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The Impact of "Belt and Road" Initiative on the Internationalization of Chinese Renminbi

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Abstract:

President Xi proposed building the Silk Road Economic Belt and 21st-Century Maritime Silk Road, which became known as the "Belt and Road" Initiative. In 2016, the RMB (Chinese currency) officially joined the SDR (Special Drawing Rights), and the RMB's entry is the integration of the Chinese economy into the global financial system. The internationalization of the RMB is the need for the development of global economic integration and the development of China's international trade. This "initiative" provides strong support for the internationalization of the RMB. Besides, how to achieve balance in maintaining the country's economic stability and promoting currency internationalization has always been a difficult issue faced by Chinese monetary authorities when the issue of "big country with small currency" presented. Based on the theory of internationalization of currency, this paper discusses the mutual promotion between RMB's internationalization and the "Belt and Road" initiative, the role of the "Belt and Road" Initiative as a driving force to RMB's Internationalization.

Keywords: Belt and Road Initiative, Chinese RMB, Internationalization, Cooperation

Introduction:

On October 1, 2016, the RMB (Chinese currency) officially joined the SDR (Special Drawing Rights), and the RMB's entry is the integration of the Chinese economy into the global financial system. In particular, China's implementation of the "Belt and Road" Initiative (B&R Initiative) and supply-side reforms have greatly accelerated the process of internationalization of the national currency. The internationalization of the RMB is the need for the development of global economic integration and the development of China's international trade. Not only enhances China's international status and influence but also can effectively relieve the pressure on China's current high foreign exchange reserves. With the implementation of the B&R Initiative, it will stimulate China's international trade and expand the international market and provide strong support for the internationalization of the RMB. China is the only country that mainly uses foreign currency in an international settlement among the top five countries in the world's GDP ranking. At the same time, with a single foreign exchange structure, long-term exposure to the impact of U.S. monetary policy, China presents the issue of "big country with small currency." How to achieve balance in maintaining the country's economic stability and promoting currency internationalization has always been a problematic issue faced by Chinese monetary authorities. With the continuous promotion of the B&R Initiative, the RMB is widely used in trade and capital exchanges with countries along the initiative to promote

RMB's function of valuation, settlement, and storage in the region, which is expected to become the key to the internationalization of RMB. This paper mainly analyzes the impact of the B&R Initiative on the internationalization of the RMB.

1. Theoretical Background- Internationalization of Currency:

Currency internationalization is the internationalization of sovereign currency, that is, the currency issued by a country (region) is used for international trade settlements, trading in the global financial market, and becoming one of the major currencies of global reserves. Cohen (1971) is one of the pioneer scholars studying international currency issues, and he defined the international currency from the perspective of the function. The function of the international currency abroad is the expansion of the domestic function. Privately or officially, for any purpose, when the use of a currency is extended beyond the country of issue, the currency has the characteristics of the international currency. Hartmann (1998) further expanded Cohen's definition from the perspective of the functions of money. He divided the functions into three different levels: accounting units, payment instruments, and value storage. When a currency is used for the valuation of international trade or financial transactions and is used by the official institution as an "anchor" of the exchange rate, the currency performs the function of international currency of the accounting units; When a currency is used for direct currency conversion in exchange transactions under international trade and capital accounts or as a vehicle currency for exchange of other two currencies, it is also used by the official sector as a tool for intervening foreign exchange market and balancing international payment, which performs the function of the international payment instrument; When a currency is used by a non-resident private sector to select financial assets, for example, possessing financial assets such as deposits, bills,stocks, etc. Alternatively, the non-resident's official sector holds reserve assets in the name of that currency, and it reflects the value storage function of the international currency. At the same time, he believed that a currency is considered as an international currency does not mean that it has all three monetary functions, and it even requires only one or two of them. For instance, SDR is an international currency that has only the value storage and part of the payment functions. For the use of currency, the IMF puts its requirements on SDR for a country's currency, emphasizing the ability of the international currency to be "freely usable (IMF, 2018)."

