RMB Internationalization: A Fragile Impetus in the Global Monetary Order and the Dilemma of Regional Leadership

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Minglou LI
University of Edinburgh, United Kingdom
minglou.li@ed.ac.uk

Abstract

The internationalization of the renminbi (RMB) is viewed by some experts as a potential challenge to the US dollar's (USD) hegemonic status in the current global monetary system. This study employs a mixed theoretical framework to delve into the prospective evolution of China's monetary influence. By applying the power transition theory to analyze the global monetary power structure, this study evaluates China's dissatisfaction as a potential challenger against the dominance of the USD and examines the power parity between China and the United States. On a regional scale, the analysis focuses on possible Asian monetary integration of the RMB-domination by adopting the neofunctionalist paradigm derived from the European experience and juxtaposing this process with European monetary integration. The analysis shows that China has not been able to directly challenge the dominance of the USD, nor has it effectively spearheaded the agenda for regional monetary integration. More specifically, China's export-oriented growth model has hindered the emergence of the RMB as a substantial competition to the USD within East and South Asia.

Keywords

Monetary Power; Hegemony; Integration; China; US Dollar; Renminbi; Internationalization of the Renminbi

Introduction

Since 2009, China has made impressive strides in the renminbi (RMB) internationalization agenda. For example, one of China's most significant achievements has been the RMB's admission to the special drawing rights (SDR) currency basket of the International Monetary Fund (IMF). Being added to the SDR currency basket has come with valuable advantages, such as international recognition of China's expanded exporting capacity and a wider usability of the RMB (IMF 2023a). The progress in the RMB internationalization is further reflected by approximately 30 bilateral currency swap deals as well as an increase in both the number of states that hold the RMB as a part of their foreign exchange reserves and its proportion in global foreign exchange transactions. Compared to the USD, however, the RMB internationalization level is still relatively low.

On one side, some scholars find that the gap between the USD and the RMB is gradually reducing. For example, Wang and Wang (2022) note that the RMB is approaching

the leading position of IMS and will soon be able to shape global currency market development in a similar way to the USD. Cheung (2021) even outlines a clear path, including some policy recommendations for China, such as liberalizing its financial markets and loosening control of capital flow, to further advance its progress in internationalizing the RMB. More so, he confidently asserts that the increasingly internationalizing RMB will unavoidably intensify monetary power competition between the US and China.

However, other researchers argue that China's potential to hold a key currency status similar to the US is unlikely, given China's export-oriented growth model and the government's tight control of the national financial market. For example, Adam Przeworski (1991) points out that an authoritarian regime, such as the Chinese Communist Party (CCP), relies on significant economic prosperity to legitimize its rules. Meaning, the domestic governance legitimacy of the CCP significantly underpins the accruement of internal wealth. Additionally, China's export-oriented growth model continues to bring domestic economic development (Hamilton-Hart 2014). Indeed, since China joined the World Trade Organization in 2001, its current account has consistently demonstrated a surplus, primarily attributed to its extensive export endeavors that target consumption-driven markets. With large capital inflows, China continues to maintain strict capital controls, and as a result, currently holds the largest foreign exchange reserves in the world.

More so, China's export-oriented growth model stimulates household savings that serve as a financial buffer, mitigating life uncertainties and unavoidable expenses. Such a private financial shield is particularly significant in China's society where welfare provisions are limited. These reserves also offer a symbolic advantage, helping the CCP to maintain an illusion of economic openness—a trend that began in 1978. With the implementation of a set of economic policies, known as the "Reform and Opening-up" policies, China's economic rise kickstarted and legitimized the CCP's development strategies for the past four decades.

While these policies ensure trade surplus, encourage domestic savings, and stimulate domestic development, they also limit China's ability to bear the costs of the key currency status. For instance, issuing extra currency to increase convertibility and foreign states' reserves would lead to currency devaluation, reducing the value of private savings. Similarly, opening the domestic market to foreign exporters and abandoning controls over cross-border movement of capital would result in capital outflow. In sum, the costs associated with acquiring the key currency status would destabilize the export-oriented economic model,

resulting in a crisis of government legitimacy. Such a trade-off is unacceptable for the CCP, which prioritizes social and political stability.

Furthermore, state interventions are necessary to maintain China's growth model (Katada 2017). To encourage the development of manufacturing industries, the state provides subsidies and low-interest loans to domestic enterprises. The state also maintains low costs of labor and turns a blind eye to unethical industrial practices. As a result, China remains "the world's factory," producing almost all imaginable goods at low cost and with high efficiency for export to global markets (Ravenhill 2020). At the same time, the state restricts domestic capital outflow through the Regulation of the Chinese Foreign Exchange Administration (State Council of the PRC 2008). Thus, the wealth earned from exports largely remains within China's borders, which limits the availability and convertibility of the RMB in the global market. Indeed, the state's restriction on capital outflow also restricts international actors from accessing sufficient amounts of RMB. Simply put, the state does not want to jeopardize its current economic growth model in favor of obtaining the status of key currency for the RMB.

Overall, state control over the national economy and regime legitimacy are interconnected. Policies that promote exports and diminish capital outflow stimulate domestic savings that citizens rely upon to absorb risks from impaired social welfare. Thus, citizens passively support the CCP's development strategy, which, in turn, encourages the CCP to adhere to earnings-oriented policies rather than invest in the internationalization of the RMB. When seeing the key currency as a public good that incurs costs for the entity that offers it, assuming the role of a provider of a public good disrupts the existing state of affairs in which the CCP's pursuit of regime stability aligns with residents' aspirations for wealth accumulation.

The existing literature tacitly presumes that China's policy goal (or at least one of its goals) for the RMB internationalization is to challenge the US hegemony. However, the analysis above shows that RMB is unlikely to obtain key currency status because China cannot afford the costs associated with it. If the goal of internationalization is to replace the US hegemony, then China should suspend or thoroughly re-design its strategy. Yet, Chinese foreign direct investments and financial aids to developing states through the Asian Infrastructure Investment Bank (AIIB) (2021, 12) have been consistently increasing in recent decades, which indicates that China aims to internationalize RMB.

To address this apparent contradiction, I posit that the existing literature oversimplifies China's rising monetary power by framing it as a zero-sum game—a power

shift challenging the US monetary hegemony. As previously mentioned, scholars such as Wang and Wang (2022) and Cheung (2021) propose that rising China has the potential to successfully challenge the dominance of the USD. In contrast, following the logics of scholars like Przeworski (1991) and Hamilton-Hart (2014), China is anticipated to face challenges in competing with the US because of inherent domestic structural barriers. This dichotomous narrative, however, falls short of capturing the intricate motivations underlying RMB internationalization. To fill the gap, this article centers on the following interconnected research questions: Why does China continue to pursue the RMB internationalization without a clear ambition to challenge the hegemonic status of the USD? What are the implications that this internationalization has on the current US-led international monetary order?

