Financial Architecture

China’s Role in Reshaping the International Financial Architecture: Blunting U.S. Power and Building Regional Order

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EXECUTIVE SUMMARY

This chapter explores how China’s efforts to reshape the international financial architecture fit within a larger grand strategy to blunt U.S. financial power and build constraining financial leverage over China’s neighbors.

MAIN ARGUMENT
The rise of China marks the first time in centuries that the world’s largest economy will not be English-speaking, Western, democratic, liberal, or market-driven. The country’s security anxieties as a rising power—one that faces both the risk of confrontation with the U.S. hegemon and the risk of encirclement by wary neighbors—will shape its international economic and financial strategies. To deal with the U.S., China has pursued blunting strategies against U.S. financial power. It has supported monetary diversification and the creation of parallel payment and credit rating institutions to reduce its vulnerability to U.S. financial sanctions. To deal with its neighbors, China has pursued building strategies to enhance its financial leverage over them. It has promoted a renminbi zone, new financial institutions, and infrastructure investment that together foster asymmetric interdependence.

POLICY IMPLICATIONS
• In the short term, China’s efforts to build constraining leverage over its neighbors could lay the foundation for a sphere of influence unless the U.S. both re-engages regional multilateral economic processes and multilateralizes some of China’s own bilateral efforts such as the Belt and Road Initiative.

• Over the medium term, China’s efforts to duplicate the substructure of the international financial system may provide sanctioned states an opportunity to escape U.S. financial pressure while reducing Chinese vulnerability to U.S. financial sanctions.

• Over the long term, China’s effort to promote monetary diversification, bypass the dollar, and promote its own currency and payments systems also could reduce its vulnerability to U.S. financial sanctions.
Four decades ago, Deng Xiaoping boldly integrated China into the U.S.-led economic system after observing that it was hardly a coincidence that the United States’ friends had grown rich and its enemies poor. Deng’s decision catapulted China into the ranks of great powers and may yet produce a bipolar order by the end of the next decade. But it has also raised an important question: what will become of the order that enabled China’s rise now that the country has almost finished rising?

China’s emergence presents a notable departure from past precedent. Indeed, for the first time in centuries, the world’s largest economy will not be English-speaking, Western, democratic, liberal, or market-driven. The period in which the global economic order shaped China is already giving way to a new period in which China will shape the global economic order. For now, this transition is occurring peacefully. While many scholars have studied wartime transitions, which often reveal the stark passing of hegemony from one power to another and make clear the critical juncture between the old economic order and the new one that replaces it, peacetime transitions have received less attention and have fewer historical reference points.

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Because the existing system that serves so many so well is unlikely to be swept away through measures short of war, it may be that the emerging Chinese order will increasingly run parallel to the U.S. order in some places (especially those related to international finance) and layer over it in others (such as within the Indo-Pacific).

This chapter argues that, while difficult to determine ex ante, China’s impact on the global economic order, and in particular the global financial order, is likely to be shaped by its long-standing security-related concerns. Indeed, even as the country has grown stronger, its structural security environment continues to present enduring challenges that date back to the end of the Cold War. China is a rising power that, on the one hand, faces a confrontational external hegemon in the United States and, on the other hand, must cope with the possibility—especially given its geographic position—that its wary neighbors may jointly form a balancing coalition encircling it in concert with the United States or other great powers. This chapter argues that financial instruments in particular are one part of China’s broader grand strategy to break out of this challenging security environment. This approach has involved China first blunting U.S. power by minimizing U.S. economic leverage and then building a China-led regional order both by acquiring economic leverage over its neighbors and by gaining legitimacy through public goods provision and institutional leadership.

This chapter discusses economic instruments broadly before delving into a more focused discussion of China’s use of financial instruments to achieve its strategic goals. Accordingly, in the succeeding sections, this chapter first explains in theoretical terms how a wide range of economic instruments fit into grand strategy. The second section briefly surveys China’s use of these instruments, while the third section outlines China’s efforts to blunt U.S. financial power through monetary diversification as well as through alternative payment mechanisms and indigenous credit rating agencies that constitute a parallel substructure to the global economy. The fourth section then explores China’s efforts to build a China-led order in Asia through the creation of a renminbi zone, trade promotion, and infrastructure investment that layer over the existing U.S. order.

The chapter concludes that, in the period ahead, China may intensify this approach. Beijing is likely to more overtly weaken the financial pillars of U.S. power while strengthening the financial pillars that support China’s own order-building in Asia. Together, these tools will take their place alongside other economic instruments that constrain China’s neighbors and lay the foundation for regional hegemony.
The Economic Instruments in Grand Strategy

Grand strategy is a state’s theory of how it can achieve security for itself that is coordinated and implemented across military, economic, and political means of statecraft. Too often, studies of a state’s grand strategy focus on military means because these have the clearest link to security matters. Comparatively less attention is directed toward understanding the role of economic instruments in grand strategy.

Part of this oversight is understandable. Many believe that economic policymaking is primarily driven by economic motivations, which span from national welfare and development at the broadest level to the parochial preferences of interest groups at the narrowest level. While these two drivers explain a considerable amount of economic activity, many consequential economic decisions are also made for strategic reasons. Indeed, economic instruments have long been part of states’ grand strategies. Great Britain developed plans for economic warfare against Germany in World War I, Nazi Germany made its neighbors dependent on the German economy to reduce their freedom of maneuver, and the United States absorbed the exports of Europe and Japan to bolster their economies and prevent their turn to Communism. These were not simply tactical applications of economic power but parts of larger, sustained grand strategies intended to create security and outcompete rival great powers through the use of economic statecraft.

What exactly does it mean to use economic means for political ends? Economics is a vast, interconnected, and dynamic domain of activity that includes diverse forms of leverage such as “sanctions, taxation, embargoes, trade agreements, asset freezing, engagement policies, currency manipulation, subsidies, tariffs, trade agreements,” and more—all of which could conceivably be used in myriad ways to affect international politics or security. Despite this complexity, it is possible to fit most forms of economic leverage into three broad categories: (1) bilateral leverage, (2) structural leverage, and (3) domestic-political leverage. Across these categories, states can pursue blunting strategies to enhance their autonomy from others and building strategies to enhance their influence over others.

**Bilateral leverage.** State-to-state relationships of asymmetric interdependence constitute the basic unit on which more systemic or regional forms of leverage are based. Such bilateral leverage involves the manipulation of dependencies to actively coerce or passively induce a state to

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3 This approach is adapted from Susan Strange’s two-dimensional approach to economic power. See Susan Strange, *States and Markets*, 2nd ed. (New York: Pinter Publishers, 1994), 24–29.
change its behavior. China and the United States enjoyed economic ties in the 1990s, but China was more dependent on the United States than the United States was on China, which afforded Washington bilateral leverage. Blunting strategies, like China’s successful pursuit of permanent normal trade relations, limit Washington’s ability to exercise bilateral leverage. Building strategies, like China’s willingness to “absorb” exports from Taiwan by dropping trade barriers and purchasing exports (e.g., agricultural products) at generous prices, enhance China’s leverage over Taipei.

