

# *New Ideas for RMB Internationalization under the Belt and Road Initiative*

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**Abstract:** President Xi Jinping put forward that, “China will further push the open economy to a higher level by enlarging its scale, expanding its area, and deepening its degree.” This proposal provides new perspectives for RMB internationalization. The new path of RMB internationalization shall be achieved under the Belt and Road Initiative and be a new option that is different from the “Three-Stage Theory” and regional monetary cooperation. RMB internationalization can only be realized through a government-driven mode with Chinese characteristics which shows the fundamental difference from the internationalization of other currencies such as the US Dollar, Euro and Japanese Yen. The Chinese government can realize the strategic objective of RMB internationalization through improving national governance, applying policies and tools for macroeconomic regulation, and implementing the Belt and Road Initiative, as well as the operation of its financial industry, the Silk Road Fund (SRF), and that of regional banks like the Asian Infrastructure Investment Bank (AIIB) and the BRICS New Development Bank (NDB). RMB internationalization is an important objective of China’s political and economic development. Efforts must be made to steadily promote market-oriented reform of the RMB exchange rate and its forming mechanism, and reform of capital account convertibility so that RMB can become the leading global reserve currency. Meanwhile, China will also undertake more responsibilities as a major power for stable development of the international economy and finance.

**Keywords:** Belt and Road Initiative; RMB internationalization; government-driven mode; the world currency

## 1. What are the ideas for RMB internationalization in the new era?

It is clearly stated in the report to the 19th National Congress of the Communist Party of China (CPC) that, “With decades of hard work, socialism with

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Chinese characteristics has crossed the threshold into a new era. This is a new historic juncture in China's development." With the arrival of new era, many issues need to be reconsidered. With rapid advancement in China's reform and opening up since the 1980s, in-depth discussions and research have been carried out on RMB internationalization in academia, covering its concept and connotation, influence and significance, earnings and costs, conditions and constraints, and path and design. Meanwhile, fruitful achievements have been yielded in the practice of RMB internationalization. These theoretic studies and reform practices have laid a solid foundation for the summarization of practice and theories and more in-depth research for further promoting RMB internationalization, playing a significant role in advancing RMB internationalization in the new era.

Karl Marx pointed out that, "The development of commerce and merchant's capital gives rise everywhere to the tendency towards production of exchange-values, increases its volume, multiplies it, makes it cosmopolitan, and develops money into world currency."<sup>①</sup> In a nutshell, a world currency is the currency that can play the role of a universal equivalent in the world market. Kindleberger held the opinion that the term "common currency" emerged quite early and it may have first been proposed by Signor Bernardo Davanzati who delivered a speech titled "A Discourse upon Coins" at Florence Academy.<sup>②</sup> Davanzati stressed that even "if the Prince makes Money of Iron, Lead, Wood, Cork, Leather, Paper, Salt, or the like, it will not be received out of his Dominions, as not being coined of the Matter generally agreed upon. It could not then be world currency."

Since the 18th CPC National Congress, some new requirements have been specified on RMB internationalization in relevant documents. It is mentioned in the 13th Five-Year Plan, "We will take systematic steps to realize RMB capital account convertibility, making the RMB more convertible and freely usable, so as to steadily promote RMB internationalization and RMB capital go global." President Xi Jinping pointed out at the fifth National Conference on Financial Work, "We shall expand the opening up of the financial industry, deepen the reform of the RMB exchange rate forming mechanism, steadily promote RMB internationalization and realize convertibility under capital accounts in due course." For all these requirements, it is essential to answer this question, "What are the ideas for promoting RMB internationalization in the new era?" This paper aims to examine this question based on the proposal of the Belt and Road Initiative and Xi Jinping Thought on Socialist Economy with Chinese Characteristics for a New Era.

## 2. Xi Jinping Thought on Socialist Economy and the Belt and Road development theory

Socialist political economy with Chinese characteristics is an important integral part of the theoretical system of socialism with Chinese characteristics. President Xi Jinping stressed the necessity of "integrating the great endeavors of building socialism with Chinese characteristics and speeding up the development of philosophy and social sciences with Chinese characteristics."<sup>③</sup> He put forward the theory for socialist political

① Marx, 2004, p. 370.

② Kindleberger, 1991

③ Xi, 2016

economy with Chinese characteristics based on China's reform and opening up over the past four decades, internationally advanced experience, theories of Marxist political economics as well as the experience and wisdom of thousands of years of a brilliant Chinese culture. His proposal of the Belt and Road Initiative plays a fundamental guiding role in steadily promoting RMB internationalization, deepening reform of the system and mechanisms of the financial industry,<sup>①</sup> building new China-US relationships, advancing new concepts of economic globalization, resolving past problems accumulated during economic development, and achieving sound development for the transition and upgrading of China's economy.

