RMB Internationalization: A Process rather than A Result[1]

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1. Introduction

At present, RMB internationalization is one of the hottest topics worldwide with great attention and heated discussion, just like what happened to the Japanese yen more than 30 years ago. Different from the other international currencies, RMB internationalization is a gradual process. The author has studied the issue of cross-border use of RMB in frontier trade since the beginning of this century with the title of *RMB Regionalization*, the background of which was that the frontier trade between China and its neighbor nations developed very rapidly and RMB was regarded as the pricing and settlement currency due to its relatively strong value and the fact that it could be used to purchase abundant China-made goods. According to the survey, in the frontier trade between Guangxi province and Vietnam in 2001, nearly 90% transactions were priced and settled in RMB. In the process of gradual promotion of opening up strategy for China, regionalization before internationalization is a realistic path for RMB to become an international currency.

Ten years after RMB became the major settlement currency in frontier trade, RMB internationalization was officially put on the agenda in April 2009 when the State Council decided to launch the trials of settling cross-border trade accounts in RMB in Shanghai and Guangdong.

China has become the world's second largest economy, the biggest trading

[1] The opinions expressed in this paper are only those of the author and do not reflect the views of China's Development Research Center of the State Council (DRC).

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nation and the third largest FDI investor, and it also has a promising outlook. China is reforming its exchange rate regime and liberalizing the capital account with gradual steps. Meanwhile China is promoting bilateral and multilateral economic and financial cooperation with a positive attitude. Those all provide strong foundation for RMB internationalization. Therefore it has no doubt that RMB is becoming an international currency. According to SWIFT (Society for Worldwide Interbank Financial Telecommunication) data, the share of RMB in global trade finance market rose to 8.7% as measured by the Letters of Credit and Collections in October 2013, surpassing the Euro for the first time to become the second-most-used currency in international trade finance.[3]

With the deepening of RMB internationalization, China's position in the international monetary system is also changing, which makes China play a more positive role in the new round of international monetary system reform.

2. The process of RMB internationalization

2.1 Outset: RMB regionalization

At the end of 1990s, RMB became the pricing and settlement currency in the frontier trade with gradually expanded scale and took the step to regionalization. RMB regionalization first appeared in China's neighboring nations with less developed economy. In these nations, international trade was underdeveloped and international hard currencies like USD were in shortage. In contrast, RMB has maintained as a stable currency since the exchange rate reform in 1994, even during the Asian Financial Crisis of 1997-1998. Nations with less hard currency were more willing to use RMB in their trade with China. Therefore, when China and these nations carried out frontier trade, RMB was accepted as the media for pricing and settlement. At that time, the share of RMB pricing and settlement in Sino-Mongolia, Sino-Vietnam and Sino-Myanmar trade was significantly higher than that in Sino-Russia trade. According to the survey, in the

[3]Data source: http://www.ibtimes.com/yuan-overtakes-euro-second-most-used-currency-international-trade-settlement-swift-1492476

frontier trade between Guangxi province and Vietnam, be it imports or exports, nearly 90% transactions were settled in RMB.

RMB regionalization purely came from the drive of market forces. There was no accurate statistics of the cross-border use of RMB in the frontier trade then, as RMB settlement and exchange in the frontier trade was mainly done through informal financial system due to lack of formal channel, e.g. ‘stall bank’ in Vietnam and underground bank in Sino-Russia border area etc.

2.2 Evolution: RMB offshore market

Along with the development of RMB regionalization, offshore RMB (CNH) market has gradually grown up with accumulated size of RMB abroad. In 1996, RMB’s offshore NDF (non-deliverable forwards) market started to take shape in Hong Kong Special Administrative Region (HKSAR) and Singapore, but the development at initial period was slow. It was until 2002 that under the joint forces of several factors, including the impact of the Asian financial crisis of 1997-1998 gradually waded, China entered the WTO and China experienced trade surplus and continuous macro economic growth, NDF transactions have become active. During the peak period from 2008 to 2009, daily trading volume in RMB NDF market was up to 10 billion USD [4].

Currently, HKSAR is the largest CNH market in the world. In 2004, CNH business in HKSAR was only limited to personal deposits, remittance and credit cards. In 2005, RMB corporate banking was available. In 2007, CNH bond named as ‘Dim-Sum bond’ in the international market was issued, which became an important breakthrough in the development of CNH market. In 2011, onshore corporate was allowed to issue CNH bonds. And according to the data of Standard Chartered, the amount of CNH bond issuance in HKSAR was 564 billion Yuan in 2014.

2.3 Fast forward: cross-border use of RMB

[4] Data source: http://www.hbot.cn/content-13-247247-1.html

In April 2009, the State Council decided to launch the trials of settling cross-border trade accounts in RMB in Shanghai and Guangdong, which presented a new opportunity for cross-border use of RMB and development of offshore RMB business, and accelerated the pace of RMB internationalization. At the end of 2009, HKSAR's offshore RMB deposits only amounted to 60 billion with 60 financial institutions operating RMB business. However, by the end of 2014, such deposits have amounted to 1 trillion RMB driven by cross-border RMB business, while totally 149 financial institutions engaged in RMB business. And the amount of settlement for RMB RTGS (real-time gross settlement) system reached RMB 170 trillion, showing doubled growth on a year-on-year basis. In October 2014, UK became the first western nation to issue RMB-denominated government debt.

Cross-border use of RMB is growing rapidly. There are 189 countries using RMB as payments currency when trading with China. According to *2015 RMB Internationalization Report* released by the People's Bank of China (PBC), the share of cross-border RMB settlement in China's trade of goods exceeded 20% in 2014 (figure 1). According to the report on RMB's inclusion into SDR (special drawing right) basket released by IMF in August 2015, this share is close to 20%, but the use of RMB to settle other current account transactions is close to 25%[5], e.g. service, revenue and dividends payout etc.

