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China's Monetary Power: A Case Study of the Chinese Method of Currency Internationalization*

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The article aims to analyse the monetary power of the PRC in terms of *influence* and *autonomy* in international relations. The object of the analysis is the internationalization of the yuan. The article attempts to answer the following questions: do the Chinese authorities keep a consistent policy of liberalization in order to increase the internationalization of the RMB? And if so, did they abandon their policy in the years 2015–2016? The author also analyses how the Chinese authorities are trying to reconcile the internationalization of the currency with maintaining control over capital account, the financial markets and the exchange rate, which is defined in the article as 'the Chinese method of currency internationalization'.

Keywords: monetary power, power-as-autonomy, power-as-influence, PRC, Chinese method of currency internationalization.

Introduction

For many years, economists and political scientists have been researching the subject of monetary power in international relations.[1] The consensus is that the internationalization of the currency is an important aspect of monetary power because it creates many potential benefits for a given country (or for a group of countries linked by a monetary union). The benefits include an increased possibility of incurring public debt and shifting the cost of possible macroeconomic adjustments to external actors. One should also consider the commercial and investment-related benefits of lowering transaction costs for domestic enterprises, and the benefits of promoting the products and services offered

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[1] Cf. J. Kirshner, *Currency and Coercion: The Political Economy of International Monetary Power*, Princeton: Princeton University Press, 1995; D. Andrews (ed.), *International Monetary Power*, Ithaca: Cornell University Press, 2006; T.G. Grosse, 'Monetary Power in Transatlantic Relations. Study of the relationship between economic policy and geopolitics in the European Union', *Natolin Papers*, No. 35, Warsaw: Natolin European Centre, 2009.

by the domestic economy. According to Albert Hirschman, smaller states that have to rely on foreign currency in their trade exchange are automatically at a disadvantage in economic and political relations with countries that have international currencies.[2] The access of smaller states to foreign currency – for example during an international financial crisis – can become an instrument of exerting geopolitical pressure.

The authorities of the People's Republic of China (PRC) are well aware of all these benefits and therefore they seek to gradually internationalize the Chinese currency. They know, for example, that all hegemonic global (and even regional) powers in history had currencies that were used in international trade.[3] However, the Chinese decision-makers are also aware of the potential costs and risks involved, and for this reason the internationalization of the yuan (renminbi, RMB) is being implemented gradually and under strict control of the state authorities.

The literature on the subject of international currency distinguishes two types of monetary power.[4] The first one is the ability to exert political *influence* on external actors, for example to maximize the economic or geopolitical benefits of a given country that is in possession of such a currency. The second one is the possibility of increasing the country's *autonomy* in international relations. By analysing the process of internationalization of the yuan, I will endeavour to answer the question whether China's power in these two spheres is indeed increasing. Does the monetary policy of promoting the RMB in foreign relations increase the power of China in the regional and global arena, and does it lead to the weakening of other powers, primarily that of the United States, whose currency is currently globally dominant? The latter question is all the more compelling because the two superpowers, although linked by strong economic connections, are definitely rivals rather than allies in geopolitical terms.

The juxtaposition between the desire to promote exports and maintain state control over the flow of capital in order to stabilize economic conditions on the one hand and the push towards liberalization of capital account and domestic financial markets in order to increase the internationalization of the yuan on the other hand is often described and analysed in literature.[5] Researchers try to ascertain whether the Chinese authorities pursue a consistent liberalization policy in order to increase the internationalization of the RMB or whether there is proof of a U-turn: whether in the recent period they have

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[2] A. Hirschman, *National Power and the Structure of Foreign Trade*, Berkeley: University of California Press, 1980.

[3] On this subject: Y. Jiang, 'The limits of China's monetary diplomacy', in E. Helleiner, J. Kirshner (eds), *The Great Wall of Money. Power and Politics in China's International Monetary Relations*, Ithaca: Cornell University Press, 2014, pp. 156–183 [177–178].

[4] B. Cohen, 'The international monetary system: Diffusion and ambiguity', *International Affairs*, 2008, No. 84 (3), pp. 453–470.

[5] Cf. R. McKinnon, G. Schnabl, 'China's exchange rate and financial repression: The conflicted emergence of the RMB as an international currency', *China & World Economy*, 2014, Vol. 22, No. 3, pp. 1–35; T.G. Grosse, 'Geoekonomia jako paradygmat zarządzania rozwojem – przykład Chin', *Zarządzanie Publiczne*, 2014, No. 2 (24), pp. 15–31.

in fact been consciously abandoning this policy. In my article, I would like to argue that the authorities are in fact trying to reconcile these two approaches and are thus in fact pursuing a uniquely *Chinese method of currency internationalization*. This approach to currency internationalization has precedents in previous decisions of the Chinese authorities, who applied their own unique approach to privatisation, decided to selectively open up to capital investment by overseas institutions, and embraced an approach to globalisation markedly different from the neo-liberal Western market rules. In such scenario of the 'Chinese method', the internationalization of the currency would not require the abolition of capital controls and foregoing the strict supervision of the financial markets and exchange rates.

Within this paradigm, I would also like to consider whether in the years 2015–2016 there occurred a meaningful change in China's exchange rate policy and whether the capital controls have been tightened. Should the recent changes be treated as a withdrawal from the earlier policy of internationalization of the yuan or are they in fact a consequence of its ongoing internationalization? Or finally, are they perhaps linked to the close economic ties with the United States (and the dollar) and thus should be treated as a result of the increase in Chinese investments in global markets? In this case, the change should be interpreted rather as confirmation of the *Chinese method of currency internationalization* than as a departure from the internationalization policy.