### **2.1 The concept of “a community with a shared future for mankind” is highly praised around the world**

The concept, goal, principle and practice of the Belt and Road Initiative are highly in line with the basic development direction of global economic integration. Financial connectivity is a part of the “five connectivity” under the Belt and Road Initiative. China is making great efforts to build a financially connectivity system for globalization, network connection and systematization, and promote the implementation of RMB internationalization. First, in terms of global integration, China is giving full play to the investment and financing roles of state foreign exchange reserves, financial capital, insurance and social funds. It is actively purchasing RMB-denominated assets in countries along the Belt and Road and across the world, expanding the scope and field for using RMB overseas, improving the convenience for using RMB across the border, filling the gap for project investment and financing, and enhancing efficiency and return rates of funds.

Second, in terms of network connectivity, China is strengthening the construction of an online Silk Road, building a big international channel for e-commerce and effectively promoting the progress of Internet Plus — connectivity of online services for finance, industry, energy, trade and logistics for countries and regions along the Belt and Road through Internet applications such as a third-party payment system, cloud computing and social networking services. China aims to align domestic and international financial markets through interconnection, expand the scale and channels of direct financing, and enhance the function of RMB as a reserve and investment currency. Finally, in terms of system integration, China is establishing a diversified investment and financing system which incorporates policy-based, development-oriented and commercial-focused finance as well as nongovernmental and international capital. It is strengthening its cooperation with multilateral development institutions such as the European Bank for Reconstruction and Development, the Investment Plan for Europe, and the Asian Development Bank in a bid to provide strong financial support for infrastructure connectivity, interconnection and mutual benefits of capacity cooperation, and resource development under the Belt and Road Initiative.

### **2.2 Establish a regional cooperation theory featuring openness and inclusiveness**

With an open and inclusive development concept, path and objectives, the Belt and Road Initiative aims to strengthen alignment with development strategies of countries along the Belt and Road and takes benefits and concerns of all the parties into consideration. It shows China's willingness to share the dividend of its development with those countries to promote joint development

① Xi, 2015

and mutual prosperity. This development theory covers a multiple of disciplines, fields and dimensions, such as international economy, finance, relationship, development, and global governance. It emphasizes a relationship featuring systematic and integrated development as well as collaborative and reciprocal coordination. It explores a variety of ways for cooperation based on specific conditions of different countries to implement corresponding cooperative projects and apply various approaches and measures to obtain fruitful results and bring benefits to people of countries along the Belt and Road as early as possible.

As for the methods for realizing RMB internationalization in more regions, deeper fields and at higher levels, this paper draws the following conclusions. First, it is necessary to deepen all-round and in-depth cooperation with countries along the Belt and Road for win-win results. Efforts shall be made to promote extensive use of RMB under current accounts or in trade settlements, infrastructure construction, and capacity cooperation to meet the demands for RMB-denominated loans and financing for more countries and regions. Political and economic means shall be taken to bring the investment and reserve functions of RMB into full play to increase its international standing and to boost the confidence and resolution of international investors in using RMB. Secondly, under the principle of “consultation, contribution and shared benefits” China has signed Belt and Road cooperation agreements with more than 40 countries and capacity cooperation agreements with over 20 countries. This action has driven joint developments between China and other countries. The “BRICS Plus,” a new cooperation mechanism has been created for establishing new theory and modes for North-South and South-South cooperation and development of global influence. Third, RMB has been officially included in the Special

Drawing Rights (SDR) basket by the International Monetary Fund (IMF), and become a “freely usable currency.” Therefore, China shall vigorously foster the advantages of its offshore RMB financial centers in the Hong Kong Special Administrative Region (HKSAR) of China, London and Singapore, making great efforts to develop RMB-denominated assets and instruments, and constantly promote the willingness of overseas entities and individuals to hold RMB, so as to make RMB one of the circulated currencies favored by countries and people along the Belt and Road. Fourth, efforts are to be made to promote bilateral opening-up of the bond markets. Bond Connect enables connectivity between the China mainland’s bond market, which boasts a scale of about RMB 65 trillion, and that of HKSAR. With the inclusion of China’s bond markets in international bond indices of Bloomberg and Citi, the ratio of foreign investment is expected to increase dramatically. With a relatively high yield rate, Chinese bonds can attract more international investors to purchase RMB bonds if pricing and clearing mechanisms can be aligned with international practice. This is significant for building a massive, highly liquid, secure and reliable bond market, and offers great support to RMB internationalization. Meanwhile, financial institutions and enterprises shall be encouraged to enhance China’s global resource allocation capability and international competitiveness through the HKSAR bond market to stimulate a qualitative change of RMB allowing it to become a global reserve currency.