In this article, I will critically rethink the nature of the monetary power conflict between the US and China, as this will allow me to explain what the RMB internationalization means to the existing IMS. To do so, I will use the power transition theory that defines satisfaction and power parity as two factors causing conflict. My goal is to explain China's motivations for promoting the RMB internationalization, as well as the country's policy ambitions, by examining the degree of the potential challenger's dissatisfaction. I argue that the US policies and economic sanctions on China that aim at promoting further liberalization of China's national financial market are the sources of China's dissatisfaction with the current unipolar international monetary power structure. I will conduct a comparative analysis of the USD and other regional key currencies (the euro and the yen) to estimate the potential of the RMB to become a key currency, as well as its relative competitive advantage in the existing IMS. I will then focus on the progress of the RMB internationalization on the regional level in East and South Asia. Here, I will examine China's potential for regional monetary integration and draw parallels to the neofunctionalist framework derived from European monetary integration by focusing on loyalty and spillover as well as their underlying motivations.

Rethinking the US-China Monetary Power Transition

In the framework of the power transition theory, conflicts can only arise when the challenger's willingness to challenge the status quo and power capacity—that is the capacity to achieve parity relative to the hegemon—are attained simultaneously (Russett and Star 1992). Organski (1958) suggests that satisfaction and dissatisfaction with the current hegemon—in this case, the hegemony of the US within the existing IMS—determine state

interactions. While satisfaction with the current hegemon leads to cooperation and peace, dissatisfaction results in competition and conflict. Although general satisfaction in the global power hierarchy does not guarantee a stable hegemony, the potential challenger's dissatisfaction often leads to different levels of power competition.

Similarly, Moul (2003) bases his analysis on empirical evidence from the past 200 years. He contends that power parity between opposing sides is very likely to incite conflict based on an analysis of empirical evidence from the past 200 years. Upon attaining a state of approximate power parity, the aspiring challenger may find a greater incentive to prioritize the potential benefits over the associated costs in the deliberation of whether to initiate conflicts aimed at contesting the prevailing hegemony of the dominant entity.

Taking the power transition theory as a starting point, my analysis will present a more in-depth investigation of the two conditions. In other words, my examination hopes to determine the likelihood of a conflict by going beyond discussing the two dichotomies that the power transition theory outlines (e.g., satisfaction/dissatisfaction and power parity/imbalance). In this sense, the power transition theory only provides a basic conceptual framework. A more nuanced analysis of each condition is necessary to go beyond simply reiterating the already established logic between the two conditions.

Hegemonic Stability Theory: Reviewing the Theoretical Base for the Current Unipolar IMS

Kindleberger's *The World in Depression 1929-1939* presents the famous hegemonic stability theory, arguing that a unipolar international system offers greater stability than either bipolar or multipolar systems (Kindleberger 1973). According to Kindleberger, the hegemon acts as a public goods provider, proposing and implementing solutions for global problems. Such solutions may include offering discount facilities, making counter-cyclical lending available, encouraging markets during periods of economic stagnation, as well as promoting international cooperation through the IMF, World Bank, trade agreements, and other institutions. Above all, such solutions are said to stabilize and maintain a liberal monetary order. However, providing such public goods comes with significant costs. Hence, the provision of public goods is contingent upon a hegemon that is willing to and simultaneously has sufficient capacity to bear costs associated with leadership (Gavris 2021).

Kindleberger dismisses the notion of a conceivable bilateral co-leadership, suggesting that such an arrangement could potentially disrupt the provision of public goods. The underlying logic in this context is that such a leadership arrangement is perpetually caught in

a cycle of being relinquished by one party and subsequently assumed by another. As one participant gradually weakens, the other progressively diminishes its inclination towards the dominant role, ultimately culminating in an inherently unstable IMS. Consequently, Kindleberger's theory unveils a causal connection between the existence of a unipolar leader within the power hierarchy and the stability of a liberal IMS. This stability is achieved through the identification of the incurred costs associated with assuming such a hegemonic position and its sustainability.

Kindleberger (1973) acknowledges the significance of small and middle powers within a unipolar framework. Small and middle powers, devoid of the direct capability to exert influence on global dynamics, tend to adopt an advisory role, primarily focused on persuading the hegemons. Without having to assume additional international responsibilities, these states tend to prioritize their individual national interests. However, on some occasions, they may extend foreign aid, a gesture stemming from rational deliberation or, at times, prompted by ethical considerations. The convergence of their respective positions and operational inclinations implies that the preferences of small and middle powers are guided by national self-interests when responding to the choices of the leaders. Consequently, these advisors are inclined to achieve swift economic progress, particularly when their exclusive focus on national interests is not subject to censure, and major powers are enticed to provide public goods.

In this article, however, I argue that Kindleberger's analysis of the international hierarchy is largely static and overlooks the potential for small and middle powers to develop over time. For example, a pivotal question that remains unanswered in his framework pertains to the resolution of conflicts arising from emerging challengers represented by small and middle powers within the unipolar structure, while concurrently upholding the integrity of this structure.

China's Dissatisfaction with the USD Hegemony

Through its participation in the US-led liberal international economic framework, China has undergone rapid economic growth, attributable to its export-driven growth paradigm. This dynamic has facilitated the augmentation of China's economic influence on a broader scale. However, China has also consistently conveyed discontentment with the unipolar IMS dominated by the US. For instance, the Ministry of Foreign Affairs of the People's Republic of China (PRC) released a report titled *US Hegemony and its Perils*, which explicitly articulates China's concerns: According to the report, "China opposes all forms of

hegemonism" (2023, 1). Diverse "hegemonic practices" bring "grave harm" (2023, 5) and, as a case in point, "the hegemony of USD is the main source of instability and uncertainty in the world economy" (2023, 3). China attributes the financial challenges faced by other nations, especially emerging economies, to the dominance of the USD within the IMS. This prevailing structure allows the US to leverage its global primacy, often to the detriment of the interests of other states. The report criticizes the manipulative exercise of authority aimed at evading the burdens of adaptation, stating that:

> The US abused its global financial hegemony and injected trillions of dollars into the global market. […] In 2022, the [Federal Reserve] ended its ultra-easy monetary policy and turned to aggressive interest rate hikes, causing turmoil in the international financial market. […] As a result, a large number of developing countries were challenged by high inflation, currency depreciation, and capital outflows. (Ministry of Foreign Affairs of the PRC 2023, 5)

Furthermore, this report levels allegations against the US for wielding its hegemonic authority as a means to advance its domestic interests by enacting regulations that favor its own agenda under the guise of safeguarding a "rules-based international order" (2023, 2). Additionally, the report asserts that the practice of "long-arm jurisdiction" (2023, 4) is harnessed as a tool to stifle economic rivals and intrude upon routine international commercial activities.

Ultimately, the report concludes that the US employs economic coercion to quell adversaries to further its own strategic economic objectives. It enumerates a range of economic sanctions and highlights the utilization of international financial institutions to manipulate the monetary sovereignty of other nations, among other tactics. The report posits that these actions are designed to compel other states to embrace financial liberalization and facilitate the opening of their financial markets, thereby aligning their economic policies with the strategic ambitions of the United States. The logic that guides China's criticism differs from the logic that underpins Kindleberger's analysis, which mainly focuses on the costs of providing public goods endured by the hegemon. China, on the contrary, directs attention to the privileges that the hegemonic power exploits for its own self-interested objectives.

