

CHINA'S GLOBAL DISRUPTION

Myths and
Reality

Chi Lo



China's Global Disruption

This page intentionally left blank

China's Global Disruption: Myths and Reality

BY

CHI LO

Senior Economist and Independent Scholar, Hong Kong



United Kingdom – North America – Japan – India – Malaysia – China

Emerald Publishing Limited
Howard House, Wagon Lane, Bingley BD16 1WA, UK

First edition 2021

Copyright © 2021 Emerald Publishing Limited

Reprints and permissions service

Contact: permissions@emeraldinsight.com

No part of this book may be reproduced, stored in a retrieval system, transmitted in any form or by any means electronic, mechanical, photocopying, recording or otherwise without either the prior written permission of the publisher or a licence permitting restricted copying issued in the UK by The Copyright Licensing Agency and in the USA by The Copyright Clearance Center. Any opinions expressed in the chapters are those of the authors. Whilst Emerald makes every effort to ensure the quality and accuracy of its content, Emerald makes no representation implied or otherwise, as to the chapters' suitability and application and disclaims any warranties, express or implied, to their use.

British Library Cataloguing in Publication Data

A catalogue record for this book is available from the British Library

ISBN: 978-1-80043-795-1 (Print)

ISBN: 978-1-80043-794-4 (Online)

ISBN: 978-1-80043-796-8 (Epub)



ISOQAR
REGISTERED

Certificate Number 1985
ISO 14001

ISOQAR certified
Management System,
awarded to Emerald
for adherence to
Environmental
standard
ISO 14001:2004.



INVESTOR IN PEOPLE

To Margaret, Edwyn and Arthur

This page intentionally left blank

Table of Contents

List of Abbreviations	<i>ix</i>
Preface	<i>xi</i>
Chapter 1 China's Global Disruption: From Digital Currency to COVID-19	<i>1</i>
Chapter 2 The Chinese Emperor Shock	<i>23</i>
Chapter 3 The China–US Tech Race	<i>39</i>
Chapter 4 The Sum of All Fears	<i>53</i>
Chapter 5 China's Role in the Global Market Cycle	<i>69</i>
Chapter 6 The Debt Time Bomb	<i>89</i>
Chapter 7 The Crooked Debate of China's Debt Risk	<i>115</i>
Chapter 8 China and the Currency War	<i>125</i>
Chapter 9 From Trade War to Global Disruption	<i>147</i>
Chapter 10 Renminbi Internationalisation	<i>165</i>
Chapter 11 The Disruptive Belt and Road Initiative	<i>181</i>
Chapter 12 Global Disruption – The New Normal	<i>197</i>
References	<i>209</i>
Index	<i>221</i>

This page intentionally left blank

List of Abbreviations

AI	Artificial Intelligence
AIIB	Asian Infrastructure and Investment Bank
BIS	Bank for International Settlements
BoP	Balance of Payments
BRI	Belt and Road Initiative
CCP	Chinese Communist Party
CFETS	China Foreign Exchange Trade System
CIPS	Cross-border Interbank Payment System
CF	Countercyclical Factor
CPI	Consumer Price Index
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
DCEP	Digital Currency Electronic Payment
EBIT	Earnings Before Interest and Tax Expenses
EM	Emerging Markets
FDI	Foreign Direct Investment
FX	Foreign Exchange
G3	Europe, Japan and the United States
GDP	Gross Domestic Product
GFC	Global Financial Crisis
ICT	Information and Communication Technology
IMF	International Monetary Fund
IP	Intellectual Property
IPR	Intellectual Property Rights
IT	Information Technology
JPY	Japanese Yen

LGD	Local Government Debt
LGFVs	Local Government Financing Vehicles
MNC	Multi-National Companies
MPA	Macro-Prudential Assessment
NBFIs	Non-Bank Financial Institutions
NEER	Nominal Effective Exchange Rate
NPL	Non-Performing Loans
OECD	Organisation for Economic Co-operation and Development
PBoC	People's Bank of China
PPI	Producer Price Index
PPP	Public-Private Partnership
P2P	Peer-to-Peer Lending
RCEP	Regional Comprehensive Economic Partnership
REER	Real Effective Exchange Rate
SDR	Special Drawing Right
SOE	State-Owned Enterprise
SPV	Special Purpose Vehicles
STEM	Science, Technology, Engineering and Mathematics
S.W.I.F.T.	Society for Worldwide Interbank Financial Telecommunication
TFP	Total Factor Productivity
UNCTAD	United Nations Conference on Trade and Development
UNPD	United Nations Population Division
WMP	Wealth Management Products
WTO	World Trade Organization
ZIRP	Zero Interest Rate Policy

Preface

The ascent of China to the global stage is going to cause disruption to the *status quo*. This is not only because China's emergence has come under the global scrutiny but also because its increasing weight will create ripples in the global system whenever it moves. As an illustration, nothing is more apt than the COVID-19 crisis that hit China first in December 2019 and then developed into a global pandemic through 2020, causing severe disruption in every aspect of human life across the world. We shall discuss this particular disruption in the beginning and concluding chapters of this book.

