

THE FINANCIAL POWER OF CHINA AND THE *RENMINBI*

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ABSTRACT: This article aims to present the main issues about China's economic growth and the internationalization of its currency - the Renminbi (RMB), as well as the financial and economic instruments used by China for this purpose not only around the world but also in the countries of South America. Finally, it assesses Brazil's foreign policy concerning China's economic and monetary expansion strategy, concluding that Brazil and South America, in general, do not have any economic and political strategy to deal with the Chinese monetary expansion.

KEYWORDS: China; Brazil; South America; Renminbi

I. Introduction

This article outlines reflections on China's economic expansion and its currency around the world, the facts that show China's ambition to broaden the RMB's use in South America and, lastly, interpretations on Brazil's stance related to China, including closing remarks.

II. China's economic growth and expansion of the RMB throughout the world

Data from the World Bank, the WTO, the IMF, China's Ministry of Commerce and academic papers reveal that Asia, and particularly China, have gained a prominent place on the international stage with political and economic impacts in many regions throughout the world, including South America.

The McKinsey Institute in 2012 computed the course of the world economy's center of gravity from year 1 to 2025, revealing that the center of the global economy is shifting towards central Asia, where it had been practically 200 years before (see fig. 1 below). The accelerated growth of China's economy, along with other Asian countries, is among some of the roots of this phenomenon. Chinese GDP now stands as the second largest in the world¹ (Campbell, 2016; Myers and Wise, 2017; and World Bank, 2017c). Furthermore, economic problems in Europe and the United States caused by the 2008 financial crisis foresaw this shift in the center of the world economy (Kirshner, 2013 and Kaplan, 2016).

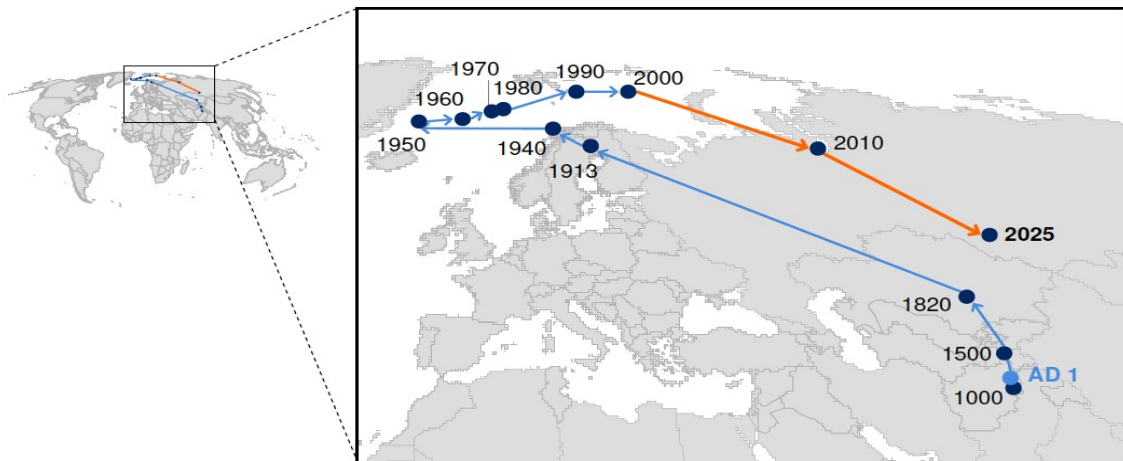
China developed into a global economic power (Bergsten et. al, 2008, p. 497), joining the WTO in 2001 and becoming the world's largest exporter in 2013, overtaking the

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¹ Measurement in US dollars.

United States, Germany and Japan (WTO, 2016). Additionally, the *Renminbi* (China's currency - RMB) in 2016 joined the dollar, the euro, the yen and the pound sterling in the basket of currencies that form the *Special Drawing Rights* (SDR - the IMF currency) (IMF, 2016).

Course of the global economy's center of gravity² / 1 AD up to 2025:



Source: McKinsey Global Institute analysis using data from Angus Maddison; University of Groningen

Through its companies and the government itself, China is today one of the three largest foreign direct investors (FDI) in the world, emphasized by investments in several commodity-producing countries that are concentrated in Southeast Asia, Oceania (Australia), Africa and Latin America (China's Ministry of Commerce, 2016). On the financial front, China already has the second largest stock exchange in the world in terms of the capitalization of listed companies, ahead of the Euro zone and trailing Japan and the United States (World Bank, 2017a, 2017b).