The key argument of the report allies with studies that attribute the global economic instability to the US exploitation of its hegemonic power to support its self-interests (e.g., Helleiner 1994; Webb 1995; Vermeiren 2010). However, the report fails to account for the expenses borne by the US in its efforts to establish the USD as the KC. Additionally, the vague nature of the critiques regarding hegemonic privilege undermines the overall persuasiveness of the report's assertions.

The idea of "hegemonic harm" (Ministry of Foreign Affairs of the PRC 2023, 1) proposed in the report implies that the additional burdens assumed by developing economies during times of crisis are linked to the contention that the United States is clandestinely advancing its self-interest within the unipolar IMS. This perspective relies on an oversimplified speculation, resembling an ideological manifesto. It is important to note that US economic sanctions are not universally applied but rather tailored to target China and some of its allies, a strategy that aims at navigating their controlled domestic markets within the framework of a liberal economic order. For example, the US imposed sanctions on China in 2019, accusing it of currency manipulations. This action was taken in response to China's alleged undervaluation of its currency, which the US viewed as a means of gaining unfair competitive advantages through protectionist interventions in the foreign exchange market. The primary objective of these sanctions, as stated by the US Department of the Treasury (2019), was to press China to increase the transparency of its exchange rate and reserve management operations, and to minimize government intervention in the foreign exchange market. Yet, in these regards, the report sidesteps the connection between China's reluctance to progress with financial liberalization and the customized sanctions on China by the US.

Another example is the punitive tariff barriers imposed by the US pose a significant threat to China's future export surplus and foreign exchange inflows (Vermeiren 2013). During the trade war initiated by Donald Trump's administration in 2018, Chinese companies experienced higher costs to access their major export markets. Most recently, Joe Biden's administration strongly condemned China's policies in Xinjiang and urged multinational corporations to reduce imports of agricultural and manufacturing products from Xinjiang to punish China for human rights violations (Layne 2020). In 2022, the US Secretary of the Treasury Janet Yellen introduced the so-called "friend-shoring" as part of a supply chain reform. This policy compels China to demonstrate allegiance and endorsement of the principles of US liberalism to uphold its exports to the US. Indeed, this strategy inadvertently diminishes the earnings derived from China's export sector, and consequently might lead to the escalation of nationalist sentiments within China and the exacerbation of scepticism towards US supremacy within the global economic framework. This sentiment is further underscored by the case of "monetary sanctions" on Russia that include the freezing of its national reserves and the assets of affluent individuals associated with the state by the US and its European allies following Russia's invasion of Ukraine in 2022.

The Policy Goal of Internationalizing RMB

To counteract US monetary hegemony and limit the ability of the US to sanction China, the state has two potential choices. First, to challenge the status of the USD as the KC. However, as the paper previously argued, China is unable to endure the costs of making the RMB a new KC. Influenced by Chinese Marxism, the willingness to pursue the status of a key currency is incongruent with the development strategy pursued by the CCP (Eichengreen and Lombardi 2017). This stems from Chinese Marxist economics, which perceives the reserve currency as an emblem of international monetary hegemony forged through imperialistic and expansionist forces, a notion that contradicts Marxist principles (Desai 2020). Consequently, assuming the role of a key currency provider is deemed unfavorable.

Secondly, the alternative approach involves striking a balance in the asymmetry of the US and a comprehensive reconfiguration of the existing unipolar IMS. This transformative endeavor would facilitate the emergence of a multipolar IMS, rendering a global key currency unnecessary and promoting the establishment of several regional key currency providers. Such a recalibration of influence spheres would create an avenue for China to augment its monetary prowess and acquire additional autonomy in monetary policy, while concurrently embracing controlled additional international responsibilities. This strategic realignment could effectively curtail the magnitude of external sanctions within acceptable thresholds. The internationalization of the RMB seems to present a more attractive avenue for undermining the foundations of the unipolar IMS.

The RMB internationalization projects are designed to expand China's sphere of influence and develop an RMB-dominated network. Indirect initiatives in the internationalization of the RMB serve a dual purpose by enlarging China's sphere of influence and intensifying the economic interdependence of smaller nations upon it. China's deployment of substantial investments and low-interest development loans for infrastructural undertakings in developing countries casts China in the role of a responsible stakeholder, committed to fostering "common development." A case in point is the AIIB, which strives to advance "prosperity and economic development for Asia," offering diverse financial services, including loans, guarantees, and equity investments, to alleviate financial strains and economic contractions in developing economies (AIIB 2023). In this manner, China assumes the role of a lender of last resort for nations grappling with deficits in foreign capital or significant obligations to Western financial institutions, potentially establishing a refined system for global crisis management akin to the post-World War II US approach

(Horn et al. 2023). This strategic move fosters closer integration into a China-led economic framework, potentially rendering these nations more susceptible to the ramifications of Chinese economic policies.

Conversely, direct initiatives aimed at RMB internationalization contribute to enhancing the RMB's utility as a medium of exchange within the global marketplace and enable the accumulation of RMB reserves abroad. As highlighted by the European Central Bank (2022), RMB currency swap agreements effectively manage potential short-term market disruptions and mitigate abrupt liquidity shortages encountered by foreign banks. This dynamic implies an increased demand for RMB in contexts marked by extensive trade and investment activities. Such arrangements facilitate heightened accessibility to RMB as a viable inclusion in the foreign exchange reserves maintained by states. The implementation of foreign exchange reserve arrangements further augments international acknowledgement of the RMB's role as a reliable store of value. A discernible outcome is the potential proliferation of an outward flow effect, where nations holding significant RMB foreign exchange reserves manifest a preference for conducting trade transactions with third parties using the RMB, thus culminating in the establishment of an RMB-dominated clearing network (Ikenberry 2005).

Assessing China's Current Monetary Power

Assessing the extent of China's monetary power thus far is crucial in gauging its potential to achieve its objectives of counteracting US hegemonic monetary power. A comparative analysis of the cumulative monetary power of the RMB against the USD and other KCs, such as the euro (EUR) and the yen (JPY), serves as a valuable metric. A prevalent approach to evaluating states' monetary power, particularly concerning the identification of a KC, involves appraising currencies based on their performance across three pivotal roles: medium of exchange, unit of account, and store of value (Cohen 2013). However, considering that China's aspirations do not revolve around inducing a power shift within the prevailing hierarchical structure of the IMS, Cohen's three functions of key currency no longer offer an apt framework for quantifying the precise monetary power sought by China. For instance, the anchor role acting as a currency numeraire provides negligible symbolic gains—international prestige—in the face of its cost. Its pegging function impairs the issuer's ability to resort to exchange-rate shifts as part of the adjustment process, thereby compromising the power to delay or deflect (Cohen 2013). This subsequently impairs China's autonomy to control the currency and financial markets, outcomes incongruent with China's strategic objectives.

