

# An Analytical Study on The Internationalization of China's RMB Currency

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**Abstract:** The internationalization of the RMB is an inevitable trend as China's economic strength increases and the value of the RMB stabilizes. This essay offers an analytical framework of the internationalization of RMB; it outlines the advantages and disadvantages of the RMB with a view to finding ways to avoid the harm in the internationalization of the RMB, so as to make useful suggestions for policy formulation. It further constructs a comparison of the pros and cons of internationalizing the RMB with the current situation and the favorable conditions for the development of internationalization. Consequently, it outlines future suggestion for the development of RMB in its facet of development.

**Keywords:** International Monetary System; RMB; Internationalization; Currency

## 1 Introduction

In the accelerated growth of China's economy, the internationalization of China's RMB also encounters an anthesis of influences and outcomes. The internationalization of the RMB refers to the process whereby the RMB is able to expand in foreign markets in line with the country's trade in goods and services and, on the basis of the functions of the domestic currency, leave the country through the current account, the capital account and the free exchange of currencies outside the country, gradually becoming a means of circulation, a means of payment, a means of storage and a measure of value outside the country, and becoming an internationally recognized currency for valuation, settlement and reserves. It is freely convertible, universally accepted and relatively stable worldwide.

## 2 Current statuses of RMB

It is generally accepted that there are three stages in the internationalization process: the currency is widely used for cross-border operations; the currency is widely used for financial transactions; and the currency becomes a reserve currency for other countries. In these three stages, China has made significant efforts and achieved some success in currency swaps, cross-border trade settlement of the RMB, exchange rate reform and efforts to join the SDR. The main purpose of currency swaps is to give the RMB access to the markets of neighboring countries and

regions by signing bilateral local currency swap agreements with their monetary governments, allowing the RMB to be widely used in cross-border trade. By the end of 2009, China had signed currency swap agreements with six countries, including South Korea, taking the first step towards the internationalization of the RMB. By 2015, the number of countries with which China has signed currency swap agreements had increased to 32. As the currency swaps have gone smoothly, the People's Bank of China has further promoted the use of the RMB for cross-border trade settlement [6]. From the pilot scheme to the implementation in several provinces and cities to the full coverage of cross-border trade settlement in RMB in August 2011, the volume of cross-border trade settlement in RMB has been growing rapidly and the scope has been extended from current items to capital items. According to data from the People's Bank of China and the Ministry of Commerce, in 2015, cross-border RMB settlement business grew by 10.38% year-on-year. The Renminbi Cross-border Payment System (Phase I) also went live in the same year, marking a further improvement in the payment system.

On 11 August 2015, the exchange rate reform further advanced the internationalization of the RMB, with the Central Bank announcing a mid-price quotation mechanism for the RMB to USD exchange rate, whereby market makers provide mid-price quotations to the China Foreign Exchange Trade Centre with reference to the closing exchange rate in the interbank foreign exchange market on the previous day. This adjustment reflects more realistically the current supply and demand in the foreign exchange market, making the two-way floating flexibility significantly greater, rather than just unilateral appreciation, which avoids large fluctuations in the exchange rate and enhances its transparency and marketability. The importance of being the last to join the SDR cannot be overstated, and China has made great efforts to join the SDR. Interest rate reform and exchange rate reform provided the preconditions for this [1]. The introduction of the Shanghai-Hong Kong Stock Connect system, allowed foreign financial institutions to access China's interbank bond market. Also opened up the country's securities market, and on 1 April 2017. T[7]he RMB was confirmed as the global reserve currency in a separate column in the IMF's Global Foreign Exchange Reserves Report. Throughout the past 30 years, the RMB has steadily progressed on the path of internationalization and has achieved significant results.