**Structural leverage.** This refers to the ability of a state to wield its role in the global economic structure—whether atop the economic hierarchy, in command of economic institutions, or as a node in economic exchanges—to shape the framework in which economic activity takes place and thereby change another state’s behavior. For example, the dollar’s centrality to global finance allows Washington to turn foreign banks into instruments of U.S. policy and cut off Iran and North Korea from the global financial system, even though Washington has limited bilateral economic ties with both countries. Similarly, U.S. influence over global payments, sovereign credit ratings, arbitral bodies, and other institutions may constitute structural leverage. Blunting strategies might involve Chinese efforts to reduce the centrality of the U.S. dollar or to build institutions that bypass U.S. economic infrastructure; building strategies might include efforts to promote a country’s own currency or payment system. In structural leverage, there is sometimes overlap between blunting and building strategies because bypassing another state’s leverage might involve creating competing institutions.

**Domestic-political leverage.** Not all economic power exists in bilateral flows between states or in the foundations of global economic structures. One of the most important forms involves the economic instruments of one state being used to reshape the domestic politics of another state, alter its conception of its own interests, and thereby change its behavior. Blunting involves protecting a country’s political system from such economic influence through anticorruption laws and the registration of foreign agents; building, by contrast, involves developing economic ties with politically influential groups, such as China’s targeted inducements to farmers in Taiwan during the debates over a bilateral free trade agreement or to political elites in Maldives.

Together, these three forms of leverage account for most of the major ways that economic instruments are directed for political purposes, and blunting and building strategies encompass the primary means by which economic leverage may translate into great-power competition. Many Chinese economic initiatives cut against China’s own economic interests, which strongly suggests that strategic motivations are behind them.
Three Phases of Chinese Economic Statecraft

China's international economic policymaking is at times driven by strategic considerations—that is, by an appreciation of the use of economic power or statecraft to force changes in state behavior. This is not to say that strategic motivations are the exclusive driver of Chinese policymaking, but that in many prominent cases strategic logics explain the variation in China's behavior at least as well as, and often significantly better than, economic logics. Even in those few cases where they do not, China's economic behavior nonetheless has important implications for U.S. strategy and the exercise of power.

China's approach to economic instruments in its grand strategy has evolved over three broad phases. In the first phase, which runs from reform and opening into the late 1980s, China was fairly ambivalent about the use of economic power and its vulnerability to Western economic leverage and focused far more on economic development. This ambivalence stemmed from the fact that the United States and China largely worked cooperatively to balance the Soviet Union throughout the decade, despite occasional disputes over Taiwan and despite China's claim to be pursuing formal equidistance between the superpowers in the late 1980s. Indeed, as Deng Xiaoping argued in an enlarged Central Military Commission meeting in 1985, “In view of the threat of Soviet hegemonism, over the years we formed a strategic ‘line’ of defense—a ‘line’ stretching from Japan to Europe to the United States.”

Because China considered the West its partner in resisting Soviet hegemonism, it could more confidently turn away from Maoist autarky and allow itself to grow increasingly dependent on Western technology, investment, managerial experience, and global economic institutions without fear that the resulting bilateral, structural, and domestic-political vulnerability would be exploited. Indeed, during this period, China did not appear to ameliorate these vulnerabilities in any comprehensive way.

The second phase began after the traumatic trifecta of the Tiananmen Square massacre, the Gulf War, and the collapse of the Soviet Union increased China's perception of the United States as a threat and raised new concerns about Beijing's vulnerability to economic coercion. These fears concentrated on U.S. bilateral economic power over China and the possibility that the United States could manipulate asymmetric interdependence by effectively revoking most-favored-nation (MFN) status, which would have more than doubled the price of many Chinese exports. Indeed, the U.S. Congress voted

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to revoke MFN status in 1992 but was stopped by a presidential veto. The next president, Bill Clinton, was initially willing to effectively revoke MFN status by tying it to progress on human rights. Chinese leaders understood that securing MFN status would not free China from dependence on the United States, but it would blunt the discretionary exercise of U.S. power over bilateral economic exchanges. This goal therefore became the focus of much of China’s economic policymaking as well as bilateral negotiations with the United States and multilateral negotiations involving the Asia-Pacific Economic Cooperation (APEC) and the World Trade Organization. As He Xin, a prominent if controversial foreign policy adviser to Deng Xiaoping, Jiang Zemin, and Li Peng, asserted in 1993, “The issue of MFN status between China and the United States is a central issue that will determine the rotation of world history.” Premier Li stated that securing MFN would ensure that “China has more room for maneuver on the international stage.” China was eventually successful, and all the while, it continued to increase its stake in Western economic institutions while attempting to reduce its vulnerability to unilateral exercises of U.S. economic power.

The third phase of China’s efforts to shape the global economic architecture began after the 2008 global financial crisis, which led Beijing to revise downward its estimation of U.S. power and to grow more confident about its own ability to set the terms of global economic statecraft. In this third phase, China has shifted away from the second phase’s narrower concern with blunting the United States’ bilateral economic leverage. Beijing now feels emboldened to expand its blunting behavior to include U.S. structural power in international finance (often considered the backbone of U.S. hegemony) as well as to build alternative financial arrangements and accumulate constraining leverage over its neighbors in Asia. China’s alternative arrangements in international finance run parallel to U.S. architecture; meanwhile, its efforts in Asia layer over elements of the existing U.S. order. Admittedly, some of these arrangements also serve economic purposes, but many seem redundant and defy clear economic rationales. In both cases, regardless of the murky intentions behind these institutions, they nonetheless have clear implications for China’s ability to resist U.S. economic power and project its own economic power—whether bilateral, structural,
or domestic-political—over neighboring countries and perhaps eventually around much of the world.

The remainder of this chapter discusses this third phase of economic statecraft, especially its focus on blunting and building financial architecture.

**Blunting U.S. Financial Power**

The 2008 global financial crisis precipitated a coordinated effort by China to gradually reduce its vulnerability to U.S. financial power, which China was previously too weak to bypass. The decline in the prestige of the United States’ economic model was perceived to have created an opening for Beijing to question elements of the existing system and to target the substructure of U.S. financial power with alternative institutions. Beijing’s efforts in (1) diversifying the monetary system, (2) building alternatives to SWIFT (Society for Worldwide Interbank Financial Telecommunication), and (3) sponsoring alternative credit rating agencies together targeted three important elements of U.S. (and in the case of SWIFT, European) structural power. Indeed, structural power is often difficult to counter unless a country either leaves the economic system, which would be economic suicide, or alternatively builds parallel infrastructure. China has naturally chosen the latter option. While progress remains slow and the possibility of success remains somewhat distant, China’s preferences are clear and its efforts remain coordinated and purposeful: as its power grows, Beijing will seek to shape the international economic architecture to reduce the importance of the U.S. dollar, thereby weakening U.S. hegemony and enhancing Chinese autonomy.

**Diversifying the Monetary System**

After the 2008 global financial crisis, China’s leadership increasingly called into question the dollar’s reserve currency status. Of course, various Chinese officials have for decades criticized the international economic order as unfair and called for its reform, and leading central bank officials have at times been critical of the “irrational” monetary system and urged greater monetary surveillance of advanced economies.9 Even so, the 2008 global financial crisis marked a shift less in China’s preferences and more in its confidence that the country could reshape the international economic architecture around it. Accordingly, as Gregory Chin notes, after the crisis

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“China’s leaders elevated financial and monetary policy, and monetary diplomacy, to a top priority.”\textsuperscript{10} The same year the crisis broke out, China’s Central Economic Work Conference set a Chinese Communist Party (CCP) line on monetary policy and promptly concluded that “international monetary diversification will advance, but the status of the U.S. dollar as the main international currency has not fundamentally changed.”\textsuperscript{11} In other words, it would take concerted effort to promote diversification.