RMB internationalization policy: instruments and results

The policy of internationalization of the yuan accelerated in the first decade of the twenty-first century. The new impetus in the policy can be seen as a reaction to the financial crisis that broke out in 2007.[6] One of the most important instruments of the policy are bilateral agreements with foreign central banks, which make it easier to accumulate foreign exchange reserves in RMB and provide liquidity to those countries in the event of difficulties in their financial systems and thus facilitate and stabilize bilateral trade and investment. According to the People's Bank of China (PBC), approximately 50 central banks or other monetary authorities in the world hold currency reserves in yuan.[7] Furthermore, the Chinese central bank has signed contracts to open currency swap lines with 33 national monetary authorities.[8] These are typically three-year (and most often renewable) contracts concerning the RMB exchange for local currency, which can be invoked in the case of problems in local financial systems and which secure bilateral trade and investment.[9] The first of these

[6] Y. Jiang, 'Response and responsibility: China in East Asian financial cooperation', *The Pacific Review*, 2010, Vol. 23, No. 5, pp. 603–623 [617].

[7] *The People's Bank of China. Annual Report 2015*, Beijing 2016, p. 73.

[8] Ibidem, p. 74.

[9] Currency swap is an agreement between two parties to exchange two currencies at a certain exchange rate at a certain time in the future.

contracts was signed in 2008 with the Republic of Korea. The policy of concluding these agreements is mainly directed at other countries in the region, including members of the ASEAN+3[10] and the Shanghai Cooperation Organization, but it also includes other countries who have robust political relations with Beijing, including the BRICS countries.[11] In addition, such agreements were signed with the largest offshore financial centres clearing commercial and investment operations with mainland China, carrying out financial investments in RMB or having other important bilateral financial relations with China. For example, the largest swap lines were opened with two major financial centres outside of mainland China, namely with Hong Kong and Singapore, as well as with two major trading partners, the Republic of Korea and the EU (the agreement was signed with the European Central Bank).[12]

In addition to the above-mentioned agreements, the PRC has signed no less than fourteen bilateral state agreements,[13] aimed at supporting trade in RMB, including in particular making it possible to make payments in that currency for energy and other raw materials used by the Chinese economy. In addition, a large number of these contracts are of political importance as they constitute proof that it is the intention of both states to tighten their mutual cooperation. This is the nature of the agreements signed with all the BRICS countries, for example,[14] which should be interpreted as a sign that the signatories pursue a system of cooperation that would be an alternative to the Western one and that they strive towards building a multi-polar world order.[15]

The aforementioned agreements were complemented by a pilot programme enabling cross-border trade in RMB between mainland China and Hong Kong and Macau. Launched in 2009, it initially had a very limited territorial scope (only five cities in Guangdong province and the Yangtze River Delta were involved). In the following years, it was extended to other Chinese provinces and, in addition to trade, it started to include provisions to pay for services (from 2010) and make direct investments (2011).[16] The programme illustrates the typical behaviour of Chinese public authorities in the sphere of economic policy. It starts typically with the cautious launch of a pilot programme, and if it is successful, the programme is further expanded with regard to both its territorial and substantive scope. In the case of this specific programme,

[10] ASEAN Plus Three is a forum that functions as a coordinator of co-operation between the Association of Southeast Asian Nations and the three East Asia nations of China, Japan, and South Korea (officially the Republic of Korea).

[11] BRICS is the acronym for an association of the five major emerging national economies: Brazil, Russia, India, China and South Africa.

[12] Cf. Y. Jiang, 'The limits of China's monetary diplomacy', op. cit., p. 169.

[13] With Belarus, Brazil, Kazakhstan, Kyrgyzstan, Laos, Mongolia, Myanmar (Burma), Nepal, North Korea, Russia, South Africa, Taiwan and Vietnam.

[14] Cf. G. Chin, 'China's rising monetary power', in E. Helleiner, J. Kirshner (eds), op. cit., pp. 184–212 [203–207]; Y. Jiang, 'The limits of China's monetary diplomacy', op. cit., p. 178.

[15] Cf. J.M. Fiszer (ed.), *Unia Europejska – Chiny. Dziś i w przyszłości*, Warszawa: ISP PAN, 2014.

[16] Q. Xu, F. He, 'Influence of RMB cross-border settlement on the Chinese economy', *China & World Economy*, 2016, Vol. 24, No. 1, pp. 104–122.

its scope was expanded from the settlement of commercial transactions to include services, direct investment and finally more advanced financial services. The actions of the Chinese authorities are also very pragmatic: they are supposed to facilitate trade and investment but also secure other political benefits. For example, in 2011, the PBC launched another pilot programme whose goal was to allow for Chinese outward investments to be denominated in RMB. It was a government programme that encouraged Chinese businesses to invest abroad (the *Go Out policy*).[17]

Gradually, the Chinese authorities have made it possible for external investors to make portfolio investments in RMB. It was crucial therefore to promote offshore financial centres, especially Hong Kong, which accounts for approximately 40 per cent of all foreign transactions denominated in the yuan and also often acts as an intermediary for other offshore financial centres in their relations with mainland China. Other important centres are Singapore (over 20 per cent of transactions) and London (nearly 20 per cent).[18] The main instrument of financial investment are the 'dim sum bonds', issued for the first time in 2007 in Hong Kong by the China Development Bank. The accumulated capital was then invested in securities in mainland China. Although the instrument was dedicated primarily to foreign entities, it was mainly used by Chinese institutional investors.[19] The 2011 agreement between the monetary authorities of China and Hong Kong made it possible to invest in other financial instruments denominated in RMB, including spot[20] and forward[21] contracts. Another form of internationalization of the yuan was the 2011 launch of a programme for qualified foreign institutional investors (RMB QFII), which allowed selected external financial institutions to invest their capital in securities on China's internal market. The programme was organized in a similar way to the dim sum bonds, as the funds collected in Hong Kong were then reinvested in mainland China. The programme was gradually expanded in such a way as to involve more and more foreign entities and to gradually raise the caps on annual investment. A sister programme that was launched some time earlier (in 2006) allowed domestic investors to invest in foreign assets (the so-called QDII programme).[22] One more instrument of the internationalization of the yuan were the pilot programmes that allowed cross-border lending, which were

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[17] D. Shambaugh, *China Goes Global: The Partial Power*, Oxford–New York: Oxford University Press, 2013.