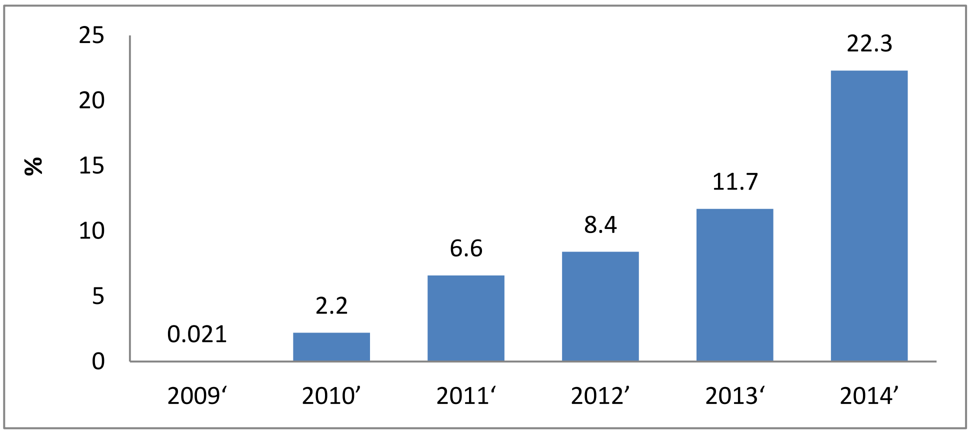

Figure 1: China's Trade in Goods Settled in RMB (share in percent)

Note: Calculated based on RMB settlement amount for current account and total value

[5] Source: Review of the Method of the Valuation of the SDR Initial Considerations, IMF, July 16 2015, http://www.imf.org/external/pp/longres.aspx?id=4975

of China's imports and exports provided in 2015
Source: 2015 *RMB Internationalization Report* released by the People's Bank of China.

IMF assessed RMB's freely usable when it reviewed RMB's inclusion into SDR basket in 2015. Data in Table 1-5 are all excerpted from IMF report of July 16, 2015. These data fully reflect the current achievements of RMB internationalization. The share of RMB used in cross-border payments has increased from 0.2% between 2012 Q2 to 2013 Q2 to 1.0% between 2014 Q2 to 2015 Q1. The share of RMB-denominated international debt securities (IDS) outstanding has increased from 0.1% in 2010 Q1 to 0.6% in 2015 Q1. The share of RMB-denominated IDS issuance has increased from 0.1% in 2010 to 1.4% in 2014. The rank of RMB in terms of proportion in foreign exchange transactions has risen from No. 17 in 2010 to No. 9 in 2013. And the share of RMB in official foreign currency assets has grown from 0.7% in 2013 to 1.1% in 2014. RMB is becoming an important member in international currencies.

Table 1: Cross-border Payments (share in percent of global total)

2012: Q2—2013: Q1		2014: Q2—2015:Q1	
EUR	48.3	EUR	41.6
USD	32.5	USD	36.6
GBP	3.6	GBP	4.3
JPY	2.9	JPY	3.3
CHF	2.6	CHF	2.4
CAD	2.0	CAD	2.3
AUD	1.9	AUD	1.9
SEK	0.7	**RMB**	**1.0**
HKD	0.6	HKD	0.9
RMB	**0.2**	SEK	0.7
Other	4.7	Other	5.0

Note: For RMB, HKSAR, Macao SAR, and Taiwan Province of China are not treated as international.
Source: Review of the Method of the Valuation of the SDR Initial Considerations, IMF, July 16 2015, http://www.imf.org/external/pp/longres.aspx?id=4975

Table2: International Debt Securities (shares in percent of global total)

2010: Q1		2015: Q1	
EUR	48.3	EUR	43.1
USD	31.3	USD	38.5
GBP	10.3	GBP	9.6
JPY	3.3	JPY	2.0
CHF	1.7	CHF	1.4
CAD	1.4	AUD	1.3
AUD	1.3	CAD	0.9
……	……	**RMB**	**0.6**
14th RMB	**0.1**	Other	1.8
Other	1.3		

Note: For RMB, HKSAR, Macao SAR, and Taiwan Province of China are treated as international.

Source: Review of the Method of the Valuation of the SDR Initial Considerations, IMF, July 16 2015, http://www.imf.org/external/pp/longres.aspx?id=4975

Table 3: Issuance of International Debt Securities (shares in percent of global total)

2010		2014	
EUR	34.7	USD	42.1
USD	45.7	EUR	37.1
GBP	9.4	GBP	11.6
JPY	2.3	JPY	1.8
AUD	1.8	AUD	1.7
……	……..	**RMB**	**1.4**
RMB	**0.1**	Other	1.9
Other	2.1		

Note: HKSAR, Macao SAR, and Taiwan Province of China are treated as international.