From a political and military perspective, China is a rising power in East and South-East Asia (Sohn, 2015, Zeng and Breslin, 2016). It is one of the permanent members of the UN Security Council and holds veto power. Another key point is the reconstruction project for the Belt and Road Initiative, linking China to Europe and which intends to promote political influence through financing for infrastructure (Yiwei, 2016). China, in conjunction with Russia, is also regarded as the second military power in the world, behind only the United States (Global Fire Power, 2018).

From a monetary perspective, the internationalization of the RMB, that is, when the currency begins to exercise its classic functions beyond the political borders of the issuing

² The shift in the points uses data from historian Angus Maddison and weighs the national GDP with the geographic center of gravity for each country. A line drawn from the center of the globe meets the "balance" point between the weights on the surface of the map (McKinsey, 2012).

government³, is one of the most complex and discussed issues pertaining to China's economic and political ascension.

According to Eichengreen and Kawai (2015), there are several academic and government-related discussions on the internationalization of the RMB - both from an economic and political point of view. Among them, could the internationalization of the Chinese currency be a natural consequence of China's economic strength, or is it a deliberate and conscious public policy by the officials in that country?

The first is that the RMB's usage in international commercial and financial transactions⁴ is seen as a natural consequence of China's hefty economic and financial weight in the international system (ex.: Subramanian, 2011; and Singh, 2013). The other is based on statements made by Chinese officials, in which the RMB's internationalization is a political target by that government, in a way that the Central Bank of China and other Chinese agencies have a mandate to stimulate the widespread use of the RMB in commercial and financial transactions, along with reducing the international reserves' exposure to the dollar, especially after the 2008 financial crisis (Eichengreen, 2011; Wheatley; Cohen, 2015; Sohn, 2015; and Kwon, 2015).

When the data is examined, it turns out that the dollar's participation in the exchange markets is still 87% (BIS, 2016) and the share of the RMB in international reserves declared by the countries amount to just 1%, while the dollar accounts for 67% of the amount declared (IMF, 2017).

As such, it appears to us that the internationalization of the Chinese currency has not followed China's economic and financial growth. This implies that a more assertive and targeted policy by the Chinese government to enable the use of the RMB in the international monetary system or, as Cohen described (2015), *the managed internationalization of the RMB*. To the contrary, the inertia of the market itself should prevail (the act of continuing to use the dollar in commercial transactions) (Ito and Chinn, 2014).

Although it has been gradual, the policy to promote the Chinese currency has intensified since the 2008 financial crisis so as to reduce the dollar's exposure in international reserves and its use in the settlement of international commercial transactions (Wheatley, 2013; Eichengreen and Kawai, 2015; Sohn, 2015; and Zhang, 2015).

Accordingly, the first step in the internationalization process of the Chinese currency took place in 2009 when its use was supported in the settlement of commercial transactions between the Association of Southeast Asian Nations (ASEAN)⁵ and China

³ Based on the functionalist – and economic – definition offered by Cohen (1971), a currency becomes international when its three classic functions are executed outside the political boundaries of a certain country. As such, it should work as: (i) unit of account; (ii) store of value; and (iii) means of exchange. These functions are usually exercised by individuals, institutions and private companies, along with public officials – such as the Central Bank and Treasury – public companies and other governments. The functionalist proposal leads to a ranking of currencies according to the roles they perform in the international monetary system, with those that carry out only one or two of the functions described, like those that perform all the classic functions, such as the U.S. dollar (Cohen, 2011).

⁴ As well as those performed by central banks and other official institutions.

⁵ ASEAN includes the following countries: (i) Brunei; (ii) Cambodia; (iii) Indonesia; (iv) Laos; (v) Malaysia; (vi) Myanmar; (vii) Philippines; (viii) Singapore; (ix) Thailand; and (x) Vietnam.