Tavlas (1997) believed that when a currency is used as an accounting unit, a vehicle or value storage method, which is an international currency. Mudell (2003) indicated that the currency circulation exceeds the legal circulation area, or other countries or regions imitate the fraction or multiple of the currency, then the currency is an internationalized currency. Bergsten (1975) summed up the conditions for currency internationalization as political and economic support. The countries that supply the international currency must have strong political influence and strength internationally in order to gain general support and to lead international economic cooperation. Besides, it needs to have strong economic strength, which internally reflects its comparative advantage in terms of the economic scale, growth rate, and price stability, as well as strong independence of currency and developed financial markets. Externally, it is reflected in confidence in maintaining currency convertibility, a reasonable liquidity ratio, and a robust structure of the balance of payments.

Andrew (1991) considered international currency to be the product of competition between the national currencies. The international status of a country's currency or the degree of internationalization is an external manifestation of the country's economic strength. The country's economic strength has determined the level of international currency competitiveness and the length of the international monetary cycle.

Studies by McKinnon (1979) and Krugman (1980) showed that the use of money has the characteristic of decreasing costs, traders will always choose the most widely used currency as a trading vehicle to reduce transaction costs. In the settlement process, the difference in traded products determines the choice of transaction money. Traders with a competitive product advantage have stronger currency options. Matsuyama, Kiyotaki, etc. (1993) particularly emphasized that the degree of openness of the economy to a certain extent determines the scope of use of the currency. The essential competitiveness of sovereign currencies as an international currency is reflected in the level of economic growth and status of international trade of the issuing country. In the open economy, the former determines the latter somehow. Eichengreen and Frankel (1996), Chinn and Frankel (2005) stressed the importance of economic aggregate, that is, the total economic volume of the international currency issuing countries should occupy a significant proportion of the world economy. Flandreau and Jobst(2006) discussed the importance of international trade, the content of acting as an international currency is reflected in the international trade process, including the extensive use of valuation and settlement.

2.Mutual Promotion between RMB's Internationalization and the "Belt and Road" Initiative:

The internationalization of RMB is an important component of China's financial power strategy. The internationalization of a country's currency is linked to the openness of capital projects. Its implementation process is generally based on the sequence of convertibility current account, convertibility of capital account, internationalization of home currency promoted by the government, and full convertibility of home currency. The realization of the internationalization of RMB will push China to become a global economic and financial powerhouse gradually. The core of internationalization is the use of RMB as a money of account. The government's traditional idea is to realize RMB outflow through imports, purchase RMB bonds overseas, and inflow of RMB in the form of FDI, relying on the widespread use of RMB in the international market to expand the recognition and acceptance of RMB. The essence of this process is to rely on the trading volume that supports the scope of RMB use, and gradually realizes the transition from the international settlement currency, investment currency to reserve currency. China has consistently maintained an independent central bank policy, a gradual opening of the capital market, and a flexible market-based exchange rate system based on the operational choices of Mundell's "impossible trinity."[1]Although this cannot achieve a simultaneous balance between monetary policy, exchange rate regime, and the capital market opening, it can use a "non-corner point" to achieve a dynamic overall equilibrium of three while maintaining the balance of the two.

What the B&R Initiative pursues is to achieve win-win cooperation. This is in line with the standard requirement of fostering a new growth point in the global economy

The impossible trinity also called the Mundell-Fleming trilemma or simply the trilemma expresses the limited options available to countries in setting monetary policy. According to this theory, a state cannot achieve the free flow of capital, a fixed exchange rate and independent monetary policy simultaneously. By pursuing any two of these options, it necessarily closes off the third. Third. and compensating for the "short planks" of economic growth in developing countries. From the perspective of economic restructuring and upgrading, China needs new growth drivers to realize high-quality development. The increase in factor costs, the decrease in comparative advantages, the long-term accumulation of many structural contradictions, all the problems need to optimize the spatial layout, balance the supply and demand structure, beautify the natural environment and achieve transformation and upgrading in regional structure, technical structure and industrial structure, etc. The B&R Initiative has provided a platform for transformation and adjustment.

From the perspective of the global economy, the focus of world economic growth is shifting. First, with the significant increase in the relative contribution of China and the vast number of developing countries in global economic growth, global economic growth has shifted from developed countries to emerging economies and developing countries; second, the diversified and multi-level international trade. China's foreign economic and trade growth is shifting from Western developed economies to countries in different regions.