Source: Review of the Method of the Valuation of the SDR Initial Considerations, IMF, July 16 2015, http://www.imf.org/external/pp/longres.aspx?id=4975

Table 4: Currency Composition of Global Foreign Exchange Market Turnover

Currency	2010		2013	
	Share %	Rank	Share %	Rank
USD	42.4	1	43.5	1
EUR	19.5	2	16.7	2
JPY	9.5	3	11.5	3
GBP	6.4	4	5.9	4
……	……	……	……	……
RMB	**0.4**	**17**	**1.1**	**9**

Source: Review of the Method of the Valuation of the SDR Initial Considerations, IMF, July 16 2015, http://www.imf.org/external/pp/longres.aspx?id=4975

Table 5: Official Foreign Currency Assets (shares in percent of global total)

2013				2014			
Currency	SDR bn	%	Reporting countries	Currency	SDR bn	%	Reporting countries
USD	2,701	61.3	127	USD	2,961	63.7	127
EUR	1,041	23.7	109	EUR	978	21.0	108
GBP	187	4.2	108	GBP	190	4.1	109
JPY	147	3.3	87	JPY	160	3.4	88
AUD	98	2.2	79	AUD	98	2.1	78
CAD	87	2.0	84	CAD	92	2.0	85
RMB	**29**	**0.7**	**27**	**RMB**	**51**	**1.1**	**38**
NZD	11	0.2	27	CHF	11	0.2	69
CHF	10	0.2	73	NZD	11	0.2	29
NOK	9	0.2	45	SEK	9	0.2	40
Other	66	1.9		Other	73	1.9	

Note: share refers to the percentage of official foreign currency assets denominated in one currency in global total. Reporting countries refer to number of countries holding official foreign currency assets denominated in one currency and making report to IMF.

Source: Review of the Method of the Valuation of the SDR Initial Considerations, IMF, July 16 2015, http://www.imf.org/external/pp/longres.aspx?id=4975.

Recently, China is launching a new RMB cross-border payments and settlements system named as CIPS (China International Payments System). The establishment of CIPS is an important milestone in the process of RMB internationalization for connecting global RMB users through one single system and facilitating cross-border use of RMB.

3. Main drivers for RMB internationalization

3.1 Continuous improvement of China's international economic status

Since the early 1980s, China's reform and opening up policy has led to a remarkable economic development. As Figure 2 shows, China's real GDP grew about 10% per year on average for 30 years before 2010 and about 8% from 2011 to 2014. At that rate, China's national income doubles every seven years. No other country in modern history has achieved such high growth for so long. Now China is the second largest economy, which is the precondition and solid base for RMB internationalization.

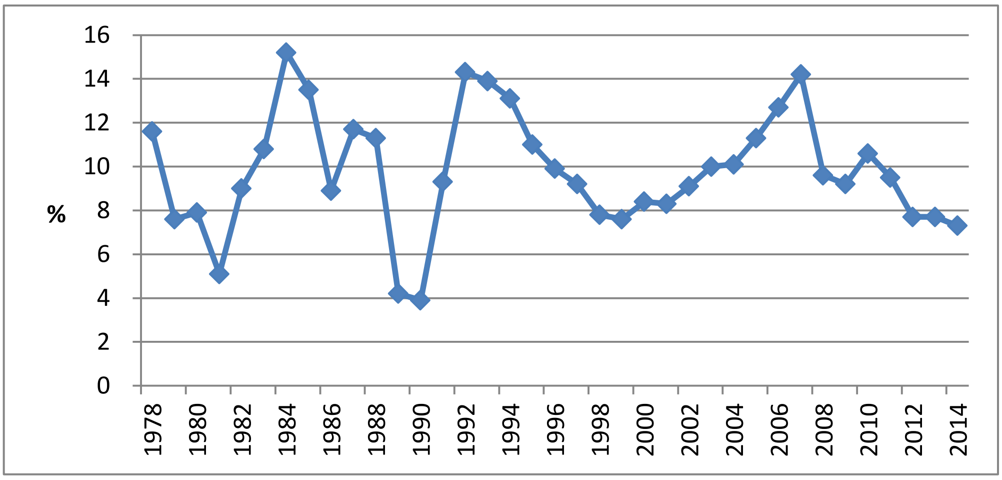

Figure 2: China's GDP growth rate from 1978 to 2014

Source: Wind database.

The growth of China's international trade is as remarkable as its GDP. In 1978 the total value of China's import and export was only 20.6 billion U.S. dollars, ranking 32nd in world trade and accounting for less than 1 percent of the world's total. In 2014 the total value of China's import and export reached 4.303 trillion U.S. dollars, about 209 times as much as that in 1978 (Figure 3). Now China had been the world's largest trader for two consecutive years. As China is major importer of commodities and exporter of consumer goods, payments in RMB seems benefit for both its trade partners to manage currency risk.

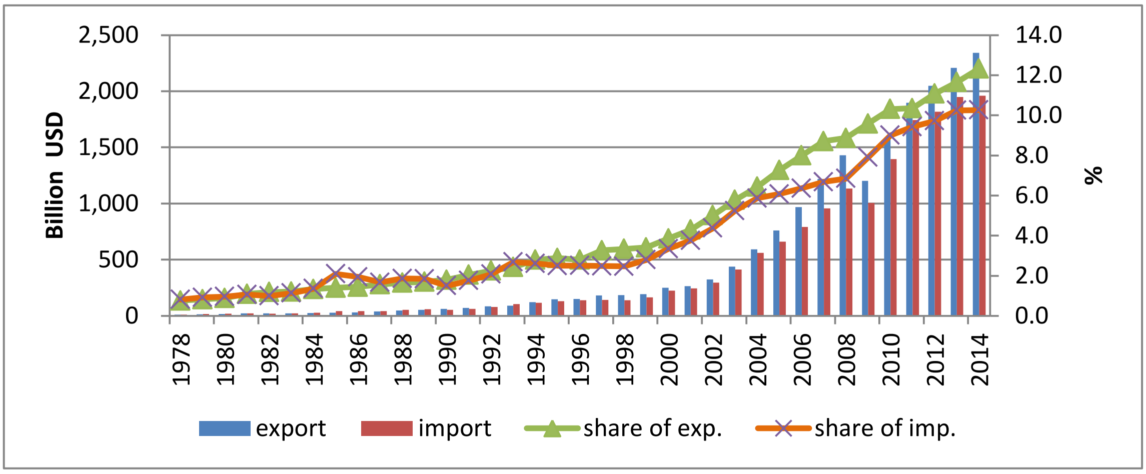

Figure 3: The share of China's exp. and imp. in the world total from 1978 to 2014

Source: Wind database.

