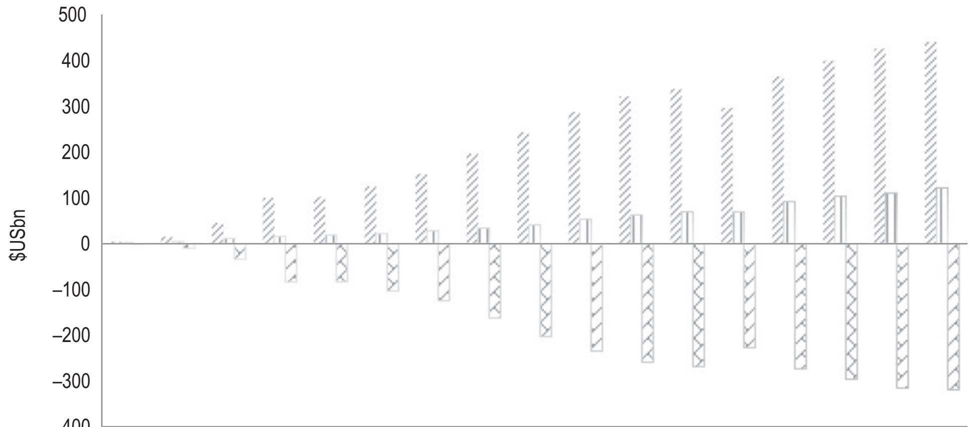
Although the United States and China both possess monetary power resources, how and with whom these two countries wield that power and under what specific conditions is a different matter. The main focus of this study is to explore why China wishes to pursue the internationalization of the RMB. Another question is what policy challenges the country might encounter in the process of currency internationalization. The final question is what might happen to the US dollar if the RMB were to become the alternative global currency. From the perspective of the exercise of relational monetary power, the rise of China will not challenge US preeminence in the international monetary system for the time being, but could later influence the US in some specific issue areas. Two recent cases illustrate the relational monetary power of China toward the United States. First, taking advantage of its creditor status, China persistently resisted demands by the United States, which was hoping to reduce perennial trade deficits against China, for RMB appreciation following market value.[11] The United States assumed that the Chinese authority's foreign-exchange market intervention promotes cheaper Chinese

9. Benjamin J. Cohen, "The Macrofoundations of Monetary Power," in David M. Andrews, ed., *International Monetary Power* (Ithaca: Cornell University Press, 2006), pp. 41–45.

10. *Ibid.*, pp. 32–33; see David M. Andrews, *op. cit.*, pp. 7–28. Andrews explains the exercise of the monetary power of a country as a "monetary statecraft."

11. Benjamin J. Cohen, "International Monetary System: Diffusion and Ambiguity," *International Affairs*, 84-3 (2008), p. 461.

Figure 1. *US trade in goods with China (1986–2013)*



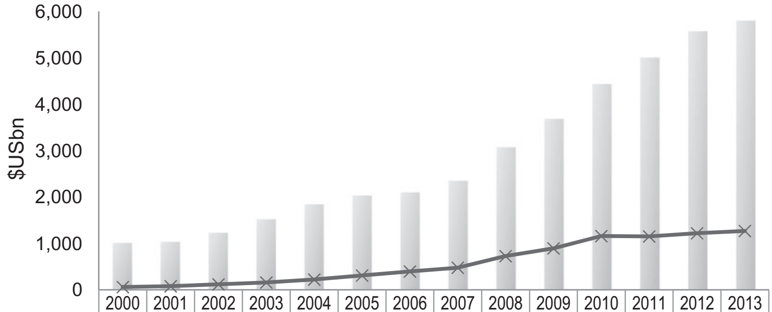
	1986	1990	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Import	4.8	15.2	45.5	100.0	102.3	125.2	152.4	196.7	243.5	287.8	321.4	337.8	296.4	364.9	399.4	425.6	440.4
Export	3.1	4.8	11.8	16.2	19.2	22.1	28.4	34.4	41.2	53.7	62.9	69.7	69.5	91.9	103.9	110.6	122.0
Balance	–1.7	–10.4	–33.8	–83.8	–83.1	–103.1	–124.1	–162.3	–202.3	–234.1	–258.5	–268.0	–226.9	–273.1	–295.4	–315.1	–318.4

Source: US Census Bureau, at <http://www.census.gov/foreign-trade/balance/c5700.html> (searched date: 2 June 2014).

exports, resulting in the huge US trade deficit with China.[12] At the 2010 Group of 20 meeting in Seoul, US President Barack Obama criticized China's aggressive RMB value manipulation as an "irritant not just to the United States, but . . . an irritant to a lot of China's trading partners and those who are competing with China to sell goods around the world."[13] In fact, the US trade deficit with China is a chronic problem, increasing to $318.4bn in 2013 from $1.7bn in 1986 (see Fig. 1). Through various official and unofficial channels, the United States exerts pressure on China to reduce its trade surplus, but these efforts have been unsuccessful due to China's relatively strong position in both its relational power and autonomy. Policy autonomy allows China to choose specific monetary or macroeconomic policy options and to maintain its intended goals independently from domestic and international environments. Beijing's status as the United States' largest creditor and as the largest foreign holder of US Treasury securities guarantees its autonomous position in the face of this US pressure. As of December 2013, China held

12. See C. Fred Bergsten and Joseph E. Gagnon, "Currency Manipulation, the US Economy, and the Global Economic Order," Peterson Institute for International Economics Policy Brief, PB12–25 (December 2012); Robert W. Staiger and Alan O. Sykes, "Currency Manipulation and World Trade," *World Trade Review*, 9-4 (October 2010), pp. 583–627.
13. Sewell Chan, "Obama Ends G-20 Summit With Criticism of China," *The New York Times* (12 November 2010), at <http://www.treasury.gov/resource-center/data-chart-center/tic/Pages/ticsec2.aspx> (searched date: 13 November 2010).

Figure 2. *Recent Chinese holdings in US treasury securities*



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Total	1,015	1,040	1,236	1,523	1,849	2,034	2,103	2,353	3,077	3,685	4,436	5,007	5,574	5,802
China	60	79	118	159	223	310	397	478	727	895	1,160	1,152	1,220	1,270

Source: US Department of the Treasury, Resource Center, at <http://www.treasury.gov/resource-center/data-chart-center/tic/Pages/ticsec2.aspx> (searched date: 6 June 2014).