3. The "Belt and Road" Initiative as a Driving Force for RMB's Internationalization:

The launch of the initiative not only meets the needs of the developing economies along, in improving infrastructure and accelerating economic growth, but also satisfies the demand for domestic capital and production capacity, and is conducive to cross-border trade and investment in RMB.

3.1 Shaping a Positive Environment:

The B&R Initiative creates an environment for China's peaceful development. It is designed to adapt to the globalization, relying on the existing bilateral and multilateral mechanisms between China and relevant countries, and through China's reform and development to establish a solid foundation for the countries along the initiative to be independent, diversified, and mutually beneficial. Creating a peaceful development environment for China is an important step to build a new type of open economic system. It will also provide intrinsic impetus to China's economic growth and opening up reforms in the medium and long term, which will help to promote the reform of RMB capital account convertibility and provide a relaxed environment for RMB internationalization.

3.2 Expanding Spatial Base:

The B&R Initiative helps the industry to export and the flow of production factors. Countries and regions have significant differences in terms of natural resources, geographical environment, culture and education, economic level, and industrial structure. The existence of such differentiation has become a strong driving force for the cooperation and development of countries and regions. China can make use of this difference to optimize the industrial structure by absorbing high-tech industries and technologies from advanced economies, helping other developing countries improve their living standards by exporting technology and investment, improving the long-term rate of return on investment through the development of markets of scale.

The B&R Initiative expands overseas capital stocks and avoids domestic inflation. The State's stock of capital in the "Belt and Road" region is relatively low, which provides a good opportunity for China's capital to move outwards. China's capital-output has created a more relaxed development space for the internationalization of the RMB: first, it promotes the transformation of domestic foreign exchange stock into real capital, reduces pressure on foreign exchange reserves, and balances the country's capital structure. The second is to expand the scope of offshore RMB, enlarge offshore RMB settlement areas and markets stock, and promote the mutual repercussions between the offshore RMB market and the onshore market. Third, inland cities participate in industry output, highlighting RMB's valuation function of the international market, and also helping to balance domestic asset prices and avoiding the possible impact on domestic inflation caused by exchange rate fluctuations. Fourth, the interlocking effect of financial capital, loan capital and financial market caused by the transfer of industrial capital, strengthening the interaction of "industry-capital-market" home and abroad and promoting the construction of China's international financial center.

3.3 Reconstructing the Global Free Trade Area Network:

The current proportion of trade between the countries along the B&R Initiative does not match the national strength. Due to severe trade and investment barriers, it does not reflect the real trade demand of all parties. At the same time, emerging economies have higher real GDP growth show that countries have great potential for trade flows(See Graph1).

Graph 1: The comparison between emerging market and developing economies and the world (%)

	Item	2009	2010	2011	2012	2013
Emerging market and developing economies	Real GDP growth	2.8	7.4	6.4	5.4	5.1
World	Real GDP growth	-0.1	5.4	4.3	3.5	3.5

Source: IMF

This initiative is not a simple capital export and input. What is more important is to establish a network of free trade areas based on Asia, and to radiate the world through cooperation to strengthen the foundation of economic and trade exchanges between neighboring countries.

Conclusion:

Under the B&R Initiative, the internationalization of RMB faces three problems. The first is that China, as a developing country, has a significant gap in economic strength compared with developed countries. It has a high degree of foreign dependence, lacks the capacity of independent innovation. Second, the financial system is not open enough, and the freedom of financial institutions is limited. The proportion of indirect financing is too high, and the domestic capital market is underdeveloped. It is necessary to deepen the reform of large-scale financial institutions further. Third, the internationalization of RMB faces political challenges. The United States' status as the world's most powerful economy and the dollar's role as the dominant global currency. RMB is unlikely to challenge the status of the dollar, and even replace the dollar.

With the development of China's economy, the RMB's position in the world's monetary system has become increasingly prominent, and its internationalization trend is irreversible. In particular, in 2013, China officially promoted the "Belt and Road" Initiative. Under this background, the optimization and upgrading of the RMB internationalization structure will exert a significant influence on China's import and export trade, financial markets, and the real economy.

Therefore, China should cooperate with other countries or financial companies to jointly promote the internationalization of RMB. At the same time, the economic system should be reformed continuously, adopt policies that are conducive to the development of the real economy, support the internationalization of RMB with the real economy, form a virtuous circle to promote the sound and rapid growth of the Chinese economy.

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