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China's Grand Strategy and Money Muscle: The Potentialities and Pratfalls of China's Sovereign Wealth Fund and Renminbi Policies

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Introduction

China's grand strategy consists of the mix of internal and external political, military, economic, technological, and socio-cultural strategies that it uses to advance its security interests, given its resources and the international context.[1] Despite the richness of the term, specialists concentrating on Chinese security interests have hijacked and narrowly conceptualized it in terms of China's military modernization, increasingly ambitious defence strategies, and efforts to warm relations with diverse countries such as Russia.[2] This myopia is ill-advised, as China has long made use of and is using economic instruments to advance its security interests (properly understood).[3] Moreover, Chinese

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[1] Avery Goldstein, 'The Diplomatic Face of China's Grand Strategy: A Rising Power's Emerging Choice', *The China Quarterly*, Vol. 168 (2001), p. 836; Yuan-Kang Wang, 'China's Grand Strategy and U.S. Primacy: Is China Balancing American Power', Brookings CNAPS Papers, June 2006, p. 3, http://www.brookings.edu/fp/cnaps/papers/wang2006.pdf, accessed on October 27, 2009; Jean-Marc F. Blanchard, 'From Stakeholder to Strategic Reassurance: An Analysis through Politico-Economy Lenses', *International Politics Quarterly*, No. 2 (2010), pp. 105–19. There is no requirement that these elements cohere, are effective, or come from a particular source. Regardless, the origins of a country's grand strategy as well as a specific grand strategy's incoherence or ineffectiveness are important analytical questions.

[2] Aside from blinding us to the non-military elements of grand strategy, a problem with this is that it neglects the fact that 'security interests' entail not only international elements like territorial integrity, but also domestic elements such as regime preservation.

[3] An illustrative recent example is that of China's investments in Europe and acquisition of billions of European government bonds which has purchased it goodwill in some European capitals and among various public constituencies. Guy Dinmore and Giulia Segreti, 'China Launches Investment Drive in Italy', *Financial Times*, October 7, 2010; Liz Alderman, 'Looking for Investments, China Turns to Europe', *New York Times*, November 1, 2010; Lex Column, 'China in Europe', *Financial Times*, January 9, 2011.

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strategic thinkers are clearly reflecting on the geopolitical implications (political, economic, and prestige) of their country's economic rise and the commensurate relative economic decline of the United States.[4] Finally, China has impressive intrinsic economic capabilities; e.g. it is the world's second largest economy, largest exporter, and a major creditor nation.[5]

In recent years, analysts have shifted their attention to China's others economic capabilities, apparent in massive foreign exchange reserves, exploding outward foreign direct investment (OFDI), and growingly active Sovereign Wealth Fund (SWF).[6] This is logical given that China has more than $2.5 trillion in foreign exchange and a currency (the Renminbi or RMB) that has the potential to become an international one.[7] Moreover, in 2009, People's Bank of China (PBOC) Governor Zhou Xiaochuan explicitly called for the creation of a new international reserve currency.[8] More relevant for us, there is a growing body of work attuned to

4 Wu Xinbo, 'Understanding the Geopolitical Implications of the Global Financial Crisis', *The Washington Quarterly*, Vol. 33, No. 4 (2010), pp. 155–63.

5 Wendy Dobson and Paul Masson, 'Will the Renminbi Become a World Currency?', *China Economic Review*, Vol. 20, No. 1 (2008), p. 124; David Barboza, 'In Recession, China Solidifies Its Lead in Global Trade', *New York Times*, October 13, 2009, http://www.nytimes.com/2009/10/14/business/global/14chinatrade.html, accessed on October 14, 2009; Deutsche Bank Research, 'Yuan as a Reserve Currency: Likely Prospects & Possible Implications, *Research Briefing*, July 16, 2010, p. 2.

6 A general treatment of all these issues is Ken Miller, 'Coping with China's Financial Power', *Foreign Affairs*, Vol. 89, No. 4 (2010). On China's foreign exchange reserves, see Yongnian Zheng and Jingtao Yi, 'China's Rapid Accumulation of Foreign Exchange Reserves and Its Policy Implications', *China & World Economy*, Vol. 15, No. 1 (2007), pp. 14–25. On Chinese OFDI (COFDI), see Jean-Marc F. Blanchard, 'Chinese MNCs as China's New Long March: A Review and Critique of the Western Literature', *Journal of Chinese Political Science*, Vol. 16, No. 1 (March 2011), pp. 91–108. On China's SWF, see Friedrich Wu and Arifin Seah, 'Would China's Sovereign Wealth Fund Be a Menace to the USA?', *China & World Economy*, Vol. 16, No. 4 (2008), pp. 33–47. A SWF may be conceived as a central government controlled, special purpose investment vehicle set up to invest a country's foreign exchange reserves, resource export surplus, or other state assets abroad for a financial return. Sarah Eaton and Zhang Ming, 'Dragon on a Short Leash: An Inside-Out Analysis of China's Investment Corporation', *Research Centre for International Finance Working Paper*, No. 0821, November 26, 2008, http://www.eaber.org/intranet/documents/41/1057/CCER_Eaton_2008.pdf, accessed on September 5, 2009, p. 4; Zhang Ming and He Fan, 'China's Sovereign Wealth Fund: Weaknesses and Challenges', *Research Centre for International Finance Working Paper*, No. 0823, December 20, 2008, http://www.eaber.org/intranet/documents/41/1060/CCER_ZHANG_2008.pdf, accessed on September 5, 2009, p. 2.

7 Wendy Dobson and Paul Masson, 'Will the Renminbi Become a World Currency?', pp. 125, 127; Zhang Ming and He Fan, 'China's Sovereign Wealth Fund', pp. 13–15; Yann Marin, 'Chinese Sovereign Wealth Funds: Past, Present, and Future', Special Issue on Sovereign Wealth Funds, *Revue d'Economie Financière*, 2009, pp. 109–10.

8 Brendan Kelly, 'China's Challenge to the International Monetary System: Incremental Steps and Long-Term Prospects for Internationalization of the Renminbi', *Issues and Insights*, Vol. 9, No. 11 (2009), p. 1; Rupert Walker, 'Global Crisis Raises Risks for China but Opportunities for its Currency', *Finance Asia*, 2009, pp. 12–13.

the implications of China's newfound money muscle.[9] Unfortunately, this literature either neglects or analyzes superficially the possible political rationales behind, or political consequences of, Chinese money policies.[10] Works that delve specifically into the politico-economy of China's SWF and currency policies often perceive a coherent strategy whose specific aim is to advance efficaciously and smoothly Chinese grand strategy, when the reality is far more complex.[11]

In this era of globalization, the relationship between economics and politics has fired the attention of many.[12] Studying the politico-economic dimensions of Chinese grand strategy provides a way of gaining deeper insight into the conditions that shape the existence and intensity of existent links. Researching these two phenomena is a way of illuminating further the complexities of Chinese grand strategy and foreign economic policy, incontrovertibly necessary given China's global politico-economic weight.[13] From a policymaking angle, studying China's SWF is critical, in view of the rapid rate at which SWFs are growing, as well as pervasive anxieties about and strong interest in regulating/controlling SWFs.[14] Similarly critical is study of China's currency policies, in terms of China's sizeable currency reserves, role

9 Michael Martin, 'China's Sovereign Wealth Fund', *CRS Report for Congress*, January 22, 2008; Eric Altbach and Michael Cognato, 'Understanding China's New Sovereign Wealth Fund', *NBR Analysis*, Vol. 19, No. 1 (2008), p. 25; Friedrich Wu and Arifin Seah, 'Would China's Sovereign Wealth Fund Be a Menace to the USA?', p. 42; Sarah Eaton and Zhang Ming, 'Dragon on a Short Leash', pp. 1, 8–9; Zhang Ming and He Fan, 'China's Sovereign Wealth Fund', p. 2.

10 This neglect is unjustified. Chinese leaders themselves are well aware that foreign economic policy decisions involving billions of dollars raise political issues and have political ramifications. Indeed, at a meeting of the world's largest SWFs in Australia in May 2010, Jin Liqun, supervisory chairman of the CIC, called on other countries to avoid discriminating against the CIC and to remain open. Peter Smith, 'Chinese Wealth Fund Calls for Fair Treatment', *Financial Times*, May 9, 2010. Two months earlier, Chinese Premier Wen Jiabao described external pressure for an appreciation of the Chinese currency as 'protectionism' (a political phenomenon). Geoff Dyer, 'China Hits at Currency "Protectionism" ', *Financial Times*, March 14, 2010.

11 For similar remarks focused on China's ability to use its creditor status as a political weapon against the United States and others, see Daniel Drezner, 'Bad Debts: Assessing China's Financial Influence in Great Power Politics', *International Security*, Vol. 34, No. 2 (2009), pp. 7–45. Below, I consider this issue, but only as one among many.

