

# *The Research on the Opportunity and Approach of RMB (Renminbi) Internationalization*

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**Abstract:** The world power, its currency is also bound to have a strong strength in the world economic field, such as the US dollar, pound sterling and the euro. Now although China's comprehensive strength is among the best in the world, the RMB are still unable to reach the position of China's comprehensive strength, whether from the circulation, settlement and reserve aspects. In other words, the internationalization of the RMB is a task that China must achieve. This paper takes the opportunity of RMB internationalization as the clue, focuses on the analysis of the ways that help promote the internationalization of the RMB, mainly analyzes the economic behaviors that have more development opportunities in the realistic background, namely, the foreign direct investment and cross-border trade. Through the study of the relationship between the two economic behaviors and the internationalization of the RMB, this paper explores the ways to promote the internationalization of the RMB.

## **1. Introduction**

In 2001, China officially joined the World Trade Organization (WTO), since then China has been playing its own advantages, actively participate in it, lowering tariffs, making lists, and conducting trade and investment activities around the world with the concept of win-win and the welcome attitude. In the more than 20 years since China joined the World Trade Organization, it has become the world's second largest economy, the largest trading nation in goods, and the largest FDI absorption country. Its economy has grown by 11 times, and China's economy and the world economy have achieved win-win in the sustainable development. With its outstanding economic achievements, China has now become a very important voice and a pivotal position in the world. Compared with China's increasing international status and growing international influence, the internationalization of the RMB has not been correspondingly developed. Looking at the world, the US dollar still accounts for a large proportion of international payment currency and global reserve assets, and is still the world's main reserve currency. The Federal Reserve's interest rate cuts, US dollar asset output, and vicious depreciation have made the United States the dominant player in the unequal monetary system. In this context, China's huge foreign exchange reserves are likely to shrink and depreciate due to US dollar fluctuations, and are subject to huge US dollar exchange rate risks. The RMB has a big gap with the US dollar and the euro in terms of usage scale, circulation volume, and storage status. Compared with China's continuous progress in comprehensive strength,

the unbalanced level of currency development may become an obstacle to the future development of the country. The research on the internationalization of RMB has gradually become a hot topic for scholars at home and abroad. How to accelerate the construction of RMB internationalization has become the focus of the research. In previous studies, scholars focus on the factors that can affect the development of RMB internationalization and put forward suggestions, mostly at the macroeconomic level. With the continuous proposal of measures to improve the level of external development in recent years, such as free trade areas, "One Belt and One Road" construction, and the formal signing of the Regional Comprehensive Economic Partnership (RCEP), China's OFDI behavior and cross-border trade activities will have more and better development opportunities.

## 2. Literature review

Scholars from different countries have a certain degree of consistency in the discussion of the challenges and opportunities of RMB internationalization. Beverly mentioned that the Industrial and Commercial Bank of China launched RMB clearing service at the beginning of this century, which represents the official start of the internationalization process of RMB<sup>[1]</sup>. However, at the same time, the promotion of the use of RMB as a global currency also faces some challenges, including the lack of RMB-denominated quotations in international trade, and the small size of RMB in direct foreign exchange transactions in the foreign exchange market." The driving force of RMB internationalization is the Chinese authorities' desire to match China's economic strength and its status as the world's largest exporter". Paul said that the representativeness of RMB in the global capital market trade is seriously insufficient at present, and in the process of RMB internationalization, China is trying to bridge the mismatch between the global influence of its economy and the global influence of its currency<sup>[2]</sup>. Sohn said in his research that China is the world's largest creditor country, the largest trading country, and the second largest economy in the world, and the use of RMB as a global payment currency is far behind China's global economic strength. At the same time, he also believes that the internationalization of RMB can further improve China's international status and competitiveness, and China's influence in the world will also increase<sup>[3]</sup>. Prasad believes that it was not until the early 21st century that China gradually liberalized its capital account, allowing financial capital to flow more freely across borders. This process was very gradual at first, and only accelerated after 10 years. In the past few years, there has been significant progress in some functions of RMB that help make it an international currency, but the seemingly unstoppable progress of the currency stalled in 2014<sup>[4]</sup>. LyBora said that RMB's participation in SDR, "One Belt and One Road", and AIIB will all promote the internationalization of RMB. China must encourage the internationalization of RMB, including transforming cross-border RMB trade into payment currency, promoting the internationalization of RMB through outward direct investment, strengthening the process of RMB exchange rate, and developing the domestic financial system and financial infrastructure<sup>[5]</sup>. From the perspective of literature research, most scholars believe that the internationalization of RMB has not reached the level it should have reached in terms of China's economic strength, international status and comprehensive national strength. For China to pursue higher quality development in the future, the improvement of the internationalization level of RMB should be the focus of attention. In recent years, the pace of RMB internationalization has slowed down, and it is urgent to change the development mode and find new driving forces to increase its development speed. Scholars also talked about China's important measures in recent years, such as the "One Belt and One Road", which will be an important opportunity for the internationalization of RMB. We must seize these opportunities and push the internationalization level of RMB to a higher stage of development. However, in addition to emphasizing the development of RMB internationalization and analyzing the favorable background,