[18] *BIS Quarterly Review. International Banking and Financial Market Developments*, Basel: Bank for International Settlements, December 2016, p. 72.

[19] Q. Xu, F. He, op. cit., p. 111.

[20] Spot transaction is the normal settlement day when the transaction is carried out as soon as practical; in the foreign exchange market spot is normally two banking days forward for the currency pair traded.

[21] In finance, a forward contract or simply a forward is a non-standardized contract between two institutions (for instance banks) to buy or to sell an asset at a specified time at a price agreed upon today, making it a type of derivative instrument. Forward contracts are very similar to futures contracts, except they are not exchange-traded or defined on standardized assets.

[22] Qualified Domestic Institutional Investor (QDII).

initially limited to exchange between several special economic zones in mainland China and Hong Kong (the 2012 programme).

One additional element of the internationalization of the RMB should also be considered, namely, the Chinese cross-border inter-bank payment system (CIPS), launched in 2015. It was originally intended to compete with SWIFT,[23] but in 2016 China signed an agreement with the SWIFT system operator in order to use its standards and its telecommunications network to conduct international transactions under CIPS. This is an example of the gradualist strategy of the Chinese authorities, who are creating their own international payment system based on the ready-made standards and networks of an existing international organization. As the next stage, the Chinese system will surely increase its autonomy and will gradually become independent from the SWIFT data flow. Even so, according to SWIFT sources, the introduction of the CIPS settlement system and the consistent development of financial instruments offered in offshore financial centres is a proof of the gradual internationalization of the yuan.[24] Most cross-border transactions with the use of CIPS belong to the category of trade, although the volume of capital investments is also gradually increasing. According to Chinese reports, financial services transactions accounted for less than 10 per cent of the total volume of cross-border operations in RMB in 2014. The rest were commercial transactions.[25]

The above is a very important aspect of the internationalization of the Chinese currency. The RMB is primarily used for the settlement of trading operations and for foreign direct investments. It is used for portfolio investments only in a relatively small degree. In international trade, the yuan is used mainly in the economic exchange with China's immediate neighbours, primarily in transactions made through the Hong Kong financial centre. According to experts, at this stage the internationalization of the yuan primarily affects the economic exchange in the region. For some South-East Asian countries, the role of the yuan in trade is already bigger than that of the US dollar.[26] The connection of the regional currencies' exchange rates to the RMB is also growing, and the relative role of the US dollar is declining as a result of increasingly strong links between the Chinese economy and other economies in this part of the world.[27]

However, on a global scale, the role of the yuan is still relatively negligible. In 2016, central bank reserves in RMB amounted to only about 2 per cent of all foreign

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[23] Society for Worldwide Interbank Financial Telecommunication.

[24] *RMB Internationalisation Stalls in 2016*, SWIFT, La Hulpe 2017, p. 1.

[25] *RMB Internationalization Report 2015*, Beijing: International Monetary Institute, Renmin University of China, 2015, p. 26.

[26] Cf. C.R. Henning, S.N. Katada, 'Cooperation without institutions. The case of East Asian currency arrangements', in S.M. Pekkanen (ed.), *Asian Designs*, Ithaca–London: Cornell University Press, 2016, pp. 59–74 [65, 71]; E. Kwon, 'China's monetary power: Internationalization of the Renminbi', *Pacific Focus*, 2015, Vol. XXX, No. 1, pp. 78–102 [97].

[27] The currencies of Malaysia, Philippines, Singapore and Thailand are linked to the yuan. Cf. R.C. Henning, 'Choice and coercion in East Asian exchange rate regimes', in B.J. Cohen, E.M.P. Chiu (eds), *Power in a Changing World Economy: Lessons from East Asia*, London: Routledge, 2014, pp. 89–110.

exchange reserves, while those denominated in the US dollar amounted to more than 63 per cent, and those in the euro to more than 20 per cent.[28] According to the Bank for International Settlements, the Chinese currency is eighth in terms of trading volume in the world's currency markets.[29] Although the scale of transactions in the purchase and sale of the yuan systematically increases (the volume of daily transactions made with the use of the RMB almost doubles year-on-year), in April 2016 they still accounted for only 4 per cent of all operations. By comparison, the share of Chinese exports in the global trade was about 14 per cent in 2015 (and additionally, Hong Kong's export share was 3 per cent).[30] The US dollar remains the dominant currency in the Bank for International Settlements, while at the same time, the role of the second most important currency, the euro, is declining steadily. Moreover, other data from the Bank of International Settlements indicate the important role of the exchange pair of the yuan and the US dollar (95 per cent of all transactions).[31] This points to the relatively small international role of the Chinese currency and therefore to the small scale of its exchange with local currencies or other international currencies. Transactions denominated in the yuan represent only less than 30 per cent of all payment operations in the Chinese trade exchange.[32] Less than 20 per cent of Chinese outbound direct investments are made in RMB.[33] Furthermore, international bonds denominated in RMB account for only 0.4 per cent of the global bond market.[34] Even in Hong Kong, the main international financial centre for the RMB, deposits in that currency amount to only about 10 per cent of all foreign currency deposits.[35]

Adding further instruments that enhance the internationalization of the RMB does not mean that the state authorities are withdrawing from careful supervision of the financial markets or are moving towards abolition of capital controls.[36] The presence of the yuan in the global markets is intended primarily to serve the Chinese economy and the domestic enterprises, so by definition it is not intended to be used in symmetrical reciprocal relations with external partners. For example, thanks to a bilateral agreement signed in 2012, RMB trading was introduced in the Japanese foreign exchange market. At the same time, Japanese investors gained very little access to the Chinese bond market when compared to the relative availability of Japanese

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[28] *Currency Composition of Official Foreign Exchange Reserves*, The International Monetary Fund, http://data.imf.org/?sk=E6A5F467-C14B-4AA8-9F6D-5A09EC4E62A4 (accessed on 27.02.2017).