12 Edward Mansfield and Brian Pollins, eds., *Interdependence and Conflict* (Ann Arbor: University of Michigan Press, 2003); Jonathan Kirshner, 'Globalization, American Power, and International Security', *Political Science Quarterly*, Vol. 123, No. 3 (2008), pp. 363–89; Jean-Marc Blanchard, 'Economics and Asia-Pacific Region Territorial and Maritime Disputes: Understanding the Political Limits to Economic Solutions', *Asia Politics & Policy*, Vol. 1, No. 4 (2009), pp. 682–708.

13 Eric Altbach and Michael Cognato, 'Understanding China's New Sovereign Wealth Fund', p. 8.

14 Michael Martin, 'China's Sovereign Wealth Fund'; Eric Altbach and Michael Cognato, 'Understanding China's New Sovereign Wealth Fund', pp. 5, 11; Friedrich Wu and Arifin Seah, 'Would China's Sovereign Wealth Fund Be a Menace to the USA?', p. 34. On the politics of SWF writ large, a useful analysis is Daniel Drezner, 'Sovereign Wealth Funds and the (In)Security of Global Finance', *Journal of International Affairs*, Vol. 62, No. 1 (2008), pp. 115–30.

in global trade and commodities, and the political frictions that China's currency policies have fuelled.[15]

This article examines how China is using its SWF and RMB policies as part of its aforementioned grand strategy to realize such security interests as national independence, regime preservation, prestige, and economic modernization.[16] It also demonstrates that worries about the political ramifications of China's SWF and RMB are overblown. First, although it may be true that China 'never before has . . . had this much financial might, and . . . is now experimenting with how to best to use it in its relations with other states', there are a number of economic and political variables that constrain Beijing's ability to wield its money muscle.[17] Second, although China's use of its money power advances some aspects of its grand strategy, it undermines others. Third, China is not acting hyper-aggressively to employ its money endowments.[18] The 'China Threat' seems to have been exaggerated—not just in the military-security realm but in the economic one as well. For now, 'the principal aim of China's financial foreign policy is to stimulate economic growth and job creation at home', though this could obviously change.[19]

In the next section, I elaborate on China's grand strategy and the ways in which its SWF and currency policies serve it. The third section provides background on China's SWF. Thereafter, I assess China's ability to wield its SWF as a grand strategy device. The fifth section surveys China's currency policy. The sixth evaluates the ease with which Beijing could mould its currency policies to serve its grand strategy. In the seventh section, I discuss certain potential economic consequences of China's SWF and evolving RMB policy. Although such consequences are not the main focus of this analysis, they are integral to debates about the significance of China's rising financial might and thus require consideration. The conclusion summarizes

15 On these frictions, see Harvey Morris, Daniel Dombey, and Alan Beattie, 'Obama Urges Wen to Act over Renminbi', *Financial Times*, September 23, 2010.

16 To avoid confusion, it should be stated that there is no claim herein that grand strategy consideration entirely or primarily determine China's SWF and currency policies. Rather the claim is that China's SWF and currency have political dimensions that require analysis.

17 The quote is from Ken Miller, 'Coping with China's Financial Power'.

18 Although beyond the scope of this article, it should be noted that inconsistencies in China's use of its money muscle as well as caution in using it are partly attributable to disagreements internally about how China's financial policies should be structured, as well as conflict between the various powers handling China's money affairs. Relevant analyses include Victor Shih, *Factions and Finance in China: Elite Conflict and Inflation* (Cambridge: Cambridge University Press, 2008); David Steinberg, 'Interest Group Influence in Authoritarian States: The Political Determinants of China's Undervalued Exchange Rate', paper presented at the Annual Meeting of the American Political Science Association, Toronto, Canada, September 3–6, 2009, http://ssrn.com/abstract=1449827, accessed on January 15, 2011; Sarah Eaton and Zhang Ming, 'A Principal-Agent Analysis of China's Sovereign Wealth System: Byzantine by Design', *Review of International Political Economy*, Vol. 17, No. 3 (2010), pp. 481–506.

19 Ken Miller, 'Coping with China's Financial Power'.

the analysis, expounds on its theoretical and policy implications, and suggests future research directions.

China's Grand Strategy

Understanding a given country's grand strategy requires pinpointing what that country sees as its interests, how it defines threats to them, and identifying the tools it employs to advance its interests and counter challenges to them.[20] The balance of this section, therefore, considers China's perceptions of its interests, definition of threats to those interests, and the way SWF and currency policies represent ways of pursuing its security interests.

For most analysts, China's national interests include territorial integrity, sovereignty, and national independence. They further encompass regime preservation, a role and prestige commensurate with China's power rank, and economic modernization.[21] This writer does not concur, though, with the view that China defines its national interests to entail revision of the international system or hegemony in the Asia-Pacific Region (APR), though it certainly covets more influence.[22] For Beijing, the primary threat to the enumerated interests is the United States, given the latter's backing of Taiwan, partnerships with India and Japan, military might, human rights pressures, and dominance in global institutions.[23] To deal with threats, Beijing has adopted strategies ranging from developing asymmetric military capabilities, to constructing soft alliances (e.g. with Iran and Venezuela),

[20] Yuan-Kang Wang, 'China's Grand Strategy and U.S. Primacy', p. 3.

[21] Fei-Ling Wang, 'Preservation, Prosperity, and Power: What Motivates China's Foreign Policy', *Journal of Contemporary China*, Vol. 14, No. 45 (2005), pp. 669–94; Yuan-Kang Wang, 'China's Grand Strategy and U.S. Primacy', pp. 3–4; Li Qingsi, 'The International Conditions of China's Peaceful Rise: Challenges and Opportunities' in Sujian Guo, ed., *China's 'Peaceful Rise' in the 21st Century: Domestic and International Conditions* (Aldershot: Ashgate Publishing, 2006); People's Republic of China, State Council, *China's National Defence in 2008*, January 2009, http://english.gov.cn/official/2009-01/20/content_1210227_3.htm, accessed on September 5, 2010; Jean-Marc Blanchard, 'From Stakeholder to Strategic Reassurance'.

[22] Yuan-Kang Wang, 'China's Grand Strategy and U.S. Primacy', pp. 4–9. Alastair Iain Johnston provides a methodologically sophisticated rejection of claims that China is a revisionist state hell-bent on overturning international rules, the distribution of power, and the hierarchy of prestige and casts doubt on the claim that China wants dominance in the APR. Alastair Iain Johnston 'Is China a Status Quo Power?', *International Security*, Vol. 27, No. 4 (2003), pp. 5–56. For similar conclusions deriving from an analysis of China's behaviour in the international economic realm, see Jean-Marc Blanchard, 'Harmonious World and China's Foreign Economic Policy: Features, Implications, and Challenges', *Journal of Chinese Political Science*, Vol. 13, No. 2 (2008), pp. 165–92.

[23] On these issues, see Avery Goldstein, 'The Diplomatic Face of China's Grand Strategy', pp. 840–2; Yuan-Kang Wang, 'China's Grand Strategy and U.S. Primacy', pp. 10–12; Andrew Erickson and Lyle Goldstein, 'Hoping for the Best, Preparing for the Worst: China's Response to US Hegemony', *Journal of Strategic Studies*, Vol. 29, No. 6 (2006), pp. 955–86; Li Qingsi, 'The International Conditions of China's Peaceful Rise', pp. 155–8; Christopher Layne, 'China's Challenge to U.S. Hegemony', *Current History*, Vol. 107, No. 705 (2008), pp. 13–18.

to increased multilateralism and support for multi-polarity, to reassurance (e.g. signing the Code of Conduct for the South China Sea and promulgating 'friendly' foreign policy doctrines such as 'Harmonious World'), to soft power projection.[24]

China's use of economic tools as part of its grand strategy is often neglected, even though there are abundant historical, theoretical, and empirical reasons to afford greater attention to this dimension. With respect to history, imperial China frequently used trade and gifts to manage threats on the periphery, to sustain interstate relationships, and to defend China's rank.[25] Moreover, In the 1960s and 1970s, China used economic aid and foreign investment to blunt the threat posed by the Soviet Union.[26] Theoretically speaking, China is likely to favour economic tools given its relatively better global economic versus military, technological, and soft power position, the relatively lower aggressive foreign reaction engendered by economic versus military tools, and the domestic gains flowing from international economic progress. With regards to empirics, China is currently using numerous economic tools in Africa, Asia, and the Middle East to advance its diplomatic, strategic, and other objectives.[27] Even those emphasizing military issues recognize that China exploits economics to build partnerships, ensure regime stability, and reduce external concerns.[28]

Beyond China's use of 'traditional' economic instruments like trade and aid, it is important to investigate how Beijing employs 'other' economic assets—which include its SWF and currency (holdings and value)—to

[24] Avery Goldstein, 'The Diplomatic Face of China's Grand Strategy', pp. 842–58; Alastair Iain Johnston, 'Is China a Status Quo Power?', pp. 38–49; Yuan-Kang Wang, 'China's Grand Strategy and U.S. Primacy', pp. 17–27; Li Qingsi, 'The International Conditions of China's Peaceful Rise', pp. 148–51; Sheng Ding, 'To Build a 'Harmonious World': China's Soft Power Wielding in the Global South', in Sujian Guo and Jean-Marc Blanchard, eds., *'Harmonious World' and China's New Foreign Policy* (Lanham: Rowman & Littlefield-Lexington, 2008), pp. 105–24.