### 3 Advantages of the RMB internationalization

**Table 1** Currency structure of global foreign exchange reserves (% of global foreign exchange reserves)

Year/currency	US dollar	Yen (JAP)	British pound	Swiss Franc	Euros
1997	65.2	5.8	2.6	0.3	-
1998	71.0	6.2	2.7	0.3	-
1999	71.01	6.4	2.9	0.2	17.9
2000	71.4	6.1	2.8	0.3	18.4
2001	67.0	5.1	2.7	0.3	19.3
2002	65.9	4.4	2.8	0.4	23.9
2003	65.9	3.9	2.8	0.2	25.3
2004	66.8	3.8	3.4	0.2	25
2005	66.5	3.6	3.7	0.1	24.4

Source: China's foreign exchange reserves

Under the modern monetary system, minting tax is not a tax under the tax system, but the difference between the face value of the currency and the cost of issuing it, i.e. the revenue generated by the issuer's privilege of issuing the currency. A country's currency becomes an international currency and generates a significant amount of revenue from minting taxes. For example, when the US dollar becomes an international currency, the minting tax is almost equal to the amount of base currency issued, as the marginal cost of issuing banknotes under a legal tender system is almost zero. According to studies, the US mint tax revenue is equivalent to 0.43% of its GDP and Japan's mint tax revenue is equivalent to 0.46% of its GDP. As of 2008, the US minted over US\$18.4 trillion as a result of the US dollar's status as the international monetary standard. If the RMB could become an international currency of exchange and payment, or even a reserve currency, China could also receive the same high minting tax revenue as the USD and JPY [3].

At present, China's foreign trade and foreign financial activities have entered a period of unprecedented development, and exchange rate fluctuations have always been one of the important factors troubling and constraining the open economy. The rapid development of foreign trade has led foreign trade enterprises to hold a large number of foreign currency claims and debts, which are subject to huge risks due to the volatility of foreign currency exchange rates, while exchange rate fluctuations have a negative impact on the operation of enterprises. The internationalization of the RMB will reduce the loss of wealth caused by the use of foreign currency and will also facilitate the development of financial markets such as RMB-denominated bonds. The greater the degree of internationalization of the RMB, the more significant its share in foreign trade and indeed in other economic transactions, and the less exchange rate risk China will be exposed to.

The internationalization of the RMB is not only conducive to the risk diversification of national reserves in terms of currency, but also to gaining more international rights for developing countries, which will be a great force for maintaining stability and justice in the international monetary system. As a result of the internationalization of the US dollar and the establishment of its hegemony after the Second World War [7], the US dollar accounts for a large proportion of global foreign exchange reserves. It can be seen in Table 1, that the US dollar accounts for more than 60% of global foreign exchange reserves and more than 70% of developed countries' foreign exchange reserves. If the RMB is internationalized, the proportion of RMB in global foreign exchange reserves should be in the range of 15-20%. With the RMB as an additional option, countries around the world would be able to stabilize their wealth without the embarrassment of having to deal with a significant depreciation of the US dollar, which would result in a significant reduction in wealth.

The currency is the carrier of funds, and funds are the blood of economic activities. The internationalization of a country's currency is the result of the development of a country's comprehensive economic strength to a certain extent. At present, China has become the fastest growing economy and a major provider of international import and export markets, with a certain degree of economic strength and international credit standing. Accelerating the internationalization of the RMB and enabling the RMB to achieve capital account convertibility as soon as possible as well as free convertibility in the future will enable China to have the power to issue and regulate a world currency, enhance China's influence, and say on global economic activities and enable China's international status to be considerably improved.

## 4 Disadvantages

The advantages of rights often come with additional responsibilities. The internationalization of the RMB is expected to improve the inherent weaknesses of the current international monetary system, such as instability, self-interest and the asymmetry between rights and obligations. The reality of the internationalization of currencies such as the US dollar and the euro shows that having the right to issue international currencies means huge economic and political benefits in terms of making or changing the rules governing international affairs. But with this power comes additional international responsibilities that may conflict with domestic policy objectives and may undermine domestic economic interests. This was illustrated by China's commitment not to devalue the RMB during the 1997 financial crisis [4].

It will have some impact on China's economic and financial stability. The internationalization of the renminbi has closely linked China's domestic economy to the world economy, and any changes in the international financial markets will have a certain impact on China's economy and finance. In particular, if the real exchange rate of the local currency deviates from the nominal exchange rate, or if the spot exchange rate and interest rate deviate from the expected exchange rate and interest rate after the internationalization of the currency, it will give international investors an opportunity to arbitrage and stimulate short-term speculative capital flows. For example, when the domestic monetary policy is tightened to control inflation and interest rates are raised, the RMB in international circulation will take advantage of the opportunity to increase the supply of RMB, thus weakening the effect of the implementation of monetary policy.