(Hong Kong and Macau; Shanghai, Guangzhou, Shenzhen, Dongguan, and Zhuhai) (Eichengreen and Kawai, 2015; and Kwon, 2015).

At the same time that the RMB was promoted in international trade, China curbed the rules on the control of capital outflows in an effort to inaugurate foreign direct investment and portfolio programs⁶ that are executed by Chinese companies and the government in RMBs in other countries, totaling 80% of investments made by China in the RMB in 2014 (Eichengreen and Kawai, 2015; Kwon, 2015).

Some of the initiatives that have also been taken to promote the spread of the RMB's use by the other countries include the execution of foreign exchange swap contracts - currency trading contracts - between the People's Bank of China (PBoC) and central banks in other countries, as well as the establishment of settlement banks for commercial transactions in RMB (currency clearings) that are set up in certain countries.

As such, the PBoC entered into a three-year *currency swap* contract with the Central Bank of South Korea in 2008 for 180 billion in RMB in an effort to continue the “currency swap diplomacy” (Cohen, 2007) established with the Chiang Mai Initiative in 1999⁷. Later, in 2014, the PBoC and the Korean regulatory authority extended the terms for the first contracts, doubling the value to 360 billion in *currency swaps*. The economic goal of the agreement was to stimulate the use of the RMB by businesses and the Korean government, providing financial liquidity in RMB and reducing the exposure of reserves pegged to the dollar (Eichengreen and Kawai, 2015).

The Chinese government has spurred various *currency swap* agreements⁸ with a number of central banks in order to pay for imports of Chinese products on the part of trading partners affected by the international liquidity crisis, boosting trade transactions with various countries (Liao and McDowell, 2015). In December 2016, thirty four (34) *currency swap* agreements had already been signed between the PBoC and central banks in other countries, totaling more than 3.5 trillion in RMB, including Brazil, Chile, European Union, United Kingdom, Australia and Russia (Sohn, 2015; PBoC, 2016; and Prasad, 2016).

Some of the signatory countries of the *currency swap* agreements include countries in Southeast Asia and ASEAN (Thailand, the Philippines, Malaysia and Singapore, for example) and China's neighboring countries that naturally undergo its political influence, forming the *renminbi bloc* (Cohen, 2007). The economic goals of China and the signatory countries were, and still are, to reduce payment risks that fluctuations in the dollar's exchange rate provoke in commercial transactions between China and other countries,

⁶ Equity investments and debt securities of foreign companies listed on stock exchanges.

⁷ As a result of the 1997-98 currency crises, China, Japan and South Korea on one side and the ASEAN on the other, signed a bilateral currency trading agreement or currency swap agreement in 1999 with a focus on providing monetary liquidity, providing dollars to ASEAN countries in emergency situations involving a lack of liquidity.

⁸ The *currency swap* agreements executed by the PBoC and the other central banks are different from those carried out by the FED and the other countries, in which the objective is only to provide dollar liquidity between countries whenever there is an acute exchange rate crisis. The PBoC agreements were specifically designed to promote the internationalization of the RMB. The method is employed deliberately to expand bilateral trade between China and other countries, including direct investments made by Beijing to other countries (Liao and MacDowell, 2015).

and to diversify the basket of currencies that pertain to the international reserves of each country (Kwon, 2015, and Sohn, 2015).

Presently, among *currency swaps*, loans, trade and foreign investments, statistical models already estimate a 31.5% growth in the use of the RMB for 2018 compared to China's total trade volume in international commercial transactions in 2015 (Ito and Chinn, 2014).

After several measures geared towards internationalizing the RMB, studies are now pointing out the political reasons behind the Chinese government's decision to make the Chinese currency an international monetary asset. Some countries among those that have entered into *currency swap* agreements with China do not have strong commercial and/or political ties with Beijing or have little influence in the international economy (Cintra and Martins, 2016 and Prasad, 2016), such as Belarus and Armenia. But they can be geopolitically important to China, such as the case with Pakistan (geographically close to India and a political challenge to that country).

There are some academics who believe that China seeks to influence the governments of other countries over issues related to the future reorganization of the international monetary system, as well as becoming economically important, to exert political influence on emerging markets (examples: Brazil, Argentina, Chile and the ASEAN countries) (Cohen, 2015; Liao and McDowell, 2015; Zhang, 2015; Sohn, 2015; and Kwon, 2015).