To augment its monetary sway relative to the US and curtail the US capability to enforce sanctions, China intervenes in its floating exchange rate system to pursue at least two intertwined goals: the preservation of monetary policy autonomy and the expansion of RMB reserves overseas, despite some associated costs including curtailed capital movement and RMB depreciation. These pursuits collectively contribute to bolstering overseas monetary influence, aligned with the broader objective of potentially supplanting the USD as the predominant medium of exchange in international transactions.

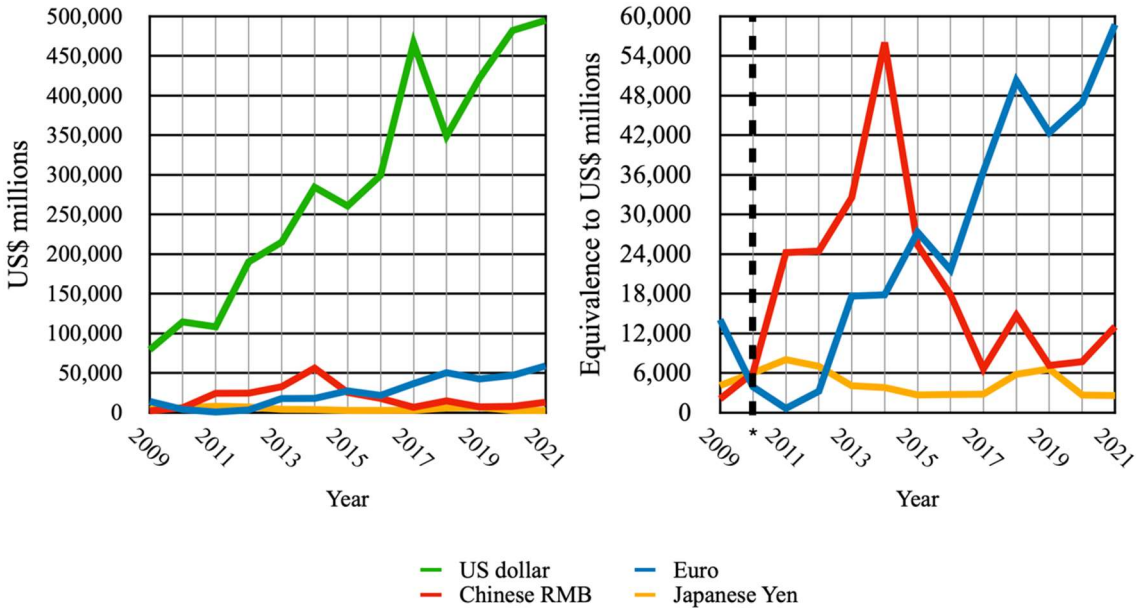
The autonomy of monetary policy is contingent upon the extent of monetary sovereignty vested in the central government. In this context, monetary sovereignty is defined as the capacity of a state to issue sovereign debt. Accordingly, assuming debt obligations denominated in a foreign currency is regarded as an abdication of sovereignty in the domains of monetary and financial affairs. Such a practice curtails the state's capacity to exercise diverse facets of monetary sovereignty, including the regulation of money supply, interest rates, and the exchange rate system (Patrício Ferreira Lima 2022, 423). This unconventional definition facilitates a quantitative evaluation of the extent to which states are predisposed to acknowledge and manifest their willingness to be influenced by Chinese monetary policy through the possession of liabilities denominated in the RMB. A greater magnitude of RMB-denominated debt held abroad signifies heightened confidence and trust exhibited by those governments in the resilience of the Chinese economy and its fiscal regulations. For China, the imperative lies in cultivating alliances and expanding its sphere of influence within the global hierarchy of monetary power.

Figure 1 illustrates that USD-denominated bonds significantly dominated the Asian market from 2009 to 2021, constituting approximately 89% of the total issued bonds. This observation underscores the considerable credibility of the US government across numerous Asian economies, rendering them receptive to the influence of Federal Reserve Bank policies. Notably, RMB-denominated bonds exhibit the most pronounced compound annual growth rate (19.45%) among the four currencies analyzed. This suggests a rapid expansion in RMB-based bond issuances, surpassing those denominated in Yen by 2010, albeit still representing a modest proportion of the broader Asian bond market.

While bonds denominated in EUR display consistent growth, RMB bonds overtook the EUR's second position in the aftermath of the European debt crisis, maintaining this position until 2015 (as depicted in Figure 1 without USD). The ascent of RMB bonds to a prominent position represents a notable challenge to the established standing of the euro. Although RMB cannot presently contend with the pervasive dominance of the USD within

the Asian bond market, its trajectory could potentially contribute to cultivating a more diversified regional landscape within the bond market in the foreseeable future.

Figure 1. International bond issuance in Asia by currency with and without USD



* = Europeam debt crisis outbreak in 2010.

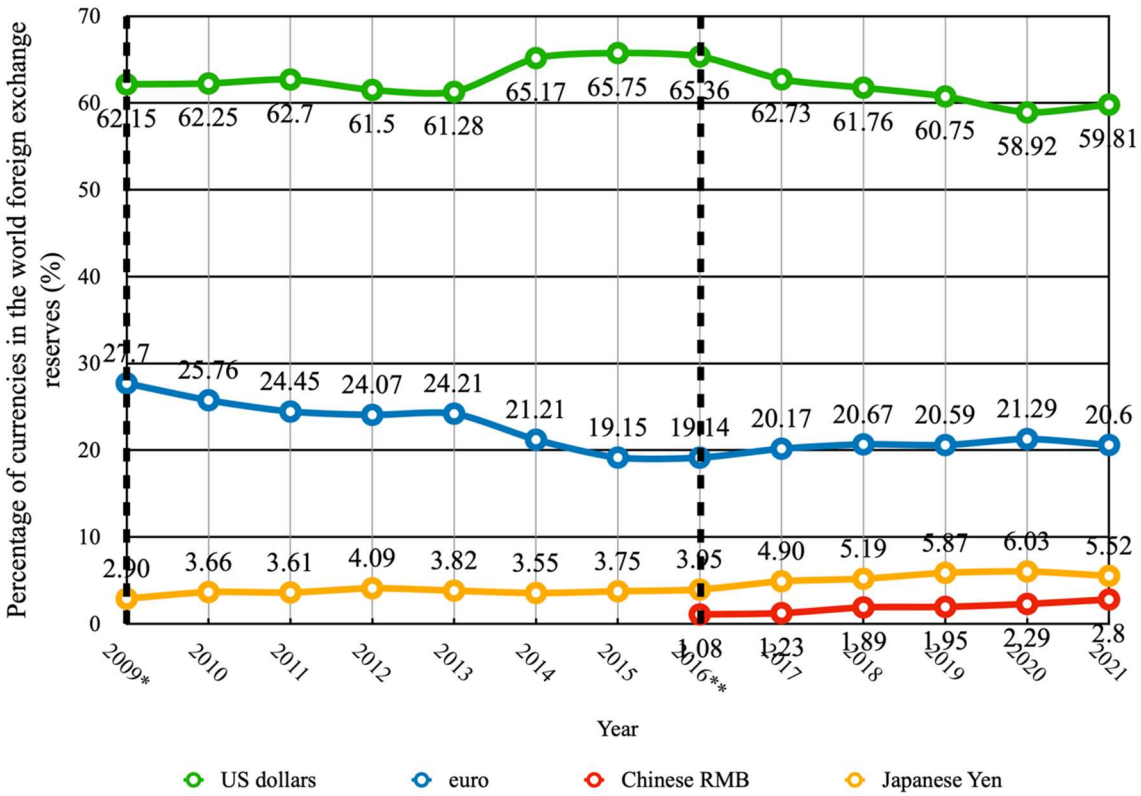
Source: International Capital Market Association (ICMA), January 2022.