### 3. The possible termination of the conventional “Three-Stage Theory”

For the path of RMB internationalization, researches by Chinese scholars mainly cover the

following opinions: (1) Three-Stage Theory is to make RMB usable first in cross-border trade with neighboring countries and then a regional anchoring currency, and later to achieve RMB internationalization. (2) Regional monetary cooperation. The first type is to create the Asian Single Currency on the basis of the “Ten Plus One” economic cooperation framework between China and the Association of Southeast Asian Nations (ASEAN) with each country fixing their own exchange rates and applying externally joint fluctuations to finally realize a RMB-centered regional monetary unification. The second type is based on the “Ten Plus Three” mechanism among China, ASEAN, Japan, and South Korea to imitate the path of Euro internationalization.<sup>①</sup> In the past five years, RMB internationalization has made substantial progress as proven by the following achievements; conclusion of currency swap agreements between governments, cross-border use of RMB, inclusion of RMB in the IMF’s SDR basket, and establishment of offshore RMB financial centers. But the Chinese government did not mention RMB internationalization and only adopted the term of “cross-border use of RMB” until the proposal of the Belt and Road Initiative in 2013.

Since 2009, RMB internationalization has made significant progress. The inclusion of RMB in the SDR basket signifies the recognition of RMB by the IMF and the international community. Nevertheless, RMB internationalization is undergoing a low-to-high shift and an upgrading period due to comprehensive factors such as global geopolitical change, the United State’s pursuit of unilateral interests with dollar hegemony, the transition of China’s economy into a development stage of

high quality, the deepening of the reform of its financial system and mechanisms, and especially the proposal of the Belt and Road Initiative. As RMB internationalization is a long-term national development strategy, its direction and momentum is difficult to evaluate through short-term market changes or proactive policy adjustments. If China can keep its economic growth rate at around 6.5%, international investors will maintain their preference for RMB assets so that the RMB exchange rate can maintain its stable growth momentum. Moreover, if the reform of the RMB exchange rate forming mechanism keeps pressing forward and all-round reform and opening up are unswervingly carried out, RMB internationalization will forge ahead.

The world’s political and economic patterns are undergoing profound changes. Countries around the world pay more attention to geographical concepts so that arrangements for various multilateral or regional political, military, economic and financial systems keep evolving. The US subprime mortgage crisis, the European debt crisis, and Brexit, affect the restructuring and adjustment of geopolitical and strategic relations among countries and regions, and are also difficult to explain with conventional geopolitical and economic theories. Under this global context, China proposed the Belt and Road Initiative and established the AIIB, SRF, and BRICS New Development Bank. This development theory, which incorporates complicated geopolitical and geo-economic patterns into geopolitical economics, contributes to China’s wisdom and the innovative development of contemporary Chinese Marxist political economics. It is also an important part of Xi Jinping’s emphasis on “continuing to open up a new realm of Marxist Political Economy (MPE).”<sup>②</sup>

① Li, 2004

② Xi, 2016

#### 4. New ideas for RMB Internationalization under the Belt and Road Initiative

In October 2013, General Secretary Xi Jinping proposed the Belt and Road Initiative after a comprehensive review of the current situation. In May 2017, he announced that China would increase the capital of the SRF by RMB 100 billion. At the same time, he encouraged domestic financial institutions to carry out offshore fund business worth RMB 300 billion in countries along the Belt and Road. These two state-level major funding moves stand for specific arrangements for China's implementation of the Initiative, highlighting China's determination and will to promote RMB internationalization during the Belt and Road Initiative.

In June 2015, the People's Bank of China issued the first RMB Internationalization Report. It was the first time that the term "RMB Internationalization" had been officially used. This marked the start of a new stage. From then on, the process of RMB internationalization has had the following new features. (1) It can be achieved in a wider scope, a deeper domain and at a higher level under the Belt and Road Initiative. (2) The role of RMB has shifted from a conventional trade settlement currency to an investment currency, and RMB internationalization has been driven by both trade and investment. The next decade will witness a surge in China's capital export for construction under the Belt and Road Initiative. (3) With the launch of the Shanghai-Hong Kong Stock Connect, Shenzhen-Hong Kong Stock Connect and Bond Connect, connectivity has been realized between domestic and overseas

securities markets, and RMB has become the currency for overseas investments in Chinese securities. This is a milestone in the process of RMB internationalization and gradual liberalization of capital accounts. (4) After RMB was included in the SDR basket, more than 60 countries such as Russia and Singapore as well as the European Central Bank have included RMB in their foreign exchange reserves, highlighting the function of RMB as a global reserve currency. (5) RMB holds a firmer position in the global monetary system.