Prasad (2017) gives an example that *currency swap* agreements and the diversification of international reserves with the addition of the RMB into the basket of currencies is a way of *purchasing protection from China*. While the amount of RMB in the countries' international monetary reserves is still modest, it is a major political symbolism because central banks throughout the world are preparing for the RMB's prominent role in international finance.

Is it only a matter of time before the RMB is prominent in international finance? In view of the data presented and the deliberate actions taken by the Chinese government to internationalize its currency, questions naturally arise as to whether the dollar could be replaced in the international monetary system - another key discussion revolving around the RMB. Due to China's size and economic dominance, Subramanian (2011) sees the RMB replacing the dollar as the main international monetary reserve by 2025.

McKinnon (2013), on the other hand, ascertains that the dollar will continue to maintain its central position in the international monetary system, even in the event that the Chinese economy becomes even larger than United States.

Eichengreen (2011) instructs that the world had a single currency only during the second half of the twentieth century and that, from a historical perspective, it makes more sense to be prepared for a monetary system where several international currencies coexist, predominantly regional⁹.

⁹ The countries of East and Southeast Asia will use the RMB for conducting business between them and China; the countries that belong to the European Union use the Euro to conduct business; and business transactions conducted with the United States will be settled in dollars.

Cohen (2015) remains skeptical on the rise of the RMB in the international monetary system. Finally, even though US hegemony in the political economy is already being challenged by the RMB, Kwon (2015) judges that the RMB's goal for internationalization is not to replace the dollar in the economic system, but merely a way for China's monetary policy to attain greater autonomy.

As this is an ongoing debate and is still novel for academic parameters, a consensus does not yet exist. Additionally, China's intentions within the international political economy are not that clear because we cannot, for example, see the political intentions behind its monetary progression.

On the South American side, reflections on the broadened use of the RMB are recent and embryonic, trending upwards over the next few years as monetary ties with China widen¹⁰. That said, after a quick assessment of the Chinese economic advance and, particularly, of the monetary measures taken by the PBoC in an attempt to stimulate the internationalization of the RMB, which do not differ from those that are applied in South America, we continue on to the next item.

III. The internationalization of the RMB and South America

In accordance with the discussion in chapter II, China has also practiced economic and monetary diplomacy in Latin America, specifically countries located in the southern region.

The United Nations Economic Commission for Latin America and the Caribbean (ECLAC) estimates that the total loans provided by China to the governments of Latin America and the Caribbean between 2005 and 2016 totaled more than 141 billion dollars (ECLAC, 2018).

Yet, according to the *Brookings Institution*, Chinese investments in Latin America continue to grow, and reached more than 200 billion dollars in 2017 (Brookings, 2018).

In this respect, data from Boston University's China-Latin America Database show - in billions of dollars - that the primary countries receiving China's investments between the years 2005 and 2017 are located in South America.

COUNTRY	NO. OF LOANS	AMOUNT
Venezuela	17	\$62.2B
Brazil	12	\$42.1B
Argentina	11	\$18.2B
Ecuador	13	\$17.4B
Bolivia	10	\$3.5B
Trinidad and Tobago	2	\$2.6B
Jamaica	11	\$2.1B
Mexico	1	\$1B
Peru	2	\$478M

¹⁰ Based on data from ECLAC 2018, p. 24. Source: <https://repositorio.cepal.org/bitstream/handle/11362/43214/1/S1701249_en.pdf>. Accessed on July 20, 2018.

Costa Rica	1	\$395M
Guyana	2	\$175M
Barbados	1	\$170M
Bahamas	2	\$99M

Source: *China-Latin America Finance Database – Boston University* - https://www.thedialogue.org/map_list/. Accessed 20 July 2018:

According to ECLAC (2018), this growth in Chinese investment in the region since 2005 is not only tied to economic interests and in ensuring the supply of commodities to China. It pertains to a broader political strategy adopted by the Chinese Government. These strategies include the RMB's use in the commercial transactions between these countries and China and the introduction and expansion of the Chinese currency in the international reserves of the countries of Latin America, particularly in South America.