China's outbound direct investment (ODI) experienced leap forward development in the past ten years. China became a net capital exporter in

2014 as the ODI figure of 116 billion USD exceeded foreign direct investment (FDI) for the first time (Figure 4). According to MOFCOM data, China's ODI grew at 20.8 percent on a year-on-year basis through the first seven months of this year, while FDI into the nation grew at 7.9 percent annually during the same period.

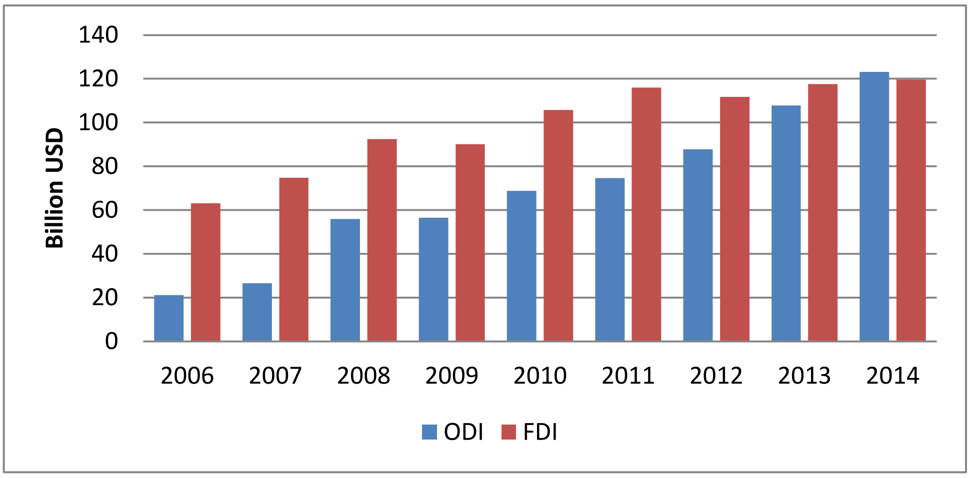

Figure 4: China’s ODI and FDI from 2006 and 2014
Source: Wind database

3.2 Reform of exchange rate regime and liberalization of capital account

It is market forces to start the process of RMB internationalization. However, to enhance the level of RMB internationalization shall be always accompanied with exchange rate regime reform and capital account liberalization. There is no successful story historically that any currency can become an international currency under strict foreign exchange control. Before reform and opening up, due to serious shortage of foreign exchange, China had been enforcing strict foreign exchange control. Afterwards, as the goal of socialist market economy was established, foreign exchange management mechanism reform continues to move forward step by step. In the process of foreign exchange management mechanism reform, China’s capital account is gradually liberalized.

3.2.1 Reform during the economic transformation period (1979-1993)

Reform at this stage laid the foundation for China’s foreign exchange management mechanism to shift from planning to market-oriented mechanism, which mainly covered the following measures: (1) reformed the foreign exchange allocation system based on total control over revenue and expenditure, and implemented foreign exchange retention system, while target, ratio and use of foreign exchange retention shall be prescribed by the State. (2) Established and developed foreign exchange swap center to adjust foreign exchange surplus and shortfall. Bank of China started foreign exchange swap business since October 1980. (3) Reformed RMB exchange rate regime and established dual exchange rate system. From 1981 to 1985, dual exchange rate system composed of internal settlement rate for foreign trade and official exchange rate for non-trading sectors was in use. From 1988 to 1994, dual exchange rate system was composed of official exchange rate and swap market rate. Official exchange rate was the managed floating rate, while exchange rate in the swap center would fluctuate with market demand and supply. (4) Relaxed the restrictions on operating foreign exchange business, which were no longer under unified management of Bank of China, and various types of financial institutions were allowed to engage in foreign exchange operations. (5) Gradually set up foreign exchange management system on capital inflows and outflows (including direct investment, securities investment and other forms of investment). Starting from 1985, remittance to domestic residents from abroad or foreign exchange carried with entry passengers was allowed to be fully kept and deposit into the banking account opening at the authorized foreign exchange bank. Since November 1991, foreign exchange owned by individuals was allowed to access into foreign exchange swap center. For individual use of foreign exchange, a certain amount of foreign currency can be purchased after getting approval as required.

3.2.2 Unification of exchange rates and current account convertibility (1994-2000)

In 1992, after the goal of Chinese socialist market economy was established, China's reform of foreign exchange management mechanism progressed rapidly towards the market-based mechanism. Two major initiatives were taken subsequently in 1994 and 1996 and full convertibility of current account was officially realized at the end of 1996.

During this period, exchange rate reform mainly covered the following aspects: (1) starting from January 1, 1994, banking exchange system was put in use for domestic companies. Foreign exchange retention as well as mandatory plan and approval for use of foreign exchange were abolished. Foreign exchange transactions of foreign-funded companies were gradually included in banking exchange system from July 1, 1996. (2) On January 1, 1994, RMB official exchange rate and swap center exchange rate were unified to a market-oriented, single and managed floating exchange rate system. (3) Build unified, regularized and efficient foreign exchange market. Chinese enterprises exited the foreign exchange swap center and designated banks became major players in foreign exchange trade. Interbank foreign exchange market, i.e. CFETS (China Foreign Exchange Trade System) was set up in Shanghai. The People's Bank of China (PBC) would offer necessary inventions in foreign exchange market based on the goal of macro-economic policy to adjust market demand and supply and maintain a stable RMB exchange rate. (4) Other remaining exchange restrictions for current account were removed in 1996 to realize convertibility of current account. (5) Standards for residents' foreign exchange use were continuously improved to expand the scope of foreign exchange supply. (6) Restrictions on use of foreign exchange in non-trading and non-operating activities, e.g. exit and entry exhibition, investment invitation etc. were abolished. RMB proceeds from sales of articles, equipment, utensils purchased by foreign organizations based in China and foreigners visiting China for self-use in China were allowed to be exchanged into foreign currency and remitted outward.