Moreover, the accumulation of renminbi (RMB) reserves by foreign governments contributes to the process of de-dollarization among nations holding substantial RMB reserves. The presence of RMB reserves establishes a foundation that prompts holding states to engage in a trade with China, thereby facilitating an augmented outflow of RMB to these nations. This phenomenon results from the heightened accessibility of and growing demand for RMB in bilateral trading endeavors. As the proportion of RMB in the foreign exchange reserves of these nations increases, there emerges an incentive for them to prioritize the utilization of RMB over the USD in their mutual trade transactions, even in the absence of direct Chinese involvement. Subsequently, an ecosystem for RMB clearing is cultivated within these nations.

While some critics argue that this pathway might be deemed impractical due to the continued reliance of these nations on sophisticated technologies, knowledge-intensive professional services, and other products from Western markets that predominantly mandate transactions in USD (as I will discuss in the next section), it is noteworthy that this scenario does not produce adverse repercussions when foreign exchange reserves serve as a metric.

Figure 2 illustrates the sustained dominance of the USD in global foreign exchange reserves, consistently retaining a majority share of approximately 60%. However, an enduring downward trajectory in the USD's share has been evident since 2016, coinciding with China's inclusion in the special drawing rights basket following a seven-year initiation of the RMB internationalization. Notably, the USD's share dipped below the 60% threshold in 2020. The average growth rate for the USD between 2009 and 2016 recorded a value of 0.4585. Subsequently, a noticeable downturn to -1.11 was observed from 2016 to 2021, aligning with RMB's incorporation into the special drawing rights basket. Conversely, the average growth rate for RMB during the same interval stood at 0.34, indicating a potential adverse correlation between the USD and RMB over the preceding six years. This correlation may suggest a subtle yet progressive realignment in monetary power dynamics. Notably, the yen also exhibited growth during this period. However, its average growth rate (0.21) remains lower than that of the RMB, signifying a more robust growth trajectory for the latter.

Figure 2. World official foreign exchange reserves by country



*= China began RMB internationalization programs in 20019.

**= RMB joined SDR basket at IMF in 2016.

Source: IMF (2023b)

Remarkably, among the top four reserve currencies, RMB's share of global official foreign exchange reserves has displayed the most formidable growth pattern. Although the substantial disparity in absolute share between the US and China suggests that immediate power parity is improbable, the divergent trends observed in recent years warrant attentive consideration.

As previously mentioned, the US monetary sanctions that hindered Russia's access to its USD-denominated foreign exchange reserves after the invasion of Ukraine in 2022 have prompted President Putin to acknowledge the imperative of alternatives to the USD in trade transactions (Simes 2020). Simultaneously, Chinese leaders view these sanctions as an opening to challenge USD supremacy (Alwago 2022). In addition to increased RMB reserves held by the Russian Central Bank, RMB bilateral swap agreements can facilitate Russia's circumvention of these sanctions (Siddiqui 2021).

Indeed, the pursuit of the so-called "de-dollarization" has persistently constituted a shared aspiration for both China and Russia. This commitment was underscored by their early currency swap agreement in 2014, amounting to 150 billion RMB (equivalent to 24.5 billion USD). Consequently, the employment of USD in bilateral trade between Russia and China has noticeably waned over recent years. In 2015, nearly 90% of bilateral transactions were conducted in USD, a figure that receded to 51% by 2019 (Simes 2020). Given the relatively stable foundation of mutual political trust between Russia and China and the increasingly deteriorating US-Russian relationship, coupled with China's rising significance as a foreign trade partner, it is reasonable to anticipate a continued increase in the proportion of RMB in Russia's foreign exchange reserves, at least in the near term.

China's palpable discontent with the prevailing global hegemony of the USD is conspicuous. Yet, despite this discontent, the prospect of imminent power parity remains remote, making it inadequate to anticipate an immediate power transition. However, China does exhibit remarkable potential and benefits from favorable external conditions—including Russia's support—that could increase of its monetary power. One avenue for exploring this latent "potential" is to scrutinize the extent to which RMB internationalization initiatives can amplify China's monetary power over an extended temporal horizon, with a narrowed emphasis on a specific region. In the subsequent section, I will evaluate the plausible future trajectory of East and South Asian monetary integration and the role that RMB internationalization may assume within this context through the lens of neofunctionalism.

Prospects for RMB-led Regional Monetary Integration in East and South Asia

Since 2000, the euro has swiftly ascended to secure the second position among global reserve currencies (as illustrated in Figure 2), maintaining a stable share ranging from 19.14% to 27%. This places it behind only the USD and significantly ahead of the yen. The period from 2017 to 2021 has seen a modest recovery and stability for the EUR, indicating its notable resilience to debt crises. While it is widely acknowledged by analysts that the euro is unlikely to surpass the USD as the primary global currency in the foreseeable future (Cohen 2009; Germain and Schwartz 2014; Polivach 2020), the EUR serves as an intriguing model for monetary integration beyond the context of USD unipolarity. It offers a ray of hope for China to potentially achieve a comparable integration, contributing to the establishment of a multipolar global monetary order alongside other regional key currencies (KCs) (Tammen et al. 2017).

As a result, economists have applied a range of optimal currency area criteria to the East and South Asian context and juxtaposed its performance with that of the Eurozone to evaluate the feasibility of an RMB-led regional common currency area. Scholars contend that this region is approaching a state of readiness for integration (as discussed in Grauwe 2012; Watanabe and Ogura 2010; Quah 2012; Lee and Koh 2012, among others). This assertion is supported by the diminishing impact of nation-specific factors within the region and the burgeoning growth of financial and trade integration, closely mirroring the developmental trajectory of the Eurozone (Lee and Azali 2012). This evidence suggests an increasing capacity within the region to embark on the path of forming a monetary union. Ahn et al. (2006) argue that East Asia has already fulfilled the macroeconomic prerequisites for an optimal currency area, and they call upon China's strategic acumen to play a pivotal role in solidifying a regional monetary union.

While the existing literature recognizes the relevance of political factors in the context of monetary integration, it tends to downplay the influence of politics. Notably, this stance contradicts Mundell's (1961) proposition, which posits skepticism about the efficacy of flexible exchange rates for economic stabilization based on an unsuccessful Canadian experiment. Intriguingly, even after six decades, countries like the United States, Canada, and other American nations have yet to actualize a fixed exchange rate system as initially postulated by Mundell. As such, Chey (2009) draws attention to the fact that regional political conditions could potentially impede the establishment of a monetary union, providing a pertinent counterpoint to prevailing assumptions.