[25] Brigadier Subrata Saha, 'China's Grand Strategy: From Confucius to Contemporary', *Strategy Research Project* A303815, February 2, 2010, http://www.dtic.mil/cgi-bin/GetTRDoc?AD=ADA518303&Location=U2&doc=GetTRDoc.pdf, accessed on September 5, 2010.

[26] A paradigmatic example is China's support for the construction of the Tanzam railway. George T. Yu, *China's African Policy: A Study of Tanzania* (New York: Praeger, 1975).

[27] Jianwei Wang, 'China's New Frontier Diplomacy', in Sujian Guo and Jean-Marc Blanchard, eds., *'Harmonious World' and China's New Foreign Policy*, pp. 21–37; Wei Liang, 'New Africa Policy: China's Quest for Oil and Influence', in Sujian Guo and Jean-Marc Blanchard, eds., *'Harmonious World' and China's New Foreign Policy*, pp. 153–71; Tim Niblock, 'China's Growing Involvement in the Gulf: The Geopolitical Significance', in Simon Shen and Jean-Marc Blanchard, eds., *Multidimensional Diplomacy of Contemporary China* (Lanham: Rowman & Littlefield-Lexington, 2010), pp. 207–31; Chien-Peng Chung, 'China's Multidimensional Diplomacy toward the Pacific Islands', in Simon Shen and Jean-Marc Blanchard, eds., *Multidimensional Diplomacy of Contemporary China*, pp. 267–82; Jean-Marc Blanchard, 'Chinese MNCs as China's New Long March'.

[28] Avery Goldstein, 'The Diplomatic Face of China's Grand Strategy', p. 847; Yuan-Kang Wang, 'China's Grand Strategy and U.S. Primacy', pp. 16–17; Robert G. Sutter, *Chinese Foreign Relations: Power and Policy since the Cold War* (Lanham: Rowman & Littlefield Publishers, 2008), chapters 7–9.

secure the national interest.[29] Even if one were unaware of China's European bond purchases, currency swap agreements with soft allies, or the China Investment Corporation (CIC) resource acquisitions, it would be relatively easy to imagine a number of ways in which Beijing could exploit its SWF and currency as part of its grand strategy. First, it could use these financial tools to strengthen economic growth—e.g. by giving help to Chinese enterprises.[30] Second, it could use them to buy strategic technology, to gain control of vital sectors like aerospace, or to lubricate special deals from those entranced by the massive sums at Beijing's disposal.[31] Third, it could shift these assets around in a destabilizing fashion. For instance, commentators have expressed alarm over the prospect of China dumping its massive US government debt holdings and thereby forcing a huge rise in US interest rates.[32]

Besides these tactics, China could conceivably mobilize its SWF and currency to augment its independence of the US-dollar-anchored international financial system in general and of the US dollar specifically.[33] Finally, China could use its financial resources to bolster its status and prestige—e.g. by assuming the role of a 'lender of last resort' such as through currency swaps or building the RMB into one of the world's reserve currencies.[34] Greater status and prestige for China, of course, conveniently diminishes those of others, specifically the United States, which has the world's leading currency and is an important lender of last resort. On a related note, China's greater

29 Works that examine how states have wielded economic statecraft to achieve their political and military objectives include Ming Wan, 'Economic Interdependence and Economic Cooperation: Mitigating Conflict and Transforming Security Order in the Asia-Pacific', in Muthiah Alagappa, ed., *Asian Security Order: Instrumental and Normative Features* (Stanford: Stanford University Press, 2003), pp. 280–310; Jean-Marc Blanchard and Norrin Ripsman, 'A Political Theory of Economic Statecraft', *Foreign Policy Analysis*, Vol. 4, No. 4 (2008), pp. 371–98; Jean-Marc Blanchard, 'Economics and Asia-Pacific Region Territorial and Maritime Disputes'.

30 It is very important to recognize that economic growth is not just an economic issue, but a critical regime preservation issue since growth helps to bolster regime legitimacy. Furthermore, economic growth supplies the funds/technology to advance China's military modernization.

31 Michael Martin, 'China's Sovereign Wealth Fund'; Eric Altbach and Michael Cognato, 'Understanding China's New Sovereign Wealth Fund', pp. 5, 26; Friedrich Wu and Arifin Seah, 'Would China's Sovereign Wealth Fund Be a Menace to the USA?', pp. 34, 40, 42–3.

32 Michael Martin, 'China's Sovereign Wealth Fund', pp. 16–17; Friedrich Wu and Arifin Seah, 'Would China's Sovereign Wealth Fund Be a Menace to the USA?', pp. 38–9; Ken Miller, 'Coping with China's Financial Power'. Like me, Drezner downplays these risks, see Daniel Drezner, 'Bad Debts', pp. 7–45; Daniel Drezner, 'Sovereign Wealth Funds and the (In)Security of Global Finance', pp. 115–30.

33 This point is further discussed below.

34 China's efforts in these directions are discussed later. A country with a reserve currency also gains 'structural power' because it must be considered in international discussions about money and thus can influence the international agenda. Jonathan Kirshner, 'Dollar Primacy and American Power: What's at Stake?', *Review of International Political Economy*, Vol. 15, No. 3 (2008), p. 425.

status and prestige in the financial realm could contribute to its soft power by painting it as a rising financial 'force' that others might be motivated to mimic or embrace.

The CIC[35]

In September 2007, Beijing created a SWF called the CIC in which to invest a portion of China's massive foreign currency reserves. Initially endowed with $200 billion, the CIC is currently the world's fourth largest SWF, with more than $300 billion under management, but easily has the potential to become the largest, should the Chinese government opt to supplement its reserves. The CIC is a semi-independent entity which reports directly to the State Council (China's cabinet). It is managed by a Board comprised of high-powered individuals drawn from diverse agencies such as the Ministry of Commerce, Ministry of Finance (dominant in terms of staffing), the PBOC, SAFE, and the National Development and Reform Commission (NDRC).[36] According to analysts, these individuals are technocrats with investment experience and records as pro-market reformers.[37]

Justifications for the CIC's founding emphasize economic imperatives. First, a disproportionate percentage of China's foreign exchange reserves (60–70% according to some estimates) were at that time in US government debt, which offered liquidity and safety but low yields. Second, the PBOC paid an interest rate on bonds it was issuing to mop up US dollars higher than that on its US government securities holdings. Third, there was a need to diversify away from an asset that was depreciating in tandem with the appreciation of the RMB.[38] Indeed a 10% depreciation of the dollar apparently meant a $170 billion loss on China's foreign exchange holdings—an astounding 5% of China's gross domestic product in 2007.[39]

35 It is not usual for reporters and academics to label other Chinese financial entities such as the State Administration for Foreign Exchange (SAFE) or National Social Security Fund (NSSF) SWFs. However, according to the International Monetary Fund (IMF) definition, these entities are not true SWFs. For discussion, see Yann Marin, 'Chinese Sovereign Wealth Funds', pp. 105–7. For an example of this labelling problem, see Henny Sender, '$2.5bn China investment in TPG Could Be Private Equity Landmark', *Financial Times*, June 11, 2008.

36 Michael Martin, 'China's Sovereign Wealth Fund', pp. 5–6; Zhang Ming and He Fan, 'China's Sovereign Wealth Fund', pp. 4–5; Yann Marin, 'Chinese Sovereign Wealth Funds', pp. 108–9. For an analysis of the political battles leading up to the creation of the CIC and the designation of its management team, see Sarah Eaton and Zhang Ming, 'Dragon on a Short Leash', pp. 10–12; Yann Marin, 'Chinese Sovereign Wealth Funds', pp. 107–8.

37 Eric Altbach and Michael Cognato, 'Understanding China's New Sovereign Wealth Fund', pp. 11–12, 16–20, 28–9.

38 Eric Altbach, 'China Fund', pp. 12–13; Sarah Eaton and Zhang Ming, 'Dragon on a Short Leash', pp. 5–6; and Zhang Ming and He Fan, 'China's Sovereign Wealth Fund', p. 3.