After the Asian financial crisis broke out in 1997, China once slowed down its pace for reform of foreign exchange management mechanism in order to avoid the risks possibly aroused by liberalization of exchange rate and capital account at too fast a pace.

3.2.3 Further liberalization of foreign exchange control (2001-2008)

As China entered the WTO at the end of 2001, foreign exchange system reform went back to a new rapid development route. Foreign exchange system reform during this period was both to continue and deepen the previous market-oriented reform, and to constitute a new round to adapt to the new situation. After accession into WTO, China experienced rapid development of its foreign trade and capital inflows with continuously expanded balance of payment surplus. China has accumulated a large amount of foreign reserve that peaked at more than 3.9 trillion USD in August 2015 (Figure 5). Therefore, China needed the more opened-up and flexible foreign exchange management system.

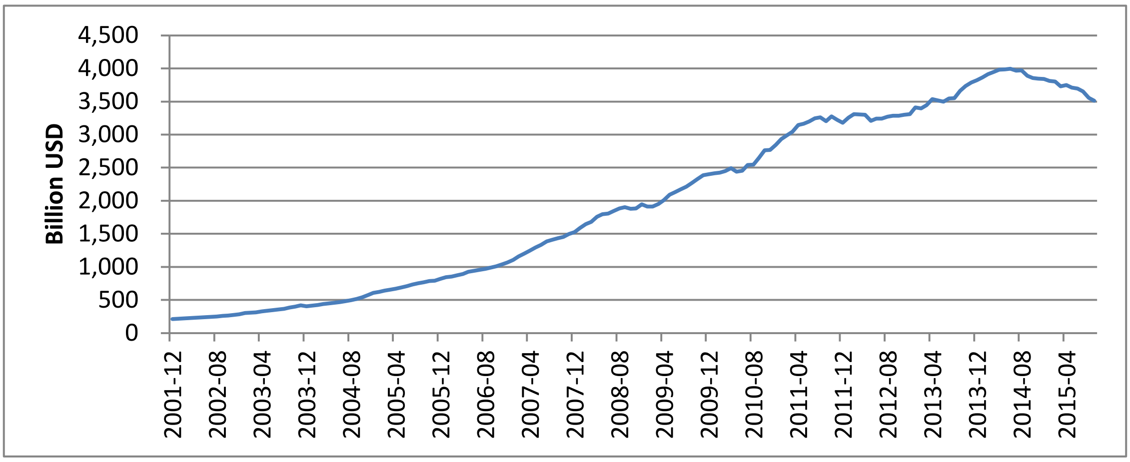

Figure 5: China's foreign exchange reserve
Source: Wind database.

Foreign exchange system reform during this period mainly adopted measures along the following six dimensions: (1) significantly reduced administrative approval items and improved efficiency of administrative licensing. Since 2001, competent foreign exchange authorities totally abolished 34 administrative licensing items in three batches, reducing by 46.5% on the original basis. (2) Further improved foreign exchange management for current account and promoted trade and investment facilitation. For example, all Chinese companies were allowed to open foreign currency account for trade payments, the ratio of cash foreign exchange that may be retained was increased many times and the deadline for foreign exchange settlement above the quota was extended. And import and export verification procedures were simplified with trial of classified management for export verification. (3) Stably promoted convertibility of capital account and expanded the channel for capital inflows and outflows. Foreign exchange restrictions on overseas investment were relaxed, including part of insurance companies' foreign exchange funds were allowed to invest in overseas securities market, individuals were allowed to transfer assets overseas, qualified foreign institutional investors (QFII) and qualified domestic institutional investors (QDII) were launched, and foreign exchange management policy for M&A by foreign capital was issued. (4) Actively nurtured and developed the foreign exchange market and improved the managed floating exchange rate system. On July 21, 2005, the managed floating exchange rate system based on market demand and supply and referring to a basket of currencies for adjustment was put into use. Meanwhile, a set of supporting measures were taken, including addition of traders, introduction of "market maker" system in USD trading, allowing all banks to engage in forward foreign exchange purchase and sales, introducing RMB to foreign currency swap business, increasing varieties of interbank trading products, implementing comprehensive position management for banking exchange and adjusting bank exchange rate management method etc. (5) Strengthened capital inflow management and actively protected against financial risks. Specifically, adjusted the caliber for short-term external debts, implemented total quantity control for external debts of foreign banks, enforced foreign exchange settlement system for making payments, strictly controlled foreign exchange settlement by using fund under capital account, reinforced management on external debts of foreign-funded companies, strengthened management on advance from customers in exports an delayed payment in imports and enhanced management for individual foreign exchange settlement of residents and non-residents. (6) Strengthened monitoring over balance of payment and put great efforts in foreign exchange market rectification and anti-laundering. Starting from 2003, large-sum and suspicious foreign exchange fund trade reporting system was officially implemented and anti-laundering information analysis was strengthened.

As of 2007, China has realized basic convertibility for nearly 30 items among 43 capital account transactions categories classified by IMF.