On October 8, 2015, Zhou Xiaochuan, then Governor of the People's Bank of China said, "The Cross-border Interbank Payment System (CIPS) will soon be launched in Shanghai to serve the city's international financial center construction and further promote RMB Internationalization and construction under the Belt and Road Initiative."<sup>①</sup> Centering on the Belt and Road Initiative, international capacity cooperation and other major national strategies, Chen Yulu and other scholars proposed that efforts shall be made to promote continuous development of cross-border RMB investment and financing.<sup>②</sup> The inclusion of RMB in the IMF's SDR basket is a milestone for RMB's integration into the global monetary system and indicates the recognition of the international community on the reform achievements of RMB internationalization. Yin Yong suggested that financial integration should be further promoted to support projects under the Belt and Road Initiative in his paper on RMB internationalization under the Initiative.<sup>③</sup> The framework for payment and uses of RMB in countries along the Belt and Road has been gradually improved, laying a solid foundation for further expanding its usage.

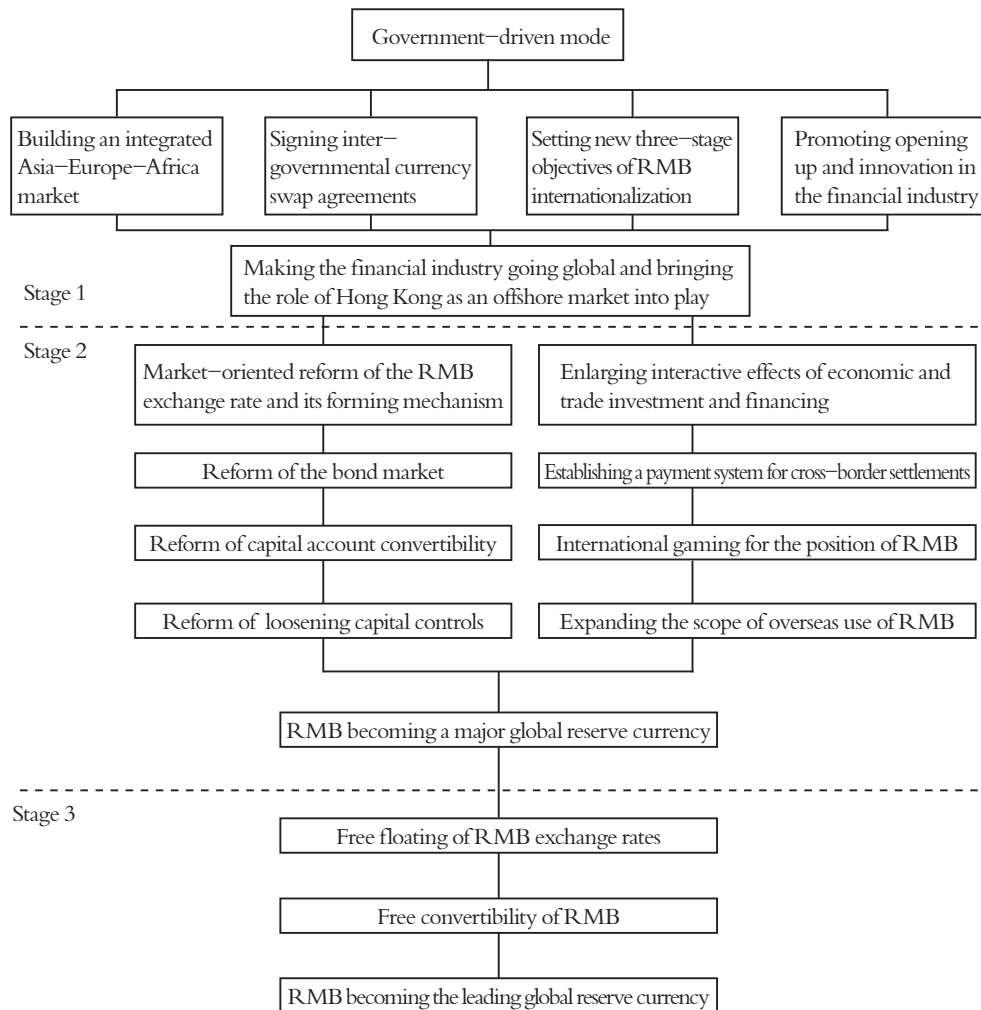
① Zhou, 2017

② Chen et al, 2005; Chen, 2016

③ Yin, 2017



Figure 1. The Belt and Road Initiative and the new path of RMB internationalization



The Belt and Road Initiative proposed by President Xi Jinping has provided new perspectives for choosing the path of RMB internationalization. The use of RMB in a wider scope, a deeper domain and at a higher level was enabled by the Belt and Road Initiative through capital exports and is of profound strategic significance to China's economic rise and the rejuvenation of the Chinese nation. This paper holds the opinion that the new path of RMB internationalization in the new era shall be realized under the guidance of the Belt and Road

development theory. The path is a new option distinct from the conventional "Three-Stage Theory" and the path of regional monetary cooperation.

China made a commitment in 2015 that it would increase RMB convertibility by 2020 and gradually remove capital controls. In October 2016, RMB was officially included in the IMF's SDR basket. This marked a steady step forward in the process of RMB internationalization during the previous 30 years and a possible termination of the conventional "Three-Stage Theory" and the path of regional monetary

cooperation. This paper proposes an objective design of three new stages for RMB internationalization in the coming three decades.