39 Zhang Ming and He Fan, 'China's Sovereign Wealth Fund', p. 3.

The CIC stresses that it operates on commercial principles and seeks returns. From the get-go, CIC decision makers have shown that they want to avoid politically controversial investment choices. In this vein, they stated a preference for publicly traded securities over direct investments in foreign firms. Moreover, they emphasized that the CIC had no intention of buying big stakes in big companies, acquiring large numbers of firms, or putting money into sensitive industrial sectors like infrastructure, airlines, telecommunications, energy, or technology. In practice, the CIC has taken smaller investment stakes—e.g. less than 10%—in firms, to avoid undergoing government investment reviews.[40]

According to the CIC, as of the end of 2009, 32% of its global portfolio was in cash, 36% in global equities, and 26% in fixed income securities (71% of which was in government securities). Of the amount in equities, 43.9% was in North America, 28.4% in the APR, and 20.5% in Europe.[41] The CIC's early major foreign investments included a $3 billion stake in Blackstone (2007), a $5 billion investment in Morgan Stanley (2007), and a $3 billion investment in J.C. Flowers (2008).[42] More recently, the CIC has poured several billion into investments such as the stock of US money manager BlackRock, Australian industrial and office property, and Chinese poly-silicon producer GCL-Poly Energy.[43]

In the eyes of certain observers, the CIC's foreign investments are relatively 'unremarkable', especially given the CIC's $300 billion endowment. What is noteworthy is the CIC's huge indirect—through its arm Central Huijin Investment (hereinafter 'Huijin')—and direct investments in the country's financial sector, specifically state-owned banks.[44] Bearing in

40 Michael Martin, 'China's Sovereign Wealth Fund', pp. 10–12.

41 Wang Bo, 'Sovereign Wealth Fund Gains 11.7% in 2009', *China Daily*, 30 July, 2010, http://www.chinadaily.com.cn/china/2010-07/30/content_11070135.htm, accessed on July 30, 2010.

42 Eric Altbach and Michael Cognato, 'Understanding China's New Sovereign Wealth Fund', p. 22; Friedrich Wu and Arifin Seah, 'Would China's Sovereign Wealth Fund Be a Menace to the USA?', pp. 36–7; Zhang Ming and He Fan, 'China's Sovereign Wealth Fund', pp. 6–7.

43 Jing Ulrich, Amir Hoosain, and Benjamin Wong, 'China's State Investment Abroad', *J. Morgan's Hands-On China Series*, August 19, 2009, p. 3; Jamil Anderlini et al., 'CIC Makes Food Security a Priority', *Financial Times*, September 22, 2009; 'CIC Planning More Resource Investments', *China Daily*, January 28, 2010, http://www.chinadaily.com.cn/bizchina/2010-01/28/content_9390095.htm, accessed on January 27, 2010.

44 Michael Martin, 'China's Sovereign Wealth Fund', pp. 8–10. The CIC apparently would have invested more, but there were battles between the Ministry of Finance and People's Bank of China about this because the former worried about losing control of the banking sector to the latter. Sarah Eaton and Zhang Ming, 'Dragon on a Short Leash', pp. 13–14. For further discussion of more recent turf wars over CIC's direct and indirect bank holdings, see Henry Sender, 'China Eyes Shake-Up of Bank Holdings', *Financial Times*, July 5, 2010.

mind the allocation percentages divulged by CIC officials—e.g. one-third of CIC funds would go into Huijin and one-third into domestic banks—this investment might now be as high as $200 billion.[45] This investment has made the CIC the largest shareholder in entities like the Agricultural Bank of China, China Construction Bank, Bank of China (BoC), China Development Bank, and Everbright Bank.[46] The CIC is a major investor in other enterprises such as China Railway Group and BBMG Corporation, too.[47]

CIC as a Tool of Grand Strategy and Constraints on its Use

This section tackles how China's SWF is being or could be used as a grand strategy tool, paying special attention to investments in the United States, the greatest 'threat' to China's interests, as earlier discussed. It concurrently evaluates the limits on China's ability to exploit the CIC as a grand strategy device. I begin by considering how the CIC is being used to bolster domestic economic growth/modernization. Second, I examine the CIC's role in acquiring assets, technologies, and resources. Third, I analyze the CIC as a lever through which to destabilize markets or other countries. Fourth, I assess the CIC's role in supporting China's independence. Finally, I reflect on the CIC's place in efforts to enhance China's prestige and regional/global roles.

As mentioned, Beijing has been using the CIC to support domestic economic modernization and, in turn, regime preservation. China's SWF investments in domestic banks specifically enhance Beijing's ability to manipulate the supply of credit. Moreover, Huijin has forced Chinese banks in which it has invested to buy its bonds, which is a means of supporting government spending.[48] The CIC has also made significant investments in the initial public offerings (IPOs) of mainland firms.[49] As elaborated below, the CIC has been investing in natural resource investments whose reliability of supply is critical to China. Beyond this, the CIC has supported OFDI by Chinese firms. News reports suggest that the CIC is backing Chinese telecommunication equipment firms Huawei and

45 Friedrich Wu and Arifin Seah, 'Would China's Sovereign Wealth Fund Be a Menace to the USA?', p. 36.
46 Eric Altbach and Michael Cognato, 'Understanding China's New Sovereign Wealth Fund', pp. 23–5; Sarah Eaton and Zhang Ming, 'Dragon on a Short Leash', pp. 14–15; Yann Marin, 'Chinese Sovereign Wealth Funds', pp. 111–12.
47 Centre for Asia Private Equity Research, 'Cementing Success', *Asia Private Equity Review*, August 2009.
48 Jamil Anderlini, 'China Fund Bond Sale Faces Criticism', *Financial Times*, August 24, 2010.
49 The CIC was a major cornerstone investor in the IPOs of China Railway Group and BBMG Corporation when they went public in, respectively, December 2007 and July 2009. Centre for Asia Private Equity Research, 'Cementing Success'.

ZTE in their efforts to make inroads into Europe and the United States.[50] There are no obvious economic limits to the CIC's ability to invest in natural resources or support Chinese multinational companies, though there would likely be a political backlash if the CIC were to go overboard. Neither are there any obvious political or economic barriers to the CIC's buying of Chinese banks and IPOs.

As one journalist quipped, 'were the CIC "so inclined", it could buy Ford, G.M., Volkswagen, and Honda, and still have a little money left over for ice cream'.[51] But so far, the CIC has taken small percentage stakes, or invested through such vehicles as index or private equity funds.[52] In theory, the CIC could be used to acquire strategic business assets or to garner special privileges, though the latter is yet to be seen. The CIC did, however, in the second half of 2009 alone, make commodity-related investments amounting to $10 billion.[53] Examples include a $939 million 11% stake in Kazakhstan energy firm JSC Kaz Munai Gas Exploration Production (2009), a $300 million 45% stake in Russian energy company Noble Oil Group (2009), and a $1.5 billion 17.2% stake in Canadian metals producer Teck Resources (2010).[54] These activities do not portray a nationalistic, aggressive SWF.[55] Although there is little economically to hinder the CIC from becoming more active, many countries have investment review processes that can be used to limit CIC stakes and the kinds of industries in which it can invest.[56]

50 Paul Betts and Michiyo Nakamoto, 'China Backs New Champions to Conquer the West', *Financial Times*, June 10, 2009. It was rumoured that CIC put $120 billion at the disposal of Chinalco, a state-owned aluminium conglomerate, to facilitate its efforts to block a takeover of mining firm Rio Tinto by mining giant BHP Billiton. Eric Altbach and Michael Cognato, 'Understanding China's New Sovereign Wealth Fund', p. 32.

51 Sarah Eaton and Zhang Ming, 'Dragon on a Short Leash', pp. 16–19; Zhang Ming and He Fan, 'China's Sovereign Wealth Fund', pp. 15–16. The quip is from James Surowiecki, 'Sovereign Wealth World', *The New Yorker*, November 26, 2007, quoted in Michael Martin, 'China's Sovereign Wealth Fund'.

52 Friedrich Wu and Arifin Seah, 'Would China's Sovereign Wealth Fund Be a Menace to the USA?', p. 36; Jing Ulrich, Amir Hoosain, and Benjamin Wong, 'China's State Investments Abroad'; 'CIC Reveals US Equity Holdings'.

53 'CIC Planning More Resource Investments'.

54 'China Sovereign Fund Buys Stake in Kazakhstan Oil, Gas Company', October 1, 2009, http://english.peopledaily.com.cn/90001/90778/90861/6774842.html, accessed on October 2, 2009; 'China Sovereign Fund Buys 45% Stake in Russian Oil Company', October 17, 2009, http://english.peopledaily.com.cn/90001/90776/6785858.html, accessed on October 17, 2009; 'CIC Planning More Resource Investments'.

55 Anderlini et al. portray a Chinese SWF aggressively on the move to secretly monopolize resources, but this is not supported by their article ('CIC Makes Food Security a Priority') which shows the CIC contemplating diverse non-resource investments and taking major stakes in the financial sector. Neither is it supported by other analyses. See, e.g. Jing Ulrich, Amir Hoosain, and Benjamin Wong, 'China's State Investments Abroad', pp. 3–4.