$1,270bn (21.9%) of total US Treasury securities,[14] making it a strong asset to China's monetary power (see Fig. 2). Because Beijing does not depend on the United States for military security, unlike both South Korea and Japan, Chinese policy-makers are able to pursue wider policy options and maintain greater autonomy.

Second, China used its financial leverage to effectively protect itself against investment losses in Fannie Mae and Freddie Mac. In the middle of the subprime mortgage crisis, Chinese policy-makers called for the US government to guarantee these companies' debt. The desperate need for Chinese financial support led the US Federal Reserve to take over these companies.[15] In a worst-case situation, China could decide to dump US Treasury securities on international financial markets in order to undermine US leadership or to dissuade the United States from a certain policy direction, but such a move is inevitably dangerous and risks devaluing China's existing holding of US securities.

Regarding the perspective of structural monetary power, China has not accumulated enough of the three monetary power resources (liquidity, reserves, and borrowing capacity), except that it holds the world's largest foreign exchange reserves. Even if China had all of these monetary power resources, its policy-makers would be hesitant to pursue their longer-term ambition of world hegemonic power. Promoting an image of a peaceful rise of China, Chinese policy-makers acknowledge that keen competition with the United States, its largest trading partner, would

14. See US Department of the Treasury, Resource Center, at <http://www.treasury.gov/resource-center/data-chart-center/tic/Pages/ticsec2.aspx> (searched date: 6 July 2014).

15. See Daniel W. Drezner, "Bed Debts: Assessing China's Financial Influence in Great Power Politics," *International Security*, 34-2 (Fall 2009), pp. 33–35.

be counter to their continuous economic growth.[16] In spite of Zhou Xiaochuan's proposal for an alternative reserve currency, the dollar's dominance in international financial markets will continue for several more decades. Partly because of the difficulty of replacing the dominant dollar with alternative currencies, such as the euro or the yen, and partly because of excessive accumulation and dollar-based transactions by the current foreign countries, foreign investors are loath to break their habitual dollar usage. Therefore, we should understand that the purpose of the Chinese authority's internationalization of the RMB is not to challenge US hegemony, but to increase China's economic policy autonomy through risk diversification. In other words, Chinese policy-makers wish to use their massive holding of US Treasury securities in their foreign exchange reserves as a hedge against any severe loss of value of its currency vis-à-vis the value of the dollar.

Background of Pursuing Internationalization of the RMB

Experiences involving both the British pound and the US dollar suggest that internationalization of currency entails various benefits and costs. Successful internationalization of the RMB would firmly mark China as a rising monetary power in the international political economy. As a key currency-issuing country, China would enjoy significant benefits, such as seigniorage,[17] reducing the cost of international business transactions, and increasing macroeconomic flexibility. China could enhance its reputation as a soft power and utilize economic leverage in areas of international political economy.[18] Yet, world monetary power also carries a price. China has to endure costs such as currency appreciation, external constraint, and policy responsibility.[19] As the number of foreign investors and countries holding the RMB increases, the value of the currency inevitably rises as well. The appreciation of the RMB would make goods manufactured in China more expensive abroad, harming the export-led growth of the country. China must take into account international economic conditions in maintaining a stable domestic monetary policy. China also has to prove its global leadership, and as did the United States under the Bretton Woods regime, provide global liquidity to international financial markets.

With these benefits and costs in mind, various domestic institutions and actors have debated whether to adopt a policy of RMB internationalization as well as the

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16. See Zheng Bijian, "China's "Peaceful Rise" to Great-Power Status," *Foreign Affairs*, 84-5 (September/ October 2005), pp. 18–24; China Daily, "Top 10 Trading Partners of the Chinese Mainland," *China Daily.com.cn* (19 February 2014), at <http://www.chinadaily.com.cn/bizchina/2014-02/19/content_17290565.htm> (searched Date: 4 March 2014).
17. "Seigniorage" means the difference between the value of the money and the cost to produce the currency.
18. See Benjamin J. Cohen, "The Benefits and Costs of an International Currency: Getting the Calculus Right," *Open Economies Review*, 23-1 (2012), pp. 15–19.
19. *Ibid*., pp. 19–20.

best strategies by which to implement the policy, should it be adopted.[20] Differing policy orientations of rival party-line and various domestic groups guarding their parochial commercial interests were evident in the discussion. If these contending domestic groups were to benefit equally from internationalization of the RMB, China could accelerate the process. However, the process necessarily burdens some groups more than others, requiring them to relinquish existing benefits. Under the circumstances, internationalization of the RMB has been supported and pursued by the reformer wing of the Chinese Communist Party (CCP) and the People's Bank of China (PBOC). Conversely, other domestic groups, such as state-owned enterprises (SOEs), the "Big-Four" state-owned banks (Bank of China, China Construction Bank, Agricultural Bank of China, and Industrial and Commercial Bank of China), the National Development and Reform Commission (NDRC), and the Ministry of Finance (MOF), have either reluctantly followed or outright opposed internationalization of the RMB.[21]

Under the old practice of financial repression, high-ranking officials of the CCP, top executives of SOEs, state-owned banks, the MOF, and the NDRC wielded political clout and enjoyed the power of regulating financial resources in the economy. Under the guidance of the State Council, the NDRC, and the MOF had long highly regulated the financial system in order to boost economic development. The NDRC is responsible for the formulation and implementation of national social economic development as well as macroeconomic management of China. The MOF manages the financial sectors, including services, credit and monetary policy. As a way to achieve continuous national economic growth and maintain proper employment in the public sector, both institutions seek to control the economic and financial sectors.[22] Under the strict guidance of the MOF, the Chinese central bank, the PBOC, has regulated national bank credit operations at below market interest rates. The PBOC at times artificially devaluated the currency value of the RMB, facilitating export-led economic growth. Although state-owned banks cannot provide a wide margin of lending rates, they enjoyed oligopolistic rents as a way of profit-making. This practice greatly contributed to the country's economic development and to public financing of various provinces, allowing the SOEs to create more jobs. As a contributor to economic development, the SOEs benefited from government subsidies, took advantage of easy access to cheap

20. See Victor C. Shih, *Factions and Finance in China: Elite Conflict and Inflation* (New York, Cambridge: Cambridge University Press, 2008); Sebastian Mallaby and Olin Wethington, "The Future of the Yuan: China's Struggle to Internationalize Its Currency," *Foreign Affairs*, 91-1 (2012), pp. 135–146.