Stage 1 (2015-2025) objectives: to involve more countries in signing inter-governmental currency swap agreements, to find ways to establish a mechanism that can be denominated and settled mainly in RMB for international trading in petroleum and bulk commodities, and to set up a cross-border payment system; to make RMB an international settlement currency recognized by the IMF and most of the countries across the world, especially countries along the Belt and Road, in about 10 years (as from the issuance of the RMB Internationalization Report in 2015), to expand the scope and domain for using RMB as an international settlement currency; to give full play to HKSAR as an offshore RMB center; to steadily promote market-oriented reform of RMB exchange rates and its forming mechanism, and to apply a managed and two-way floating exchange rate regime, and to loosen controls on certain capital account items; to enhance the ability to stem inflation and maintain the stability of RMB exchange rates; to expand the use of RMB as a pricing, trading, circulation and settlement currency for the Belt and Road, and to reduce the risk of exchange rate fluctuations.

During the first stage of RMB internationalization, efforts shall be made in China's financial industry to increase two-way opening up, deepen market-oriented reform, steadily press ahead with market-oriented reform on RMB exchange rates and its forming mechanism, and maintain managed and two-way floating of RMB exchange rates. Measures shall be taken to steadily push ahead with the realization of RMB capital account convertibility, and to make RMB a widely used international settlement currency in global trade, thus, further boost the progress and level of RMB internationalization. HKSAR, as an offshore

RMB center, sees unprecedented rise in its market position with the increase in the opening-up of Chinese stock and bond markets, the launch of the Shanghai-Hong Kong Stock Connect, the Shenzhen-Hong Kong Stock Connect and Bond Connect, and the inclusion of a number of China A-shares into the MSCI Emerging Markets Index, providing external circulation channels for offshore RMB. The Financial Stability and Development Committee under the State Council was established to help strengthen oversight of the financial system and enhance coordination and collaboration among regulators so that the reform goals for the system can be clearer and market opening-up can be accelerated on condition of no occurrence of systematic risks.

Stage 2 (2025-2035) objectives: to make RMB the pricing and settlement currency for international trade, investment and financing in the integrated Asia-Europe-Africa market along the Belt and Road; to make RMB the major global reserve currency held by central banks of countries around the world in another 10 years or so; to speed up market-oriented reform on RMB exchange rates and its forming mechanism so that it can become a freely traded currency in the international foreign exchange market; to realize capital account convertibility and gradually remove capital controls.

Market-oriented reform of RMB exchange rates is a task that goes through the three new stages of RMB internationalization with a staged objective to enhance the intrinsic currency function of RMB in pricing, payments and reserves for global trade, bulk commodities transactions, investments and financing. Efforts shall be made to further enhance the internationalization levels of China's financial markets. A managed floating exchange rate regime is the long-term goal for market-oriented reform of exchange rates. Under this condition, measures shall be taken to steadily realize free convertibility under capital accounts and gradually lift capital controls



to make RMB one of the leading global reserve currencies.

Stage 3 (2035-2045) objectives: to make China the largest economy in the world and the issuing country of RMB as a world currency under the new global governance framework, and make RMB one of the world currency for international trade and investment, and be open to international capital to facilitate sound development of the world economy and global trade. In 10 more years, i.e. 2035 to 2045, RMB exchange rates will be entirely in free float. And it will be determined by the daily transaction value of RMB against the US Dollar and other major currencies in the international foreign exchange markets, and RMB can be freely converted.

The objectives of the three new stages are designed holistically. Some are set throughout the whole period from 2015 to 2045 while other objectives may be defined only for a certain stage. In addition, the sequence requires different policy options based on overall and partial arrangements as well as difficulty, time and emphasis of implementation.

## 5. Government-driven is the best mode for RMB internationalization

Currently, research on RMB internationalization is based on two drive modes. One is a market demand mode and the other is a policy-driven mode. But owing to constraints of multiple internal and external factors, it is difficult to smoothly achieve the objectives of both modes. It is believed that a government-driven mode will be the main direction for future development. The Chinese government is full of confidence and ability to realize the set objectives of RMB internationalization through improving national governance, applying policies for macroeconomic regulation, and implementing the Belt and Road Initiative, as well as the operation

of its financial industry, SRF, and that of regional banks like AIIB and the BRICS New Development Bank. RMB internationalization can only be achieved under the Belt and Road Initiative and it will take a government-driven mode with Chinese characteristics. That is its fundamental difference from other modes.

In 2017, the strategy of “Center on the Belt and Road Initiative and innovate foreign investment modes to boost trade and industry development with investments” was put forward at the Central Economic Work Conference. Currently, the development scope has been expanded beyond the 65 countries along the Belt and Road to nations in partnerships with China. The Initiative not only involves the Silk Road Economic Belt and the 21st Century Maritime Silk Road, but also extends to the Polar Silk Road and the online Silk Road, featuring four Silk Roads in total. These remarkable results are closely related to the active support and incentive policies of the government.