56 Eric Altbach and Michael Cognato, 'Understanding China's New Sovereign Wealth Fund', pp. 26–7; Friedrich Wu and Arifin Seah, 'Would China's Sovereign Wealth Fund Be a Menace to the USA?', pp. 42–3. It should also be acknowledged that the CIC has accepted limits on its stakes, rights as a shareholder/investor, and so on. For an example, see the discussion of the CIC's investment in Teck Resources. Jing Ulrich, Amir Hoosain and BenjaminWong, 'China's State Investments Abroad', pp. 3–4.

It is conceivable that the CIC could use its immense assets to entangle investment destination countries with China or, after investments are made, rapidly withdraw monies to destabilize markets or destination countries. Pessimists have voiced alarm that a heavy CIC investment in the United States might push the United States into a recession.[57] Much as the superpowers held one another other hostage during the Cold War with their massive nuclear arsenals, however, it seems that, to paraphrase one analyst, 'blowing up another [major] economy would do [China] at least as much financial damage'.[58] China might have more financial clout with regards to a smaller country, but this would entail incredibly calibrated investments since the CIC's scale typically means that it must buy the debt of large borrowers or the securities of large issuers.[59] The other constraint on Beijing's using the CIC as a destabilization device is that of the latter making investments—e.g. agriculture—that are relatively illiquid. That CIC investments give other governments an opening to encourage changes in Chinese policies also must be taken into account.[60]

China's SWF can be used to support China's national independence in diverse ways, ranging from the mild to the aggressive, but mostly the former. For instance, although its investments have been used to reduce China's dependence on the US dollar, they have not appreciably done so, as apparent in the amount of dollar assets in its portfolio.[61] In addition, the CIC has played a role in facilitating China's access to resources, as shown by the aforementioned investments and an $856 billion investment in Noble Group (2009), a commodity trading firm that owns farms, ports and agricultural production facilities.[62] These investments have bolstered and diversified China's sources of supply, but have not resulted in Chinese monopolization or diversion of the best resources. If directed towards prospective allies, CIC investments might further augment China's independence, but there are no reports of serial, major CIC investments in countries like Iran, Russia, or Sudan. CIC investments in resource-rich but troubled countries like Sudan, of course, create new kinds of dependencies and hurt China's image.

57 Michael Martin, 'China's Sovereign Wealth Fund'.

58 Adam Davidson, 'U.S. Watches Nervously as Oil-Rich Nations Invest', *National Public Radio* [Morning Edition], November 30, 2007, quoted in Michael Martin, 'China's Sovereign Wealth Fund'. As Friedrich Wu and Arifin Seah elaborate, a large dumping of US government securities would significantly reduce the value of Chinese dollar-denominated assets, hurt China's best customer, and damage its reputation as a 'responsible stakeholder'. Friedrich Wu and Arifin Seah, 'Would China's Sovereign Wealth Fund Be a Menace to the USA?', pp. 39–40. For a similar argument, see Ken Miller, 'Coping with China's Financial Power'.

59 The CIC also spreads out its money to diversify in terms of sector and geography. See 'CIC Planning More Resource Investments'.

60 Eric Altbach and Michael Cognato, 'Understanding China's New Sovereign Wealth Fund', p. 35.

61 Henny Sender, 'Filing Reveals Chinese Wealth Fund's Exposure', *Financial Times*, February 9, 2010.

62 Jamil Anderlini et al., 'CIC Makes Food Security a Priority'.

The existence of the CIC itself acts as another marker of China's surging wealth and conceivably embellishes China's image. In actuality, though, exactly how much China's SWF adds to the country's status is open to question. First, no one thinks of UAE or Norway as great (or greater) powers by virtue of their extraordinarily large SWFs. Second, the existence of the CIC derives from other widely known facts, such as China's being the world's second largest economy or trading nation. As for soft power, other countries might theoretically defer to Beijing because of the size of the CIC and the lure of a model that produced such a SWF. China's financial firepower, though, clearly creates alarm as well as excitement. To illustrate, China's relatively small \$27.4 billion purchase of Japanese government bonds between January and September caused even greater Japanese anxiety about China.[63] Aside from these facts, there is no evidence that Chinese policymakers flaunt the CIC as they did the 'China model', which is odd if Beijing indeed does regard the CIC as a soft power device.

Contrary to what many perceive, therefore, the preceding discussion shows that China has not been aggressively using the CIC to advance its grand strategy. Instances where it has been used in this vein have been largely in support of preserving China's domestic economic modernization/regime. This section further demonstrates that there are constraints on the ability of Chinese elites to wield the CIC as a grand strategy device, and that using it that way might hinder China's use of it in others. Besides these considerations, the CIC's poor first-year investment performance, as earlier mentioned, makes problematic the idea of the CIC as a monolith moving according to a master plan wherein many domestic constituencies have their own ideas on how the CIC should use its funds, and others demand that the CIC deliver good investment returns.[64]

A Primer on China's Currency Policies

In this section, I consider Beijing's currency policies and grand strategy. A country's currency policies can involve, among other things, the valuation of its currency (market- or government-determined and the basis for that valuation). It also can pertain to the status that a government seeks for its money in the international politico-economic system—e.g. international currency.[65]

63 Michiyo Nakamoto and Geoff Dyer, 'Japan Alarm over China's JGB Purchases', *Financial Times*, September 9, 2010.

64 Michael Martin, 'China's Sovereign Wealth Fund'; Sarah Eaton and Zhang Ming, 'Dragon on a Short Leash', p. 23; Henny Sender, 'China Eyes Shake-Up of Bank Holdings'.

65 International currencies are used globally for invoicing/settlement directly and by third parties, for denominating assets and liabilities, and as central bank reserves. Put differently, an international currency serves as a unit of account, a store of value, and a medium of exchange. Wendy Dobson and Paul Masson, 'Will the Renminbi Become a World Currency?', p. 126; Brendan Kelly, 'China's Challenge to the International Monetary System', pp. 1, 6.

Finally, it can relate to the investment of a country's foreign currency reserves. As the investment of China's foreign currency reserves is considered in the preceding discussion of the CIC, this section focuses on the first two policy issues. It is first of all worth pointing out that the RMB has so far served none of the purposes of an international currency; it is not used significantly in invoicing trade, is not employed as a reserve currency, and is not used to denominate borrowings.[66]

In 1994, China adopted a pegged currency system linking the RMB to the US dollar at the rate of 8.28 to 1. This peg, which was too low in the eyes of many, resulted in exploding current and capital account surpluses and, in turn, the massive accumulation of US dollars by the PBOC. The fall-out of undervaluation (particularly inflation), coupled with external pressures and the inadequacy of ad hoc measures, led China to modify its currency system in 2005. The 2005 reform changed the currency peg from the US dollar to a basket of currencies and re-valued the RMB at 8.11 to the dollar.[67] Between the 2005 reforms and March 2009, the RMB appreciated 25.8% in value in real terms—an amount numerous analysts regard as inadequate. More recently, in the face of rising international pressure, China allowed the currency to rise in value, by fixing it at the value of 6.83 to the US dollar from September 2008 to June 2010.[68]

With regards to the status of the RMB, China punctuated its interest in a new international currency order through PBOC Governor Zhou's afore-mentioned March 2009 call for a new supra-national reserve currency based on IMF Special Drawing Rights (SDRs).[69] To carry out this proposal, Zhou advocated the introduction of SDR-denominated securities. This backroom

66 Wendy Dobson and Paul Masson, 'Will the Renminbi Become a World Currency?', pp. 124–5.

67 Lee Branstetter and Nicholas Lardy, 'China's Embrace of Globalization', in Loren Brandt and Thomas Rawski, eds., *China's Great Economic Transformation* (Cambridge: Cambridge University Press, 2008), pp. 665–8; Wayne Morrison and Marc Labonte, 'China's Currency: An Analysis of the Economic Issues', *CRS Report for Congress*, December 7, 2009, http://www.fas.org/sgp/crs/row/RS21625.pdf, accessed on 18 May, 2010, pp. 1–2.

68 Wayne Morrison and Marc Labonte, 'China's Currency', p. 1; Geoff Dyer, 'China's Currency Plans Remain Unclear', *Financial Times*, June 25, 2010; William R. Cline, 'Renminbi Undervaluation, China's Surplus, and the US Trade Deficit', *Peterson Institute for International Economics Policy Brief*, No. PB10-20 (2010). Treatments of external pressure appear in Sarah O'Connor, 'US Hardens Stance on Renminbi Rigidity', *Financial Times*, October 16, 2009; Chris Giles and Alan Beattie, 'China Reprimanded by G20 Leaders', *Financial Times*, March 30, 2010; Geoff Dyer, 'Brazil and India Add to China Pressure', *Financial Times*, April 21, 2010.