An important symbol and proponent of this effort was President Hu Jintao, who quickly “became the lead spokesperson on China’s global monetary thinking.” This marked a shift from the pre-crisis decade when China’s monetary statecraft was largely “the preserve of senior technocrats from the central bank, and to a lesser extent, the finance ministry.”\textsuperscript{12} At the G-20 meeting in 2008, the first one called to coordinate a response to the crisis, Hu asked the leaders of each country to “improve the international currency system and steadily promote the diversification of the international monetary system.”\textsuperscript{13}

These views were expressed in a far more operational form in a 2009 essay by the then governor of the People’s Bank of China, Zhou Xiaochuan, who specifically advocated for special drawing rights (SDR) as an alternative to the dollar-based system.\textsuperscript{14} In a provocative essay entitled “Reform the International Monetary System” and timed for impact just before the 2009 London G-20 summit, Zhou argued that the use of the U.S. dollar as the reserve currency “is a rare special case in history” and that “the crisis again calls for creative reform of the existing international monetary system.”\textsuperscript{15}

Although Zhou only implicitly referenced the dollar, Hu was far more direct about his intentions to diversify away from it at the Central Economic Work Conference held shortly after Zhou’s essay was published: “Since the international financial crisis, the international community has generally recognized a major reason for the imbalance in the world economy and for the international financial crisis is the inherent drawback associated with a U.S. dollar–dominated international monetary and financial system.”\textsuperscript{16} For that

\begin{itemize}
\item \textsuperscript{10} Chin, “China’s Rising Monetary Power,” 192.
\item \textsuperscript{11} Hu Jintao, \textit{Hu Jintao wenxuan} [Hu Jintao Selected Works], vol. 3 (Beijing: People’s Press, 2016), 280.
\item \textsuperscript{12} Chin, “China’s Rising Monetary Power,” 192.
\item \textsuperscript{13} Hu, \textit{Hu Jintao wenxuan}, 139.
\item \textsuperscript{14} An SDR is a unit of account created by the International Monetary Fund (IMF) and based on a basket of major world currencies. It represents a claim that member countries of the IMF have on the currencies within the basket, and for that reason, it is not quite the same as an international currency.
\item \textsuperscript{16} Hu, \textit{Hu Jintao wenxuan}, 281.
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reason, “promoting the diversification and rationalization of the international monetary system” was essential to reform. Hu was explicit that weakening the centrality of the dollar was a key goal, but that it would not be quick. “At the same time,” Hu continued, “we must see that the dominant position of the U.S. dollar is determined by U.S. economic strength and comprehensive national power, and for a long period of time it would be relatively difficult to fundamentally change it.” China’s strategy would be prolonged: “We must adhere to the principles of comprehensiveness, balance, gradualism, and effectiveness in promoting the reform of the international monetary system.”

For the next several years, at major multilateral economic gatherings—including most G-20 summits, BRICS (Brazil, Russia, India, China, and South Africa) summits, and the G-8 + G-5 summit—Hu or other high-level Chinese officials continued to call for reserve diversification, the SDR, and monetary reform. Many G-7 countries, including the United Kingdom, Canada, and Japan, all defended the dollar and questioned the “appropriateness” of China’s focus on it. But China continued to push, in part because, as the president of China’s Export-Import Bank Li Ruogu noted, the dollar’s power was dangerous to China: “the U.S. used this method [manipulation of the dollar] to topple Japan’s economy, and it wants to use this method to curb China’s development.” Chinese leaders believed that they needed to blunt and bypass this U.S. power, and Li asserted that “only by eliminating the U.S. dollar’s monopolistic position” would it be possible to reform the international monetary system.

China’s support for a diversified international monetary system with a reduced role for the dollar and a greater role for the SDR cannot be explained in terms of its “economic interest,” as Hongying Wang argues. A decline in the value of the dollar would damage China’s export-driven economy and reduce the value of its enormous holdings of dollar-denominated assets. Although Wang contends that national identity concerns explain China’s policy, Hu’s explicit call for a reduced role for the dollar in internal CCP documents is not accompanied by any chest-beating nationalist rhetoric about China’s status, nor are his statements at the G-20. Indeed, the call for diversification is made separately from any discussion of renminbi internationalization. Instead, the best explanation is that China recognizes the dollar as an enduring source

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17 Hu, Hu Jintao wenxuan, 281–82.
18 Ibid., 218; and Chin, “China’s Rising Monetary Power,” 196–98.
21 Quoted in ibid., 223.
22 Wang, “China and the International Monetary System.”
of U.S. structural power and wishes to weaken it. Even so, after four years of intense diplomatic effort and lobbying by Hu, it was clear that efforts to put forward the SDR as an alternative to the U.S. dollar, or to promote reserve diversification away from the dollar, would not succeed in the short term. Despite failing to advance the SDR, China was able to gain approval from the International Monetary Fund (IMF) for the renminbi to join the fund’s SDR basket in 2016, though this particular move was largely symbolic and had little direct economic impact. Nevertheless, despite China’s shortcomings in promoting financial diversification, its actions reveal intense and long-standing hopes for an international economic architecture in which the dollar is only one among many reserve currencies. As we will see, Beijing has increasingly turned to renminbi internationalization as an instrument to not only hasten diversification but also build the foundation for China’s own structural power across Asia.

**Developing SWIFT Alternatives**

SWIFT is a standard-setting and messaging institution with a network that makes cross-border financial payments possible, thereby constituting the substructure of global finance. The organization, known as the Society for World Interbank Financial Telecommunication, was founded in 1973 when 239 banks from fifteen different countries created unified messaging standards, a messaging platform, and a network to route messages. It replaced Telex, a slow and error-prone patchwork manual system with conflicting standards that effectively required banks to work in several contradictory formats to make payments. Today SWIFT spans two hundred countries and more than ten thousand institutions, facilitates fifteen million messages daily, and is the essential infrastructure that makes international payments possible. Although SWIFT is a messaging service and does not engage in clearing and settling, if a bank is cut off from the network, it is essentially cut off from the global financial system and from much of the clearing and settling infrastructure that exists. In this way, control over SWIFT offers considerable structural power.

That structural power has already been wielded against countries. While the organization sees itself as apolitical, it is nonetheless required to comply with the laws of Belgium, the European Union, and—through the threat of secondary sanctions—the United States as well. In 2012 the United States and Europe used their influence over the organization to force it to delink Iranian banks from SWIFT networks, which marked the first

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23 For example, the SDR currently determines the mix of currencies countries receive when requesting IMF support.

time in its history that the institution had cut off an entire country from access to the company’s network. Iran had relied on SWIFT for two million cross-border payments annually—a volume that could not be replaced by another messaging network—and loss of access made payment for Iranian oil impossible, devastated the country’s economy, and prevented the government from accessing substantial amounts of its own foreign reserves that it had invested abroad. A few years later, in 2017, SWIFT access was also denied to North Korean banks.

SWIFT’s structural power has even been threatened against great powers like Russia after its invasion of Crimea. The threat was concerning enough that Prime Minister Dmitri Medvedev discussed it publicly and threatened that Russia’s “reaction will be without limit.” Russian Central Bank governor Elvira Nabiullina then began preparing a Russian alternative to SWIFT as early as 2014. In a meeting with Putin, she stated that “there were threats that we can be disconnected from SWIFT. We have finished working on our own payment system, and if something happens, all operations in SWIFT format will work inside the country. We have created an alternative.” Russia has sought to popularize this alternative system within the Eurasian Union and discussed it with Iran. Though imperfect, the system demonstrates that great powers are actively searching for ways to bypass U.S. influence over SWIFT for strategic reasons.

