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Essay Geopolitics & Globalization

China Wants To Ditch The Dollar

Should Beijing successfully wean the world off the U.S. dollar, it would reshape the global economy and geopolitical landscape.

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JANUARY 11, 2024

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Ganzhou, a landlocked city that once served as a revolutionary base for the Communist Party of China, is not a typical tourist stop for visitors to southeastern

China. Spread across an expanse larger than Maryland, however, the city boasts a population that rivals New York City and an economy similar in size to Alaska.

Known as the "Rare Earth Kingdom" and the "Tungsten Capital of the World," Ganzhou today serves an important role in the Chinese government's overall effort to use mineral exchanges as a way to increase the use of its currency, the renminbi, and improve its pricing power in global commodities markets.

Home to the headquarters of the China Rare Earth Group — a state-owned behemoth born from the 2021 merger of three of China's largest state-owned rare earth enterprises — Ganzhou now produces nearly 70% of the country's rare earth mineral products, with China fulfilling roughly 90% of global demand.

Ganzhou also hosts the Ganzhou Rare Metal Exchange, where China's renminbi currency is used to quote prices for spot trading of tungsten, rare earth products and critical minerals like cobalt that are essential to the clean energy transition.

The metal exchange, established in 2019 with the approval of the State Council, now operates as a subsidiary of China Rare Earth Group. It is China's second mineral exchange, which was established to use the renminbi to price and trade minerals and rare earth products.

The first such exchange, the Baotou Rare Earth Products Exchange, which started operating in 2014, is jointly owned by 14 major Chinese rare earth suppliers and was explicitly set up, at least in part, to increase China's overall role in pricing rare earth products. To that end, China also launched two renminbi-denominated exchanges — oil futures in 2018 and copper futures in 2020 — on the Shanghai International Energy Exchange.

By establishing commodities exchanges across its industrial cities, China aims to boost the use and power of the renminbi in global commodities pricing to establish an alternative global financial system that is less reliant on the almighty dollar. This effort also involves regional cooperation with China's neighbors and non-Western multilateral partnerships to develop regional currency arrangements and enhance the use of local currencies in international trade and investment.

In China's telling, these strategies are less about offense — trying to dethrone the U.S. dollar or replacing it in the global system with the renminbi — and more about defense: strengthening China's financial security and reducing its geo-economic vulnerabilities within the existing dollar-dominated global economic and financial system. Beijing wants to minimize its exposure to a potential dollar liquidity crunch and ensure its continued access to global capital markets even during times of geopolitical crisis.

No Chinese leaders have publicly expressed an intention to dethrone the dollar despite escalating geopolitical and trade tensions between the U.S. and China beginning in 2018. However, as those tensions persist, Chinese financial regulators and scholars have explicitly expressed concerns about Beijing's vulnerabilities and urged government officials to step up efforts to protect the financial system.

Fang Xinghai, vice chairman of the China Securities Regulatory Commission, has cautioned that China should urgently prepare for the possibility of being removed from the U.S. dollar-based global payment system — a form of "forced financial decoupling." In such a scenario, Chinese entities would lose the ability to access the U.S. dollar or use it to conduct international transactions.

The comments came at a time when two U.S. senators had proposed a bill that would sanction Chinese entities enforcing Beijing's then-proposed national security law cracking down on antigovernment protests in Hong Kong and would penalize banks in business with those entities.

Since President Xi Jinping came to power in 2013, he has repeatedly emphasized worst-case scenario thinking to "prevent macro-risks that may delay or interrupt the process of the great rejuvenation of the Chinese nation."

From Xi's vantage point, China's state-owned financial institutions and enterprises must inoculate themselves against potential international sanctions in the event of a military conflict with the West over Taiwan. That concern has only grown more urgent after China witnessed the collective sanctions imposed by the West on Russian entities and individuals to punish President Vladimir Putin for his war against Ukraine.

The West's decision to freeze Russian foreign exchange reserves has caused particular consternation in Chinese policy circles. Chinese economist Yu Yongding described such a move as "a blatant breach of…trust" and proof of the United States' "willingness to stop playing by the rules."

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Jin Canrong, an international relations and strategy professor at Renmin University of China in Beijing warned in 2022 that China must be vigilant about the safety and security of its overseas financial assets. This includes China's more than $3 trillion in foreign exchange reserves — foreign currency-denominated assets and gold held by the Chinese central bank to settle international trade and maintain exchange rate stability — and over $8 trillion in other overseas assets, like stocks and real estate, owned by the Chinese government-affiliated entities.

In response to Chinese policymakers' anxieties over the country's future financial security, China has accelerated its development of an alternative global financial system independent of the dollar to fortify its economy against potential sanctions.