More generally, the 'China disruption' is a natural phenomenon as the world needs to accommodate a rising power while the existing ones try to defend their positions. So, let us face it. You can run but you cannot hide from it. Understanding China properly is imperative to enable the world to manage the upcoming disruption and transit to a state with a new global power. But, China has often been misunderstood, leading to distorted business and policy decisions.

In my view, the media has played its part in creating confusion and propagating distorted views on China without substantiation. For example, in reporting on China's COVID-19, or coronavirus, outbreak in early 2020, a major international newspaper published an opinion piece by an academic calling China 'the real sick man of Asia' and accusing its government of covering up the health crisis.¹ While a healthy dose of scepticism is appreciated and there is nothing wrong with exposing any possible wrongdoings, both the author and the publisher provided no evidence at all to support the claim, at which Beijing took serious offence.

Similarly, another international newspaper reported that

...the most fateful consequence of the official silence was that it facilitated the exodus of some five million people in the weeks before the city (of Wuhan, the epicentre of the coronavirus outbreak in China) was quarantined on January 22, thus helping to transport the virus all over the country and overseas

¹China is the real sick man of Asia, by Walter Russell Mead. *The Wall Street Journal*, February 3, 2020.

to underscore their narrative of China covering up the serious state of the virus outbreak.² This kind of reporting was hardly intellectual or impartial, as it showed that the journalists were either ignorant about China or distorted the evidence to fit their narratives.

Any informed China watcher knows that most if not all of these five million people that the report alluded to were migrant workers who always went back to their home towns during the Chinese New Year (and other major Chinese festivals) for family reunion. They left early (before the city of Wuhan was locked down) because they had to get home before the New Year, not because the city government ‘facilitated the exodus’ as the journalists assumed and promulgated as a fact. China has some 280 million migrant workers, or floating population, who travel back home from the cities where they work every Chinese New Year for family reunion. That is why many observers call this Chinese New Year travel the largest migration on earth.

So the problem with misreading China and, hence, the analysis about its global disruption has a lot to do the contamination and abuse of public information, aggravated by socio-cultural differences in doing the analysis. The latter is highlighted by the fact that what is understood by the West of China is often not the same understanding by China of the West. These problems have created an expectation gap between what the world expects China to deliver and what China can actually, and want to, deliver in terms of policy and reform actions. This gap has become a key factor in creating geo-political tensions and market volatility, and in hyping the fears about China’s global disruption.

All these distortions, suspicions and confusions have led to an irony of the world’s opinion on China’s global impact. It is worried about the global disruption that China would cause when it thrives, and it is also worried about the disruption when it collapses. Most of the time, it does not even seem to have a clue about whether China would thrive or collapse, and many China watchers and experts are often wrong about their predictions on China’s development.

Underscoring the problem of misreading China is the fact that over the decades, major speculators who bet on a China collapse sending shock waves across the globe in the form of a banking crisis, or an asset market blow-up, or a debt-currency crisis have all lost big money. It seems that these ‘intelligent’ money managers have never learnt their lessons. On the other hand, optimists and alarmists think that China would take over the world with its technological advancement and economic clout in the not too distance future. This also creates fears about the emergence of a dominant China disrupting the world order.

Does the world want China swim or sink? Or is it too confused about the Middle Kingdom and does not know what to do with it? Research and media coverage on China abound, but China-bashing is a favourite and common approach to talk about China. This does not help to better understand this giant country. To put it bluntly, when a lie is told a thousand times (about China in our case here), it becomes the truth. In the public domain, guesstimates, conjectures,

²Coronavirus: The cost of China’s public health cover-up, by James Kyngé, Sun Yu and Tom Hancock. *Financial Times*, February 7, 2020.

a priori reasoning from dubious assumptions and media-generated hallucinations are reiterated so often that they are taken as facts. The demagoguery of contemporary populism, especially in America, ensures that clamour about China needs no evidence at all to fuel it! The two international media reports on China's coronavirus outbreak that I alluded to above underscore all this vividly.

To aggravate the problem of confusion and misunderstanding about China, some observers who often disguise themselves as experts would even skillfully turn some structural positive stories, such as Beijing's anti-corruption campaign and withdrawal from the distortive implicit guarantee policies, into negative horrifying stories of a systemic collapse in China.³ Some had even bet on a collapsing China based on these distorted views by short-selling Chinese assets and lost tens of millions of dollars in the end due to these bad decisions.

Past mistakes about China abound. When it joined the World Trade Organization (WTO) in 2001, for example, many observers and analysts thought that China would liberalise to become a democracy. This was because, the logic goes, Japan, Taiwan and South Korea had all moved in that direction after joining the WTO when their countries became wealthy enough to prompt their growing middle classes to demand more say in the system. Hence, China would follow the pattern.