the literature is a little inadequate in terms of how to do it, namely the lack of description of the specific methods to promote the internationalization of RMB, including the study of the import and export trade can directly create the circulation opportunity of currency, and provide conditions for the strengthening of the basic functions of currency. Kubarych believed that the greater the trade volume of a region, the greater the demand for local currency in foreign exchange transactions, which will further enhance the pricing power of the domestic currency<sup>[6]</sup>. Dwyer Jr., in his study on the key characteristics of international currencies, took the currency issued by the world's trading powers as one of the main characteristics he summarized, and believed that sufficient trade scale is a necessary condition for currency internationalization<sup>[7]</sup>. Goldberg believed that the key to becoming a global currency lies in people's confidence in it, and the amount and scale of currency circulation play a great role in supporting people's confidence<sup>[8]</sup>. Shams discussed the internationalization of domestic currencies from the perspective of trade, assuming that the countries with the largest proportion of international trade in global trade often have international currencies<sup>[9]</sup>. Andrews, in his study on currency internationalization, pointed out that domestic enterprises should have the ability to use the domestic currency as the settlement currency when conducting economic and trade in the international market<sup>[10]</sup>. This means that as long as the trade scale is larger, the currency can promote its own international development through expanding the settlement efforts. Candidate believed that the currency of economic powers and countries with large trade volumes is likely to become an international currency. China's development and trade scale not only need more trade settlement and financial transactions to be settled in RMB, but also become a solid cornerstone for the internationalization of RMB<sup>[11]</sup>. Hiro and Kawai believe that currency settlement in international trade is one of the early steps for any national currency to become a major international currency<sup>[12]</sup>. Through their research, they observed the settlement of US dollars and euros in international trade, providing some perspectives on the future potential or obstacles of the internationalization of RMB. Kondratov believed that as more and more international trade partners accepted the RMB-denominated settlement, only when local governments support the international settlement of RMB through tax incentives, simplification of administrative procedures and other ways can the internationalization of RMB continue to improve<sup>[13]</sup>. Scholars believe that cross-border trade is a very important factor affecting the level of currency internationalization. Its basic idea is to use the national currency more in the import and export trade for settlement, so as to expand the scope of use of currency, enhance the liquidity of currency and strengthen the function of currency. Literature research shows that the expanding trade scale due to the development of import and export trade is an indispensable condition in the process of currency internationalization, and trade has a positive effect on currency internationalization. However, many literatures do not discuss the import and export trade issues from different paths of import and export trade respectively, because there are differences in the circulation mechanism of currency in import and export, which may have different effects on the function of currency, so the impact on the internationalization of currency may also be different<sup>[14]</sup>.

### **3. Opportunities for the internationalization of RMB**

In recent years, China has been striving to seek a high-level development path of opening up and constantly exploring the external development mode suitable for China's national conditions. It is necessary to create a gateway to the world's economy and trade from the domestic side, and actively practice the initiative of participating in international cooperation. Through continuous trials and efforts, China has become more and more open to the outside world and more and more closely connected with the world. These reforms, initiatives and cooperation not only make the country better adapt to the trend of economic globalization, but also bring more favorable opportunities for

the internationalization of RMB<sup>[15]</sup>.

### 3.1. China's pilot free trade zones

The construction of China's pilot free trade zones is an important strategic measure for China to comply with the new trend of globalization and promote China's high-level opening up and high-quality development. The so-called pilot free trade zones are experimental zones with greater advantages in trade and investment and other fields compared with the relevant provisions of the WTO. Outside the border of a sovereign state or region, a place is delimited where goods are not subject to tariffs and foreign goods can enter and exit freely. The first free trade zone, namely the Shanghai Pilot Free Trade Zone, has been built in 21 pilot areas since 2013. And each free trade zone has its own development strategy and characteristics. The establishment and development of China's free trade zones is an important embodiment of China's active adaptation and grasp of the new situation and new requirements of current development, constantly promote reform and opening up, and promote the high-quality development of the economy<sup>[16]</sup>. The core significance of the establishment of China's free trade zones is to promote foreign trade growth and attract foreign investment. In the pilot free trade zones, not only import and export trade can be exempted from tariffs, but also trade procedures will be greatly simplified, further promoting trade facilitation, so as to attract more high-quality trade partners, and fully integrate the domestic market with the foreign market, and fully grasp the development of the "double circular economy". Under such advantageous conditions, China's foreign trade will have more and better opportunities. In foreign trade, if the initiative to use RMB for settlement can be strengthened, the overseas circulation of RMB can be effectively promoted, and the circulation and payment function of RMB can be enhanced. More use of RMB for pricing in trade can also enhance the function development of the value scale of RMB. With China's pilot free trade zones becoming more and more mature, there will be more pilot free trade zones in the future, and foreign trade will also be further developed. Therefore, the establishment of pilot free trade zones is undoubtedly a favorable opportunity for the internationalization of RMB.