Multilateral Partnerships

China is the world's largest consumer of fossil fuels and dominates the supply chains of several highly sought-after critical minerals, such as cobalt and rare earth minerals, which cannot be easily substituted by other materials using existing technology in the clean energy transition. Despite its significant role in these markets, Chinese policymakers have worried in their public comments about the nation's historically limited control over price setting.

China remains heavily dependent on the U.S. dollar for pricing and settling commodities contracts, which means Chinese businesses face higher transaction costs, and its economy is more vulnerable to global volatility and geopolitical tensions. To reduce these vulnerabilities, Chinese policymakers and scholars have been working to increase the influence of the renminbi in global commodities markets.

These policymakers and scholars see the ongoing energy transition as an opportunity for the nation to raise the global standing of the renminbi in commodities markets; to them, there's no guarantee that the U.S. dollar's dominance in our current fossil fuel-powered global economy will persist in a decarbonized world. To capitalize on this opportunity presented by the green transition, China has been actively developing marketplaces and institutions for pricing and trading commodities using the renminbi. These efforts include launching commodities exchanges in resource-rich areas such as Baotou and Ganzhou as well as in its financial center, Shanghai.

China has pursued de-dollarization — efforts to reduce global reliance on the U.S. dollar for trade and financial transactions — through partnerships with non-Western regional and multilateral groups, such as the Shanghai Cooperation Organization (SCO) and BRICS, by advocating for the use of local currencies in international trade and investment, and broadening participation in an alternative global financial system. After the West imposed sanctions against Russia, Xi publicly called for the use of local currencies in international trade and development finance.

At the September 2022 SCO Summit, Xi explicitly proposed expanding the use of local currencies in trade settlement to promote regional integration, strengthening the development of local-currency cross-border payment and settlement systems and promoting the establishment of an SCO development bank to help shepherd such changes. SCO members agreed on a "roadmap" to accomplish these goals.

In a December 2022 address to the China-Gulf Cooperation Council (GCC) Summit, Xi emphasized his hope that China and members of the GCC should increase the use of renminbi for oil and natural gas trading and settlement through the Shanghai Petroleum and Natural Gas Exchange (SHPGX) in the next three to five years.

Since Xi's speech, Chinese national oil and gas companies have accelerated initiatives to use the renminbi, instead of the U.S. dollar, in their international fossil fuels transactions through SHPGX. In March 2023, an important step towards the de-dollarization of energy trading occurred when China National Offshore Oil Corporation — known as CNOOC, China's largest offshore oil and gas field operator — used the renminbi to complete the transaction of importing 65,000 metric tons of liquefied natural gas (LNG) from TotalEnergies SE, a French multinational oil and gas company, through SHPGX. The LNG was produced in the United Arab Emirates, a member of the GCC, carried by a Liberian-flagged LNG tanker Mraweh, and finished unloading in May at the CNOOC Guangdong Dapeng LNG receiving station.

This transaction was the world's first cross-border LNG trade settled using the renminbi. Since then, CNOOC has executed more renminbi-settled transactions using the renminbi through SHPGX. In October, PetroChina, the largest oil and gas producer and distributor in China, settled a purchase of one million barrels of crude oil using the digital renminbi through SHPGX, marking the first cross-border oil transaction using the country's central bank's digital currency.

Chinese policymakers have been exploring opportunities to promote renminbi usage in bilateral trade and settlement since the launch of Xi's 2013 Belt and Road Initiative (BRI), a massive global infrastructure development project. But even before the BRI, China's leaders had expressed interest in using the SCO framework to promote its currency for international financing schemes.

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After the 2008 global financial crisis, China used concerns about the ripple effects of a U.S. economic downturn, to begin promoting the use of local currencies in bilateral trade with SCO members. At the 2012 SCO Business Forum, now Vice

President Wang Qishan stressed that SCO members should promote local currency trade settlement by launching bilateral currency swaps, particularly with China, to strengthen regional financial cooperation and develop new financing models.

Such a swap enabled other countries to borrow renminbi from the People's Bank of China (PBoC) to facilitate short-term liquidity at relatively low interest rates. Such agreements would also encourage partner countries to increase their use of the renminbi in international trade, especially when purchasing Chinese goods financed by renminbi-denominated loans.

Among SCO members, China has since signed bilateral currency swap agreements with Uzbekistan, Kazakhstan, Russia, Tajikistan and Pakistan. China also now has swap agreements with SCO observer and dialogue partner countries Mongolia, Turkey and Armenia; last March, Saudi Arabia committed to joining as a dialogue partner and a full member in the near future. While China doesn't have an agreement with Kyrgyzstan, which is in the SCO, Kyrgyzstan's national bank signed a letter of intent in September 2015, stating it aims to work with the PBoC toward establishing a bilateral currency swap.