Make it more difficult to manage and monitor RMB cash. After the internationalization of the RMB, it will be more difficult for central banks to manage RMB cash as it will be more difficult to monitor the demand and circulation of RMB cash abroad. At the same time, the cross-border movement of RMB cash may increase the emergence of illegal activities such as smuggling, gambling and drug trafficking. The abnormal cross-border flow of RMB cash accompanying these illegal activities will affect the stability of China's financial markets on the one hand and make it more difficult to combat counterfeit currency and money laundering on the other. Although the internationalization of a country's currency may have some adverse effects on the country, the benefits of internationalization in the long run far outweigh the costs.

## 5 Suggestions

### 5.1 Break through the plateau of economic development and maintain stable economic growth.

Strong economic strength is the material guarantee for the internationalization of the RMB. Since the reform and opening up, China's economy has continued to grow at a rapid pace, especially since the 1990s. Table 2 shows that China's GDP grew at an average annual rate of 9.1% from 1990 to 2005, with 8.6% from 2000 to 2005. However, there is still a significant gap between China's economic strength and that of countries with more internationalized currencies, both in terms of total and per capita figures. The country's economic development at this stage is still beset with plateau that must be broken through in order to maintain rapid and stable

economic growth. Some specific measures: Firstly, the economic structure should be adjusted. We should speed up the reform of state-owned enterprises, establish a state-owned capital management budget system, continue to promote the establishment and improvement of the board of directors of wholly state-owned companies on a pilot basis, and promote the cultivation and development of a number of large companies and conglomerates with independent intellectual property rights, well-known brands, and strong international competitiveness [2]. Industrial restructuring should be accelerated. We should consolidate and strengthen the basic position of agriculture, upgrade the industrial structure, improve the technological content of products, restructure industries with excess capacity and strictly limit new production capacity, and optimize the structure of the service industry, vigorously developing information, finance, insurance, logistics, tourism, and community services.

**Table 2** Comparison of China's GDP relative to other countries with higher degree of currency

Unit: billion US dollars

Year/country	China	US	Japan	German	England
1996	8218.55	78168.20	46882.58	24385.72	11924.84
1997	9034.48	83043.30	43055.85	21605.65	13275.21
1998	9542.66	87469.80	39332.49	21844.72	14253.74
1999	9986.78	92684.30	44553.54	21435.56	14651.98
2000	10791.92	98169.70	47488.52	19002.21	14457.26
2001	11911.57	101279.00	41649.73	18909.54	14352.92
2002	13035.95	104696.00	39733.31	20187.47	15740.11
2003	14706.95	109712.00	42938.42	24416.67	18074.82
2004	17203.99	117343.00	46692.95	27511.13	21339.37
2005	n.a	124857.00	n.a	27924.94	22034.85

International Monetary Fund IMF Database

## 5.2 Improving the financial system and providing quality and efficient financial services

The internationalization of the RMB inevitably requires the internationalization of financial services. China's current financial system is not perfect and is unable to provide quality and efficient financial services to promote the internationalization of the RMB. Improving the construction of China's financial system is an indispensable condition to ensure the successful internationalization of the RMB. Specific measures: First, continue to deepen the reform of state-owned banks. For a long time, due to the serious shortcomings of "one share is too big", the lack of owners and the lack of separation between government and enterprises, state-owned banks have had a high rate of non-performing assets and difficulties in operation. The Bank of China and China Construction Bank were reorganized as joint stock companies on 26 August and 21 September 2004 respectively. China Construction Bank was successfully listed on 27 October 2005. The next step is to continue to promote the reform of Bank of China and China Construction Bank and shift the focus of the reform to improving the corporate governance mechanism. Specific measures include, firstly, clarifying the responsibilities of the various organizational bodies and establishing a scientific agenda for deliberation and decision-making, in particular to regulate the exercise of shareholder ownership; secondly, establishing a standardized board of directors system, which should establish a system of efficiency evaluation and accountability