3.2.4 Expanded use of RMB in cross-border payments (2009 till now)

Since July 2009, along with the promotion of the trials of settling cross-border trade accounts in RMB, for capital account, China has liberalized the management on the inflows and outflows of capital dominated by RMB. On the one hand, it has expanded the channel for RMB outflows by increasing the quota for carrying foreign currencies abroad and interbank underwriting etc. On the other hand, it has also opened up the channel for CNH funds to flow back into China's capital markets by allowing foreign institutions to invest in interbank bond market and launching RQFII. The process of RMB internationalization has been vigorously promoted.

On June 19, 2010, exchange rate reform was re-launched. The PBC has repositioned the objective of reform as further promote the reform of RMB exchange rate formation mechanism and enhance the flexibility of RMB exchange rate. The re-launched reform is in nature the extension of exchange rate system reform in 2005, highlighting that a basket of currencies shall be taken as reference and market supply and demand shall be treated as an important indicator for making exchange rate related decisions.

In August 2015, the PBC decided to improve quotation of the central parity of RMB against US dollar. The quotes of central parity that market makers report to the CFETS daily before market opens should refer to the closing rate of the inter-bank foreign exchange market on the previous day, in conjunction with demand and supply condition in the foreign exchange market and exchange rate movement of the major currencies. Such exchange rate mechanism drew great attention from the international community as it resulted in RMB depreciation for a number of days in a row (central parity rate for RMB depreciated by 4.26% in August). It cannot be denied that after the adjustment, RMB exchange rate mechanism is more market-oriented and flexible, which meets the needs of RMB internationalization better. And a global RMB clearing and settlement system the creation of by this year, transactions costs in trading through the RMB could be as cheap and robustly settled as in the dollar or the euro.

And China is continuously liberalizing the capital market and capital account by introducing Shanghai-HK Stock Connect (Hu Gang Tong) system[6] in 2014. China is planning launch Shenzhen-HK Stock Connect in

[6] The system allows investors on China mainland and in HKSDR to trade a regulated range of stocks listed on the

the late 2015.

2.3 Further promotion of China's international cooperation

China is promoting the bilateral and multilateral economic and financial cooperation with positive attitudes, which is conducive to further improvement of RMB internationalization. During the past decade, China has quickened its integration into the global economy by promoting WTO Doha round negotiation as well coming to 14 FTAs with 22 economies up to the end of October 2015, including China-ASEAN FTA, China-Chile FTA, CEPA, China-Switzerland FTA, China-Korea FTA, China-Australia FTA, and so on. Seven FTAs are under negotiation, including China-Japan-Korea (CJK) FTA[7].

In addition, China's bilateral local currency swap is continuously expanded. In 2014, China signed new bilateral local currency swap agreements with central banks of Swiss, Sri Lanka, Russia, Qatar and Canada with the total size of RMB 545 billion; meanwhile, it renewed the bilateral local currency swap agreements in the amount of RMB 957 billion with central banks or monetary authorities of 8 countries and regions, including New Zealand, Argentina, Mongolia, South Korea, Hong Kong, Kazakhstan, Thailand and Pakistan. By the end of May 2015, the PBC has signed bilateral local currency swap agreements with central banks or monetary authorities of 32 countries and regions and total size of these agreements amount to 3.1 trillion RMB (Figure 6).

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other side's bourse. Hu Gang Tong imposed a 300 billion RMB limit on the amount of Shanghai-listed shares that investors in HKSDR can buy. The limit the other way was set at 250 billion RMB.

[7] Data source: http://fta.mofcom.gov.cn/english/index.shtml.

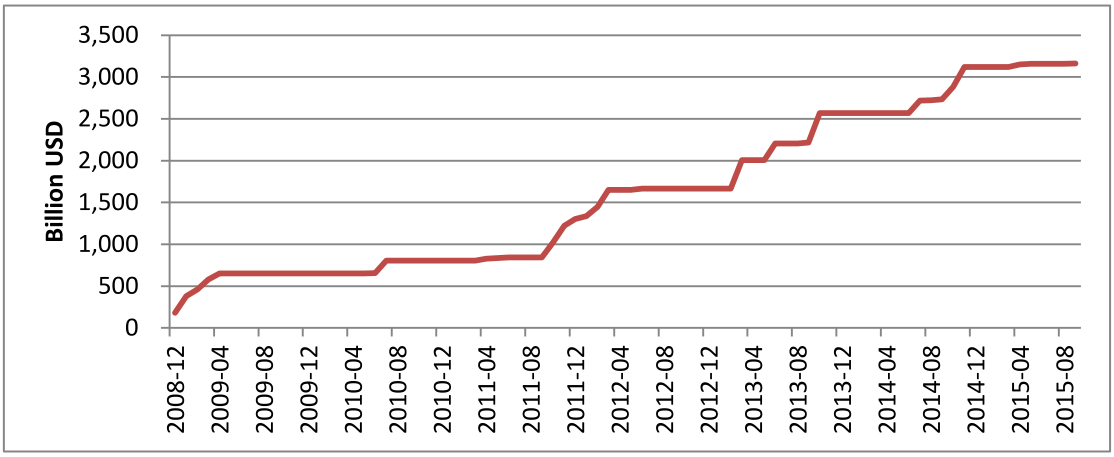

Figure 6: National currency swap of RMB
Source: Wind database.

In addition, China proposed the belt and road initiative in 2013, and then the AIIB (Asian Infrastructure Investment bank) and the Silk Road Fund established. All these initiatives reflect China’s desire for satisfying the global need for bettering infrastructure, improving trade and realizing inclusive development by working together with the surrounding nations. To make full use of the initiatives, it is necessary for China to further internationalize RMB in the coming days.