The United States has threatened to wield SWIFT against China. Washington already sanctioned at least one Chinese bank involved in trade with North Korea, and Treasury Secretary Steven Mnuchin threatened that “if China doesn’t follow these sanctions [on North Korea], we will put additional
sanctions on them and prevent them from accessing the U.S. and international dollar system.” Similarly, members of Congress suggested cutting off some of China’s largest banks from the global financial system.\footnote{Zhenhua Lu, “U.S. House Committee Targets Major Chinese Banks' Lifeline to North Korea,” \textit{South China Morning Post}, September 13, 2017, https://www.scmp.com/news/china/policies-politics/article/2110914/us-house-committee-targets-major-chinese-banks-lifeline.} China indeed has reasons to fear these threats, and like Russia it appears to be acting on them.

The People’s Bank of China—with approval from the Chinese government—began developing its own alternative to SWIFT for financial messaging and interbank payments as early as 2013, roughly one year after the West cut off Iran, and it went live around two years later.\footnote{Michelle Chen and Koh Gui Qing, “China’s International Payments System Ready, Could Launch by End-2015,” Reuters, March 9, 2015, http://www.reuters.com/article/2015/03/09/us-china-yuan-payments-exclusive-idUSKBN0M50BV20150309.} This system, known as the China International Payment System (CIPS), not only insulates China from financial pressure but also increases its autonomy, giving the country sovereign control over all information that passes through its network, the power to help others bypass sanctions, and the ability to one day cut others off from this system. Moreover, the ambition for CIPS exceeds that for SWIFT: the former will not only be a messaging service like SWIFT but also provide clearance and settlement—that is, full integration of the payment process. Unlike Russian elites, Chinese elites have been far less obvious in telegraphing their system’s possibility as a rival to SWIFT; nevertheless, its strategic potential is real, if still somewhat distant.

Skeptics of these strategic motivations point out that China’s pursuit of CIPS has some genuine economic motivations as well. First, CIPS is an improvement on the previous system of cross-border renminbi payments. Before CIPS, China’s domestic interbank clearing and settlement system, the China National Advanced Payment System (CNAPS), could not support international payments; instead, cross-border transactions took place through designated offshore yuan-clearing banks or correspondent banks in China. Moreover, CIPS for the moment is primarily concerned with clearing and settling. Indeed, CIPS signed a 2016 agreement that provides it access to the SWIFT messaging system. From that perspective, a charitable observer might conclude that the system does not appear to be an alternative to SWIFT financial infrastructure but a complementary appendage.

Neither of these arguments dismisses the strategic logic underlying CIPS. First, if China had purely economic and technical motivations for launching CIPS, it may have been more economical to simply reform the existing CNAPS system so it could communicate with SWIFT. Other countries with domestic interbank payment systems that similarly do not communicate with SWIFT have often modified those systems to allow communication.
This suggests that economic motivations may not have been the leading factors in the establishment of CIPS.

Second, the fact that CIPS has signed an agreement for access to the SWIFT network and uses SWIFT messaging standards does not reduce its viability as a strategic alternative because CIPS is building the capability to process messages outside the SWIFT network. Indeed, just as SWIFT requires banks to purchase costly technology connecting them to the network, so does CIPS, which allows it to exist in parallel to SWIFT’s technology.\(^{33}\) As CIPS continues to develop, the goal is in many ways to operate independently from SWIFT. As an individual with knowledge of the People’s Bank of China’s plans for CIPS told the *Financial Times*, “In the future CIPS will move in the direction of using its own dedicated [communications] line. At that point it can totally replace SWIFT” for interbank messaging involving renminbi.\(^ {34}\) Indeed, as Eswar Prasad argues:

> CIPS has been designed as a system that could eventually also serve as a conduit for interbank communications concerning international RMB transactions that operates independently of SWIFT. This would make it not only a funds transfer system, but also a communication system, reducing the SWIFT’s grip on interbank communications related to cross-border financial flows. China’s government is astute enough not to challenge SWIFT until the CIPS has matured, but no doubt one day the challenge will come.\(^ {35}\)

The collaboration between SWIFT and CIPS helps the latter mature, providing China with market share and expertise as it builds a parallel system. It also gives SWIFT continued relevance, and indeed employees at the company have been concerned that “Chinese authorities were considering replacing SWIFT with an indigenous network built to rival, if not exceed, SWIFT’s own.”\(^ {36}\) Its China head, Daphne Wang, apparently tried to persuade CIPS not to invest in alternative messaging but to focus on clearance: “We do not do clearing, as in CIPS’s case. When we talked to CIPS, we said: ‘Why build your highway [i.e., messaging platform] if the highway exists already? As of now it’s as if you are selling a car [i.e., clearance and settling] but nobody can drive it on the

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\(^{36}\) *China and the Age of Strategic Rivalry* (Ottawa: Canadian Security Intelligence Services, 2018), 113–22.
highway that’s already built.” Despite SWIFT’s attempt to disincentivize the creation of an alternative highway, China’s desire remains to develop one. As one person involved with CIPS noted, the system was launched without all these features but there was “ambition” for more: “[CIPS] doesn’t include a lot of things [yet], but there is pressure for delivery.” Eventually, the system is intended to “allow offshore banks to participate, enabling offshore-to-offshore renminbi payments as well as those in and out of China.” This would make CIPS a wholly independent financial infrastructure and provide any two parties anywhere in the world a method for messaging, clearance, and settlement entirely free from U.S. review, which would seriously undermine the United States’ financial power worldwide.

Third, even when CIPS does not act in parallel to SWIFT, its connection to and through SWIFT still provides useful influence. Before CIPS, SWIFT had already operated in China for more than 30 years and was connected to four hundred Chinese financial institutions and corporate treasuries. Now, all SWIFT messages to China must be routed through CIPS. As one payment expert notes, “CIPS is trying to be the middleman between SWIFT and CNAPS,” which would give China’s central bank an ability to determine who has access to the country’s financial system. This provides a central control point over transactions in renminbi and boosts China’s structural power.

For now, CIPS is not a meaningful alternative to SWIFT. It may bolster China’s structural power by making it much easier for China to cut off other institutions or countries from its financial system, but CIPS is not yet ready to serve as an alternative messaging system for cross-border payments outside China. Even so, that day will come, and this makes CIPS one of the most promising initiatives for the country’s hopes of diversifying the international monetary system. Other great powers like Russia are already investing in such systems, and China—which also faces the threat of Western financial sanctions—has ample reason to continue developing CIPS into an alternative that can bypass U.S. structural power over international payments in the coming decade. As one columnist has observed, “A return to a pre-SWIFT world, in which banks were forced to send and accept transaction information in a multitude of formats, isn’t unimaginable,” and this demonstrates how

39 Wildau, “China Launch of Renminbi Payments System Reflects SWIFT Spying Concerns.”
40 China and the Age of Strategic Rivalry, 113–22.
41 Wildau, “China Launch of Renminbi Payments System Reflects SWIFT Spying Concerns.”
China’s strategic anxieties will intertwine with its rise to fragment the substructure of global finance.42

\textit{Alternative Credit Rating}

Credit rating agencies help provide investors information on the risks of various kinds of debt, and their ratings can significantly alter the fortunes of companies and countries. The market for international credit ratings is largely dominated by the “big three” U.S. firms—Standard and Poor’s, Moody’s, and Fitch Group—which together have a global market share of more than 90%. The dominance of these three firms is in part a function of the United States’ structural power, including the centrality of the dollar, the importance of New York financial institutions, and the ability of the Securities and Exchange Commission to determine who can issue ratings.