21. Sebastian Mallaby and Olin Wethington, *Ibid*., p. 139; Ulrich Volz, "All Politics is Local: The Renminbi's Prospects as a Future Global Currency," in Leslie Armijo and Saori Katada, eds., *Financial Statecraft of Emerging Market Economies: "The New Kids on the Block" and Global Rebalancing* (London: Palgrave Macmillan, 2014), pp. 103–137.

22. Eundak Kwon, "Financial Market Liberalization in the People's Republic of China," *Pacific Focus*, 26-2 (August 2009), p. 226.

financial capital, and exploited the Chinese authority's practice of financial repression. Were the Chinese authority to pursue internationalization of the RMB, the SOEs might lose the benefits of this preferential policy. Thus, many politically connected domestic groups, anticipating potential loss of their financial benefits and vested interests, have opposed or only reluctantly supported internationalization of the RMB.

In contrast, the PBOC and other international business-oriented bureaucrats favored internationalization of the RMB.[23] Domestically, the continuous huge foreign capital inflows and excessive accumulation of the dollar in foreign reserves, from foreign direct investment and the booming export trade, made it difficult for the PBOC to maintain an appropriate RMB value through sterilization and traditional financial repression measures. Internationally, a number of trading partners, mostly the United States and major international financial institutions, continue to criticize Beijing's artificial manipulation of the exchange rate as a way to boost exports. The PBOC admitted that internationalization of the RMB, as a liberal financial reform measure, would be an important policy alternative as a way to deal with the excessive foreign reserves and growing international criticism. In addition, since internationalization of the RMB inevitably connects with financial liberalization, such as relaxing the rigid foreign exchange system and deregulation of interest rates, the implementation of the policy requires authorization by reform-minded high-ranking leaders in the State Council. For the PBOC, internationalization of RMB would provide more opportunity to cultivate its ability to manage monetary policy, facilitating its independence. High-ranking reform-minded party leaders see internationalization of the RMB as a way to promote broader domestic economic and financial liberalization.

The internal power competition within the CCP influenced the decision by the top leaders to pursue internationalization of the RMB. One ruling party, CCP, has been functioning as a center of monopolistic political power controlling all areas of policy-making and implementation. However, the CCP has not always been unanimous in its decisions. The differing policy guidelines, ideological views, and leaders within the CCP could compete among each other for power for a long time. At times a faction's victory against other factions completely changed the political economy features of China and led the country to different ways of policy direction as in the cases of Mao Tse-tung, founding father, and Deng Xiaoping, a symbol of reform. The two leaders' visions and policy guideline trickled down and their influence reached far into every region, institutions, and into the military. Because the Politburo and its Standing Committee in the CCP are the most powerful decision-making body, which faction winds up occupying the majority of these power centers is pivotal in major processes of policy-making and implementation. The CCP's strict control restricts discretionary power of state organs and agencies

23. Benjamin J. Cohen, "The Yuan's Long March," Working Paper (2012), at <http://www.polsci.ucsb.edu/faculty/cohen/working/pdfs/Yuans_Long_March_rev_1.pdf> (searched date: 3 June 2013).

in pursuing internationalization of the RMB. However, as key figures in state organs, agencies, and SOEs have been appointed by the CCP leadership, the parochial vested interests of those groups tend to be imbedded with, to back up, and to be maintained along party lines. Within the power center of the CCP, the rise of the Elitists ("Princelings") in rivalry with the Populists (*Tuanpai*) affects the decision of internationalization of the RMB.[24] The Populists trace their roots to the Communist Youth League, later reaching the top ranks of the CCP. The Populists, in espousing a harmonious socioeconomic structure that would take into account vulnerable social groups, such as farmers and the working class, favored steady economic development to boost domestic demand along with continued support for SOEs. In contrast, the Elitists, who come from former revolutionaries or wealthy families, tend to advocate the interests of the emerging middle class and entrepreneurs, promoting foreign trade and investments. For instance, the Elitists Xi Jinping and Wang Qishan support the international business community's interests through market liberalization and private sector development. They believe that China's active involvement in the international economy is essential for continuous economic growth. In November 2012, the Elitists were a majority in the 18th Politburo Standing Committee of the Communist Party of China, signaling steady and great progress toward internationalization of the RMB. On 12 November 2013, the 18th Central Committee of the CCP adopted "[t]he Decision on Major Issues Concerning Comprehensively Deepening Reforms" and President Xi Jinping announced an economic and social reform plan. The plan enunciated an ambitious financial reform plan to drive internationalization of the RMB.

> 12. Improving the financial market. We will open the financial industry wider, . . . We will push ahead with reform of policy financial institutions. We will improve the multi-layer capital market system, promote reform toward a registration-based stock-issuing system, promote equity financing through diverse channels, develop and regulate the bond market, and increase the proportion of direct financing. . . . We will encourage financial innovations, and enrich the financial market with more levels and more products. . . . We will improve the mechanism for market-based Renminbi exchange rate formation, accelerate interest-rate liberalization, and improve the national debt yield curve that reflects the relationship between market supply and demand. We will promote the opening of the capital market in both directions, raise the convertibility of cross-border capital and financial transactions in an orderly way, establish and improve a management system of foreign debt and capital flow within the framework of macro-management, and accelerate the realization of Renminbi capital account convertibility.[25]

When the subprime mortgage crisis devastated the US economy, a number of Chinese scholars expressed anxiety over Beijing's vulnerability to its dollar

