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# China's Currency Internationalization:

# Domestic Debates and International Destiny

China's growing weight in the global economy has intensified debate on the potential international role of its currency, the renmenbi (RMB). What are the motives behind RMB internationalization? Who are the actors shaping the debate on Chinese monetary policy? How likely is the RMB to replace the U.S. dollar in the current global currency hierarchy? Injoo Sohn, Associate Professor, Department of Politics and Public Administration, University of Hong Kong, addressed these questions in a presentation on "China's Monetary Ambition: Renmenbi Internationalization in Comparative Perspective" at the Sigur Center for Asian Studies on February 26.

## Structural and Domestic Dynamics in China's Currency Internationalization

What is the origin and process of China's move to internationalize its home currency? A realist explanation of China's decision to internationalize the RMB would suggest that powerful states tend to internationalize their currencies to achieve greater freedom of action and to increase political influence. This follows the logic of power maximization in realist thought. However, this explanation fails to explain why great powers choose currency internationalization to achieve policy autonomy, to increase influence, and to defend against global financial crisis when there are many other ways to seek the same goals. Additionally, due to its focus on structural factors, realism cannot account for the domestic politics behind the decision to internationalize currency, including in the instance of China. Thus, in order to understand the direction and timing of RMB internationalization, an examination of the internal dynamics of China is also needed.

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There are two competing schools of thought in China on the issue of currency internationalization. Liberals argue that RMB internationalization would expose China to global practices and standards and lock China into further financial liberalization. Conservatives argue that full-fledged RMB internationalization would eventually put an end to the de facto dollar link, which could cause a significant appreciation against the U.S. dollar and negatively impact Chinese manufacturing and export industries. Job losses in such sectors might generate domestic unrest, undermining the Chinese leadership's grip on power at home. These two camps have support from different constituents in China. Liberals draw support from private business groups and the People's Bank of China (PBOC). Conservatives consist of officials of State-Owned Enterprises (SOEs), the Ministry of Finance (MOF), the National Development and Reform Commissions (NDRC), and the State Asset Supervision and Administration Commission (SASAC).

## Following the Trajectory of RMB Policy Experimentation

The process of RMB policy experimentation began in the first half of the 2000s when the CCP first promoted RMB regionalization as a stepping stone towards RMB internationalization. The argument was that RMB regionalization would enable China to enhance its influence over Southeast Asian countries. Advocates of RMB regionalization (namely, the PBOC) framed policy proposals in ways that would be more acceptable to skeptics who prioritized national security --or power-- over economic liberalization, arguing that RMB internationalization would increase China's power and influence. In the early 2000s, the RMB was primarily used in trade near border areas with countries such as Cambodia, Mongolia, Russia, and Vietnam. In 2004, China turned to Hong Kong as a laboratory for offshore RMB transactions with an arrangement that allowed the city to develop an offshore RMB deposit market.

The result of the regional experimentation was largely successful. The offshore RMB transactions via Hong Kong contributed to the wider use of the RMB while allowing the RMB to maintain relatively stable parity with dominant international reserve currencies such as the U.S. dollar. As advocates of RMB internationalization (notably the PBOC) were perceived to be responsible for policy success, they were able to exert even more influence within Chinese policy circles and have been continuously encouraged to offer more detailed action plans to Chinese leaders since the mid-2000s. A key turning point emerged in 2006 with the publication of a report on "The Timing, Path, and Strategies of RMB Internationalization" by a study group set up by the PBOC. Following the report, the Chinese governmental view has moved further in favor of RMB internationalization. The 2008 global financial crisis fortified and strengthened this view.

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The 2008 global financial crisis opened more policy space for the idea of RMB internationalization. As the financial crisis resulted in a weakened dollar and trade financing instability, Beijing moved decisively toward further RMB internationalization as a means of reducing dependence on the dollar in terms of foreign reserve and trade settlement. In April 2009, Beijing approved a pilot scheme for cross-border trade settlement using the RMB. The initial scheme included Shanghai, Hong Kong, and four cities in Guangdong Province. In June 2010, program eligibility was expanded to include 20 of the 31 mainland Chinese provinces.

RMB internationalization continues to follow an experiment-based model, wherein the CCP first applies a new policy to a small number of selected sites, and then spreads these local experiences to larger areas. The successes and failures of policy correspond with the rise and fall of political coalitions behind the policy; for this reason, the positive results of the limited scope of RMB internationalization thus far have expanded the voice of pro-RMB internationalization actors in a positive feedback loop. The usage of the RMB in trade and bilateral swap arrangements during the global financial crisis helped China strengthen its relationships with targeted countries and improved its image as a "responsible great power," while addressing realists' concerns regarding financial stability, capital controls, slow economic adjustments, and national security.

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## The RMB's International Destiny

Given the continued internationalization of the RMB, does the RMB have the potential of achieving the status of a hegemon, eventually replacing the dollar in the global currency hierarchy? In 1998, prior to RMB internationalization, the Chinese yuan occupied a 0% share of average daily currency trading, ranking 30th in the world. Following RMB internationalization, this ranking in 2013 increased to 9th in the world following the Mexican peso, but only occupied 2.2% shares of average daily currency trading compared the United States' 87% share. Sohn argues that the factors contributing to the slow pace of RMB internationalization include: China's lack of hegemonic power, weak non-state actors, normative fragmentation, different comparative advantages, and the absence of security alliances.[1] These structural variables may conspire to undermine the greater international use of the RMB, despite growing policy advocacy by pro-RMB internationalization liberals. Ultimately, examination of the RMB's path towards internationalization shows that consideration of both structural factors and domestic politics are needed to understand the RMB's international destiny.

*By Winnie Nham, Research Manager, Rising Powers Initiative, Sigur Center for Asian Studies*

1. For further discussion of these variables, see Injoo Sohn, "Five political challenges in China's monetary ambition," March 2015, http://www.brookings.edu/research/opinions/2015/03/09-china-monetary-ambition-sohn

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