After the 2008 global financial crisis, the big three were seen as vulnerable, given their mistaken appraisal of the assets that set off the crisis. Many European leaders blamed them as biased and political for having touched off and then intensified the eurozone debt crisis, especially following their downgrade of Greek debt to junk status in 2010, and some leaders encouraged (unsuccessfully) the creation of an alternative European credit rating agency.43 The fact that even U.S. allies sought alternatives to the influence of the big three, which have retained more than 76% market share within Europe even after the crisis, should make it relatively uncontroversial that China might act according to similar motivations.44

As with Europe, China’s interest in alternative agencies was precipitated by the global financial crisis that tarnished the big three firms while also revealing their ability to shape capital flows. Although Washington lacks the ability to directly control these credit raters or manipulate their ratings, China views them as tools of direct or indirect U.S. power corrupted by political bias. At the 2010 G-20 summit in Toronto, President Hu Jintao called for the countries to “develop an objective, fair, reasonable, and uniformed method and standard for sovereign credit rating,” demonstrating that the issue had received top-level political attention. Only a month later, seemingly in coordination with Hu’s call, Dagong Global Credit Rating—China’s largest credit rating agency—launched its own sovereign credit ratings for the first time. For years following the crisis, China’s government has continued to

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42 Bershidsky, “How Europe Can Keep Money Flowing to Iran.”
formally attack the credit rating agencies. Finance Minister Lou Jiwei declared that “there’s bias” in the ratings of the “big three,” while the Finance Ministry issued a statement calling a Moody’s downgrade of China’s credit “the wrong decision” in 2017.45

Dagong is the lead instrument in China’s effort to influence the global ratings system. The company’s public documents, as well as the statements by its CEO and founder Guan Jianzhong—essentially the face of credit rating in China—indicate a view both that credit ratings are strategic instruments and that the United States’ domination of them is harmful to China’s political interests. As Guan wrote in 2012, “U.S. dominated ratings serve the global strategy of the United States” and “the existing international rating pattern will restrict the rise of China.” Guan and others argue that rating agencies exercise “rating discourse power” that enables them to shape the global economy. If the United States controls this “rating discourse power,” then China “will lose financial sovereignty.” Worst, the “rating discourse power can be manipulated… in an effort to erode the social basis of the ruling party.” In contrast, the 2008 global financial crisis offered “a great historical opportunity for China to strive for international rating discourse power.”46 China’s ratings, even if they do not gain overwhelming market share, could nonetheless pressure the big three to adjust their ratings and “converge” toward China’s, an outcome Guan welcomes.47

Accordingly, in the midst of the global financial crisis in 2008, Dagong began to float proposals for the Universal Credit Rating Group (UCRG), which was finally launched in June 2013 when Dagong partnered with a Russian firm and smaller U.S. rater. The new initiative’s mission was to compete with the big three, and it purported to be a private, collaborative, and apolitical venture. These claims proved false when the CEO of that initiative, Richard Hainsworth, stepped down and later admitted that the effort was essentially financed and supported by the Chinese government.48 Hainsworth claimed that the Russian and U.S. partners provided little capital, that the venture was primarily controlled by Dagong, that virtually every major

expenditure was subject to a vote by Dagong’s board, and that the Chinese government was likely bankrolling not only UCRG but even Dagong. In this light, Dagong’s collaboration with foreign raters appeared to be a fig leaf to boost the legitimacy of its revisionist undertaking. Hainsworth further argued that UCRG’s true purpose appeared political rather than commercial—both to reduce the legitimacy of Western ratings and to put forward a Chinese alternative, though spending on the latter objective was inadequate. Dagong hired a number of senior Western officials on behalf of UCRG to criticize U.S. ratings, including former French prime minister Dominique de Villepin, who traveled the world attacking Western agencies in ideological terms and drew a “straight line from the Opium Wars, the British Raj, and the European colonial powers’ grab for Africa to current forms of Western privilege, including its control of credit ratings.”

Eventually, despite its ideological bent and alleged Chinese-backing, UCRG sputtered and was shut down.

The failure of UCRG did not mark the end of China’s ambition to reshape global credit ratings. Instead, the country appears to have increased its support for Dagong to go global. The firm has opened up offices around the world and overtly stated its interest in competing with the big three. Dagong is clearly carrying on the mission that UCRG was to have undertaken and has retained many of the same international advisers to give it legitimacy. Although Dagong claims to be fully private, Hainsworth suggested that the company was funded by Beijing; moreover, Guan Jianzhong was a government official immediately before he launched Dagong. Not only did he apparently continue to be employed by China’s State Council for years while running Dagong, his firm so directly affects the interests of SOEs that it is genuinely hard to believe it is free from state influence. Even so, Beijing clearly seeks to maintain some plausible distance from Dagong to enhance its legitimacy. Indeed, Chinese officials have privately opposed efforts to create a BRICS credit rating agency precisely because they believe that “a government-backed credit rating agency will not have any credibility” in challenging the big three. Despite the fact that Dagong is formally a private and apolitical entity, its rankings have also given rise to claims of political bias. Dagong raised eyebrows when it rated

49 “Man in the Middle.”
the Chinese Railways Ministry’s debt higher than China’s sovereign debt, as well as when it rated Russia’s and Botswana’s debt higher than U.S. debt. In a discussion of its methodology, Dagong includes ideological CCP phrases and claims to use “dialectical materialism” as part of its evaluative approach.\(^5\) The firm is usually eager to downgrade the United States. Its own website boasts that “Dagong is the first agency in the world to study American credit rating theories and methodologies and reveal their shortcomings. It is also the first agency to downgrade the U.S. credit rating.”\(^5\)

Nonetheless, China’s efforts to influence global credit ratings remain relatively modest. Its goal appears to be to gradually gain market share rather than to displace the big three, especially given that a higher market share may be sufficient to bring about convergence. Moreover, China has allowed the big three into the country, a policy ostensibly intended to help promote foreign investment as the Chinese government pursues deleveraging. This is a positive step, though one possibly consistent with the goal of influencing global credit ratings: as U.S. credit rating agencies gain access to China’s lucrative domestic market, they may find it more challenging to negatively rate politically sensitive Chinese entities or the government’s sovereign debt.

Together, China’s focus on monetary diversification and construction of both an alternative payment substructure through CIPS and an alternative credit rating agency through Dagong reveal a long-standing interest in weakening and bypassing the U.S. dollar’s constraining effects on China. For the most part, these efforts have not yet been successful in dislodging the United States’ financial dominance, but they do represent a clear Chinese desire to transform the global economic architecture into one of financial multipolarity. At some point in the future, if concerns grow about the dollar and China offers an alternative financial architecture and a more open capital account, Chinese leaders could conceivably begin that process.

### Building Chinese Structural Power

China has also sought to expand its use of financial instruments to gain constraining leverage over neighboring countries, provide them public goods, and claim leadership and legitimacy. Many of these initiatives explicitly fall under China’s conceptual framework of a “community of common destiny” in Asia. These efforts, which operate at the multilateral and bilateral levels, require too much effort and planning to be improvisational and should be

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seen as part of a longer-term effort to enhance China’s structural power within Asia propelled by the country’s confidence following the global financial crisis. Some of these initiatives also cut against China’s economic interests, making strategic motivations likely.