[29] *Triennial Central Bank Survey. Foreign Exchange Turnover in April 2016*, Basel: Bank for International Settlements, September 2016, p. 3.

[30] *World Trade Statistical Review 2016*, Geneva: World Trade Organization, 2017, p. 94.

[31] *BIS Quarterly Review. International Banking and Financial Market Developments*, op. cit., p. 43.

[32] Ibidem, p. 72.

[33] *RMB Internationalization Report 2015*, op. cit., p. 28.

[34] Ibidem, p. 30.

[35] R. McKinnon, G. Schnabl, op. cit., p. 16.

[36] R.N. McCauley, 'Renminbi internationalization and the China's financial development', *Journal of Chinese Economic and Business Studies*, 2013, Vol. 11, No. 2, pp. 101–115; Y. Jiang, 'The limits of China's monetary diplomacy', op. cit., p. 181; E. Kwon, op. cit., p. 93.

securities to Chinese investors (primarily the PRC monetary authorities and related investment funds). Foreign entities are encouraged to trade in RMB, including investing in mainland China, as long as it is conducive to the development of the Chinese economy and to the stabilization of the local financial market.

In addition, it should be noted that the international role of the RMB serves to exert political pressure. For example, London has become the largest financial centre outside of Asia for the RMB, but this position came at a price: the British authorities had to support China's bid to be granted 'market economy' status by the World Trade Organization (WTO) and to recognize the PRC's full sovereignty in Tibet.[37] This was a classic geo-economic manoeuvre on the part of China as an economic instrument (in this case, the internationalization of the yuan) was used to gain geopolitical benefits.[38]

Course correction of Chinese policy

For many years, Chinese authorities were struggling with the appreciation of the yuan, which was driven by China's very high economic growth and the influx of capital into the country, primarily in the form of foreign direct investments. The Chinese currency was also a relatively attractive investment option in the context of the loose monetary policies of the United States and the EU after 2008. The yuan's attractiveness was also underscored by higher interest rates in the PRC and thus by higher returns on equity investments than would not have been possible in highly developed markets. Under such conditions, the policy of the internationalization of the yuan and the gradual liberalization of capital account, which was related to this policy, contributed to additional influx of capital into China and to the strengthening of the yuan exchange rate.[39] This tendency was unfavourable for export activities, which led the Chinese central bank to intervene in order to curb appreciation of the RMB versus the US dollar. The side effect of these operations was the accumulation of huge foreign exchange reserves. In mid-2014, the reserves reached a total of USD 4 trillion. For this reason, state authorities began to actively encourage Chinese investments abroad, and the internationalization of the yuan was also planned to help find a productive use for the huge capital reserves.

The situation began to change in 2014. Most importantly, that year the US monetary authorities ended their quantitative easing policy, implemented in the aftermath of the financial and economic crisis of 2007–2010. This led to the appreciation of the dollar as investors were expecting FED[40] interest rate hikes and acceleration

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[37] Y. Jiang, 'The limits of China's monetary diplomacy', op. cit., p. 181.

[38] Cf. E. Haliżak, 'Geoekonomiczna strategia Chin', in idem (ed.), *Geoekonomia*, Warszawa: Wydawnictwo Naukowe Scholar, pp. 590–619; T.G. Grosse, 'Geoeconomic relations between the EU and China: The lessons from the EU weapon embargo and from Galileo', *Geopolitics*, 2014, Vol. 19, No. 1, pp. 40–65.

[39] Cf. R. McKinnon, G. Schnabl, op. cit.

[40] The Federal Reserve System is the central bank of the United States of America.

of the US economic growth. Naturally, this has adversely affected the exchange rates in the emerging markets, including China, where it led to the devaluation of the yuan. In addition, new forecasts released at that time predicted a slowdown in the pace of growth of the Chinese economy and estimated a slump of returns on investment in this market. That is why the year 2015 witnessed a collapse on the Chinese stock exchanges and considerable capital outflow from China as well as a marked loss of investors' interest in Chinese currency. All these unfavourable trends culminated in the one-off devaluation of the RMB by 2 per cent, effected by the Chinese monetary authorities in August 2015. As could be expected, the intervention only exacerbated the investors' attitudes towards the Chinese currency. While earlier PBC data had showed that the year-on-year volume of foreign equity investment in RMB-denominated assets was steadily increasing, in August 2015 this trend was reversed, and a growing number of foreign investors began to sell such securities.[41] In 2016 there also occurred a significant reduction in payments made in RMB (almost by 30 per cent) using SWIFT, compared to the previous year.[42] Thus the flight of investors from the Chinese currency has contributed to slowing down the process of internationalization of the yuan.

The aforementioned decision of the American FED was of fundamental importance for the change of the investors' moods. Nevertheless, the development of Chinese financial markets and the increasing liberalization of cross-border capital flows also played a part. In times of boom, these factors ensured the influx of capital, but in a situation of turbulence in both global and local financial markets, they caused an outflow of capital from China and a slump in RMB-denominated investments. Another cause of the outflow of capital was the fact that many Chinese enterprises had taken out foreign loans, most often denominated in US dollars, when the conditions for doing so were very favourable as a result of the FED's quantitative easing policy. In 2015 and 2016, the debtors had either to pay off these debts or hedge against further decrease of the yuan exchange rate and thus had to amass dollar reserves in order to repay the loans. Therefore, the PRC monetary authorities tried to intervene in the foreign exchange market in order to limit the devaluation pressure. An excessive and overly fast currency depreciation was detrimental to the stability of the Chinese economy and had especially harmful effects for those companies that had taken out loans abroad. This led to a decrease in foreign exchange reserves, which at the end of 2016 were already at the level of approximately USD 3 trillion.