China's support for the expansion of SCO and BRICS over the last two years to include major commodities-exporting countries like Iran, Saudi Arabia, the United Arab Emirates, among others, suggests it is eyeing new opportunities to accelerate renminbi use in commodities trading.

The expansion has also given SCO and BRICS added significance as political forces in the shaping of commodity markets. SCO members include major hydrocarbon and minerals exporters in Central Asia like Kazakhstan and Uzbekistan, Russia and its newest member as of last year, Iran.

SCO also includes major commodities importers like China and India. In this context, as a non-Western group of countries, SCO potentially represents a potent coalition of exporters and importers of commodities centered around using the renminbi to finance the entire commodities lifecycle from production to trade to consumption.

Similarly, the expansion of BRICS to oil-rich nations bolsters the group's collective economic power and influence on the clean energy transition despite introducing greater internal complexity among its members, such as regional rivalries between the Saudis and Iran, China's rivalry with India as well as rising populism and its subsequent political unpredictability in Latin America.

SCO and BRICS now share overlapping members with similar incentives for using local currencies in international trade settlement and investment. This configuration facilitates formal and informal policy efforts to implement incremental de-dollarization initiatives in energy and commodities markets, with the potential to scale up.

The membership includes leading oil and natural gas producers and countries with significant reserves of critical minerals that will power the clean energy transition. Two of the world's five largest lithium producers —China and Brazil — are members of BRICS. Iran, a member of both SCO and BRICS, announced last February the discovery of its first lithium deposits, estimated to potentially be the world's second-largest after Chile. Iran already possesses the world's largest proven zinc reserves that are extractable using existing technology, the fifty-largest copper deposits, the 10th-largest uranium reserves and the 10th-largest iron ore reserves.

The Iranian regime has been coping with severe Western sanctions for decades and is firmly in favor of de-dollarization. Iranian President Ebrahim Raisi has emphasized that Tehran sees SCO membership as one way to counter American unilateralism and bypass sanctions. The shared membership and aligned incentives between SCO and BRICS make the two major non-Western groups attractive platforms for China's de-dollarization coalition.

A Long March Toward Expansion

The timing of China's first attempt to gradually internationalize the renminbi and how Chinese officials implemented it suggests that the initial motivation for gradually internationalizing the renminbi was primarily economic, intending to shield the Chinese economy from exogenous financial shocks rather than geopolitical dangers.

After the 2008 global financial crisis, then Premier Wen Jiabao openly expressed the Chinese government's concerns about the safety and security of China's holdings of U.S. assets during a March 2009 press conference. He urged the U.S. government to maintain its credibility and ensure the safety of Chinese government-owned assets.

Months later, Chinese financial regulators and central government agencies promulgated their guidance for cross-border renminbi settlement, enabling qualified Chinese enterprises to settle such trades in renminbi. The policy marked China's official first stride toward fostering broader international use of the renminbi.

"China aims to make its Cross-Border Interbank Payment System a critical piece of the world's existing financial infrastructure to promote international use of the renminbi."

Chinese economists have argued that the ultimate goal of renminbi internationalization should be to have central banks and major international financial institutions worldwide willingly hold large amounts of renminbi for international transactions so that China's currency can become an international reserve currency alongside the U.S. dollar and the euro.

Since then, the Chinese government has put resources into developing a renminbi-based financial infrastructure for cross-border settlement. In 2015, it launched the Cross-Border Interbank Payment System (CIPS) to improve the convenience of using the renminbi in international transactions by providing onshore renminbi clearance and settlement services.

CIPS allows global banks to clear cross-border renminbi transactions onshore instead of through offshore renminbi clearing banks, providing a one-stop alternative to the combination of the SWIFT system — a secure messaging system used by major banks to send financial information to one another — and the New York-based Clearing House Interbank Payments System.

However, CIPS is not a complete departure from SWIFT and still uses SWIFT's standards to connect with the global system. It has adopted the ISO 20022 international payments messaging standard to be interoperable with other payment systems as well as with correspondent banks around the world.

By adopting existing cross-border messaging standards, China aims to make CIPS a critical piece of the world's existing financial infrastructure to promote international use of the renminbi. By 2023, CIPS's annual business transaction volume reached 123 trillion renminbi (roughly $17.3 trillion), according to data on the CIPS website. CIPS now has 139 direct participants and 1,345 indirect participants worldwide, most of which are foreign branches of Chinese banks.

The Chinese government has also used subtle but strategic initiatives to increase the global appeal of its currency and deepen the market depth of renminbi-denominated assets. Despite hesitations around liberalizing China's capital account to allow capital to move freely in and out of the country, Chinese authorities have worked to broaden international acceptance of renminbi bonds as collateral.