**Building a Renminbi Zone**

China’s efforts on international currency can be divided into two broad initiatives. On the one hand, Beijing has sought to promote international monetary diversification through its quixotic quest for SDR adoption and through informal agreements on central bank reserve diversification away from dollars and into other currencies. This aspect of its approach largely targets U.S. structural power by gradually eroding the dollar’s central position in the global economy. On the other hand, China has also sought to carefully promote and internationalize its currency, especially with Asia and its commodity suppliers. This second aspect of its strategy indeed partly targets the dollar, but it more fundamentally reflects China’s desire to build structural power by increasing the use of the renminbi in international transactions. As Jonathan Kirshner argues, “States that pursue leadership of regional (or global) monetary orders are almost always motivated by political concerns—in particular, the desire to gain enhanced influence over other states.”

He notes that France sought to establish a franc area to exclude Germany in the 1860s, that Nazi Germany and imperial Japan extended their currencies in the twentieth century to gain structural power, and that the United States did this as well following World War II.

Like so many of China’s efforts to reshape the global economic order, the promotion of the renminbi began after the 2008 global financial crisis. Conventional wisdom holds that a currency’s role in the international system depends on the capital account convertibility of the country issuing it, the currency’s usage in denoting and settling cross-border trade and financial transactions, and the currency’s proportion in central bank reserves. China increased its efforts in all three areas after 2008 to varying degrees. It has taken extremely modest steps toward capital account convertibility and attempted to promote the renminbi as a reserve currency.

Ultimately, however, where China has been most active is in promoting the renminbi’s use in international trade, especially through signing several dozen swap agreements of different varieties that facilitate the use of its currency overseas. By 2015, trade settlement in renminbi reached

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56 Prasad, *Gaining Currency.*
$1.1 trillion—30% of China’s total trade—up from virtually zero in 2000. If this percentage increases, it partly reduces China’s vulnerability to U.S. structural power because the country will increasingly be able to settle trade in its own currency. At the same time, however, the development should not be overstated. The fact that China uses renminbi in settling its own trade does not mean that the currency is becoming a widely accepted medium for international transactions, which limits China’s own ability to exercise structural power over others. Data from SWIFT suggests that the renminbi only accounts for between 1% and 2% of all international payments. While SWIFT data is not reflective of all transactions worldwide (especially those denominated in renminbi), it nonetheless provides a useful estimate.

Although the renminbi has so far failed to gain a global position, it may still achieve a regional one. By 2015, the renminbi constituted 30% of all transactions between China and an Asian state, which made it the main currency in regional trade with China, outstripping the dollar, the yen, and the euro. If that proportion continues to rise over the next decade, China may enjoy a renminbi zone within Asia that allows it to wield structural power over its neighbors. Indeed, as Kirshner argues, the renminbi is not likely to overtake the dollar globally in the near future, but China’s centrality to Asia’s economy and supply chains makes it likely that the renminbi will eventually become the dominant currency in the region. He further argues that China may be taking a different path to regional internationalization, one that involves creating infrastructure for the renminbi, promoting its use in transactions, and encouraging central banks to hold it as a reserve currency—all while retaining some capital controls and regulation. China’s swap agreements help advance this goal, as does its promotion of renminbi-denominated bonds that can be purchased by foreign central banks.

For the most part, the promotion of the renminbi in Asian payments has generated little concern within Asia. Moreover, several Asian states have signed swap agreements with China for economic reasons, including Australia, Indonesia, Japan, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Singapore, South Korea, Sri Lanka, and Thailand, among others.

57 Prasad, Gaining Currency, 103.
59 James Kynge, “Renminbi Tops Currency Usage Table for China’s Trade with Asia,” Financial Times, May 27, 2015, https://www.ft.com/content/1e44915c-048d-11e5-adaf-00144feabdc0.
60 Kirshner, “Regional Hegemony and an Emerging RMB Zone,” 214.
61 See ibid., 236–37.
These swaps enable settling trade in renminbi, and indeed it continues to be the major currency for Asian trade within China.

However, if much of Asia becomes an effective renminbi zone in the next decade or more, then China could wield some of the instruments of U.S. financial power against its neighbors. Those neighbors would need access to the renminbi system, payment infrastructure like CIPS and CNAPS, and Chinese banks—all of which China can control. An era of Chinese financial statecraft and sanctions within Asia, though perhaps not globally, may not be so distant, and may in turn lay the foundation for a regional sphere of influence. In this way, a Chinese financial zone in Asia could be layered over the U.S. financial order worldwide.

Infrastructure Investment

Infrastructure investment not only facilitates trade and connectivity but also offers the opportunity to practice economic power projection—and through it, an opportunity to reshape the strategic geography of great-power competition. In the first half of the twentieth century, a rising Germany pursued the Berlin-Baghdad railway to bypass British naval supremacy and create an outlet into Asia and the wider Indian Ocean. During the same period, Japan considered a canal on the Isthmus of Kra to bypass the British advantage over the Malacca Strait. Like these past great powers, China has used infrastructure investment not only for economic purposes but also as a tool to enhance its great-power competitiveness. The foremost example is of course the Belt and Road Initiative (BRI) and the financial institutions that support it. Because BRI is discussed in greater detail in Joel Wuthnow’s chapter in this volume, the following discussion will focus only on the forms of economic leverage that the initiative may offer.

Some believe that BRI is primarily an economic initiative or a status-driven project for President Xi Jinping and is not at all aimed at acquiring economic leverage. Those who view it in purely economic terms are generally unable to explain why Beijing has invested vast funds in projects that are not only loss-making, but could not absorb much of China’s surplus capacity, even if they were all funded and successfully completed.\textsuperscript{62} Those who view BRI in status terms may be right, but they generally overlook the fact that the initiative as a practical matter did not begin with Xi. Many of the projects, especially in the Indian Ocean and Southeast Asia, not only preceded him but also were explicitly described in strategic terms in

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Chinese government discourses. A number of critics argue that BRI has been overhyped and that if everything China does is now folded under it by the government—from a polar belt to even a space road—then the term means nothing. This criticism is entirely warranted, but BRI is taken here to mean “core BRI”—that is, the infrastructure projects located in the original geographic focus of the initiative (the Indo-Pacific) that may have been initiated before or after BRI was formally announced. Even if BRI is an empty concept, the infrastructure is very real.

Understood in these narrower terms, BRI is at least as much a strategic initiative as an economic or domestic-political one. First, it creates multiple channels of bilateral leverage for China over regional states. It creates financial leverage over those that accept Chinese loans, such as Sri Lanka and Maldives, the latter of which pays 20% of its budget to Beijing in interest. It creates asymmetric interdependence with respect to trade, especially as greater connectivity effectively increases bilateral trade between China and its neighbors. It also creates leverage over maintenance. Several Chinese projects will require Chinese engineers for upkeep, especially given that Chinese state firms dominate many of these markets, ranging from hydroelectric power to high-speed rail.

Second, with respect to structural leverage, the program allows Beijing to create connectivity that essentially excludes other countries. Commercial ports in some ways constitute the new chokepoints of maritime trade and coexist along with more traditional focuses on sea lines of communication and geographic chokepoints. A growing number of critical ports are operated or leased by Chinese state companies. Finally, the possibility that Beijing will export its engineering standards not only for traditional infrastructure like rail lines but also for high-tech infrastructure supporting the internet and 5G networks could create considerable leverage. One can imagine, for example, that future U.S.-made autonomous vehicles could be unable to connect to Chinese wireless networks in BRI countries.