4. Position and future of RMB in international monetary system

The international standing of RMB has risen steadily along with the promotion of RMB internationalization. According to SWIFT data, RMB became the world’s No.5 payment currency and No. 6 currency in foreign exchange trading in December 2014, and also maintained its position as the second largest currency in trade finance. China’s role in international monetary system is being changed. On the one hand, China’s exchange rate system, composition of reserve assets, convertibility of RMB, liberalization of capital account and financial security etc. are becoming the important components in international monetary system and any initiative launched by China will have noticeable effect on the international monetary system. On the other hand, China’s dependence on the international monetary system is increasing rapidly and China’s stable economic development is increasingly depending on a sound international monetary system. Nevertheless, these changes will not challenge the existing international monetary system, but inevitably inject new elements for its future development.

4.1 China is transforming from a periphery economy into a semi-periphery economy

In case the international monetary system is divided into three layers, core, semi-periphery and periphery. At present, in such a system led by the USA, the core shall be USD, semi-periphery part includes EUR, JPY, GBP and other freely convertible international currencies, and the periphery is the rest of currencies. With the economy rising, China's position in tiers of international monetary system is changing, shifting from periphery to semi-periphery (Figure 6). This means China is getting rid of the status of a pure follower of international monetary system rules with gradually improved influence on international monetary system. Such change of China won't transform the existing structure of international monetary system, as the core nation, US, is still in dominance in the system. It took USD more than 70 years to overtake GBP as world's dominant currency from 1870 when US became the largest economy to 1944 when the Bretton Wood System was established.

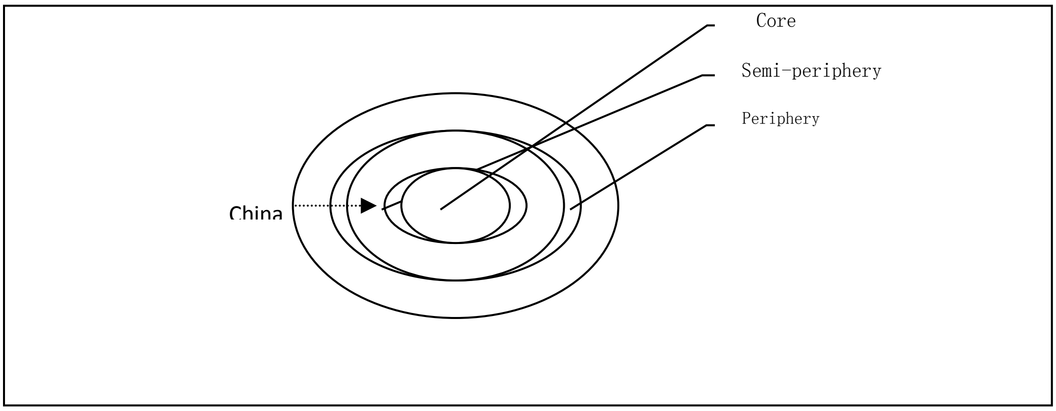

Figure 7: illustration about changes of China's role in international monetary system
Source: *Position and Role of China in the International Monetary System,* Liping Zhang, research report of DRC, 2012.

As a member of the international monetary system and the largest developing nation, such transformation of China means progress. The rise of China in status has brought new vigor to future development of the international monetary system.

4.2 Future strategic option

The global financial crisis in 2008 triggered a new round of international monetary system reform. The international community needs a stable international monetary system, which can both meet the needs of payment for international trading, avoid and effectively mitigate the financial crisis, maintain the globalization trend, and realize balance development of the world. To this end, all countries shall strengthen cooperation and focus on promoting the reform in exchange rate system, reserve currency, financial security and bailout. China is experiencing a switching of role from rule receiver to participant in discussion. It shall be one of the major topics for China to consider and study for how to better bring out it role to contribute to a healthier and more stable monetary system.

4.2.1 To support the international currency diversification

In terms of reforming the reserve currency, the demand for building super-sovereign reserve currency is gradually gathering weight. Compared to the realistic practice of reserve currency diversification across countries in the past, the role that super-sovereign currency may play will be far superior to the presence of multiple international currencies and fluctuation of exchange rate of major currencies. However, it’s extremely difficult to put super-sovereign currency into practice for the time is immature. The international monetary system will still be dominated by USD for a long period, but the trend of international currency diversification will also be increasingly apparent. The fact that RMB becomes an international currency is both the main content of this trend, and China’s active option to proactively participate in building a more stale international monetary system. It will be a major step in this process for RMB’s inclusion into SDR basket. Currently, one common view is that RMB’s inclusion in SDR is just a matter of time.

4.2.2 To maintain the exchange rate basically stable

When the financial crisis broke out, many people would cherish the golden time of low inflation, stable economic growth and automatic adjustment of international balance of payment under gold standard system. Actually, there is also crisis under gold standard system, but it's relatively easy to control. In today's world where globalization has almost penetrated everywhere, it's impossible to go back to the gold standard system, as it could only bring about global deflation. Moreover, in the international monetary system with USD as the core, it's also proven by history that it's difficult for the fixed exchange rate system to sustain.

At present, the realistic option shall be striving to avoid extreme fluctuation of the exchange rate to a maximum extent by continuously improving conditions through international cooperation. Firstly, it is to strive to narrow the gap between periphery and semi-periphery & core nations in terms of degree of economic development. Secondly, it is to build up information exchange and sharing mechanism for global capital, especially cross-border flow of short-term capital, and the linkage mechanism among countries to respond to international hot money. Thirdly, it is to help emerging economies build efficient control mechanism for speculative short-term capital flow.