### 5.1 Actively promote the RMB inter-governmental swap agreements

The People's Bank of China has signed 37 currency swap agreements worth over RMB 3 trillion with central banks of other countries, including 21 countries along the Belt and Road, with a total amount of around RMB 1.4 trillion. On the one hand, the central bank of China can provide RMB to countries along the Belt and Road through currency swaps so that the central banks of those countries can offer financing or loans to their commercial banks and enterprises in RMB, and the enterprises obtaining RMB financing can import goods and equipment from China. In this way, direct investment and financing can be used by RMB. On the other hand, Chinese exporters can receive RMB payments directly to avoid exchange rate risks and reduce currency conversion and remittance expenses.

## **5.2 Continue to enhance the status of RMB as a global reserve currency**

In March 2017, the IMF separately identified the world's holding (1.07%) of RMB-denominated foreign exchange reserves for the first time, signaling the new identity of RMB as a global reserve currency. According to the forecast of the Hong Kong and Shanghai Banking Corporation, central banks around the world will hold 10% of their foreign exchange reserves in RMB by 2025. This prediction corresponds to one of the Stage 2 objectives mentioned in this paper. The Chinese government is speeding the two-way opening up of banking, securities, insurance, and bond markets through measures such as the launch of worthy the Shanghai-Hong Kong Stock Connect, Shenzhen-Hong Kong Stock Connect and Bond Connect. Meanwhile, several of China A-shares were added to the MSCI Emerging Markets Index. These two-way opening up measures not only facilitate mainland investors to invest in HKSAR's capital markets, but also attract foreign investors to the Chinese markets. This achievement can further promote the launch of the Shanghai-London Stock Connect and linkage with capital markets of other countries, making China's domestic capital markets more comprehensively integrated into the international capital market. Currently, more than 60 countries, including Russia, Germany, and France, have included RMB in their foreign currency reserves, and nearly 2000 financial institutions across the world have used RMB as a payment currency while this figure was zero 5 years ago. These are hard-won achievements for the global position of RMB.

## **5.3 Innovate measures for diversified investments with foreign exchange reserves**

The SRF is the first institution that uses foreign exchange reserves as an investment capital source. This move indicates that the Chinese government attaches greater importance to achieving good

management and use of national foreign exchange reserve and the unity of efficiency and return. Meanwhile, future investment orientation and application methods for national foreign exchange reserves are proposed under the principle of balancing security, liquidity and profitability. The SRF is the largest private equity in China. It can leverage stock rights, creditor's rights, loans and funds to initiate the establishment of mutual investment funds with international development organizations and financial institutions to conduct assets trusteeship management or outbound entrusted investments in a bid to realize connectivity of bilateral and multilateral investment demands.

By the end of 2017, the SRF had signed 17 projects and committed to investing approximately USD 7 billion, involving projects with a total investment amount of more than USD 80 billion. The SRF specializes in equity investments for medium-to-long term infrastructure and resource development under the Belt and Road Initiative. It is like a global medium-to-long term infrastructure project investor in terms of investment propensities and return expectations. This kind of investment features long cycles and inflation resistance, and shares project profits on the basis of equity investment to obtain relatively high rates of return on long term investments. Therefore, it generally suits the demand for retaining and increasing the value of foreign exchange reserve over a long period. According to the statistics of Hamilton Lane in 2016, during the decade ending June 2017, the overall annual rate of return on investments in global private equity reached 9.4%. In Asia in particular, the figure stood at 11%, exceeding the annual rate of return on investments in infrastructure construction (9.5%), real estate trust (7.5%), American stock market (7.4%), and high-yield bonds (7.1%). Sovereign wealth funds, major banks, insurers and pension funds in developing and developed countries are

all striving to attract capital for infrastructure construction. Considering international practice and the investment concept and preference of the SRF, it is beyond doubt that the SRF can realize a relatively high and reasonable rate of return on investments in medium-to-long term projects.

#### **5.4 Enable Chinese capital to reach out to the world with AIIB's support**

The China-led AIIB is aimed at promoting the use of RMB across the world to make it a leading currency for infrastructure-related financial integration under the Belt and Road Initiative. This not only indicates the matching of the Belt and Road development theory to regional geopolitics and international economic division of labor, but also is in line with China's needs for economic transition and capacity relocation to realize the development goal of win-win cooperation. China stressed that the AIIB was established to supplement and improve global governance, and to provide superior public goods for countries along the Belt and Road. AIIB's operation follows international rules and market principles. As current demands for investment and financing in infrastructure construction are enormous, such a huge gap for substantial financial integration will definitely attract international investors so that financial cooperation can be promoted globally, and more international opportunities can be explored for RMB internationalization.