Third, with respect to domestic-political leverage, BRI creates clear opportunities to bribe powerful constituencies in recipient countries, altering their politics. Chinese SOEs have been implicated in payoffs to politicians in Sri Lanka and Malaysia, among other countries. Favorable business terms,
consulting contracts, and direct payments could reshape the incentives of some politicians and generate policies more favorable to Beijing. Behind BRI stands a variety of financial institutions that enhance China's structural power. These include the New Development Bank launched by the BRICS, the Silk Road Fund, and the Asian Infrastructure Investment Bank (AIIB). However, the financial power of most of these initiatives is still miniscule compared to preexisting domestic institutions in China, such as the China Development Bank and the Export-Import Bank of China, which together have in some years engaged in more lending to developing countries than the World Bank.66

Of all these institutions, the AIIB is the most intriguing because it offers a roadmap to leadership and legitimacy rather than just power. The AIIB is neither a naked instrument of economic statecraft nor a benign multilateral bank with Western best practices. China’s initial negotiating preferences for a 50% stake with a powerful Chinese veto make clear that Beijing wanted the bank to be a tool that it could dominate. The AIIB clearly had a political purpose as well, with Xi marketing it explicitly as a companion to BRI, despite later attempts to distance the bank from that initiative. Such a nakedly political bank, however, would not be viewed as legitimate by China’s own neighbors. Instead, the result was a kind of hegemonic grand bargain—much like the United States’ own postwar institutions—that reflects a liberal compromise between the AIIB’s founder and its client states that tempers, but does not eliminate, the bank’s potential use as a political tool. China accepted diminished direct political control and greater institutionalization in exchange for legitimacy; Asian and European states in turn offered legitimacy in exchange for institutionalization, checks on direct Chinese political influence, and economic public goods. Although the bank is not a complete political tool, it nonetheless can be directed by Beijing to act politically. Indeed, development banks like the Inter-American Development Bank and Asian Development Bank have occasionally served the political aims of their founders, even if such use was tempered by inclusive institutionalization. Ultimately, the AIIB’s true influence lies in its ability to signal the legitimacy of Chinese leadership; set norms and even technical standards through reports, indices, conditionality, and other bank functions; and perhaps even occasionally coerce states through the denial of loans. In any case, the bank offers a unique template for future efforts by China to institutionalize its power within Asia.

Despite the success of the AIIB, the region’s reaction to Chinese infrastructure financing has been mixed. Many Asian states have responded warmly to institutionalized Chinese power, such as that exercised through the

AIIB and the New Development Bank. But in contrast to these multilateral institutions, the more unilateral Belt and Road Initiative has provoked growing concern and backlash. Skepticism in the region was first concentrated in Japan and India, which tentatively put forward their own alternative concepts. But suspicions about the purpose of Chinese investments, the difficulty of repaying loans, concerns over procurement requirements from Chinese companies, and frustration with the extensive use of Chinese labor have filtered down to a wide range of Asian states, including Thailand, Myanmar, and Malaysia, among others. Even China’s “all-weather friend” Pakistan has pushed to review all BRI agreements signed with China.67

Conclusion

As China collides with the international economic architecture, it is likely to create a parallel substructure in international finance at the global level while accumulating financial leverage over its neighbors at the regional level. The former threatens U.S. structural power, whereas the latter creates Chinese bilateral, structural, and domestic-political power over Asian states. These trends generate important implications for China, the United States, and the region.

Implications for China

In the decade since the global financial crisis, China has sought to blunt elements of the United States’ financial power while building the foundations of its own. Its efforts have partly been defensive, with Chinese leaders hoping that their attempts to promote monetary diversification, bypass the dollar, and promote China’s own currency and payment systems could eventually reduce the country’s vulnerability to U.S. financial sanctions. Beijing’s aspirations to build financial power, both through promoting the renminbi in regional transactions and through the use of financial instruments in BRI, have seen advances in some areas and setbacks in others.

With respect to blunting U.S. financial power, China has largely failed to diversify the international monetary system. Alternative currencies such as the euro, pound, yen, and renminbi all have limitations, and the world’s

major economies tend to be U.S. allies skeptical of Chinese initiatives for diversification. Yet the fact that China has not dislodged the dollar does not mean it has failed to blunt U.S. financial leverage. Chinese efforts to enmesh U.S. financial institutions in China are not only an attempt at attracting capital but, at least according to some Chinese financial officials, also an attempt at mitigating asymmetric dependence. Moreover, while its alternative credit rating agencies have yet to gain international traction, China’s decision to open its market to them, as well as its efforts to win support from others for alternative rating standards, could both complicate the independence of major rating agencies and promote some convergence on standards. Taken together, these efforts could render the country less vulnerable to Western ratings. Most importantly, China’s efforts at duplicating SWIFT’s messaging system will eventually produce a parallel financial architecture that will allow messaging, clearance, and settling outside the U.S. financial system. This effort to recreate the substructure of the international financial system, especially through an alternative payments system, may offer U.S. adversaries or nonstate actors that China supports an opportunity to escape U.S. financial pressure, which could seriously undermine Washington’s financial power worldwide, even if China fails to fully internationalize the renminbi. It also would reduce the potency of U.S. financial sanctions over China.

With respect to building financial power, China’s hesitancy to pursue full capital account liberalization for fear that doing so could bring economic and political instability reduces the ability of the renminbi to rise as a share of global transactions. Even so, China’s success in promoting its currency in regional transactions involving China has indeed created structural power that will likely grow in the future. The fact that the renminbi may remain a small portion of international transactions does not prevent China from accumulating leverage if the renminbi becomes the major currency for regional transactions—even if only for those involving China. Such status would allow Beijing to exercise financial leverage it has not previously enjoyed.

Meanwhile, China’s efforts to use financial instruments to boost connectivity with its own economy through BRI have provoked a wave of backlash. A more concessionary approach—one that lowers interest rates, prevents debt traps, uses more local labor, and eschews the kinds of bribes that alienate local populations and embolden opponents—could well emerge and be quite successful. The fact that China is struggling now with BRI does not mean that it cannot adapt its approach.

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68 Author’s interviews.
Implications for the United States

The dollar's status as reserve currency is the backbone of U.S. hegemony, allowing the United States to spend beyond its means, monitor international transactions, cut states and individuals from the global financial system, and finance its military advantage. As the preceding discussion makes clear, China's efforts to weaken the United States' financial power have had mixed success so far. Ultimately, they will be far more successful if the U.S. system loses its luster. Indeed, the global financial crisis raised concerns about the role of the dollar and credit rating agencies, while Washington's renewed willingness to sanction allies over Iran has already raised serious concerns about payment systems and U.S. financial power more broadly. Although U.S. financial power is strong, the United States' position is nonetheless most vulnerable when the hegemon overuses the privileges of its dominant currency.

Accordingly, Washington needs to elevate the maintenance of financial power into a national security priority. This of course has both domestic and international components. First, at the domestic level, the United States needs to prudently manage its fiscal deficits to reduce the risk that allies, who previously raised concerns over the dollar's role after the financial crisis, do not feel that the dollar is being misused and work with competitors like China on robust diversification efforts. Indeed, the fact that many U.S. allies previously blanched at China's SDR proposals should not be taken for granted.

Second, financial regulation should be seen not merely in economic terms but also in strategic ones. A balance needs to be struck that maintains the competitiveness of U.S. financial institutions and their nodal position in global finance while also reducing the risk of another financial crisis that could erode their legitimacy.