One other factor in this situation was the government's policy to encourage Chinese outbound investments. In practice, this only increased the outflow of capital, including the depletion of dollar reserves and other currency reserves. An important role in this policy is played by the largest investment fund in the world, namely the China

[41] *The People's Bank of China. Annual Report 2015*, op. cit., p. 168.

[42] It is worth noting that the SWIFT payment in RMB compared to other currencies was relatively low, but it was also down from 2.31 per cent of the value of all transactions in 2015 to 1.68 per cent in 2016. Cf. *RMB Internationalisation Stalls in 2016*, op. cit., p. 1.

Investment Corporation (CIC), founded in 2007, which currently has approximately 650 billion of assets under management.[43] For example, in the year 2016, Chinese investments in the EU reached a record high of more than EUR 35 billion, four times more than the total of comparable European investments in the PRC in the same period. In Germany alone, in 2016 the total sum of investments by Chinese companies and funds amounted to EUR 11 billion. It should also be noted that Chinese companies invested in Europe mostly in sectors that would be inaccessible to foreign investors in China.[44] This illustrates the asymmetrical approach of the PRC to foreign investment and its protective approach to sectors that are considered strategic. In 2016, the Chinese also made record investments in the United States, with the total exceeding USD 45 billion.[45] All in all, the scale of Chinese acquisitions in 2016 exceeded 200 billion dollars globally (in the EU and US alone, they are estimated at over 94 billion dollars). This sum would be bigger by at least USD 75 billion if not for the restrictions imposed by Western governments (mainly in the EU, US and Australia) and the capital account restrictions imposed by the PRC monetary authorities.[46]

On the one hand, internationalization of the currency clearly remains an important goal for Chinese policy-makers and an instrument of China's economic policy. It stabilizes the conditions for trade and increases opportunities for Chinese outward investments. On the other hand, devaluation of the RMB and the outflow of capital in the years 2015–2016 posed a risk to the stable economic growth of the PRC. For this reason, the authorities tightened control of capital account in order to contain the flight of funds and investments denominated in the yuan. Such restrictions were also imposed on Chinese outbound investments. For example, state authorities have tightened control over foreign acquisitions and mergers whose value exceeded USD 10 billion and over transactions of more than USD 1 billion if they were outside the investor's core business or pertained to real estate.[47] The renminbi transfers from Chinese companies abroad were also limited if they exceeded 30 per cent of the shareholder's equity. The State Administration of Foreign Exchange closely monitored foreign transfers (such as dividends), including those of Western corporations operating in China, often delaying such transfers. Such restrictions reduced access to the yuan in offshore financial centres, and they also influenced commercial transactions, especially those carried out on credit and involving asset-backed securities in mainland China.[48] Restrictions have also been placed on banking operations by, for example, stipulating that transfers abroad were only possible if an equivalent (or greater) amount is paid into China from abroad at

[43] Cf. S.M. Pekkanen, K.S. Tsai, 'The external is incidental. Asia's SWFs and the shaping of the Santiago Principles', in S.M. Pekkanen (ed.), op. cit., pp. 75–91.

[44] 'Chinese investment in EU dwarfs flow going other way', *Financial Times*, 11 January 2017, p. 4.

[45] 'China groups pump record amount into US', *Financial Times*, 3 January 2017, p. 4.

[46] 'Foreign transactions worth $75bn scrapped amid Beijing crackdown', *Financial Times*, 6 February 2017, p. 1.

[47] 'China weighs outbound deal curbs to buoy renminbi', *Financial Times*, 30 November 2016, p. 1.

[48] 'China's war on capital flight hits trade', *Financial Times*, 25 January 2017, p. 2.

the same time.[49] Furthermore, restrictions were imposed on extant programmes for Chinese institutional investors interested in foreign equity investments (including QDII.)[50] Restrictions have also affected individual investors, especially in the sphere of acquisition of foreign real estate, securities and insurance programmes.[51] Other miscellaneous restrictions were imposed, for example regarding gold imports.[52] All these actions weakened the internationalization of the RMB.

At the same time, Chinese companies were encouraged to transfer foreign loans to China. Foreign investors were likewise incentivized to increase their exposure to the Chinese capital market. For example, in 2016 the RMB QFII investment caps were increased,[53] and global corporations were allowed to purchase advanced financial products, such as the high-risk asset-backed securities.[54] In this case, the instruments used to internationalize the yuan were employed to increase the inflow of capital into China. This shows very clearly that the Chinese authorities are using a range of different instruments, both to promote the RMB on the regional and global markets and to control the capital account and exchange rate policy. These instruments can be deployed simultaneously, according to the need of the moment, and can be adapted to local conditions and the situation in the global financial markets.

The regional dimension of the PRC's policy

The Asian crisis (1997–1998) was a shock to all economies in East and South-East Asia. It led to a heated debate on the possibility of introducing more institutionalized monetary co-operation in the region. As early as in September 1997, the Japanese Finance Minister proposed the establishment of the Asian Monetary Fund (AMF), modelled on the International Monetary Fund (IMF). It was envisaged to help the economies of the region in time of crisis as well as to support them in times of diminishing liquidity or other dangers in their national financial systems. The proposal met with a hostile reaction of the United States, who argued that Japan was trying to use the crisis for its own benefit, seeing it as a springboard to increase its monetary power. Some American politicians went on record accusing Japan of making a bid for regional hegemony.[55] In view of such reactions in America, the IMF also met the proposal with reluctance. China kept silent about this plan, but in truth it was also unwilling to support it because it feared Japanese domination in monetary affairs. In this way,

[49] 'China closes capital controls loophole by banning net outflows from banks', *Financial Times*, 23 January 2017, p. 1.