#### **5.5 Establish an RMB-denominated cross-border payment system**

During the National People's Congress and the Chinese People's Political Consultative Conference in 2015, Premier Li Keqiang pointed out in the Report on the Work of the Government the goal to "accelerate the establishment of a cross-border payment system for the RMB, improve the worldwide clearing system for the RMB." With unremitting efforts, the cross-border RMB payment

system developed by the People's Bank of China was officially launched in October 2015. It has greatly enhanced the efficiency of cross-border clearing and represents an important achievement in the modernized payment system featuring coordinated operation of domestic and international RMB payment systems. According to the overall design requirements of the worldwide RMB clearing service system for security, high efficiency and convenience, the system ensures that RMB payments can be settled efficiently both at home and abroad with its role as the fourth leading global payment currency and the second leading trade and financing currency. This meets the requirements of the Belt and Road Initiative, corresponds to RMB's status as a global reserve currency, and is also essential for RMB going global.

### **6. Promote the reform of the systems and mechanisms of financial markets with the Belt and Road development theory**

#### **6.1 Give play to and improve the unique role of Hong Kong's offshore RMB market**

China has the unique advantage of owning four currencies in one country. The launch of the Shanghai-Hong Kong Stock Connect and the Shenzhen-Hong Kong Stock Connect and Bond Connect enhances the status of HKSAR as the world's largest offshore RMB market, which can develop various financial products, manage freely convertible currencies, establish a mechanism for the backflow of RMB to the mainland, expand all-round cooperation with international financial organizations, support financial integration under the Belt and Road Initiative, and promote RMB internationalization. This is the unique role of Hong Kong's offshore RMB market for capital export, investment and financing. The development

of HKSAR mainly benefits from the support of the central government and its highly liberalized and internationalized financial management systems and favorable tax policies. It represents a unique carrier and systematic innovation for RMB internationalization. Petroleum and bulk commodity futures are closely related to RMB internationalization. Once these instruments are launched, they will enhance the scale of RMB used as an internationally freely convertible currency. In the meantime, RMB will face derivative risks in term of pricing, risk hedging, arbitrage, and liquidity. Hong Kong's offshore RMB market has the strength to research and develop products that can hedge these derivative risks, and therefore can give full play to its unique role as a market center.

## **6.2 Steadily advance market-oriented reform on RMB exchange rates and its forming mechanism**

According to Marxist political economics, the exchange rate system is not only an economic issue, but also a political choice. The trend of market-oriented reform of RMB exchange rates is irreversible. First, continuous improvement in the benchmark exchange rate system and the establishment of a high-efficient transmission mechanism underpin the reform of the exchange rate forming mechanism. The central bank plays the role of regulator and controller by establishing a benchmark exchange rate system and continuously improving it. In terms of the monetary policy transmission mechanism, the monetary market is enabled to react timely to the two-way floating currency policy issued by the central bank to avoid unilateral appreciation or depreciation so that unstable sentiment in the market can be stabilized. Second, the reform orientation shall be maintained toward establishing a managed floating exchange rate system and international practice shall be followed to reduce the uncertainty faced by the

reform of the foreign exchange administration system to minimize risks due to international capital flow. A well-managed floating exchange rate system is a long-term goal of the market-oriented reform of exchange rates. Under this condition, efforts shall be made to gradually realize free convertibility under capital accounts and the removal of capital controls, which will be conducive to the development and rise of China's economy.

China's exchange rate forming mechanism is undergoing a reform to shift from the previous long-term fixed exchange rate regime to a flexible floating exchange rate mechanism. This change is in line with the evolution of the international exchange rate system for currencies, and meets the requirement that China's economy and its financial sector must be adapted to the process of global economic integration and financial liberalization. Reform practices prove that the current managed two-way floating exchange rate system can establish and improve the foundation of exchange rate marketization, rectify human factors that affect the exchange rate forming mechanism, improve market-oriented operation in the foreign exchange markets, further increase the flexibility of exchange rate movements, and improve the promptness of exchange rate adjustment mechanisms. The realization of these reform objectives is crucial to improving the effectiveness of monetary policies. China shall actively press ahead with its market-oriented reforms of exchange rates and bring the role of government into full play. Strengthening administration does not mean to take the place of the market's role, but to find better ways to enable the market to play an important role in exchange rate forming mechanisms.

## **6.3 Steadily promote the reform of RMB capital account convertibility**

It is the goal of China to realize capital account convertibility, yet the opening-up of capital accounts

cannot be achieved in a single action. Compared with reforms of the exchange rate forming mechanisms and capital controls, reforms to realize RMB free convertibility are the hardest part. It took 36 years for the Japanese government to ultimately open its capital accounts for the internationalization of Japanese Yen, but the 20 years of stagnation and recession after that should be a lesson from which we can learn. After the Asian economic crisis in 1997, the US subprime mortgage crisis in 2007, and the European sovereign debt crisis in 2010, Western finance circles started to reconsider their previous radical practice on the opening-up of capital accounts. IMF has recently supported appropriate capital controls over capital flow and called for prudent macro-regulation measures.