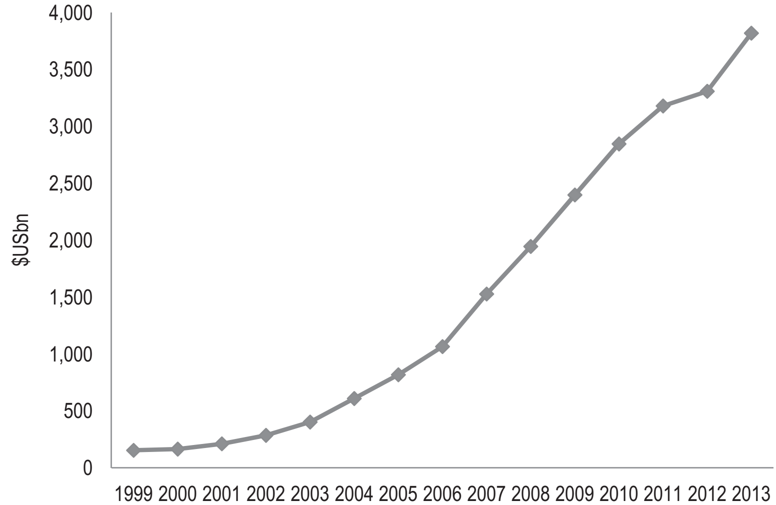
24. Cheng Li, "China's Team of Rivals," *Foreign Policy*, 171 (March/April 2009), p. 91.
25. Central Committee of the Communist Party of China, "Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform," *China.org.cn* (16 January 2014), at <http://www.china.org.cn/china/third_plenary_session/2014-01/16/content_31212602.htm> (searched date: 12 June 2014).

holdings and its export dependence on the US market. When diverse financial institutions and bureaucrats reached policy consensus, the Chinese government began to pursue internationalization of the RMB as an official goal.[26] Even though the policy will bring attendant benefits, Chinese policy-makers have accurately recognized potential problems and have anticipated a series of negative policy implications. If Beijing were to follow the conventional method of full capital account convertibility prior to the internationalization of currency, China clearly would not be able to support the SOEs with cheap capital while enjoying a continuing export boom. China thus decided to pursue an unconventional way of currency internationalization adopting a strategy of only gradually opening its capital markets as it moves forward with the internationalization.

When Chinese policy-makers decided to embark on internationalization of the RMB, they also seriously considered related economic and political factors. First, the Chinese authority promotes internationalization of the RMB as a way to efficiently manage enormous foreign exchange reserves. China's successful export-oriented economic development strategy yielded a continuous current account surplus and huge volumes of foreign direct investment inflows. At the end of 2013, China's foreign exchange reserves stood at $3.82 trillion,[27] the world's largest. From December 1999 to December 2013, China's foreign exchange reserves increased to $3.82 trillion from $155bn (see Fig. 3). In general, an independent central bank's monetary policy or flexible exchange rate system of a free market economy administer capital inflows according to free market principles. In China, the PBOC cannot implement its monetary policy without the oversight of the State Council. Although the PBOC regulates the volume and level of the RMB's exchange rates by direct selling or buying of currency based on market condition of a basket of currencies under the current managed floating exchange regime,[28] it does not guarantee exchange rate flexibility. If Beijing were to apply a flexible exchange rate system, the excess volumes of foreign reserves would have to be adjusted by the appreciation of the RMB, which would lower the price competitiveness of Chinese manufactured goods. In order to maintain RMB stability, the PBOC under the guidance of the State Administration of Foreign Exchange (SAFE) uses massive sales of bonds as well as issuing more RMB to enforce heavy sterilization by setting higher interest rates and reserve requirements for Chinese banks.[29] Such a mechanism goes against free market principles and further strains the Chinese economy and financial system. Were China to

26. Ming Zhang, "China's New International Financial Strategy amid the Global Financial Crisis," *China & World Economy*, 17-5 (2009), p. 24.
27. PBOC, "Financial Statistics 2013" (2013), at <http://www.pbc.gov.cn/publish/english/955/2013/20130114164249631487923/20130114164249631487923_.html> (searched date: 2 June 2014).
28. See Xiaolian Hu, "A Managed Floating Exchange Rate Regime is an Established Policy," *The People's Bank of China* (15 July 2010), at <http://www.pbc.gov.cn/publish/english/956/2010/20100727144152118668062/20100727144152118668062_.html> (searched date: 2 March 2013).
29. Eundak Kwon, *op. cit.*, p. 230.

Figure 3. *China's foreign exchange reserves (December 1999–December 2013)*



Source: China State of Administration of Foreign Exchange, at <http://www.safe.gov.cn/> (searched date: 12 June 2014).

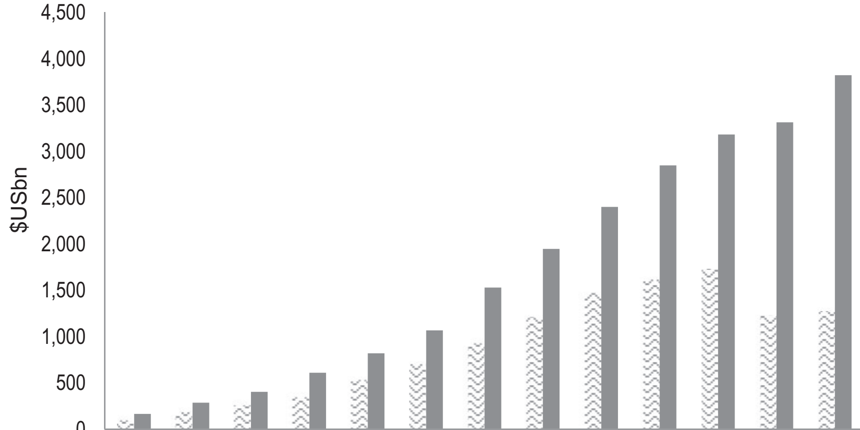
encourage an outflow of the RMB through internationalization, the burden of using sterilization to manage excessive accumulation of foreign reserves would be reduced.

Second, Chinese policy-makers believed that internationalization of the RMB would be an efficient way to reduce its over-reliance on the US dollar.[30] China heavily depends on its trade with the United States, which has the world's largest trade and financial markets. Because access to the US trade market is vital for Beijing's continued economic development, the Chinese authority pegged the currency value of the RMB to the dollar in order to hedge against abrupt fluctuation in currency value to US economy as well as to take advantage of the global key currency status of the dollar.[31] Although the Chinese government does not publicize the extent of its foreign exchange reserve holdings in US securities, the US Treasury data show what portion of US securities holding is in Chinese foreign exchange reserves. In December 2013, China held $1.27 trillion in US public and private securities out of a total $3.82 trillion foreign reserves (see Fig. 4). Although the ratio of US securities holdings in China's foreign exchange reserves fell 33.2

30. Gregory Chin and Eric Helleiner, "China As a Creditor: A Rising Financial Power?" *Journal of International Affairs*, 62-1 (Fall/Winter 2008), p. 97; Paola Subacchi, "One Currency, Two Systems: China's RMB Strategy," Chatham House Briefing Paper, IE BP 2010/01 (October 2010), p. 2.