As for China, besides actively participating in the above actions, it shall keep promoting the market-oriented reform of RMB exchange rate, meanwhile maintain relative stability of the exchange rate, so as to meet the needs of China for further expanding opening up, accelerating the transformation of development pattern and improving the level of RMB internationalization.

4.2.3 To improve collective intelligence in crisis management

One of the important functions for the international monetary system to maintain the financial security and help the member states in crisis. However, performance of the existing international monetary system in this aspect is barely satisfactory up to now. Under such circumstance, some periphery economies resort to 'self-security' by holding a large amount of foreign currency reserves. For developed economies, some choose trade protectionism as 'self-security'. 'Self-security' is not favorable for the development of international trade and investment. Any measure based on accumulating foreign currency reserve or trade protectionism will reduce the world's total demands and impede the rapid response to the crisis (Stiglitz, 2011). The top priority shall also be bringing out the role of international monetary system for 'collective response', reducing the foreign currency reserved of emerging economies and firmly resisting trade protectionism. In the context that global 'collective response' can't be improved in short term, some regional 'collective response' starts to be built, for example, Chiang Mai Initiative established after the Asian financial crisis.

For emerging economies including China, their demands for 'collective response' for financial crisis management are stronger. On the one hand, the opportunity cost for emerging economies to hold huge amount of foreign reserves will be increasingly higher. On the other hand, trade protectionism is increasingly becoming the barrier to hinder globalization and sustained development of emerging economies. To build and improve effective 'collective response' system shall be the important content for China to actively participate in construction of international monetary system.

5. The historical experience of Japan

The context for internationalization of Japanese yen (JPY) is very similar to that of RMB, both accompanied with rapid economic rise and substantial accumulation of balance of payment surplus. JPY internationalization started from 1970s, when Japan's position in the world economy was increasingly high and demands for JPY from the other countries rose, which promoted the payment and settlement of JPY in international trade and investment. During that period, promotion of JPY internationalization was always accompanied with deregulation of control over foreign exchange.

In 1964, Japan became Article VIII member of IMF, which created the condition for use of JPY in international trade and foreign exchange transaction. However, as the government stuck to the policy of combining fixed exchange rate with capital account regulation, JPY internationalization was far from successful until the revision of Foreign Exchange Law of Japan in 1980.

Revision of *Foreign Exchange Law* in 1980 is the watershed divide for JPY internationalization. According to the revised *Foreign Exchange Law*, Japan's current account basically realized convertibility and its capital account also transited from restricted control to deregulation in principle. Revision of *Foreign Exchange Law* marks the change of attitude for Japanese government from passive to active. Though *Plaza Accord* in 1985 caused sharp appreciation of JPY and then improper countermeasures to JPY appreciation subsequently resulted in recession of Japanese economy for more than 20 years, these cannot be interpreted as JPY internationalization was unsuccessful after revision of *Foreign Exchange Law*.

After capital account was liberalized, the share of JPY in global trade settlement and international reserves is still not high. According to Japan's statistics, the shares of yen as invoice currency in Japan's export and import are from 35% to 40% and from 20% to 25% respectively between 2001 and 2015. As invoice currency, yen is mainly used in Japan's own foreign trade. Japan accounts for less than 10% in global trade. That is why the share of yen as invoice currency in global trade is less than 5%, which is 3.3% from 2014 Q2 to 2015 Q1 showed in table 2. And since 1995, ratio of JPY in official foreign exchange reserves has been under 7% with a continuously falling trend (see Table 6).

Table 6: 1995-2009 The share of JPY as official foreign exchange reserves (%)

	USD	EUR	GBP	JPY
1995	59.0		2.1	6.8
1996	62.1		2.7	6.7
1997	65.2		2.6	5.8
1998	69.3		2.7	6.2
1999	70.9	17.9	2.9	6.4
2000	70.5	18.8	2.8	6.3
2005	66.9	24.1	3.6	3.6
2010	61.8	26.0	3.9	3.7
2011	62.3	24.7	3.8	3.6
2012	61.3	24.2	4.0	4.1
2013	61.1	24.4	4.0	3.8
2014	63.1	22.1	3.8	3.9
2015Q1	64.1	20.8	3.9	4.2
2015Q2	63.8	20.5	4.7	3.8

Source: IMF

Such result can be mostly attributed to Japan's trade structure, limited investment chance for foreign fund in its domestic market and exchange rate volatility of JPY. Japan relies on overseas resources and markets heavily. The international resource market is mainly denominated in USD, so if Japan makes settlement in JPY in its exports, there will be currency mismatching between foreign exchange receipt and payment. Constrained by the domestic market, overseas JPY holders have very limited direct investment chance in Japan, which greatly reduce the willingness in holding JPY. Additionally, JYP exchange rate is extremely instable, that makes it hard for JPY to become the major reserve currency for other countries.

The experience of JPY internationalization has profoundly revealed two important characteristics for currency internationalization. Firstly, if one currency is to bring out its function in wider geographical area, the country must vigorously promote capital account liberalization. Secondly, capital account liberalization won't necessarily make the country's currency become a major international currency, as it is also constrained by many factors e.g. national economic strength, domestic economic scale, currency investment channel, currency stability etc. It is always market force that decides the destiny of currency internationalization.

6. Conclusion

RMB internationalization is advancing rapidly and there are increasingly stronger demands for China's further liberalization of capital account and improved flexibility of exchange rate. At the same time, it's also increasingly difficult to maintain the balance between risk and stability. The level of RMB internationalization eventually depends on market force and there is still large uncertainty for the final result. Consequently, RMB internationalization shall continue to follow the model of gradual improvement and go with the trend. As the level of RMB internationalization is improved, influence of China in the international monetary system will also be increased, so that it can make more contribution to reform and improvement of the international monetary system by strengthening international cooperation.

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