69 Brendan Kelly, 'China's Challenge to the International Monetary System', p. 1; Wayne Morrison and Marc Labonte, 'China's Currency', p. 10. SDRs were created in 1969 and have a value relative to a basket of currencies currently comprised of the US Dollar, Euro, Yen, and Pound. The IMF examines the basket every five years to ensure that it reflects the relative importance of currencies in the world's trading and financial systems. The relative weighting of the currencies inside the basket ties to the value of exports and reserves 'denominated in the respective currencies which are held by other members of the IMF'. There is no statutory restriction on the currencies that may be part of the basket. Brendan Kelly, 'China's Challenge to the International Monetary System', p. 4.

diplomatic manoeuvring has not been made public, but it appears that China attempted to work with Brazil, Russia and India to ensure there would be buyers of such securities. Moreover, China emphasized that any contribution it made to IMF resources would be in the form of buying an SDR bond.[70] In September 2009, PBOC representatives duly signed an agreement to buy a 32 billion SDR IMF bond.[71] Aside from pushing SDR-denominated debt, Zhou also called for expanded use of the SDR as a settlement currency.[72]

These steps include authorizing, in growing numbers over time, Chinese cities (the first wave in Guangdong province) and firms to settle trade in RMB, initially with Hong Kong and members of the Association of Southeast Asian Nations (ASEAN), and later with all countries.[73] In May 2009, Chinese and Brazilian policymakers announced plans for the two countries to use their respective currencies for trade settlement. Specifically, China would pay Brazilian exporters in RMB and Brazil would pay Chinese exporters in real.[74] And in July 2009 Beijing and Moscow reached an agreement to expand use of the rouble and RMB in bilateral trade.[75] Later agreements were concluded between China and Laos and China and Vietnam.[76]

Aside from promoting the RMB's role as a settlement currency China has, since December 2008, signed six currency swap agreements worth a total of 650 billion yuan ($95 billion) with Indonesia, South Korea, Hong Kong, Malaysia, Belarus, and Argentina. Prior to this—more specifically by the end of 2008—China had concluded $230 billion currency swap arrangements with diverse ASEAN member states. In principle, such agreements have the function of bolstering the role of the RMB as a reserve currency. According to Chinese sources, however, the purpose of agreements with Southeast Asian countries is to facilitate the regionalization, rather than internationalization, of the RMB.[77]

70 'China Ready to Contribute to IMF', *BBC News*, March 29, 2009, http://news.bbc.co.uk/go/pr/fr/-/2/hi/business/7967706.stm, accessed on March 29, 2009.

71 'China Agrees to Buy 50-billion-dollar IMF Bonds', September 3, 2009, http://english.peopledaily.com.cn/90001/90776/90883/6746736.html, accessed on September 3, 2009.

72 Brendan Kelly, 'China's Challenge to the International Monetary System', p. 5.

73 *Ibid*., p. 2; Ren Jie, 'All Nations Allowed for RMB Use in Cross-Border Trade', *China Daily*, March 1, 2010, http://www.chinadaily.com.cn/bizchina/2010-03/01/content_9520391.htm, accessed on March 1, 2010; 'China Expands Pilot Program of Yuan Settlement', June 22, 2010, http://www.chinadaily.com.cn/imqq/bizchina/2010-06/22/content_10004819.htm, accessed on June 23, 2010.

74 Brendan Kelly, 'China's Challenge to the International Monetary System', pp. 2–3; Russell Hsiao, 'Yuan Gaining Currency beyond China', *Asia Times Online*, October 29, 2009, http://www.atimes.com/atimes/China_Business/KJ29Cb01.html, accessed on November 5, 2009.

75 Brendan Kelly, 'China's Challenge to the International Monetary System', p. 9.

76 Russell Hsiao, 'Yuan Gaining Currency beyond China'.

77 Francesco Sisci, 'The Yuan Lies In Waiting', *Asia Times Online*, 18 June, 2009, http://www.atimes.com/atimes/China_Business/KF18Cb04.html, accessed on November 5, 2009; Russell Hsiao, 'Yuan Gaining Currency beyond China'.

Another step Beijing has taken to promote China's currency as an international one is to facilitate borrowings/financial dealings in RMB. To illustrate, Beijing has given approval to two foreign banks, the Bank of East Asia and HSBC, to sell RMB denominated bonds in Hong Kong, having earlier allowed the mainland-based BoC to sell yuan-denominated bonds in Hong Kong. Earlier still, Hong Kong banks had already started accepting RMB deposits.[78] Noteworthy also is that, since 2005, China has allowed the Asian Development Bank and the International Finance Corporation to borrow in China RMB-denominated 'Panda bonds'.[79] On a related note, Chinese decision makers have created space to expand the country's capital markets by allowing for a significant growth in markets for local government securities and foreign purchases of interbank bonds.[80]

Currency Policy as a Tool of Grand Strategy and Limits on its Use

I next examine how China's currency policy serves its grand strategy, and highlight in tandem the constraints on China's ability to employ this policy as a grand strategy tool. I go on to discuss how China employs its currency policy to support economic modernization, and to elaborate on how the policy contributes to China's independence. Lastly, I consider how Beijing's currency policy fits into initiatives to bolster China's prestige and regional/global status. As I have already addressed Beijing's possible dumping of assets (e.g. currency or government debt) on the market to punish or gain leverage over others, I do not raise the matter again in this section.

Facilitation of exports is the most obvious benefit that Beijing's RMB policy brings to China's economic growth/modernization. The sustainability of the current policy, however, is questionable for both economic and political reasons. From the economics angle, Beijing's contemporary currency policy fuels inflation and asset bubbles, over-concentrates PBOC reserves, and limits the ability of the PBOC to use monetary policy as a tool of macroeconomic management.[81] As earlier mentioned, POBC's huge accumulation of dollar reserves makes it vulnerable to changes in dollar value, which undermines China's independence.[82] Meanwhile, the securities it issues to mop up

78 Brendan Kelly, 'China's Challenge to the International Monetary System', p. 3. Recently, Hopewell Highway Infrastructure, a Hong Kong-based toll road company sold RMB denominated bonds. Robert Cookson, 'Renminbi Bond Deals Begin to Flourish', *Financial Times*, July 5, 2010.

79 Wendy Dobson and Paul Masson, 'Will the Renminbi Become a World Currency?', p. 129.

80 Brendan Kelly, 'China's Challenge to the International Monetary System', p. 13; Jamil Anderlini, 'Beijing Looks to Broaden Renminbi Use', *Financial Times*, August 17, 2010.

81 Wendy Dobson and Paul Masson, 'Will the Renminbi Become a World Currency?', p. 130; Wayne Morrison and Marc Labonte, 'China's Currency', p. 5; Huang Yiping, 'Yuan Focus Must Shift from Dollar', *China Daily*, August 10, 2010, http://www.chinadaily.com.cn/opinion/2010-08/10/content_11126162.htm, accessed on August 10, 2010.

82 Wayne Morrison and Marc Labonte, 'China's Currency', p. 9.

excess funds injected into the economy to buy dollars generate interest outlays that exceed returns on the securities in which the PBOC invests its dollars. As for the political angle, other countries have become more vocal in their complaints about China's RMB valuation, and are threatening action.[83] Beijing is nonetheless consumed by the need to deliver economic growth and create jobs.[84]

With regards to economic growth, giving the RMB an international role would reduce both the exchange rate risk and transaction costs that trade in currencies other than the RMB imposes on Chinese entities.[85] But in spite of China's huge role in resource markets, making the RMB a settlement currency is no small task for several reasons. First, other parties would be cautious about accumulating RMB, given its non-convertibility.[86] Second, promoting the RMB as a settlement currency would require greater RMB liquidity, RMB holdings outside China, and an easing-off of RMB use in non-trade activities. To achieve these objectives, Beijing needs to expand *inter alia* opportunities for Chinese actors to send RMB outside China, and also the depth and breadth of RMB-denominated financial and commodity instruments. This, in turn, requires Beijing to undertake major legal, accounting, and regulatory reforms, and to recapitalize the banking system. Beijing is reticent on that score, partly because major reforms would dilute the political and economic leverage which control over the financial system affords.[87]

With respect to valuation, the below-market pegging of the RMB actually augments the independence of others, especially the United States. This is so because China's massive accumulation of foreign obligations expands their capacity for spending on domestic initiatives and foreign adventures which, were China not such a willing buyer of their debt, might not otherwise exist.[88] Furthermore, undervaluation of the RMB constrains the ability of

83 See footnote 68 above.

84 Wendy Dobson and Paul Masson, 'Will the Renminbi Become a World Currency?', pp. 130–1; Wayne Morrison and Marc Labonte, 'China's Currency', pp. 4, 8; Huang Yiping, 'Yuan Focus Must Shift from Dollar'.