31. See Wayne M. Morrison and Marc Labonte, *China's Holdings of U.S. Securities: Implications for the U.S. Economy* (Washington, D.C.: Congressional Research Service, 6 December 2012).

Figure 4. *China's US securities holdings in foreign exchange reserves (FXR)*



	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
US Securities	92	181	255	341	527	699	922	1,205	1,464	1,611	1,727	1,220	1,270
China's FXR	165	286	403	609	819	1,066	1,528	1,946	2,399	2,847	3,181	3,312	3,821

Source: China State of Administration of Foreign Exchange, at <http://www.safe.gov.cn/> (searched date: 13 June 2014) and US Department of Treasury, Resource Center, at <http://www.treasury.gov/resource-center/data-chart-center/tic/Pages/index.aspx> (searched date: 13 June 2014).

percent in 2013 from 63.3 percent in 2002, such a large portion of US securities in foreign reserves exposes vulnerability to US macroeconomic conditions. Arithmetically, a 10-percent devaluation of the dollar due to weak US economic conditions reduces the value of US Treasury securities ($1.7 trillion) in Chinese foreign reserve holdings to RMB 2.49 trillion from RMB 2.77 trillion ($1 = RMB 1.63 as of 18 June 2013). Thus, China is exposed to a potential risk of devaluation from US securities in its foreign exchange reserves holding. China has long taken a firm stance against Washington's accusations that Beijing's manipulation of the RMB value toward the dollar is highly responsible for the chronic US trade deficit.[32] If international financial markets were to accept the RMB as the medium of exchange in global trade, China could have enough breathing room to adjust huge amounts of US securities in foreign reserves and to change the RMB value in order to promote exports.

Third, the US subprime mortgage crisis alerted the Chinese authority to the need to pursue internationalization of the RMB more seriously.[33] In order to resuscitate the faltering US economy, the Obama administration followed Keynesian fiscal

32. See US Department of the Treasury, Report to Congress on International Economic and Exchange Rate Policies (27 December 2011), p. 19.
33. Sebastian Mallaby and Olin Wethington, *op. cit.*, pp. 139–140.

policy and expansionary monetary policy, arranging a massive public investment and financial support program.[34] As follow-up measures, the US Federal Reserve kept interest rates near zero to boost the economy and sold huge numbers of Treasury bills to finance ailing financial firms and the big three automakers. These policies encouraged a devaluation of the dollar, which negatively affected Chinese exports. When confidence in the dollar weakened, China inevitably faced the decline in the value of its dollar holdings in foreign exchange reserves. Nevertheless, China could not sell its US Treasury securities on international financial markets as this action would further reduce the value of US securities in its foreign exchange reserves. In order to sustain Chinese continuous economic growth, China depends on US consumer demand. Therefore, the only feasible option for Beijing was to help the United States recover from the financial crisis. If the RMB were adopted as an alternative global currency, China would have no need to support the US in this manner. Such an awkward situation would be eliminated with internationalization of the RMB.

Politically, internationalization of the RMB would contribute to building a strong foundation of Chinese soft power. China's status as having the world's second largest gross domestic product (GDP) and being the largest creditor country enhanced its national prestige. The country's efforts at peaceful engagement with the international political economy promoted its soft power. Considering China's status as having the world's second largest GDP, China and the United States are being called the Group of Two. Whenever foreign countries use the RMB for their foreign exchange reserves holdings or as a medium of exchange in international transactions, they are reminded of the economic success of China. Nowadays, several scholars[35] predict that China will surpass the United States in GDP within several decades. As the monetary power of the United Kingdom and the United States reflected their respective hegemonies,[36] China expects in the long run to rise as a great economic power based on the status of the RMB. Further, the RMB's influence could extend from neighboring Southeast Asian countries to the overall global economy. In becoming the world's largest economic power, China intends to raise its voice in the international community as well. The internationalization of the RMB would be an ambitious statecraft for China, along with a series of recent modernizations of the People's Liberation Army, such as newly launched aircraft carriers and a space exploration program. In the longer-term perspective, China will move to terminate its dependence on the dollar-dominated international political economic order and may stand up as a possible veto power against US world hegemony.

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34. See Edward Kwon, "Managing a Financial Crisis: A Comparative Political Economic Analysis of the United States and South Korea," *The Journal of East Asian Affairs*, 25-2 (Fall/Winter 2011), pp. 55–84.
35. Melissa Murphy and Wen Jin Yuan, *op. cit*.; Arvind Subramanian and Martin Kessler, *op. cit*., p. 1; Carolyn Cohn, *op. cit*.
36. David M. Andrews, *op. cit*., pp. 7–28.

China's Strategy and Challenge Regarding Internationalization of the RMB

In pursuing internationalization of a currency, a state should fulfill three fundamental preconditions – liquidity, adjustment, and confidence.[37] At this point, China's pursuit of internationalization of the RMB faces a torturous path fulfilling these three requirements. According to the Bank for International Settlements' Triennial Central Bank Survey,[38] the US dollar, the euro, and the yen are the major currencies in the world as measured by turnover volumes during 1998–2013. In the same period, the RMB occupied a mere 2.2 percent of global turnover in 2013 compared to the 87.0 percent occupied by the US dollar. Given the size of the Chinese economy and trade sector, the volume of RMB turnover is too small to perform as a global currency. The primary reason for the lower level of international transactions of the RMB is the Chinese authority's strict financial repression and capital control of its underdeveloped financial market. Despite the country's status as having the world's second largest GDP, the RMB cannot be used for international invoicing currency of trade and for cross-border portfolio transactions. The adjustment function turns on the ability to maintain a stable macroeconomic policy in the face of possible balance of payments disequilibrium. A state typically uses regulation of exchange rates, contraction or stimulation of domestic economic activities, and introducing direct controls over cross-border transactions as a way of managing adjustment problems. However, a state exploiting the adjustment function as a means of only maintaining macroeconomic stability or boosting continuous economic growth may lead to a loss of confidence in its status as a global reserve currency. Chinese practice, dependent on its export-oriented economic growth through an artificial devaluation of the RMB without consideration of other countries, may find it difficult to fulfill the requirement for the global adjustment function. Other serious concerns would arise from the fact that the degree of confidence depends on how many foreign countries and investors intend to utilize the currency. In other words, to become a global currency, full and free convertibility of the RMB would have to be guaranteed under continuing stable macroeconomic conditions. The Chinese authority intends to transform its traditional regulating role as an efficient capital mobilizer to boost its export-led manufacturing sector into a follower of free market principles through internationalization of the RMB.