and make full use of the professional committees to achieve effective governance and scientific management of the bank; thirdly, improving the professional management level of the management; and fourthly, strengthening the functions of the Supervisory Board. Fourth, the functions of the Supervisory Board should be strengthened. At the same time, the financial restructuring of the ICBC and the Agricultural Bank of China should be accelerated, and the pace of shareholding reform should be accelerated. Second, we should vigorously develop small and medium-sized banks and optimize the structure of the banking system. Small and medium-sized enterprises (SMEs) occupy a pivotal position in China's economy. According to data, by 2004, the number of SMEs accounted for 99.6% of the total number of enterprises in China. The value added created by SMEs accounted for 55.6% of China's GDP. At present, the environment for the development of SMEs is very difficult, especially in terms of financing. Large banks are hardly the main channel for SME financing due to the difficulty of risk control and high operating costs. Based on the experience of SME financing, the vigorous development of small and medium-sized banks is an effective way to solve the financing difficulties of SMEs. In addition, it is prudent to provide guarantee and deposit insurance services for SMEs. Thirdly, we should promote the development of the bond market. Accelerating the construction of the bond market will help to resolve the long-standing imbalance between indirect and direct financing in China, continue to broaden the investment and financing channels of enterprises and financial institutions, reduce the risks of the banking system, innovate money market trading tools, and improve the transmission mechanism of monetary policy. To promote the bond market, it is necessary to vigorously develop the secondary market to increase the liquidity of bonds; develop a market maker system, establish a bond quotation system, and improve the bond pricing mechanism; promote the reform of the interest rate market, increase the variety of bonds and expand the scale of the bond market; and establish an objective and scientific bond rating agency[5].

### **5.2.1 Promoting the favorable effects of RMB internationalization and avoiding the unfavorable effects of RMB internationalization**

As China's economic strength continues to grow and its financial system continues to improve, the internationalization of the RMB has become an objective and natural development process. At the same time, in order to better promote the internationalization of the RMB, some measures need to be taken to promote the beneficial effects of the internationalization of the RMB and avoid its adverse effects. 1. Strengthen the statistical work of the flow of RMB into and out of the country. The author found that statistics on the entry and exit of the RMB were incomplete or difficult to find when he was collecting revenue from the RMB internationalization minting tax. On the one hand, it is beneficial to China's supervision of the flow of RMB to prevent risks, and on the other hand, it is also convenient for scholars to conduct relevant research, so as to better contribute to the internationalization of RMB. Specific measures: Firstly, the outflow and return of RMB should be more integrated into the banking system. The number of border bank branches should be increased, and the scope of services expanded so that RMB settlement for border trade can be more bank-based; the scope of RMB business conducted abroad should be expanded, etc. Secondly, we should step up law enforcement supervision and crack down on illegal activities such as smuggling, drug trafficking and offshore money laundering. Third, strengthen exchanges and cooperation with neighboring countries. 2. Improve the monetary policy transmission mechanism. As already mentioned, the internationalization of the RMB will have a negative impact on the effectiveness of China's monetary policy. Strengthening the capacity of China's monetary and economic policy regulation is an important condition to ensure

the smooth internationalization of the RMB and to resist external shocks. An important aspect of strengthening the ability to regulate monetary policy is to improve the monetary policy transmission mechanism. Specific measures: firstly, deepen the reform of interest rate market and strengthen the construction of bond market; secondly, we should strengthen the research on the theory of money demand and supply in an open economy.

## 6 Conclusion

To conclude, the benefits of internationalization far outweigh the costs, despite the adverse effects of internationalization on a country's currency. A comparison of the benefits and costs of internationalization of the RMB shows that the costs of internationalization are relatively limited compared to the tangible and intangible economic and political benefits of internationalization. It is certain that actively promoting the internationalization of the RMB is an inevitable choice. The internationalization of a currency is an inevitable consequence of a country's path to power, and likewise the internationalization of the RMB is an inevitable choice for China's path to power. As history has shown, just as the road to power is a long one, the internationalization of the RMB will also be a long one, requiring both economic strength and political strategy. In order for China to transform itself from a great power to a strong one, it must resolve the conflict between a large trading power and a small financial power, which depends on the rise of finance, which requires an internationalized currency environment. In the current global financial crisis, where the overall strength of countries is waxing and waning, the opportunities for RMB internationalization are, on the whole, greater than the challenges.

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