Hence, deliberately and with the same economic and political objective related to the internationalization of the RMB being done with the countries in East and Southeast Asia (ECLAC, 2018), China has entered into and encouraged the signing of currency swap agreements with certain countries in South America, most notably Argentina, Brazil, Chile and Suriname. The PBoC has likewise received authorization for implementing settlement banks for transactions in Chinese currencies, gradually inserting the use of RMB in the South American economy.

The chart below illustrates the distribution of this strategy among Latin America countries, especially Argentina, Brazil, Chile and Suriname related to the signing of *currency swap agreements*:



Source: CEPAL – Comissão Econômica para América Latina e Caribe. *Exploring new forms of cooperation between China and Latin America and the Caribbean. Report* - Jan/2018. https://repositorio.cepal.org/bitstream/handle/11362/43214/1/S1701249_en.pdf. Accessed 25 July 2018.

These *swap agreements* were entered into in order to stimulate trade and investment in the RMB in South America, in addition to acting as a relief measure against the weakening of international reserves in dollars (ECLAC, 2018).

With this in mind, the PBoC entered into a *currency swap* agreement in 2015 with the Chilean monetary authority for 50 billion in RMB in order to augment trade between the two countries (Reuters, 2015).

Also, the China Construction Bank that same year was authorized by the Chilean Central Bank to act as a clearing and settlement bank for agreements in Chinese currency in Chile (*currency clearing*) (Subacchi, 2017), so that copper exports from Chile to China would have the option of being settled in RMB instead of the dollar. There were also more than sixty (60) central banks around the world in 2017 that declared to be holding RMB positions in their international reserves, among them the Central Bank of Chile (Subacchi, 2017).

The PBoC and the Central Bank of Argentina entered into a 70 billion *currency swap* agreement in Chinese currency in July 2014 (Peters, 2015), which was also intended to provoke trade between the two countries directed at settling commercial transactions in the RMB.

But by the end of 2014, Argentina faced a speculative attack against its currency – the *peso*. It had liquidity problems due to the scarcity of dollars in its international reserves. In order to stem this financial crisis, the central bank in Argentina made use of a *swap agreement* signed with China that same year. In this case, Argentina traded the Argentine *peso* for RMB and, in the international currency market, the Central Bank of Argentina converted the RMB into dollars and ended up obtaining about 2.7 billion to clean up its reserves (CFR, 2015).

The PBoC pointed out in 2015 that the Industrial and Commercial Bank of China would be the clearing bank for the RMB in Argentina, inciting that bank to promote the clearing and settlement of commercial operations in Chinese currency in that country (Reuters, 2015).

These clearing and settlement banks for the RMB based in Buenos Aires and Santiago are joining other Chinese financial institutions that are seeking to clear and settle commercial transactions through the Chinese currency (examples: The China Construction Bank in London and the Bank of China in New York; Paris and Frankfurt).

China has been Brazil's largest trading partner since 2009 and has increased its economic importance (Ministry of Foreign Affairs) as it enters into a number of contracts and agreements that are geared towards increasing Chinese investments in Brazil and the RMB's penetration into commercial transactions between Brazil and China. There was a currency swap agreement between Brazil and China for 60 billion reais / 190 billion in RMB / 30 billion dollars in March 2013 (*Valor Econômico*, 2013). According to the Central Bank of Brazil, the agreement would also act as a way to facilitate bilateral trade between the two countries.

The facts support the information and theory that China is deliberately creating a demand for the use of the RMB in foreign trade operations so as to lower the transaction costs for Chinese and South American companies (Cohen, 2016, ECLAC, 2018).

Maintaining this principle, the Bank of China in 2009 in Brazil completed the first RMB export and import business in South America involving a Chinese company worth 38,611 billion yuan (Bank of China, 2009). Moreover, the RMB's relevance as a global reserve currency and the greater demand in Brazil for commercial and financial transactions in the Chinese currency have already prompted studies on the creation of a currency clearing in Brazil, one that is similar to those that already exist in Chile and Argentina, targeted towards the settlement of commercial transactions in RMB and not in dollars (*Valor Econômico*, 2017).

Lastly, the New BRICS Development Bank, based in China, made its first issue in 2016 of debt securities in Chinese currency in an effort to raise funds for infrastructure investments in South American countries (*Valor Econômico*, 2016).