### 3.2. "The Belt and Road" Initiative

The "Belt and Road" Initiative is an acronym for the cooperation initiative of building "the New Silk Road Economic Belt" and "the 21st Century Maritime Silk Road" proposed by China. The initiative aims to promote economic development and regional cooperation of countries along the Belt and Road<sup>[17]</sup>. The construction of "The Belt and Road" can make China's relationship with the international economy more closely, and at the same time can make China's new industry and economic structure be further optimized. China will strengthen economic and trade cooperation with countries along the road through "The Belt and Road" and promote China's foreign trade development. In the face of many countries with development potential along the road, China will more frequently carry out economic and trade activities, whether in marginal industries or emerging industries, can make more choices by using this bridge. The establishment of AIIB will further deepen the cooperation with countries and provide more space for China's development<sup>[18]</sup>. The Belt and Road Initiative will be the most important opportunity for the internationalization of RMB in recent years. In addition to its huge size, numerous participating countries and long duration of development, many links in the construction of the Belt and Road provide a broad stage for the development of RMB. Economic and trade exchanges with countries along the routes can promote the settlement and circulation of RMB, expand the application of RMB, improve the pricing level of RMB, and thus enhance the functions of circulation, payment and value scale; OFDI can not only strengthen the circulation and payment ability of RMB, but also increase the ability of enterprises to

price their products in RMB, expand the scope of influence of RMB, and enable RMB to participate in more trade and investment activities.

### **3.3. Signing the Regional Comprehensive Economic Partnership (RCEP)**

RCEP is a free trade agreement jointly initiated by ten ASEAN countries, forming a unified market among 16 countries by reducing tariffs and non-tariff barriers. It is a form of organization, namely the opening of markets among member countries to achieve regional economic integration. The goal of RCEP is to eliminate trade barriers, establish and improve the free investment environment, expand trade in services, intellectual property protection, competition policy and so on<sup>[19]</sup>. China officially signed the RCEP in November 2020, marking China's official start of a new journey of deeply participating in economic globalization with the opportunity of the free trade area with the largest population, the largest economic and trade scale and the best development prospects. The signing of the RCEP is not only of great significance to China's economic development, but also creates very good opportunities for the internationalization of RMB. In the region, countries will not only focus on eliminating trade restrictions and barriers, but also gradually expand the scope of trade with the negotiations. The depth, content and volume of trade between participating countries will be brought to a higher level. The economic and trade exchanges within the region will be more frequent, and China's foreign trade scale will rise with a more significant trend. In terms of investment, the RCEP will create a more free, more convenient and more competitive investment environment. Chinese enterprises will have more opportunities to "go global", and do better in the choice, quality and environment of foreign direct investment. In the interaction with partners in the region, RMB will also have a very broad stage, and can continue to deepen development in cooperation with a more positive trend, and gradually improve its internationalization level.

## **4. Approaches to RMB Internationalization**

### **4.1. OFDI**

The OFDI activities carried out by a country or region may affect the development of currency internationalization from direct and indirect aspects. First of all, OFDI has a direct effect on currency internationalization. Through OFDI, overseas subsidiaries will be able to improve the ability to absorb offshore domestic currency. In this way, the overseas stock of domestic currency may increase, and when the subsidiary returns the profits to the motherland, it will also involve the process of converting foreign currency into domestic currency, which will also increase the volume of foreign exchange transactions. Through the growth and development of the subsidiary and the advantages (technology, capital, etc.) provided by the motherland, the overseas subsidiary will be able to improve the production efficiency of the enterprise, reduce the production cost of the enterprise and win a place in the market of the host country, so as to obtain the initiative to use the domestic currency for transactions in the negotiation process with the partner. This will strengthen the circulation and settlement of the domestic currency, and greatly promote the internationalization of the currency. According to the currency substitution theory, in order to meet the currency substitution of the transaction demand caused by OFDI, people will choose to hold RMB instead of the domestic currency to exercise the basic function of currency circulation. The holding of RMB for financial investment to meet the needs of investment currency substitutes, which strengthens the basic functions of RMB.

The development of RMB internationalization, in essence, depends on the play of its monetary functions, namely from the three most basic aspects of circulation, reserve and pricing. According to

analysis, OFDI, import and export trade can through a series of different ways to make RMB play these functions, strengthen its basic performance as an international currency.