Third, the United States must not overuse financial sanctions. The current re-imposition of sanctions on Iran is driving U.S. allies to look for ways to bypass the U.S. financial architecture. European initiatives, such as the “special purpose vehicle” backed by France, Germany, and the United Kingdom, are now eagerly embraced by China and Russia. This unprecedented vehicle would serve as a barter exchange disconnected from the dollar-based financial system. It would allow Iranian exporters to acquire “credits” they could use to purchase products from European firms on the exchange. Despite lingering skepticism about whether such an approach would work, whether it would protect companies from U.S. secondary sanctions, and whether any state is willing to host the exchange, the fact that U.S. allies are working to create a mechanism to bypass the dollar is a serious development that threatens the foundations of U.S. financial leverage even if it fails to threaten the dollar's nodal position.
Finally, engagement with countries that are “global swing states” on financial issues, such as India and Brazil, is necessary. These states often share China’s objections to U.S. financial power and have at various times supported its calls for diversification. Efforts to engage these states, address their concerns on financial matters, and integrate them into financial institutions could complicate Chinese coalition-building. In short, even if the dollar remains dominant, the United States must attend to the foundations of its financial power. In many ways, its financial power has political roots in the acquiescence of allies that the United States is now alienating.

At the regional level, China’s financial power, as well as its growing economic influence, requires U.S. attention. If the United States does not re-engage the region’s multilateral economic processes, then China’s attempts to build constraining leverage over its neighbors will be likelier to succeed and could eventually form the foundation for an enduring sphere of influence. A more active U.S. policy could exploit certain openings that are materializing as Chinese order-building stokes nationalist opposition in Asian states.

Specifically, preventing Chinese regional hegemony requires strengthening the autonomy of Asian states vis-à-vis China where possible. This could be accomplished in a number of ways. First, Washington could join China’s economic initiatives (e.g., the AIIB) and influence, repurpose, or stall them from within. Even if Congress proves unable to authorize funding for a U.S. contribution, especially as trade tensions with China continue, the Trump administration could propose an advisory or observer role for the United States as part of a U.S.-China deal on some other issue. The legitimacy benefit China gains from U.S. participation is outweighed by the possible voice opportunities the United States would gain within the system, especially because they could provide support for Asian states and bring transparency to Chinese practices. Relatedly, U.S. financial partnerships with BRI projects would shine a light on Chinese practices while simultaneously reducing dependence on Chinese financing. Second, Washington could create parallel trade, investment, and even financial alternatives of its own with its allies and partners—taking a page from China’s book—and thereby reduce the dependence of Asian countries on China. The current BUILD (Better Utilization of Investments Leading to Development) Act marks a step in the right direction. Third, Washington could strengthen and engage existing multilateral bodies, including the World Bank and the Asian Development Bank, to ensure that they play a higher-profile role in Asia’s financial future. Efforts to strengthen regional multilateral bodies, including Association of Southeast Asian Nation (ASEAN) forums and the East Asia Summit, reduce the likelihood that Chinese-led alternatives become focal.
Implications for the Region

China’s efforts to build financial power could reshape Asian politics. The promotion of the renminbi and Chinese financing creates bilateral, structural, and domestic-political leverage that could seriously constrain the autonomy of Asian states.

China’s trade ties within the region provide a window into how the country may convert its financial leverage into political power, as well as insight into how the region might productively respond. Especially after the 2008 global financial crisis, China has been increasingly willing to wield its leverage in trade, including against Japan over the East China Sea, Norway over the Nobel Prize, Taiwan over its elections, the Philippines over the South China Sea, Mongolia over a Dalai Lama visit, and South Korea over Terminal High Altitude Area Defense. These efforts have accompanied a change in China’s domestic discourse on the appropriateness of economic coercion that also followed the crisis. The country’s willingness to use instruments of trade coercively suggests the possibility that financial instruments would be similarly employed.

The case of trade also shows that in many instances China has run into obstacles when its agenda is multilateralized. For example, China has long seen the Regional Comprehensive Economic Partnership (RCEP)—a multilateral economic agreement that would cover sixteen countries, nearly half of the world’s population, and roughly one-third of its GDP—as an important vehicle for regional leadership. In a 2014 statement by the Ministry of Commerce, China made clear that “the smooth establishment of the RCEP is of great importance to China’s fighting for the initiative [in] the new round [over the] reconstruction of international economic and trade rules.” After the United States’ withdrawal from the Trans-Pacific Partnership (TPP), China’s Foreign Ministry initially elevated these efforts. The head of the ministry’s Department of International Economic Affairs declared, “If China has taken up a leadership role, it is because the front runners have stepped back, leaving that place to China. If China is required to play that leadership role then China will assume its responsibilities.”

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These lofty leadership ambitions, however, encountered obstacles from regional states—especially Australia, India, and Japan. China’s desire to enshrine its preferences on issues relating to cross-border data flows and intellectual property face Japanese and Australian opposition; meanwhile, India is extremely reluctant to extend to China the same low tariffs it offers ASEAN, given the enormous Sino-Indian goods deficit, especially in manufactures. Under Japanese instigation, Asian states even managed to resurrect the TPP as RCEP floundered. At least for now, RCEP remains an example both of Chinese order-building ambitions and of Asian resistance, as well as a keen demonstration of how China’s agenda can stall when it is multilateralized.

In financial matters, China’s efforts to internationalize its currency within the region have largely been welcomed for the economic benefits and convenience they bring, especially amid concerns about U.S. protectionism. Japanese prime minister Shinzo Abe, for example, pushed forward a $30 billion three-year swap agreement with China in 2018, and nearly half of all Chinese swap agreements are in Asia. But concerns over Chinese investment in infrastructure have engendered a stronger response featuring a wide mix of strategies—some more successful than others.

Some states like India have pursued hardline strategies and largely boycotted BRI. This approach avoids offering legitimacy to the initiative but reduces the possibility of influencing its investments. Other states, particularly recipient states like Malaysia, Myanmar, Pakistan, and Thailand, have revisited, scaled back, or canceled some Chinese infrastructure investments while continuing others. This approach may provide an opportunity for recipient countries to push China to adjust its practice, thereby putting recipients on stronger and more independent financial footing. Finally, some donor states like Japan have objected to BRI while at the same time pushing to work with China on some infrastructure projects. This more participatory and multilateral approach could bring greater transparency to BRI projects, effectively reducing their political component and the leverage that they can generate. Indeed, the transformation of the AIIB from China’s initial proposal to the institution that was subsequently launched demonstrates the power of such approaches. While BRI projects are largely bilateral, efforts to multilateralize them attenuate China’s influence.

Indeed, just as the multilateral structure of RCEP provided Asian states more options than a strictly bilateral structure, so too would attempting to multilateralize some elements of Chinese financial power. Ultimately, regional states do want Chinese funding for infrastructure, but they want it on terms that are less politically and financially problematic. By supporting them, and where possible partnering with Chinese entities, donors like the United States
could enhance the leverage of these smaller states and, in so doing, reduce the risk of asymmetric dependencies.

For these reasons, the United States should re-engage regional multilateral economic processes and endeavor to multilateralize some of China’s own bilateral efforts, such as its BRI investments. Doing so can make it easier for Asian states to resist or repurpose China’s financial statecraft and would also bring greater transparency to its efforts to harness such instruments for political purposes. In contrast, U.S. disengagement promotes bilateral approaches between China and its Asian neighbors and only hastens the arrival of a Chinese sphere of influence.