In addition to the requirements of liquidity, adjustment, and confidence, several scholars[39] recommend that internationalization of currency should be based on full

37. Benjamin J. Cohen, *Organizing the World's Money*, *op. cit.*, p. 28.
38. BIS, Triennial Central Bank Survey: Foreign Exchange Turnover in April 2013: Preliminary Global Results (Basel, Switzerland: September 2013), p. 10.
39. See Peter B. Kenen, "Currency Internationalization: An Overview," in *Currency Internationalisation: Lessons from the Global Financial Crisis and Prospects for the Future in Asia and the Pacific*, BIS Paper, 61 (January 2012), pp. 11–12; Haihong Gao and Yongding Yu, "Internationalisation of the

achievement of capital account liberalization. However, the current state of China's financial liberalization has been far below average compared to the OECD countries.[40] The Chinese authority's primary focus in financial liberalization is on how its current outmoded financial markets could efficiently allocate and provide adequate financial capital to various SOEs in order to continue economic growth and exports. Based on lessons learned from observing the Asian financial crisis, the Chinese authority perceived that haphazard financial liberalization poses a high risk of speculative attacks from outside. The global financial crisis and failure of the US economy alerted China to the potential of severe problems associated with capital account liberalization and neoliberal-oriented market reforms in the United States and western European countries.

Under these circumstances, the Chinese authority, conscious of the experiences of developed countries that have accomplished the internationalization of currency through full convertibility with comprehensive capital account liberalization, adopted different ways of internationalization of the RMB. At the initial stage, the Chinese authority is pursuing a two-track strategy: a global and a regional strategy without full convertibility of the RMB.[41] In a global strategy, Chinese policymakers have employed various ways to increase the circulation of the RMB in international financial markets. As the dollar declines in the wake of the subprime mortgage and global financial crises, China is taking aggressive measures (settlement currency of international trade and currency swaps) to reduce the RMB's exchange rate appreciation against the dollar and encourage use of the RMB as payment for exports and imports. In 2008, the Chinese authority launched a pilot program of RMB settlement in trade between Guandong Province and the Yangtze River Delta with Hong Kong and Macao. In 2010, the regions were extended to 20 provinces and major cities, such as Shanghai, Guangzhou, Shenzhen, Zhuhai and Dongguan in Mainland China. In addition, the Chinese authority introduced a measure accepting the RMB for trade settlement with neighboring countries, including Russia, Mongolia, Vietnam, Cambodia, and Nepal.[42]

Renminbi," BIS Paper, 61 (January 2012), pp. 112–113; Nicholas Lardy and Patrick Douglass, "Capital Account Liberalization and the Role of the Renminbi," Working Paper Series, WP11–6 (Washington, D.C.: Peterson Institute for International Economics, February 2011); Jeff Chelsky, "Capital Account Liberalization: Does Advanced Economy Experience Provide Lessons for China?" *The World Bank Economic Premise*, 74 (February 2012), pp. 1–4; Wendy Dobson and Paul R. Masson, "Will the Renminbi Become a World Currency?" *China Economic Review*, 20 (2009), p. 133.

40. Haihong Gao and Yongding Yu, *Ibid*., pp. 119–120.

41. See Yung Chul Park, "RMB Internationalization and Its Implications for Financial and Monetary Cooperation in East Asia," *China & World Economy*, 18-2 (2010), p. 8; Paola Subacchi, *op. cit*., pp. 3–4.

42. Xinzhen Lan, "Yaun Goes Global," *Beijing Review* (19 April 2009), at <http://www.bjreview.com.cn/business/txt/2009-04/17/content_191668.htm> (searched date: 2 January 2013); Friedrich Wu, Rongfang Pan and Di Wang, "Renminbi's Potential to Become a Global Currency," *China & World Economy*, 18-1 (January–February 2010), p. 72.

The PBOC also has arranged various bilateral currency swaps with foreign countries to enhance RMB usage in the global and regional financial markets and to promote financial stability in the event of a currency crisis. The total value of the deals is more than RMB 3.5 trillion (See Table 1). Through the currency swap deals, China and signatory countries diversify their foreign exchange rate reserves, further reducing risk from fluctuation in the value of the US dollar. As the total amount of the RMB currency in international financial markets increases, the RMB could play an important role in providing global liquidity.

The Chinese authority pushed ahead with internationalization of the RMB by contributing financially to regional cooperation in an effort to prevent a future financial crisis befalling its neighbors. East Asian countries that suffered a financial

Table 1. *The People's Bank of China's Bilateral Currency Swap Agreements*

Agreement date	Extension date	Counter party	Value (RMB bn)	Maturity
12 December 2008	October 2011	Republic of Korea	180.0; 360.0	3 years
20 January 2009	November 2011	Hong Kong	200.0; 400.0	3 years
8 February 2009	February 2012	Malaysia	80.0; 180.0	3 years
11 March 2009	–	Belarus	20.0	3 years
23 March 2009	–	Indonesia	100.0	3 years
2 April 2009	–	Argentina	70.0	3 years
6 June 2010	–	Iceland	3.5	3 years
23 July 22010	March 2013	Singapore	150.0; 300.0	3 years
18 April 2011	–	New Zealand	25.0	3 years
19 April 2011	–	Uzbekistan	0.7	3 years
6 May 2011	March 2012	Mongolia	5.0; 10.0	3 years
13 June 2011	–	Kazakhstan	7.0	3 years
23 June 2011	–	Russian Federation	150.0	3 years
22 December 2011	–	Thailand	70.0	3 years
23 December 2011	–	Pakistan	10.0	3 years
17 January 2012	–	United Arab Emirates	35.0	3 years
21 February 2012	–	Turkey	10.0	3 years
22 March 2012	–	Australia	200.0	3 years
26 June 2012	–	Ukraine	15.0	3 years
7 March 2013	–	Singapore	300.0	3 years
26 March 2013	–	Brazil	190.0	3 years
22 June 2013	–	The United Kingdom	200.0	3 years
9 September 2013	–	Hungary	10.0	3 years
11 September 2013	–	Iceland	3.5	3 years
12 September 2013	–	Albania	2.0	3 years
1 October 2013	–	Indonesia	100.0	3 years
8 October 2013	–	European Union	350.0	3 years
21 July 2014	–	Swiss	150.0	3 years
16 September 2014	–	Sri Lanka	10.0	3 years
3 November 2014	–	Qatar	35.0	3 years
8 November 2014	–	Canada	200.0	3 years