[50] 'China halts overseas investment schemes', *Financial Times*, 29 February 2016, p. 3.

[51] 'Chinese investors shrug off forex scrutiny', *Financial Times*, 4 January 2017, p. 4.

[52] 'China limits gold imports and renminbi outflows', *Financial Times*, 1 December 2016, p. 2.

[53] 'Beijing offers renminbi securities sop to US funds', *Financial Times*, 8 June 2016, p. 5.

[54] 'China poised for subprime-type sale of packaged bad loans to global investors', *Financial Times*, 4 March 2016, p. 1.

[55] Y. Jiang, 'Response and responsibility…', op. cit., p. 608.

geo-economic objections and rivalry between the United States, Japan and the People's Republic of China effectively put paid to this proposal.[56]

Another Japanese proposal stipulated the introduction of a regional settlement currency called the Asian Monetary Unit.[57] The idea was first formulated by the Japanese Institute of International Monetary Affairs in 1998 and subsequently re-launched by the Asian Development Bank (an institution dominated by the political influence of Japan and the United States) in 2005. Initially, the idea was to tie regional currencies to a common basket of three currencies: the US dollar, the euro and the Japanese yen. Later, it was modified in such a way as to reflect only the interrelation of regional currencies. The solution was modelled on the example of monetary cooperation in Europe. Its goal was primarily to stabilize the exchange rates in the region, thus counteracting another possible crisis and facilitating trade.

The proposal was summarily blocked by China. Fundamentally, China was against tying the currencies of the region too closely to the dollar and the yen and thus disregarding the Chinese ambitions of the internationalization of the yuan. Additionally, the long-term strategy of the PRC was to undermine the role of the US and Japanese currencies in the region. At that time, the Japanese economy was more powerful than the Chinese, and Japan as a consequence played a much more dominant role in the region than China. Such strong monetary co-operation would probably consolidate Japan's leading role and hamper the PRC's regional ambitions. This was all the more likely as in a second version of the monetary union proposal the weight of the Chinese currency in the basket was clearly lower than that of the yen, which would further favour the Japanese economy. In addition, the stabilization of exchange rates could make it difficult for Chinese authorities to control the RMB exchange rate thus lowering the competitiveness of Chinese exports. For this reason the idea of the common Asian currency was seen by China as a threat to its economic growth as well as to its plans of internationalization of the yuan. In addition, Australia and New Zealand were invited to join the club and co-operate with the ASEAN+3 countries on monetary matters, which was seen in Beijing as a covert introduction into South-East Asian monetary affairs of American allies, who could in the future threaten Chinese interests.[58] After the outbreak of the euro area crisis, the idea of an Asian currency was postponed indefinitely.[59]

At the beginning of the twenty-first century the Chinese strategy was very cautious, favouring bilateral rather than multilateral solutions. As I argued above, China was particularly concerned about the introduction of overly institutionalized

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[56] W.W. Grimes, *Currency and contest in East Asia. The great power politics of financial regionalism*, Ithaca–London: Cornell University Press, 2009, pp. 204–217.

[57] In 1998 this settlement currency was named Asian Currency Unit, in 2005 renamed as the Asian Monetary Unit.

[58] Y. Jiang, 'Response and responsibility…', op. cit., p. 617.

[59] C.R. Henning, S.N. Katada, op. cit., p. 67.

and binding forms of cooperation in the region. Chinese policy-makers saw that the creation of advanced international (or even transnational) institutions at this stage of China's economic development would limit the country's further growth potential, hampering its economic sovereignty and thus threatening its national security. Therefore, in 1998 the Chinese authorities proposed a loose formula of dialogue between finance ministers and the central bankers of the ASEAN+3 grouping. In 2000, the group drafted a proposal for bilateral currency swaps between its members (the so-called Chiang Mai Initiative [CMI]). It was a plan that was energetically championed by the Chinese. The planned initiative was rooted in the desire to protect the signatory countries in case of difficulties in their national financial systems and to support economic exchange in the region. For this reason, it also enjoyed the support of other countries in South-East Asia. Nevertheless, it was much more timid than the earlier Japanese proposals for setting up a regional currency or a currency fund. In fact, this is probably why it met with the IMF's approval. The CMI was perceived as complementary to the activities of the IMF and not as possible competition.[60]

The benefits resulting from this proposal for the PRC were self-evident. They mainly involved improving trade security and financial stability in the region. The fact that it was China who came up with the idea of how to respond meaningfully to the problems of the region and that it was spearheading the initiative also gave the PRC a measure of international prestige. Additionally, the risk of implementation of this proposal to China was negligible. The initiative was on a relatively small scale. It did not demand the creation of transnational institutions and mandatory exchange of financial information, and it offered great flexibility to all the countries involved. In addition, the swap agreements were based on the conditionality applied by the IMF, and thus they guaranteed solvency of the various partners.

Over the years, the Chiang Mai Initiative has been further deepened and developed, which is one more example of the Chinese strategy of gradually expanding the pilot solutions when they fulfil initial expectations. Thanks to the CMI, China has gained more and more influence in the region and in the world and has therefore increasingly played a leading role in regional cooperation. In 2006, the finance ministers of the ASEAN+3 countries agreed to take the CMI formula to a new level by creating joint financial reserves that would provide security to the countries of the region in the event of crisis (CMIM).[61] Initially the reserves amounted to USD 80 billion, and in 2009 they were increased to 120 billion dollars, eventually reaching the present level of 240 billion dollars. Thus, the CMIM became a scheme similar to the Asian Monetary Fund, not only because of the creation of joint stabilization funds but also because of the standards of macroeconomic supervision and conditionality for potential lenders, which were similar to those used in the IMF. However, there were also significant

[60] Y. Jiang, 'Response and responsibility…', op. cit., p. 609.
[61] Chiang Mai Initiative Multilateralization.

differences between the CMIM and the original Japanese proposal of the previous decade. First of all, the financial contributions of China and Japan were comparable, and thus both countries had similar political influence on the functioning of the institution. This was a visible sign of China's growing structural position in the region.