#### **6.4 Steadily promote the reform of loosening capital controls**

International practice shows that western developed countries implemented free convertibility of capital accounts along with the establishment and improvement of macro-economic policy systems, stable financial systems, effective regulations and increases in comprehensive national strength. The above conditions are not yet mature in China, so it is crucial to apply necessary controls over capital accounts.

Meng Xiangjun and Huang Wujun introduced the “Impossible Trinity” as, “Under specific conditions of open economy, it is impossible for a country to have an independent monetary policy, a fixed foreign exchange rate, and free capital flow at the same time since there is uncoordinated contradictions among the three goals. So, a country can only choose two of the goals.”<sup>①</sup> In 2015, China wanted to ensure the independence of the monetary policy of its central bank so it partially loosened its control on capital accounts convertibility while

it was changing its fixed exchange rate regime to a floating exchange rate regime. This move, however, led to serious foreign exchange outflow and depreciation of RMB, which forced the central bank to give up the independence of monetary policy. In the end, the Chinese government tightened capital controls once again which slowed RMB internationalization. In addition, to hedge the pressure from RMB depreciation brought about by capital outflow, the central bank resolutely sold foreign exchange reserves to support the exchange rate of RMB. At the end of 2016, China's foreign exchange reserves also dropped to less than USD 3 trillion from a peak of nearly USD 4 trillion.

According to the theory of the “Impossible Trinity,” a country must make a policy choice from the three goals by selecting one or two but cannot do it all. China is no exception. For China, the solution to the “Impossible Trinity” lies in capital control. This is primarily because monetary policy is a sovereignty policy by which a country regulates its economy for stable development. Therefore, there is no reason for a country to give up an independent monetary policy. Second, to realize market-oriented reform of the exchange rate forming mechanism and the long-term goal of RMB internationalization, China must abandon its fixed exchange rate mechanism and apply a managed two-way floating exchange rate regime. Finally, removing capital controls must be steadily implemented because they cannot be accomplished in a single action. A bottom line — no systematic risks allowed — an indicator that has a higher requirement than capital control, was put forward in both the report to the 19th National Congress of the CPC and the report of the National Conference on Financial Work.

#### **6.5 Promote the global governance reform in world trade rules and the global currency system**

<sup>①</sup> Meng & Huang, 2011



At the G20 Summit in 2015, the leaders made commitments that they would strengthen international financial supervision, speed up the reform of international financial institutions, and encourage developing countries to engage in global economic governance. The world order needs new values and a new system design. China aims to enhance its soft power through promoting the Belt and Road development philosophy, establishing the AIIB and the SRF, and providing a concept for global development that is different from western values. The current world order in economy, trade, finance and monetary systems needs change to form a new pattern. This requires the participation of China and emerging market economies to obtain their due identities in global governance.

#### **6.6 Ultimately make RMB the leading global reserve currency**

The objective of Stage 3 is to make RMB one of the leading global reserve currency and China the important economy in the world, so that it can become the issuing country of RMB as a global currency under the new global governance framework and to realize global deployment of capital. In this way, China's financial sector will become more international- and market- oriented and diversified. To ensure marketization of exchange rate pricing, the RMB exchange rate forming mechanism needs to be transparent, and the RMB payment system needs to be highly efficient and secure. Moreover, the debt paying ability of the government and the private sector needs to be enhanced significantly to ensure the free flow of RMB under capital accounts. Measures shall be taken to lift capital controls to make RMB

the leading reserve currency in the world in the true sense. Meanwhile, when RMB becomes one of the leading global reserve currency, it also means that the Chinese government needs to bear more responsibility as a major power for stable development of the international economy and finance.

### **7. Conclusion**

The political gaming between China and the United States is, in reality, currency gaming between RMB and the US Dollar. On the one hand, the United States strives to maintain its dollar hegemony; on the other hand, China fights for the RMB pricing and settlement rights for petroleum and bulk commodity futures and calls for reform of current world trade rules and global monetary systems. China shall take greater initiative to expand the scope and domain for cross-border use of RMB in the construction of the Belt and Road to create better political environments and economic conditions. It shall make government-led economic management more transparent, enable the central bank to enact monetary policy more independently, and steadily push ahead with market-oriented reforms on interest rates and exchange rates, to gradually realize full convertibility of RMB and remove capital controls so that RMB can become a global reserve currency favored by countries across the world. It will be a gradual process for the realization of RMB internationalization, which is a vital goal for China's economy to be integrated into the world economy.

*(Translator: Wen Yi; Editor: Xiong Xianwei)*



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