Source: The People's Bank of China, *Annual Report 2007–2013*, at <http://www.pbc.gov.cn/publish/english/> (searched date: 27 December 2014).

crisis during 1997–1998 had a hard time soliciting financial support and dealing with harsh conditions brought on by the structural adjustment program of the International Monetary Fund. Recalling this painful experience, the affected countries devised a countermeasure to bolster regional financial cooperation under the leadership of China, Japan, and South Korea. In 2001, financial ministers of the ASEAN plus three (China, Japan, and South Korea) agreed to establish bilateral currency swap arrangements (the Chiang Mai Initiative Multilateralization [CMIM]) in order to provide alternative short-term liquidity assistance for the members. Following the CMIM, China contributed 32 percent ($38.4bn) of the total amount of $120bn.[43] In May 2011, the members of the ASEAN plus three agreed to double the size of the reserves pool up to $240bn and China is expected to provide more funding resources.[44]

As a regional strategy for internationalization of the RMB, the Chinese authority made use of Hong Kong's offshore financial market. As a special administrative region of China, Hong Kong has its own currency, the Hong Kong dollar, which has no strict capital control by the Chinese authority. On 19 November 2003, in an agreement to increase RMB transaction between Mainland China and Hong Kong, both the PBOC and the Hong Kong Monetary Authority signed a cooperation memorandum to conduct RMB business in Hong Kong.[45] In accord with the agreement, the China Development Bank issued the first "Dim Sum" bond in July 2007. From 2007 to 2012, a total of RMB 401.5bn Dim Sum bonds were issued (see Table 2). China and Hong Kong signed another memorandum allowing various RMB trading activities, such as spot and forward RMB trading in July 2011.[46] China's massive provision of the RMB to Hong Kong financial markets through Dim Sum bonds or various RMB-denominated securities leads to higher demand for the RMB, easing the problem of restricted convertibility.[47] In 2011, RMB trade settlement through Hong Kong reached RMB 1,915bn, and the Dim Sum bond issuance in Hong Kong amounted to RMB 108bn.[48] In 2013, Hong Kong stood as the premier offshore RMB business center and Hong Kong has broken records in RMB business. For example, banks in Hong Kong's RMB trade

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43. See John D. Ciorciri, "Chiang Mai Initiative Multilateralization," *Asian Survey*, 51-5 (September/October 2011), pp. 926–952.
44. Shamim Adam and Andy Sharp, "Asia Doubles Reserve Pool to $240 Billion to Shield Region," *Bloomberg* (3 May 2012), at <http://www.bloomberg.com/news/2012-05-03/asia-set-to-double-reserve-pool-as-region-steps-up-cooperation.html> (searched date: 2 March 2013).
45. "Mainland, HK Sign Memo on RMB Business," *The People's Daily* (20 November 2003), at <http://english.peopledaily.com.cn/200311/20/eng20031120_128609.shtml> (searched date: 2 January 2013).
46. Oswald Chen, "PBoC, HKMA Ink Pacts to Boost RMB Biz," *China Daily* (20 July 2010), at <http://www.chinadaily.com.cn/hkedition/2010-07/20/content_11021380.htm> (searched date: 2 January 2013).
47. Xiaoli Chen and Yin-Wong Cheung, "Renminbi Going Global," *China & World Economy*, 19-2 (March–April 2011), pp. 6–9.
48. Hong Kong Monetary Authority, *Annual Report 2011* (Hong Kong: HKMA, 2012), p. 7 and p. 84.

***Table 2.** Dim Sum Bonds Issued by Year (2007–2012)*

Year	No. of issues	Total amount issued (RMB bn)	Average rates
2007	5	10.00	3.15
2008	5	12.00	3.31
2009	8	16.00	3.21
2010	28	35.68	2.58
2011	290	152.01	2.15
2012	461	175.83	3.14
Total	797	401.52	

Source: Quoted from Hung-Gay Fung, Glenn Ko and Jot Yau, *Dim Sum Bonds: The Offshore Reminbi (RMB)-Denominated Bonds* (Hobeken, New Jersey: John Wiley & Sons, 2014), p. 22.

settlement increased to RMB 3,841bn in 2013. For the first time, total outstanding RMB customer deposits and certificates of deposit issued by banks in Hong Kong amounted to more than RMB 1 trillion that same year. The outstanding RMB loans in Hong Kong reached RMB 116bn at the end of 2013. Among offshore RMB foreign exchange activities, the turnover of spot and forward transactions amounted to $30bn on a daily average. In addition, the average daily turnover RMB Real Time Gross Settlement System in Hong Kong surpassed RMB 500bn in December 2013.[49] Thus, Hong Kong has become a successful offshore RMB business center and has flourished as the largest RMB liquidity pool for an offshore market of China.

In addition, as supplementary ways for promoting circulation of the RMB in international financial markets, the Chinese authority raises the cap on available investments in the Qualified Foreign Institutional Investor (QFII) and the Qualified Domestic Institutional Investor (QDII). Since China introduced the QFII, which allowed qualified foreign institutional investors to invest in the domestic securities market (A-shares) in 2002, the total quota has increased to $30bn under the permission of the State Council in 2007. As of 9 March 2012, the total approved quota of foreign investment in the QFII had reached $24.55bn. Under the QDII, which in 2006 allowed qualified domestic investors to invest in foreign securities markets, 96 qualified domestic firms had been approved to invest a total of $75.2bn as of 9 March 2012.[50] These two measures contribute to China's capital account liberalization as well as to an increase in RMB circulation in international financial markets.