85 Brendan Kelly, 'China's Challenge to the International Monetary System', pp. 6–7.

86 According to one report, by the end of June 2010, there was only 20bn of RMB-denominated trade versus 9400bn RMB of China's total trade. Jamil Anderlini, 'Beijing Looks to Broaden Renminbi Use'.

87 Wendy Dobson and Paul Masson, 'Will the Renminbi Become a World Currency?', pp. 128–30, 133–4; Brendan Kelly, 'China's Challenge to the International Monetary System', pp. 2, 7, 8–9, 15; Deutsche Bank Research, 'Yuan as a Reserve Currency', pp. 2–3. And even if all these changes are made, these studies make clear the RMB still would have to contend with the appeal, availability, and widespread use of the dollar and breadth and depth of dollar-denominated financial and commodities markets. For a more pessimistic analysis about the future of the dollar that highlights its waning political and economic supports, see Jonathan Kirshner, 'Dollar Primacy and American Power', pp. 418–38.

88 Wayne Morrison and Marc Labonte, 'China's Currency', p. 10. For a sense of the economic and political adjustment costs that the United States might face if its currency lost status as a reserve currency as well as the increased freedom China might gain, see Jonathan Kirshner, 'Dollar Primacy and American Power', pp. 422–5; Deutsche Bank Research, 'Yuan as a Reserve Currency', pp. 5–6.

Chinese entities to acquire overseas assets, while at the same time bolstering foreign abilities to invest in China. As to the status of the RMB, it is clear that Chinese elites see the elevation of the RMB as a way of enhancing China's independence. Specifically, a greater RMB role in the pricing and invoicing of commodities would minimize China's vulnerability to commodity price volatility and related supply disruptions.[89] Beyond this, a greater international role for the RMB would facilitate Chinese asset acquisitions and lending/aid, since an international currency, by definition, has wider appeal.

I next consider how Beijing's currency policy fits into its efforts to bolster the country's prestige and regional/global roles. Over the past two years or so, China has frequently cast doubt on the US dollar. To illustrate, Chinese Premier Wen Jiabao said at the March 2010 Chinese National People's Congress meetings, 'We are very concerned about the lack of stability in the US dollar. I was worried last year . . . I am still worried this year.'[90] Indeed, the US government has faced calls to guarantee the safety of Chinese holdings of US government debt, and to assuage Chinese worries that it might try to inflate its way out of its debts.[91] Ironically, in raising doubts about the dollar, China makes sustaining its RMB undervaluation more difficult. China stands to gain the most soft power from the currency swap arrangements it has signed with the various countries that are loath to tap institutions such as the IMF. RMB swap arrangements, however, can only go so far, because swapping with China provides counterparties with a 'reserve' currency which, due to its non-convertibility, cannot really function as one.[92]

China's championing of the SDR as a reserve currency and the RMB as a reserve currency/component of the SDR implies that Beijing is looking to bolster the stature of the RMB, hence China's image/soft power.[93] But many of the impediments to making the RMB a settlement/invoicing currency also hinder Beijing's ability to make the RMB a reserve currency. To reiterate, Beijing needs to expand the ability of RMB holders to use, invest, and hedge

89 Brendan Kelly, 'China's Challenge to the International Monetary System', p. 8. On the other hand, the internationalization of the RMB would make it more difficult for the PBOC to control inflation, to adjust the RMB value in the service of promoting exports, and to remain independent of foreign preferences. Wendy Dobson and Paul Masson, 'Will the Renminbi Become a World Currency?', pp. 125, 134.

90 Geoff Dyer, 'China Hits at Currency 'Protectionism''; George Parker et al., 'China Attacks Dollar's Dominance', *Financial Times*, July 9, 2009.

91 Kathrin Hille, 'Geithner Confident of China's Support', *Financial Times*, June 3, 2009; 'China to Voice Concerns about Asset Safety at Strategic-Economic Dialogue with U.S.: Official', July 22, 2009, http://english.peopledaily.com.cn/90001/90776/90883/6707430.html, accessed on July 23, 2009; 'Premier: US Needs to Keep Deficit at Appropriate Level', November 9, 2009, http://english.peopledaily.com.cn/90001/90776/90883/6807097.html, accessed on November 9, 2009.

92 Brendan Kelly, 'China's Challenge to the International Monetary System', pp. 2–3.

93 David Pilling, 'China is Just Sabre-Rattling over the Dollar', *Financial Times*, April 1, 2009.

the RMB. But, as explained, the policies, markets, and investment options necessary for this have not been created. Moreover, the RMB does not meet certain necessary criteria required of it as component of the basket of currencies used to value SDRs.[94] Aside from these considerations, the popularity of the dollar makes the greenback difficult to displace. Even Chinese bankers find themselves forced to rely on the dollar despite talk of diversification.[95]

We must also take political variables into account when assessing Beijing's ability to use currency policy to enhance China's image/soft power. Some contend that China's status as a one-party state, preference for opaqueness, and hostility to the free market would limit the willingness of others to accept the RMB as a reserve currency.[96] On a related note, countries like Japan are suspicious of China's newfound monetary muscle, and hence less likely or unlikely to embrace the RMB as a reserve currency.[97] One investment bank report puts this in the stark terms: 'states do not typically . . . accumulate claims on countries that are, or may be, their geopolitical competitors—if they can help it, that is, or if there is any credible alternative'.[98]

The foregoing review of China's currency policy demonstrates that the country is employing this policy in service of its grand strategy. The conclusions stemming from it, however, are less clear cut. One is that employing the RMB to serve certain elements of its grand strategy undermines Beijing's ability to employ the RMB in the service of others. Hence, it is not always obvious which grand strategy elements take the highest priority. For instance, undervaluing the RMB promotes growth, but restricts China's independence. Promoting the RMB as an international currency would bolster China's status/prestige, but limit the ability of Chinese policymakers to pursue economic growth through traditional means (e.g. promoting exports and manipulation of the country's financial system).[99] In any event,

94 For discussion, see Brendan Kelly, 'China's Challenge to the International Monetary System', p. 4.

95 On Chinese reserve diversification, see Jamil Anderlini, Song Jung-a, and Lindsay Whipp, 'South Korean Treasuries Sought by China', *Financial Times*, August 18, 2010; 'China to Trim US Treasury Holdings, Diversify Forex Reserves', August 20, 2009, http://english.peopledaily.com.cn/90001/90780/91421/6734461.html, accessed on August 20, 2009; Michiyo Nakamoto and Geoff Dyer, 'Japan Alarm over China's JGB Purchases'. For evidence of China's continued plunge into dollar assets, see 'China Still the Largest Holder of US Treasury Securities', *China Daily*, February 28, 2010, http://www.chinadaily.com.cn/china/2010-02/28/content_9514425.htm, accessed on February 28, 2010. For various reasons, the euro is not an obvious alternative, see Keith Bradsher, 'European Debt Woes Complicate China's Money Moves', *New York Times*, April 29, 2010, http://www.nytimes.com/2010/04/30/business/30yuan.html, accessed on April 29, 2010.

96 Wendy Dobson and Paul Masson, 'Will the Renminbi Become a World Currency?', p. 134.

97 Michiyo Nakamoto and Geoff Dyer, 'Japan Alarm over China's JGB Purchases'.

98 Deutsche Bank Research, 'Yuan as a Reserve Currency', p. 3.

99 For a discussion of some of these crosscurrents, albeit focused on the economic, see also Deutsche Bank, 'Yuan Reserve Currency', pp. 4–5.

although vocal on this matter, Beijing has not been aggressive in promoting a greater international role for the RMB. Most crucially for our purposes, there are numerous economic and political constraints, domestic and foreign, on the ability of Chinese policymakers to use the RMB to achieve its grand strategy objectives.

Economic Implications of China's CIC and Currency Policy

The economic effects of China's SWF and currency policy merit discussion, given that they are part of the discourse on the ramifications of China's surging financial firepower. Certain analysts agonize over the impact of CIC activities and China's currency policy on market stability; some go as far as to forecast a potential collapse of the dollar.[100] Commentators on the CIC specifically express concerns about the impact of the CIC on natural resource prices. Those that focus on the RMB tend to concentrate on the fall-out of China's RMB policy on its trade partners without giving due attention to the adverse, far-ranging impact of RMB policy on China. Some researchers hint at certain downsides of the RMB becoming an international currency.[101] Others still highlight the danger to the global neoliberal economic system emanating from the CIC and state-orchestrated RMB valuation.