Secondly, OFDI has an indirect effect on currency internationalization. The OFDI of a country or region will indirectly promote the internationalization level of currency under the influence of three results: economic strength, trade scale and financial market construction. First, OFDI will enhance the economic strength of the home country, and the continuous deepening of economic development will promote the development of optimal allocation of resources, industrial upgrading and the increase of overseas income. The optimal allocation of resources and industrial upgrading will not only promote the development of domestic industry, but also promote the transnational transfer of domestic marginal industries, and will promote the development of OFDI and expand the scale of OFDI, thus indirectly affecting currency internationalization. Second, the further increase of overseas earnings will also expand the scope and scale of the parent company's OFDI, and play a positive role in the same influence path. OFDI can also obtain advanced technical experience, reduce trade costs, and realize the optimization of trade structure. These advantages not only strengthen the comprehensive strength of the parent company, but also help the subsidiary have a stronger competitiveness in the host country market, thus expanding the world market influence, enhancing trade scale, and promoting currency circulation. Third, the promotion of domestic financial market construction can help promote the construction of supporting services and enhance overseas influence, which not only can comprehensively affect the overseas development of OFDI, but also enhance the world's confidence in the domestic currency and enhance the willingness to hold it due to its increasing influence, and further promote currency internationalization.

#### **4.2. Cross-border trade**

Cross-border trade is divided into export trade and import trade. Although there are some differences in the actual economic behavior, they can ultimately promote the development of currency internationalization through certain ways of realization. In export trade, when the transaction is denominated in domestic currency, the exporter delivers the goods and obtains a certain amount of domestic currency. This not only reflects the enhanced pricing and settlement ability of domestic currency and the expanded scope of currency use, but also enables offshore domestic currency to play a reflow mechanism, stabilize the currency liquidity and reduce inflation pressure. This path can effectively play the basic monetary function of domestic currency in the international market and improve the internationalization level of currency. When the transaction is denominated in foreign currency, it is necessary to strengthen the initiative of domestic currency pricing through various efforts, such as improving economic strength. The sovereign currency of a country with strong economic strength will also have higher credibility and more stable currency value, which is more acceptable to traders. In the market of counterparties, the higher occupation of the market share, the greater the importance of the market, and the more powerful the initiative to negotiate currency. When the domestic exporter has a higher market share in the counterparty market, the transaction settlement of trade behavior is more likely to use domestic currency as the denomination currency; when the domestic economic strength is stronger, the possibility of choosing domestic currency as the denomination currency is greater. In the export trade of a country or region, if the proportion of highly differentiated commodities and high-tech products is larger, the higher the negotiating position of the country in international trade is, the greater the possibility of its currency internationalization is. Through these measures, the initiative to use the domestic currency in export transactions is actively enhanced, further promoting the performance of the function of the currency in the international market, and promoting the development of currency internationalization. Import trade will also have an impact on currency internationalization through

different paths. When the domestic importer purchases foreign products and uses the domestic currency for payment and settlement, the domestic currency will flow abroad in the form of export earnings. In this process, in addition to enhancing the liquidity of the domestic currency and improving its settlement scope and scale, it can also play its storage function to a certain extent. For example, the holder of the currency has confidence in the currency and chooses to continue to hold or purchase products with the face value of the domestic currency, which can play the storage function of the domestic currency as valuable assets abroad. When the import trade is settled in foreign currency, it is also necessary to make positive attempts to improve the currency pricing initiative, such as active negotiations with exporters and striving for the currency pricing right through preferential means. Besides, as an importer, it is more initiative in the trade market, can make more extensive and balanced choices, and takes the currency pricing power as an important factor in choosing exporters. Therefore, the basic path of import trade can also eventually improve the internationalization level of the currency by striving to point to the development of the all-round function of the currency. China is the world's largest trading nation, actively seeking cooperation in cross-border trade worldwide, and it is precisely because of this that the RMB can start to develop without mature international conditions. Based on this, China's OFDI activities and cross-border trade are favorable factors for the internationalization of the RMB. Measures such as pilot free trade zones, "One Belt and One Road" and RCEP can vigorously promote the internationalization of the RMB with more favorable conditions. As for the boost of RMB internationalization by individual economic behaviors, the comprehensive construction of "One Belt and One Road" can not only increase the opportunities of OFDI and cross-border trade at the same time, but also achieve comprehensive and favorable development in the form of two-way interconnection and development by promoting trade through investment and promoting investment through trade. RCEP also focuses on trade, and OFDI is also its focus, so trade and investment can develop in parallel and promote each other. The promotion of RMB internationalization by OFDI and cross-border trade is not isolated, but can be combined.

## 5. Conclusions

The development of RMB internationalization essentially depends on the performance of its monetary functions. OFDI and cross-border trade can make RMB play these functions through a series of different ways, and strengthen its basic performance as an international currency.

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