These facts illustrate that China has gradually boosted its international monetary power not only towards Southeast Asia, but with South America as well, challenging even the small-scale role of the dollar in the international financial market and U.S. monetary hegemony in the South American economy.

This situation makes the analysis of the relationship of political and economic forces in the region more sophisticated, particularly due to the triangular linkage between the United States, China and South America (Stallings, 2008), in which Beijing suggests advancing forward in South America in search of a monetary hegemony or a coexistence with the dollar. This was projected by Eichengreen (2011, p. 8), when he assessed that the monetary future in the world is the peaceful coexistence between strong currencies.

MacNally (2012) considers that, although from the military point of view, China does not yet represent a threat to the United States in the financial arena. Seeking the geo-economic dominance of several regions, the Asian country already represents a challenge, but on a large scale, the United States. On the other hand, Prasad (2017), while agreeing that there is a growing dispute over monetary matters in certain regions, including South America, believes that the dollar will continue to dominate international finance and that the Chinese currency will not be able to threaten the currency, at least in the short term.

Reflecting on this, we perhaps wonder why the study of the growing Chinese monetary presence in South America matters?

This study is crucial because the internationalization of the RMB has political impacts on trade and financial operations with emerging markets, not only in Asia but especially in South America. Also, the ever growing use of the RMB in the international economy and its use as a reserve currency are symbolic with the growing political influence of China in certain regions of the world, including South America.

Another point that provokes a closer look at the internationalization of the RMB is the perception that South American countries, notably Argentina and Brazil, do not have a strategic plan or an adequate view on what the role of countries in this region's roles should be when it comes to economic and political relations with China (Arnes and Soares, 2016, pp. 6-9).

For example, what are the trade-offs and what benefits could South American countries gain as a result of the rise of China's currency? And how is Brazil positioned in front of the Chinese economic and monetary advance, which has political and economic consequences?

IV. Chinese economic and monetary advancement and Brazil's foreign policy

According to Altemani (2012), sino-Brazilian relations have always been controversial in Brazilian society and have been divergent since the Cold War. At that time, the differences were principally ideological on whether or not Brazil should maintain a relationship with a communist China. Although the ideological bias still remained after the Cold War, the questions over human rights and Democracy have gained importance.

Disagreements these days are centered on the positive or negative aspects of the growing economic and commercial presence of China in Brazil (Altemani, 2012). Despite the divergent positions from a commercial point of view pertaining to China's closeness, assuming this could lead Brazil into an economic dependence in the current molds (with high economic dependence that would make us a commodity exporter), we cannot simply disregard the Chinese economic advance and maintain a passive foreign policy towards China.

As Holanda (2015) points out: “(...) there needs to be a refiguring of the current mold of the sino-Brazilian agenda, otherwise we will crystallize a pattern of international insertion for Brazil that is beyond our means”. Altemani (2012) suggests that the differences in the economic context have no effect on the sino-Brazilian relationship in other areas like technology and politics. In this regard, Brazil needs to intensify a technological cooperation agenda with China, such as the development and production of satellites that have proven to be successful since the Fernando Henrique Cardoso administration.

Holanda (2015) stresses that relations between Brazil and China can be improved, and that the Brazilian Government should structure a foreign policy agenda for the coming years that is geared towards increasing cooperation between the two countries and favors the political and economic balance.

On the other hand, the high volume of bilateral trade agreements between South American countries and China suggests an increase in the use of the RMB to liquidate these operations, not only due to currency swap contracts, but also from monetary clearings located in Chile and Argentina (Arner and Soares, 2016).

It might be incumbent upon Brazil to take advantage of these financial instruments - *currency swap agreements* - that China provides to lower import and export costs between the two countries and obtain counterparts, such as a transfer of technology. Another possibility is the issuance of debt securities in RMB on the basis of these agreements, diversifying the sources of financing for companies and for the Brazilian Government. However, these hypotheses rely on Brazil's strategic foreign policy towards China.

To sum up, it may be inferred from the chapters presented above that Brazil and even other countries from South America do not have any economic or strategic plans to deal with the monetary expansion of China.

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