In March 2021, the International Swaps and Derivatives Association (ISDA), a New York-based group composed primarily of the world's largest banks, together with the China Central Depository and Clearing Corporation, the Beijing-based central depository for all Chinese government bonds, released a whitepaper detailing the usage of Chinese government bonds as an initial margin in derivatives contracts.

This past September, the Hong Kong Exchanges and Clearing (HKEX) and London Stock Exchange started to study the use of Chinese government bonds as eligible collateral for derivatives contracts as a way to reduce Asia's heavy reliance on cash for margins on derivatives trades. Chinese institutions have also teamed up with leading resource-rich economies to make renminbi-denominated assets more attractive for international investors.

Also in September, the Shanghai Stock Exchange signed a memorandum of cooperation with Saudi Tadawul Group, the operator of the Saudi Exchange, that includes collaboration on expanding equity market connections and emerging financial issues such as cross-listings, or listing stock shares on multiple countries' exchanges to enable their interchangeability; new financial technologies; and environmental, social and governance (ESG) issues.

All these initiatives are aimed at increasing the utility of Chinese government bonds in international finance, thereby fostering investor demand for renminbi-denominated assets and upping the currency's overall liquidity.

Reducing Dollar Dependence

China's pursuit of broader use of the renminbi and an alternative financial system is de-dollarization in action. Such strategic defensive efforts could similarly be applied to other members of SCO and BRICS. Together, these nations form a potential de-dollarization coalition of countries across Asia, Africa, and Latin America, incentivized to create an alternative financial system as a bulwark against Western financial instability or weaponization of the dollar-based financial system to influence government policies.

This defensive effort by other countries might be seen in the revival last March of the proposal for an Asian Monetary Fund (AMF). Malaysian Prime Minister Anwar Ibrahim has actively advocated for the AMF to shelter the Malaysian economy against rising geopolitical tensions, supply chain disruptions and rapid U.S. interest rate hikes.

China's promotion of an alternative financial system is not about cheering on the demise of the U.S. dollar, but rather about creating an alternative financial system without a dominant currency in which the renminbi is accepted without bias. China has a strong incentive to prevent the dollar's collapse because it would likely be the largest financial loser should the dollar depreciate. The majority of China's over $3 trillion in foreign exchange reserves are invested in U.S. bonds and the lion's share of Chinese sovereign fund portfolios are tied to dollar-based Western markets.

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For now, China's development of an alternative financial infrastructure does not pose a credible threat to U.S. leadership in financial markets or the dollar's status as the world's reserve currency. The U.S. dollar remains the dominant currency in nearly all aspects of international trade and finance. However, history reminds us that no previously dominant currency, such as the British sterling, lasted forever; in fact, the sterling's decrease in dominance echoed the United Kingdom's reduced profile on the global stage over the last century.

Hence, the U.S. dollar's dominance should not be taken for granted or assumed to last forever. The accelerated adoption of non-dollar currencies in international transactions following the West's collective sanctions against Russia is a reminder of former U.S. Treasury Secretary Jacob Lew's warning in 2016: "The more we condition the use of the dollar and our financial system on adherence to U.S. foreign policy, the more the risk of migration to other currencies and other financial systems in the medium-term grows."

Geopolitical tensions and financial technologies (such as blockchain-based decentralized digital currency networks) may provide strong incentives and nuanced mechanisms for alternative financial systems to emerge and expand. The adoption of local currencies and financial digitization brings economic benefits to those involved in these new systems by improving transaction efficiency and reducing transaction costs.

However, it is important to note that governments pursuing de-dollarization initiatives are not solely motivated by economic and efficiency gains. The governments of countries in rivalry or competition with the United States, such as China, Russia and Iran, all seek to have a plan B to hedge against sanctions. By diversifying away from the U.S. dollar and dollar-based system, they aim to reduce their geopolitical vulnerabilities and strengthen their financial security in the face of geopolitical challenges.

The renminbi-based system has gained prominence due to the direct and active support of Chinese leaders and the Chinese government. A growing coalition centered around the renminbi's use in international trade and finance could, in the long run, erode the deterrence power of U.S. and Western financial sanctions overall by offering sanctioned countries a rival source of capital and less ideologically restrictive connections to the global economy.

Should China successfully wean the world off the U.S. dollar and the renminbi increase its status as a global currency or the dominant currency, it would reshape the global trade system and the international political landscape. The U.S. government could lose its privilege to raise debt at a low cost and its ability to exercise financial sanctions as a deterrence measure or to punish foreign regimes, entities and individuals.

Overall, the trend towards de-dollarization has far-reaching implications beyond the realm of international finance, as it has the potential to redefine international power dynamics as we know them.