49. Hong Kong Monetary Authority, *Annual Report 2013* (Hong Kong: HKMA, 2013), p. 6; Hong Kong Monetary Authority, *Hong Kong: The Premier Offshore Renminbi Business Centre* (Hong Kong: HKMA, May 2014), pp. 5–16.
50. State Administration of Foreign Exchange, "Actively Adapting to the New Situation in Opening Up and Orderly Advancing Convertibility under Capital Account" (7 July 2012), at <http://www.safe.gov.cn> (searched date: 12 January 2013).

These recent efforts by the Chinese authority have increased RMB transactions in the Southeast Asian region. As the Shanghai and Hong Kong financial markets rose to major world financial centers, the circulation of RMB currencies in the Southeast Asia region was already surpassing that of the US dollar. This regional success is a good start for internationalization of the RMB. Moreover, if the RMB becomes a global currency, China would almost surely enjoy various privileges, such as premium of seigniorage, easier financing of balance of payments, and enhanced national prestige. China also faces costs associated with internationalization of the RMB, although it is too early to predict such policy challenges.

First, a major challenge that might confront the Chinese authority upon internationalization of the RMB is the loss of monetary policy autonomy.[51] Because of existing repression of financial markets, China could maintain lower interest rates of capital for their SOEs without serious macroeconomic strain. The country also could maintain a relatively lower RMB currency value against the dollar even with a massive accumulation of foreign reserves. If Beijing consistently maintains such a control, foreign investors might not hold onto their investment in the RMB. In order to boost free transaction in the RMB-denominated securities, the Chinese authority should open its financial markets with proper capital account liberalizations. Chinese financial markets therefore would have to estimate the exact macroeconomic conditions of the international economy favorable to ensuring their monetary or financial policy autonomy. In the end, the country's exchange rate system might not be able to withstand foreign investor pressure for appreciation of the Chinese currency.

Second, the Chinese authority must reform the domestic financial market system to conform to global standards. In order to facilitate free cross-border transactions in financial capital, a well-functioning financial market infrastructure must be in place, including advanced computer and communication technologies, a clearinghouse, settlement system, hedging facilities, and credit rating agencies. Chinese policy-makers also inevitably would incur other related administration costs to harmonize its legal and regulatory system, accounting and auditing practices, and its tax system with those of global markets.[52] Redesigning its outmoded financial system and modifying various laws and regulations require more social consensus and careful policy evaluations by the various banking and financial institutions.

Third, China ultimately will not be immune to the Triffin Dilemma.[53] If the RMB becomes a means of trade settlements or financial derivatives in international financial markets, China must provide sufficient RMB liquidity while maintaining continuous stable exchange rates. China has so far enjoyed a surplus in its balance of payments mainly from foreign direct investment inflows and trade surpluses

51. Wendy Dobson and Paul R. Masson, *op. cit*., p. 134.
52. Yung Chul Park, *op. cit*., p. 15.
53. Cheng Li, *op. cit*., p. 92.

from the United States and European countries. The Chinese authority would do well to also prepare a contingency plan for unfavorable macroeconomic conditions. Thus, successful internationalization of the RMB depends on how well Chinese policy-makers recognize possible policy challenges and responds with appropriate measures.

Conclusion

Several scholars have carefully predicted that China will replace the hegemonic status of the United States in the near future. Similarly, some international political economy scholars see internationalization of the RMB as a way to counter US hegemony. However, many Chinese policy-makers are not likely to accept this argument. The intent of Chinese policy-makers is not to replace the top currency status of the United States, but rather to increase Chinese policy autonomy. As Chinese policy-makers fully recognize that continuous access to US trade and financial markets is essential to Beijing's economic growth, they are not likely to aspire to supplanting US hegemony. The Chinese authority's internationalization of the RMB does not purport to challenging US hegemony, but to increasing its own economic policy autonomy. Chinese policy-makers wish to secure a safety net to protect their massive holdings of US Treasury securities in their foreign exchange reserves and to minimize the country's over-reliance on the US economy. Thus, Chinese efforts to internationalize the RMB would be a type of statecraft for increasing policy autonomy under the current dollar-dominated international political economy.

Moving gradually, China has undertaken various strategies to internationalize the RMB, but prospects are not so bright because of Beijing's repression of its financial market. Chinese policy-makers, aware of how the Asian financial crisis affected neighboring countries, thus far have followed a very gradual approach of capital account liberalization. From an external view, Beijing's strict regulations of portfolio investments and cross-border transactions are likely to impose a dispensable administration cost on foreign investors who want to do financial business with China. Although the existing government controls by the PBOC and the SAFE could contribute to the stabilization of financial markets, in the long run these control mechanisms might disturb the free market principle of an invisible equilibrium function of currency transactions in China. The current managed foreign exchange rate system also does not fully reflect correct market conditions of foreign exchange rates, which discourage foreign investors from making massive investments in RMB-denominated securities. Until the Chinese authority installs full convertibility of the RMB with proper guaranties of property rights under a trustworthy legal system, foreigners might be unwilling to hold massive levels of the RMB. Eventually, Chinese policy-makers should learn how advanced countries' financial markets have maintained well-functioning risk diversity mechanisms of hedging instruments toward currency transactions.

The global financial crisis undeniably has led to a decline in the status of the dollar in international financial markets. However, the dollar has not been displaced in international financial markets by either the substantial rise in prominence of the RMB or the euro. Although the RMB has been successfully deployed in Southeast Asian regional financial markets, China still faces competition from the Japanese yen and the Korean won in that region. For the RMB to become a global currency as proposed by Chinese policy-makers, the country requires more comprehensive reforms in its economy and financial system as well as various political reforms. The reason many foreign investors still hold the dollar for their foreign reserves is because of the stability of the US economy and financial system operating under a free market principle, as well as its high ethical standard of democratic rule. If a country's political economy is unstable resulting from intrinsic social or political unrest, that country cannot maintain a stable currency value. Nowadays, many global civil society groups are watchful of how the Chinese authority deals with issues of human rights, excessive income inequalities between social classes as well as between urban and rural areas, rampant political corruption, and territorial disputes with neighboring countries.

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