Applying a Neofunctionalist Framework

Neofunctionalism, a theoretical framework rooted in coherent political propositions concerning regional monetary integration, has been particularly applied to the European context (as discussed in Rosamond 2000, 51-52). Central to neofunctionalism are two key concepts—loyalty and spillover—which provide essential political criteria for evaluating the potential for a common currency area in East and South Asia.

In terms of loyalty, the establishment of the European Monetary Union (EMU) in 1999 stands as compelling empirical support for Haas's (1958) proposition that the transfer of loyalty to a new regional center while retaining pre-existing national (or local) identities is attainable. This transfer of loyalty relies on the presence of a widely trusted regional monetary framework with clear leadership, wherein smaller states entrust the integration process to offer more systematic and efficient solutions to their economic interests compared to their national authorities. On the other hand, Haas (1968) originally defined spillover as the phenomenon wherein the initiation and deepening of integration within a given economic sector led to further integration within and beyond that sector, necessitating augmented authoritative capabilities at the regional level. Furthermore, Haas (1961) suggests that economic sectors involving "low politics"—those directly impacting daily life—tend to foster integrative tendencies more effectively than sectors dealing with macro-level and grandiose issues, such as defense and diplomacy.

Then returning to the PTT, an examination of the RMB's regional sphere of influence within the global context reveals significant progress in mitigating China's reliance on the USD through efforts towards internationalization in Asia. This progress is exemplified by the establishment of a loosely structured bilateral RMB clearing network, with China serving as the central axis. However, it is essential to acknowledge that the entrenched affiliations and vested interests of the US and its regional allies impose substantial constraints on the wider proliferation of the RMB, rendering it susceptible to potential US interventions.

Loyalty: A look into competing leaderships and the choices small powers make

The pursuit of key currency status within a confined regional context operates on principles akin to those governing global key currency status. This implies that similar challenges arise, including potential trade deficits stemming from domestic market openness, the tension between domestic inflation control and the need for currency stability as a store of value, and the obligation to serve as an anchor in an intraregional fixed exchange rate system, among other factors. While the burdens faced by regional key currency providers

may be relatively lighter than those of their global counterparts, they are nonetheless inherent.

However, recent developments underscore the CCP's heightened vigilance in safeguarding monetary and financial autonomy. The Central Committee of the CCP has initiated a new phase by elevating financial power to a higher political standing within the party-state structure, as evidenced by the 2023 Program for Party and State Institutional Reform. This reform introduces the State Administration for Financial Supervision, transferring the daily oversight responsibility of financial matters from the central bank to the State Council. Additionally, it establishes a Central Financial Commission, relocating the Financial Stability and Development Commission – formerly accountable to the State Council – to CCP headquarters. This reflects that CCP has been even further centralizing and reserving its monetary and financial autonomy. Implicit in these changes is the indication that the CCP is unlikely to anchor a currency or accept a fixed exchange rate, relinquishing the critical autonomy to adjust the floating exchange rate for advancing monetary integration.

Moreover, the opportunity cost of not providing a regional key currency (or merely anchoring a potential Asian exchange rate mechanism) should not involve accepting a foreign currency to assume this role. Such an arrangement potentially deepens the regional monetary hegemony of the USD. Japan, a prominent Asian economy capable of maintaining key currency status similar to that of the USD, faces constraints posed by China. The Chiang Mai Initiative[1], co-proposed by China, provides an alternative framework to the Japan-proposed Asian Monetary Fund, which downgrades Japan's leading role to a cooperative role in the region (Rapkin 2001). Consequently, China and its potential Asian allies, such as Russia and ASEAN members, can diminish the US sphere of influence in shaping East and South Asian monetary integration by marginalizing Japan as the US agency.

However, at the behest of the US, Japan will collaborate to counteract any actions that might downgrade the USD's status to a "negotiated" currency in the region (Katada 2008). Given the considerable reliance from export-oriented Asian economies (including China itself) on Japan's extensive consumption markets and advanced production resources, even a slight appreciation of the USD or the yen can notably bolster the US and Japanese

[11] The Chiang Mai Initiative (CMI) originated as a series of bilateral swap arrangements, evolving into a consolidated multilateral agreement via the CMI process in 2009. This transformation culminated in the establishment of a regional reserve pool, valued at USD120 billion, consolidated under a singular contract. This pool was significantly backed by contributions from the 'plus three' states and Association of Southeast Asian Nations (ASEAN) member states. Subsequently, in 2011, the ASEAN+3 Macroeconomic Research Office (AMRO) was instituted as the regional surveillance agency for the CMI (De Grauwe and Zhang, 2012).

capital influence in the region, thereby rendering de-dollarization less likely. This competitive landscape underscores that China and Japan both resist initiatives that bolster the other's position in leading monetary integration, potentially leading to a contentious struggle for dominance. Considering the prevailing circumstances, it becomes apparent that neither China nor Japan is presently positioned to assume key currency status, casting a shadow over the prospects for the emergence of a preeminent supranational monetary institution.

The absence of clear leadership and consensus among major global powers presents a significant impediment to smaller states in their consideration of realigning allegiance towards external entities such as the under-institutionalized Chiang Mai Initiative. For peripheral states, the calculus involves weighing anticipated benefits from integration against potential hazards tied to potential encroachments on their national governments' spheres of competence (Lindberg 1966). In comparison to committing to a binding regional framework devoid of a clearly defined dominant power, these states prioritize the preservation of their national policy-making autonomy. This preference is guided by a belief that such autonomy serves their economic and political interests more effectively (Solís and Wilson 2017). Another concern is that the commitment to a binding reginal framework without a clearly defined dominant power could introduce unwelcome uncertainties into domestic political arrangements due to the resultant diminution of domestic autonomies.

The Asian Development Bank underscores that the credibility of the Chinese central bank still stands on par with central banks in any other emerging markets (Aizenman et al. 2011, 26), thereby raising questions about the capacity for it to serve as a dominant regional monetary authority. Reflecting on the Annual Dinner of the Economics Society of Singapore, Lee Hsien Loong emphasized Singapore's imperative for adaptive flexibility and consistent economic reform (Bank for International Settlements 2003). He expressed support for "broad leadership groups" as opposed to centralized agencies for international governance. This viewpoint is substantiated by the external context characterized by the competition between great powers, notably the Sino-Japan rivalry for monetary leadership in this case. Leaders of small states (such as Singapore, the Philippines, and Thailand), therefore, find themselves necessitating substantial independent autonomy to enact frequent domestic economic reforms in response to the volatile global economic landscape marked by shifting hegemonic dynamics.

However, this emphasis on preserving domestic policy autonomy engenders strategic divergence among small states. The resultant policy landscape is illustrated by the delicate solidarity within ASEAN member states, wherein some members lean towards forging closer

ties with the US, while others gravitate towards China (Graham 2013). This underscores the reality that small states make disparate choices in navigating the competition for economic interdependence between competing major powers, further attenuating the prospects for regional integration.