The next stage of China's regional strategy was the establishment of its own international financial institution, which initially had only regional significance but is rapidly advancing to global prominence. In 2015, at the behest of the PRC, the Asian Infrastructure Investment Bank (AIIB) was launched. China is the leading founding member in that institution. The AIIB was modelled on the Asian Development Bank and on the World Bank (WB). The new institution's initial funds amounted to 100 billion dollars for infrastructure investments in Asia and other parts of the world. One of its goals was to help in the implementation of the ambitious 'One Belt, One Road' programme, which, according to Chinese leaders, is expected to cost as much as 1 trillion dollars within the next few years.[62] The founding members of the AIIB are 57 countries, including many EU countries (such as Great Britain, Germany, France, Italy and Poland). Another 25 countries from Europe, Africa and South America are expected to join the initiative.[63] While the AIIB is providing loans in US dollars, there is a high probability of launching a credit line also in the RMB down the road. The Bank could serve geo-economic, commercial and financial PRC's purposes, and in the future also the policy of internationalization of the Chinese currency. The project is thus proof of the systematic growth of China's monetary power, which increasingly transcends regional boundaries. Over time, China tends to move from bilateral actions to increasingly institutionalized and multilateral forms of cooperation. This fact is reflected in the increased economic and political prominence of the PRC in the region and in the world. China's growing role is also visible in geo-economic terms. That is why several countries, such as the United States or Japan, chose not to join the AIIB and why American diplomacy sought to persuade its European allies not to engage in the project.

The global dimension of PRC's policy

The final part of my analysis is the assessment of the global dimension of Chinese actions connected to the internationalization of the yuan. In the global dimension China's policy is gradualist as well, changing in accordance with the needs of the current stage of development of the PRC and flexibly adapting to reflect the international conditions. China is not planning to build an alternative to the existing system, created as a result of the Bretton Woods agreements, where the United States and other Western states had a strong political advantage. Initially, China's aim was to join this

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[62] 'China's $1tn Project raise bank risk fears', *Financial Times*, 26 January 2017, p. 6.

[63] 'Beijing-led bank to gain 25 more members', *Financial Times*, 25 January 2017, p. 5.

system. However, since the global crisis, the PRC's strategy is increasingly focused on reforming it, in order to increase the political influence of China, to support the process of internationalization of the RMB, and to counter the political dominance of the United States and the US dollar in the global economy.[64] The overall aim is to delegitimize the current order as too liberal, crisis-prone and unilaterally beneficial for the United States and to use these criticisms in order to promote the multipolar monetary system. As the next stage, the Chinese authorities are more and more boldly launching their own financial institutions, as it was the case with the AIIB.

An important result of the crisis that started in 2007 was the creation of the G20 summit. The first meeting of G20 leaders took place in Washington in 2008. Since then, the institution has become a prominent forum of debate on financial markets and currency issues, somewhat eclipsing the G8 summits.[65] The main beneficiaries of the new order are the BRICS countries, and in particular China. It is worth noting that the PRC was not interested in entering the G8 as the ninth member of this group, as it considered it to be a grouping still very much dominated by Western powers.[66] For this reason, promoting the prominent role of the G20 in global economic affairs can be seen as a success of China's strategy.

In 2009, the head of the PBC proposed a reform of the global system of foreign exchange reserves.[67] He suggested moving away from the domination of the dollar ('the new system should not be linked to the currency of a single country'), towards the international currency basket using the IMF's settlement unit, the so-called special drawing rights (SDR). The goal of the PRC was to include the RMB in the currency basket, which would be a great step towards internationalization of the currency. Significant new SDR emissions were also proposed. The Chinese proposal won great acclaim among the BRICS countries, which offered 10 billion dollars each for the SDR, supplementing China's proposed contribution of 50 billion dollars.[68] All these ideas met with reluctance of the United States, which demanded in return conditions that China would not be able to meet: the monetary authorities of the PRC were supposed to ensure the full convertibility of the RMB, the liberalization of capital account, and the political independence of its central bank. However, the United States finally relented and agreed on a new SDR emission (in 2009) and allowed for the RMB to be included in the IMF international currency basket (in 2016). The yuan has much lower weight in the basket than the dollar and the euro (RMB: 10.9 per cent, USD

[64] E. Helleiner, J. Kirshner, 'The politics of China's international monetary relations', in E. Helleiner, J. Kirshner (eds), op. cit., pp. 1–22; B.J. Cohen, 'The China question. Can its rise be accommodated?', in E. Helleiner, J. Kirshner (eds), op. cit., pp. 23–44.

[65] T.G. Grosse, 'G20 jako barometr słabnięcia Zachodu', *Rzeczy Wspólne*, 2013, No. 11 (1), pp. 156–163.

[66] R. Xiao, 'A reform-minded status quo power? China, the G20, and reform of the international financial system', *Third World Quarterly*, Vol. 36, No. 11, pp. 2023–2043.

[67] Zhou Xiaochuan, *Reform the International Monetary System*, Governor of the People's Bank of China, 23 March 2009, http://www.bis.org (accessed on 27.02.2017).

[68] G. Chin, op. cit., pp. 194–195, 199–202.