With regards to market stability, pessimists have pinpointed certain incidents which allegedly highlight the danger that the CIC potentially poses to market stability. For instance, they cite the major jumps in the Hong Kong and Tokyo markets in 2009 concurrent with rumours of large-scale CIC investments.[102] But this problem is hardly unique to China's SWF, given the leverage employed by many investing entities or the star power of certain hedge fund managers. Moreover, greater CIC transparency will help to mitigate this kind of risk. As for the volatility that could result from China massively selling US government securities, this possibility has already been dismissed. Contrary to the pessimist view, the CIC actually constitutes a source of stability through its ability to provide capital to troubled firms, as illustrated by its injection of billions into teetering financial firms during the 2007–2008 financial crisis.[103]

100 Zhang Ming and He Fan, 'China's Sovereign Wealth Fund', p. 7; Andy Xie, 'If China Loses Faith the Dollar Will Collapse', *Financial Times*, May 4, 2009.

101 For instance, countries issuing currencies that fall in popularity relative to the RMB would find fewer opportunities to earn seigniorage, to finance their debts as cheaply, and so on. Wendy Dobson and Paul Masson, 'Will the Renminbi Become a World Currency?', p. 125; Deutsche Bank Research, 'Yuan as a Reserve Currency', p. 4.

102 Michael Martin, 'China's Sovereign Wealth Fund'.

103 *Ibid*; Eric Altbach and Michael Cognato, 'Understanding China's New Sovereign Wealth Fund', p. 33; Friedrich Wu and Arifin Seah, 'Would China's Sovereign Wealth Fund Be a Menace to the USA?', p. 34.

Other commentators have fretted about the impact of China's SWF on international natural resource prices.[104] But this is a worry not solely confined to the CIC. In any event, the CIC has incentives to minimize rather than exacerbate price rises, taking into account Beijing's desire to boost supplies of reasonably priced, reliable supplies. And over the medium- to long-term, CIC investments may actually boost resource supplies which, in turn, can reduce/moderate prices. Assuming the RMB is kept stable, China's efforts to enhance the international status of the RMB might effectively reduce the price volatility of natural resource prices, given the volatility of international commodity prices in recent years which reflect fluctuations in the US dollar—the currency unit in which most other currencies are denominated.

Many representatives of national legislatures, labour unions, and certain manufacturing firms argue that China's currency policies are causing unemployment, de-industrialization, and high trade deficits.[105] These problems, however, are often overstated, and the link between them and China's currency policy exaggerated. Moreover, China's currency policy benefits others by providing cheaper goods and inputs, and creating a willing buyer of debt (which lowers interest rates). In the case of China, there are those at home that gain jobs and export markets from the government's RMB policies. On the other hand, China's currency policy compels Chinese consumers and firms to pay more for foreign goods. It also encourages overemphasis on exporting and a low level of value-added activities. Finally, China's currency policy makes it relatively more costly for Chinese to invest abroad but relatively cheaper for foreign firms to invest in China.[106]

Worries that the CIC and Beijing's currency tactics will undermine the global liberal economic system are debatable. Indeed, the need for CIC capital during the eurozone's latest crisis is one factor that encouraged European governments to become more transparent; specifically, by publishing the results of their banking stress tests.[107] Furthermore, the activities of the CIC and the internationalization of China's currency must be (and are being) conducted within the parameters of the contemporary international economic order.

Conclusion

China's SWF and RMB policies are 'in the news'. So far, the emphasis has been on their economic rather than political facets. Yet the political

104 Friedrich Wu and Arifin Seah, 'Would China's Sovereign Wealth Fund Be a Menace to the USA?', p. 34.
105 Wayne Morrison and Marc Labonte, 'China's Currency', pp. 3, 5–6.
106 *Ibid*., pp. 5–7; Huang Yiping, 'Yuan Focus Must Shift from Dollar'.
107 Gillian Tett, 'Asian Players are a Worry for Eurozone', *Financial Times*, July 14, 2010.

dimensions require analysis in light of the fact, as shown herein, that China's SWF and currency policies are being used to support grand strategy objectives such as *inter alia* economic growth (and hence regime preservation), national independence, and greater Chinese status/prestige. Commentary attuned to the political facets of China's money muscle tends to be alarmist. Yet for the most part, Beijing is making modest use of its money power to serve the aforementioned ends. Furthermore, the political impact of China's SWF and RMB policies has been exaggerated.[108] In addition, as shown throughout this essay, there are numerous economic and political obstacles hindering China's full use of the CIC and RMB as grand strategy devices, not least the fact that there are inconsistencies in the goals Beijing seeks to realize.[109] There might be a 'Red Dawn', but it will be some time before the (monetary) sun permanently rises in the East.[110]

With respect to theory, this study shows that to develop a richer understanding of China's grand strategy and the tools that China uses to carry it out, we must pay attention to the economics tools of statecraft. The examination of China's CIC and RMB policies also demonstrates that we must pay attention to domestic and international variables and to political and economic ones as well to appreciate both the factors that drive China's use of economic mechanisms to achieve its grand strategy and the constraints on Beijing's ability to exploit these mechanisms. As to policy insights, this analysis shows that decision makers should remain calm about China's SWF and Beijing's efforts to internationalize the currency. Since China's SWF and RMB policies bring benefits, policymakers should work to channel Beijing's policies in the right direction, rather than adopt an outright rejectionist attitude.

As with most studies, there are certain limitations to this analysis. In the first place, the situation can obviously change as China's economic power grows, and as domestic coalitions and their interests evolve. Second, it does not specify the elites that shape the economic dimensions of China's grand strategy or the politics of their interactions. Third, this analysis does not supply a framework through which to understand how Chinese elites reconcile the competing grand strategy goals—i.e. the desire for greater prestige through internationalization of the RMB versus the desire to maintain control of the domestic financial system. To address comprehensively herein the second and third issues, however, would take

108 Eric Altbach and Michael Cognato, 'Understanding China's New Sovereign Wealth Fund', pp. 10, 30.

109 In terms of economic constraints, some speculate it will take 15–20 years alone for the RMB to become a reserve currency and decades longer for it to displace the dollar; i.e. assuming China undertakes the necessary reforms. Wendy Dobson and Paul Masson, 'Will the Renminbi Become A World Currency?', p. 134; Deutsche Bank Research, 'Yuan as a Reserve Currency', pp. 6–7.

110 The use of the term 'Red Dawn' here was inspired by Geoff Dyer's 'Consequences of Stronger Renminbi Dawn on US', *Financial Times*, February 23, 2010.

this study in a substantively different direction. Fourth, this article does not analyze how foreign actors, most significantly the United States, will react to the economic elements of China's grand strategy, which, in turn, could have feedback effects on Beijing.[111] Fifth, it focuses on only two, albeit highly important, economic elements of China's grand strategy.[112]

Each of these lacunas suggests additional areas for study. Moreover, analysts might want to consider the interaction between the economic and the military elements of China's grand strategy. On the one hand, they could mutually reinforce one another—to illustrate, a stronger navy and a richer CIC would facilitate China's efforts to secure national resource supplies. On the other, they could mutually undermine one another. An undervalued RMB and massive foreign currency accumulation could limit China's independence; a stronger military could enhance it. Another potential avenue for study would be research into the domestic special interest groups—e.g. think tanks, exporters, and importers—involved in China's policymaking with respect to the CIC and the RMB.[113]

The alarm about China's newfound cash clout is ironic in view of the international community's longstanding wish for China's deeper global economic integration. CIC investments and the internationalization of the RMB link China with others and give it a stake in the health and proper functioning of markets. Furthermore, CIC activities and the internationalization of the RMB will drive reforms in China. In the former case, they could stem from learning, increased transparency, and the hiring of foreign staff; in the latter from domestic reforms necessary to support the RMB's internationalization. Economically speaking, Chinese money can provide capital, stabilize markets and firms, and encourage reforms.[114] All that glitters may not be gold, but a balanced analysis requires acknowledgement that China's money endowments bring positives, that Beijing is not hell-bent on using its SWF and RMB to achieve its grand strategy, and that there are numerous factors—e.g. internal consistency and external political constraints—that hinder China's ability fully to exploit its economic levers.

111 Daniel Drezner posits that 'aggressive Chinese soft balancing against the US would encourage greater soft balancing against China'. Daniel Drezner, 'Will Currency Follow the Flag?', *International Relations of the Asia-Pacific*, Vol. 10, No. 3 (2010), p. 404.

112 The point being that China has other economic tools it can use to advance its grand strategy. For instance, SAFE used its purchase of major batches of Costa Rican government debt in 2008 and 2009 to encourage the Costa Rican government to sever diplomatic ties with Taiwan. Jamil Anderlini, 'Beijing's Shadowy Pool for Buying up Best Assets', *Financial Times*, September 12, 2008.

113 See footnote 18 above for some relevant examples.

114 Eric Altbach and Michael Cognato, 'Understanding China's New Sovereign Wealth Fund', pp. 33–5; Gillian Tett, 'Asian Players are a Worry for Eurozone', *Financial Times*, July 14, 2010; Ken Miller, 'Coping with China's Financial Power'.