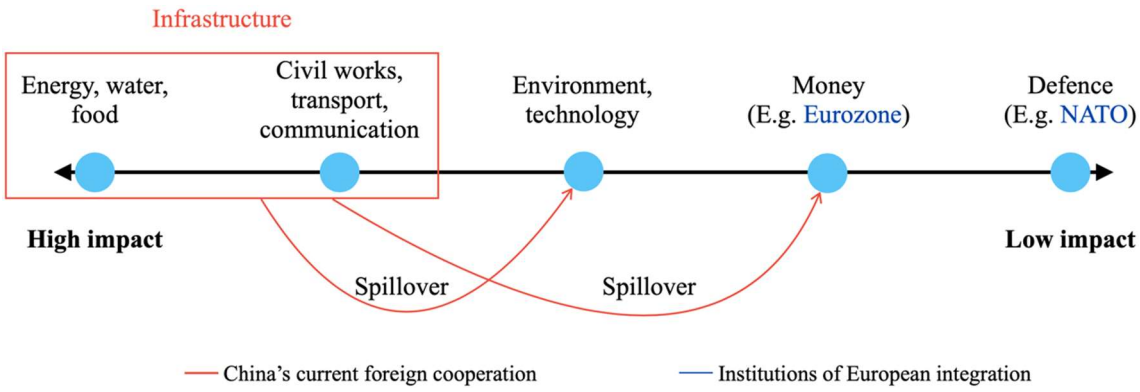
Spillover: An impaired effect with political pressure as its driver

Analogous to the role of coal and steel in igniting the process of European integration, cooperation in infrastructure development stands as the foundational cornerstone of China-led integration. Both realms hold pivotal significance in the everyday lives of individuals, although the latter encompasses a considerably broader spectrum of indispensable sectors (refer to Figure 3). The 2021 Annual Report of the Asian Infrastructure Investment Bank (AIIB) highlights that over the period spanning 2016 to 2021, a total of 70 approved projects were dedicated to essential sectors, encompassing domains such as energy, transportation, water resources, and agriculture (AIIB 2021). This subset represented a substantial 44% of all projects that received approval.

In a responsive maneuver to the exigencies arising from the COVID-19 crisis, the AIIB also sanctioned the approval of 45 projects under the pandemic recovery facility in the years 2020 and 2021 (AIIB 2021, 12). Remarkably, this cluster accounted for more than 28% of all approved projects during that timeframe. Thus, a noteworthy 72% of the cumulative projects, equivalent to an estimated value of 23 billion USD, were strategically channeled towards directly buttressing the quality of everyday life for targeted populations in specific locales. This pronounced emphasis on addressing the immediate needs and welfare of the populace underscores the centrality of infrastructure development as a pivotal conduit for realizing China-led integration objectives.

The spillover has manifested most notably in the realm of environmental cooperation (Figure 3). Both international and local non-governmental organizations have raised concerns regarding the lack of transparency pertaining to resource utilization and the limited strides taken towards safeguarding animal and environmental interests within projects funded by Chinese investments (Siripurapu and Berman 2022). A technical examination conducted by Sattar et al. (2022) has empirically validated that China's overseas investments exert a substantial influence on environmental degradation, with energy expansion being identified as a dominant contributor to carbon emissions within the host regions of such investments. These adverse environmental repercussions not only imperil China's own commitments within the framework of the Paris Agreement but also cast a shadow on the commitments of its partner nations.

Figure 3. Different economic sectors' impact on people's everyday lives



Note: Economic sectors are measured in a form of ordinal data in which categories possess an inherent order up daily impact on the public during non-war period but with distances between them that are not uniform.

Source: Author.

In response to mounting environmental concerns and pressure to align with global climate objectives, China has embarked on an augmented trajectory of cooperation with its investment destinations, specifically focusing on climate-related issues. A tangible reflection of this evolution is discernible in the recalibrated corporate vision of the AIIB in 2021. This re-envisioned paradigm underscores the pursuit of a prosperous Asia that hinges upon sustainable economic development and heightened regional collaboration. Concomitantly, it conveys the collaborative intent to channel increased investments towards sustainable infrastructure, thereby unlocking fresh reservoirs of capital, novel technologies, and innovative mechanisms aimed at addressing the specter of climate change across the Asian domain (AIIB 2021, 9). The 2021 AIIB Annual Report (AIIB 2021) delineates that a substantial 92 projects are earmarked as "green infrastructure" constituting the highest proportion (80%) among all areas prioritized by the AIIB for financial assistance. In contrast to the explicitly articulated intent to collaborate on climate-centric matters, the dynamics of monetary collaboration undergo a subtler influence through spillover effects.

As China's international trade and investment activities continue to expand, a growing number of foreign states find their financial systems becoming increasingly reliant on RMB liquidity. This trend is exemplified by the approximately 20 Asian states, including advanced economies like Singapore, Japan, and South Korea, which have entered into currency swap agreements with China (for a comprehensive list, refer to Chandrasekhar and Ghosh 2020). David Mutimer (1989) introduces an additional prerequisite for achieving higher levels of regional integration, emphasizing the necessity for potential member states

to establish a more profound degree of multilateral interdependence before experiencing spillover. In its pursuit of heightened regional integration, China has positioned itself as an exclusive partner for Asian countries seeking to overcome mutual distrust and integrate into the global economic chain. This strategic approach aims to grant China substantial latitude and external advantages within these regional partnerships.

However, it is crucial to acknowledge that such a bilateral cooperation often culminates in partnerships cantered exclusively around China, with limited relevance to interactions among states interconnected through bilateral currency swap arrangements. Consequently, while bilateral cooperation may encompass a myriad of economic sectors within specific geographical domains, it frequently falls short of elevating these two-way partnerships to the level of a multilateral network or a comprehensive integration process. Notably, the renewal of bilateral currency swap arrangements with China frequently transpires without substantial alterations to the pre-existing conditions, as observed in the cases of Singapore, Japan, Thailand, and others. A discernible trend in the number of agreements and their authorized values has consistently emerged over the observed period (Chandrasekhar and Ghosh 2020), suggesting sustained stability in the swap values encompassed within each agreement.

Drawing parallels from the historical progression from the European Coal and Steel Community (ECSC) to the European Monetary Union (EMU) as an empirical model of functional spillover (Rosamond 2000), it becomes apparent that the ECSC was fundamentally rooted in genuine multilateral cooperation before evolving into the more advanced EMU stage. In contrast, existing bilateral cooperation often fails to encapsulate the overarching desire of the signatory parties to achieve comprehensive integration. Empirical analysis by Mohammed Ahmed (2019) suggests that the principal incentive driving the signing of swap agreements lies in the substantial symbiotic benefits accrued to both recipient and provider countries, rather than in actively contributing to collective endeavors aimed at advancing the region's shared interests.