41.7 per cent, EUR 30.9 per cent), but its weight is still higher than that of the remaining two currencies, namely the Japanese yen and the British pound. Within the IMF, the yuan has become the third-largest settlement currency, which in itself is a great success of the Chinese diplomacy. What is more, China made this great step towards the internationalization of the RMB without giving way to the demands to relinquish the control of capital flows and to forego control over the exchange rate. The American concessions were due primarily to the IMF's financial needs during the eurozone crisis, when it needed considerable funds in order to save Greece (nearly USD 40 billion of IMF loans paid out to Greece by the end of 2015).[69]

It should be added that during the crisis, China also sought to diversify its own foreign exchange reserves. By doing so, they wanted to reduce the susceptibility of their economy to the situation in the United States and thereby increase the country's autonomy in monetary relations. Dollar deposits accounted for only about 30 per cent of all PBC reserves in 2013, while a mere ten years earlier, they exceeded 63 per cent.[70] The drive towards diversification meant moving towards other international currencies, including the yen and the euro. This situation again showed clearly the geo-economic aspect of China's activities. During the euro area crisis, the Chinese authorities made a series of investments in debt securities of crisis-stricken countries. In return, the Chinese voiced various political demands and expected them to be met. These included granting China market economy status in the WTO, the abolition of the EU arms embargo, and support for China's bid for increased political influence in the IMF and the WB.[71]

As a consequence, thanks to support from the EU countries, China's role in both institutions has in fact increased. In 2010 it was agreed to change the voting system in the IMF and the WB in such a way as to significantly increase the power of the PRC. China has effectively become the third largest stakeholder in these institutions (after the US and Japan). The Chinese also took key positions in the management of both organizations. The price for this was increased contribution of Chinese funds, but it was clearly money well spent as it led to a significant increase in the international standing of China and of its currency. Americans were for a time very reluctant to accept the changed situation, and for several years they refused to ratify the IMF reform (it finally came into effect only in 2016, when it achieved the approval of the US Congress).

Conclusions

The Chinese authorities are pursuing the policy of internationalization of the yuan without relinquishing control over capital flows, financial markets, and foreign currency

[69] 'Congress ends foot-dragging on IMF reform', *Financial Times*, 21 December 2015, p. 4.
[70] E. Kwon, op. cit., pp. 89–90.
[71] Y. Jiang, 'The limits of China's monetary diplomacy', op. cit., pp. 166–187.

exchange. Thus they eschew the neo-liberal doctrine of promoting the country's currency in international relations, which stipulates the need to open up the capital account, ensure full convertibility of the currency and liberalization of financial markets, and also recommends the independence of the central bank as well as maintaining a flexible exchange rate.[72] However, Chinese policy-makers rely on their own unique approach, which I would like to call 'the Chinese method of currency internationalization'. The Chinese approach is rooted in the care for the security and stability of the financial markets and the desire to control all the instruments necessary for the development of the Chinese economy. In spite of this, and regardless of the tightening of control over financial flows in the years 2015–2016, the progress of internationalization of the RMB is visible. This is evidenced by, for example, the growing prominence of this currency in economic settlements and in central banks reserves in the region, the inclusion of the yuan in the prestigious IMF currency basket, as well as in the establishment of the AIIB, an investment instrument which could potentially trade in RMB. All the above clearly show an increase of Beijing's monetary power.

In the article, I have analysed the issue of monetary power with regard to the categories of *autonomy* and *influence*. The above analysis shows that China's autonomy in relations with external actors is growing. An example of China's strong stance is its resistance against the pressures exerted by the United States and the IMF, which tried to force China to devalue the RMB (before 2015), to open up its capital account and to create other neo-liberal financial institutions. The autonomy of the People's Republic of China is not complete, as evidenced by its susceptibility to the situation in the global financial markets and primarily to the effects of the decisions made by the US monetary authorities. Still, the political influence of the PRC is growing, both in the region and in the world. One example of this is its growing influence on the policies of the EU countries and the increase of power within the IMF and the WB. However, also in this dimension, China's power has its limitations, as can be seen from the fact that its impact on US policy is very moderate, despite the fact that the PRC is America's main creditor. An example of China's limited impact on the United States are the Chinese diplomacy's unsuccessful efforts to increase the IMF's macroeconomic oversight over America's monetary policy.[73]

The PRC's strategy for the RMB is gradualist and adapted to the current economic and international situation. It is also pragmatic, focusing on specific commercial and investment-related benefits. In its very concept it is also asymmetric, as China strives to maximize its benefits in comparison with those of its largest international rivals. China often resorts to pilot programmes in order to test specific solutions on a small scale, and if they are successful, to develop and expand them. China's policy uses a range

[72] J. Kirshner, 'Regional hegemony and an emerging RMB zone', in E. Helleiner, J. Kirshner (eds), op. cit., pp. 213–240.

[73] Cf. A. Walter, 'China's engagement with international macroeconomic policy surveillance', in E. Helleiner, J. Kirshner (eds), op. cit., pp. 127–155.

of different instruments. The internationalization of the RMB is just one of many tools of economic policy and – to put it more broadly – of China's geo-economic strategy. The central goal is simply the economic growth of China and thus also the growth of its geopolitical power.

China's strategy is dual in nature, with both a regional and a global dimension. Initially, it focused primarily on bilateral solutions, including attempts to establish relations with states sometimes referred to as peripheral, which were not the focus of interest of great powers. Subsequently, the strategy changed and began increasingly to rely on entering existing financial institutions and organizations and trying to gradually change their rationale in order to obtain benefits and to block or limit the power of the biggest regional or global rivals (whereas Japan would be an example of the former, and the US – of the latter.) The next stage in China's strategy is building its own institutions that can increase the PRC's monetary power in East and South-East Asia and in the world. It seems that whereas China is committed to maximizing its *influence* and monetary *autonomy*, its elites are not yet ready to assume full responsibility for the stable functioning of the system on either the regional or the global scale. Such responsibility would have to involve the willingness to support the financial liquidity of countries in crisis or to provide capital to an institution acting as the lender of last resort. Such political ambitions are currently beyond China's capabilities, and thus at this stage they do not constitute a goal of the Chinese decision-makers.