It is imperative to underscore that bilateral cooperation oriented towards self-interest and immediate gains yields limited progress in the establishment of a supranational high authority that necessitates member states relinquishing a degree of autonomy. An analogous phenomenon from the European experience, termed "spill-around and retrenchment" (Schmitter 1971), emerges wherein cooperation expands across different sectors while maintaining the existing level of cooperative engagement within each sector. In this context, while relevant states may elevate the extent of collaboration contingent upon their

assessment of its impact on national interests, the creation of comprehensive regional institutions remains an elusive strategy.

This intricate interplay between bilateral cooperation and multilateral integration is evidenced in the case of RMB liquidity and currency swap agreements. The substantial volume of swap lines, peaking at 347.2 billion RMB (Chandrasekhar and Ghosh 2020), has not significantly altered the overall trade settlement dynamics of partner countries, which predominantly continue to be denominated in USD (Hao, Han, and Li 2022). This underscores the inherent limitations of bilateral cooperation in driving substantive shifts in the broader economic landscape, with much of the trade dynamics remaining anchored to established patterns.

In summary, while the expansion of RMB liquidity and bilateral cooperation holds the potential to catalyze regional integration, the prevailing pattern of exclusive bilateral partnerships centered around China and driven by self-interest poses challenges to the establishment of a comprehensive multilateral framework. The dynamics between self-interest and shared regional objectives underscore the need for a more nuanced and encompassing approach to achieving lasting regional integration.

A fundamental disparity in the underlying dynamics of the spillover is apparent when comparing the process of East and South Asian integration with that of the Eurozone. In case of the Eurozone, the EMU's establishment served to notably reduce transaction costs within the well-established European single market. This integration was underpinned by the need for coordinated transportation policies among member states to facilitate the efficient movement of essential commodities such as coal and steel. The resultant spillover effect primarily aimed at enhancing economic gains for the participating nations, fostering a cohesive economic landscape. Conversely, when the spillover is driven by political considerations, its durability becomes more susceptible to fragility. An illustrative example is the spillover stemming from AIIB's new corporate vision, which accentuates environmental concerns. In this context, the spillover is not market-driven but instead is a result of political pressures arising from China's commitment to the Paris Agreement and its endeavor to evade Western critique. The spillover effect might be less stable because the CCP can arbitrarily withdraw climate treaties without direct economic cost. Overall, political "obligations" of this nature tend to exhibit a heightened fragility to develop and sustain such spillover in comparison to the enduring influence of economic interdependence. Such different nature of the driver of the spillover gives China an ambiguous future.

Regional Sphere of Influence under the Global Hegemony's Interference

PTT posits the concept of hierarchical structure in global and regional power dynamics and describes the interactions between great powers at these levels. Regional powers are typically unable to effectively engage with global power structures, while global powers can influence regional outcomes (Lemke 1996, 2002). In East and South Asia, where strong ties and interests with the US and EU are prevalent, there is heightened interference from these global powers. This consequently limits China's ability to exert influence within the region. The *2022 Indo-Pacific Strategy of the United States* accentuates the escalating challenges emanating from China, serving as the principal catalyst for the intensified focus of the United States and its allies (White House 2022). The 2022 strategic blueprint pledges to bolster the US economic leadership in Asia, outlining a competitive strategy against China. Although the UK and the EU have established a certain level of financial cooperation with China, such as currency swap agreements, they publicly endorse the US strategy and are relatively conservative and falter in these collaborative actions.

Despite China's considerable accumulation of monetary power through its active engagement in Asian infrastructure development, its global influence remains constrained. This is primarily attributed to the persistent reliance of developing states on the enduring hegemony of the United States in knowledge-intensive industries and its robust domestic consumption market, which continue to prevail despite the ongoing transformation of the region. The focus of South-South cooperation predominantly centers on primary and secondary industries that cater to essential human needs, including agriculture, manufacturing, and transportation. However, these collaborations do not encompass the production processes associated with products and services demanding high levels of knowledge-intensive expertise from tertiary and quaternary industries.

As a result, Asian states continue to heavily rely on Western consumer markets for the export of their basic goods, while simultaneously importing advanced technology products and professional services to augment their production capabilities and broader societal developments. This entrenched dependence underscores the necessity for these Asian countries to sustain trade relations with Western markets, thereby reinforcing the indispensability of the US-led IMS. Consequently, the pursuit of closer monetary integration under the leadership of China may not be perceived as a credible or prudent strategy to effectively meet their trade requirements, particularly for non-communist states like Japan, South Korea, and Taiwan. In these cases, the United States wields substantial power and

influence over their decision-making processes and developmental trajectories, making the prospect of a China-led monetary integration less viable (Niemann and Ioannou 2015).

Conclusion

This article offers a twofold contribution. First, it supports the prevailing consensus that China is unlikely to pose a challenge to the hegemony of the USD on the global stage because of structural barriers on the domestic level that render the key status unattainable for RMB.

In this article, I used the power transition theory framework to provide valuable insights into the current state of relations between the US and China in the context of monetary power. By doing so, I was able to highlight that despite China's dissatisfaction with the prevailing dominance of the US, a substantial power disparity continues to exist between the two nations. A monetary power shift between the US and China is improbable, as noted by Tammen (2017). Following this logic, I argued that China seeks to promote RMB internationalization without an ambition to replace USD as the key currency. China has long criticized the US for exploiting its hegemonic monetary status to impose sanctions to promote the liberalization of China's national financial market. To mitigate the impact of US sanctions, the establishment of a monetary network cantered around the RMB within China's economic sphere of influence could potentially serve as a countermeasure against the prevailing US power asymmetry. This network has the potential to escalate costs for the US as it endeavors to advance its strategic objectives by imposing sanctions. Indirect RMB internationalization programs expand China's sphere of influence by increasing the economic dependence of small and middle powers in China to build a new monetary alliance. Direct initiatives aimed at the internationalization of the RMB contribute to enhancing its role as a viable medium of exchange in the global market and facilitate the accumulation of RMB reserves abroad. Nonetheless, empirical evidence indicates that these efforts have not yet posed a substantial threat to the prevailing hegemony of the USD.

At the regional level, this study delved into the potential for China to establish monetary supremacy within the confines of East and South Asia. The creation of a unified currency framework for the region could strategically serve China in countering the US's ability to wield sanctions. However, the comprehensive analysis of factors such as loyalty and spillover revealed that China's reluctance to offer a global key currency extends to the regional sphere. Furthermore, the foregone benefits of not providing a regional key currency do not include permitting others to assume that role. The competitive dynamic between

China and Japan obstructs both nations from assuming the role of a key currency provider, thereby inhibiting the emergence of a supranational monetary institution. As a result, neither major powers nor smaller states can shift their economic dependence to a regional entity due to the lack of consensus on leadership and a dependable regional authority. Concerning the spillover, it is evident that this phenomenon promotes collaborative efforts between China and the region across various economic sectors. However, there is no substantiated indication that spillover, arising from bilateral collaborations, significantly impacts the depth of integration among the participating partners. Meanwhile, the USD dominates this region, and China has yet to demonstrate the capability to serve as a viable alternative in terms of both its driving force and competencies.

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