That turned out to be wrong. China seems to be moving more towards political centralisation since President Xi Jinping took office in 2013. This has led to an emerging concern that China's economic collapse would be inevitable because it has defied for too long the widely held view that political openness was necessary for sustaining economic growth. China's exceptionalism of high growth without political openness should be ending soon, according to this logic. So, its growth rate would have to collapse to commensurate with its closed political system, creating devastating effects on the global system.

A less dramatic view is that China would get stuck in the 'middle income trap', just like many other emerging economies that do not make it to the rich income country status after decades of high growth. The worry about China's future growth has, in turn, raised a practical concern about China disrupting the world order by pursuing currency devaluation as an escape route to its potential growth disaster, thus triggering future currency wars.

China's history of surprising the world goes even earlier. Before Deng Xiaoping's economic liberalisation in 1978, most China watchers did not think that China would undertake serious economic reforms and usher in the longest period of fast economic growth in the world history. But it did. And earlier yet, it was inconceivable that a large country like China would lose the Opium War

³For example, see Chinese bank on verge of collapse after sudden bank run, by Tyler Durden. *Zero Hedge*, January 11, 2019. Retrieved from <https://www.zerohedge.com/markets/chinese-bank-verge-collapse-after-sudden-bank-run>. The Zero Hedge website was permanently banned by Twitter for violating rules against harassment and abuse in early 2020, as reported by *Bloomberg News*, 'Zero Hedge Permanently Suspended from Twitter for "Harassment"', by Siraj Dattoo, February 1, 2020.

(Yu, 2018) so decisively to a relative small British naval fleet and ended up having to cede Hong Kong. And it did.

Amid all the China-bashing and negativity on one hand and hype and optimism on the other hand about the Middle Kingdom, is the world going to get China wrong again? This time around, may be the Middle Kingdom is not doomed to live under the Communist Party's ruling; may be its growth is not collapsing; may be its demographic problem is not biting so soon as many observers have expected; may be its banks are not crumbling; may be its debt bomb is not going to explode; may be its technological advancement is not as threatening as commonly perceived; may be Chinese President Xi Jinping is not just grabbing power as seen by the West; may be China is not going to trigger another currency war... The list can go on.

What complicates the analysis on China and what kind of disruption it will cause to the world is the emergence of neo-conservatism, led by the United States (Elghossain, 2019), towards the rise of China in the global stage. This attitude has manifested itself in strategic competition between the two nations, creating biased views on each other by each other and by the public that interfere with rational analysis.

Ideally, the developed world in the West, led by the United States, should take steps to engage China with mutual understanding, especially on global issues and shocks like the COVID-19 pandemic and environment and climate changes. Practically, the United States would have to accept China as a country with a different political and economic model, in which the state leads the way in pursuing some economic and social objectives. China, on the other hand, should accept those Western practices that could help it progress and integrate into the world system. If both sides can accept and accommodate each other's differences, they can co-exist with peace and stability.

However, all these co-operation and co-existence will not be possible without proper understanding of China's policies, intentions, changes, risks and actions. Blindly insisting on China to accept the Western value of democracy and socio-economic systems will not work. China will not bow to any foreign demand to transform its development model by weakening state-owned enterprises substantially or withdrawing the role of the state in directing strategic economic sectors. Escalating tensions with China could push the world powers, led by the United States, into the Thucydides Trap of disastrous war (Allison, 2017).

Furthermore, most Western players tend to misread the internal and external pressures on China since President Xi took office by thinking that these pressures had weakened his governance. Arguably, this misreading has emboldened the West to force China to change and accept the Western values. But, there is a distinct difference between how political development like the Hong Kong protests (which started in June 2019 and turned into riots that are still ongoing at the time of writing) and the Taiwanese presidential election in 2020 are seen inside and outside China.

In China, these chaotic incidents did not raise feelings of admiration or envy, let alone inspiring people to challenge Beijing's authority that the West thought they would. Instead, they reaffirmed the belief of most ordinary Chinese in the

importance of stability for delivering continued social and economic progress and prosperity. This belief has actually helped Chinese President Xi Jinping and the Communist Party to leverage on the Hong Kong and Taiwan issues to rally nationalism to solidify their power as opposed to weaken the Chinese leadership and eventually lead to the demise of the Communist regime.

Even the COVID-19 health crisis was not able to shake the Chinese leadership power as the United States had hoped when US President Donald Trump capitalised on growing public distrust of China that was fanned before the outbreak by waging a major anti-China campaign in May 2020. Leveraging on the xenophobic anti-Chinese discourse in some western countries, the Chinese government turned its political campaign to combat COVID-19 into a moral crusade involving the whole country. As a result, Mr Trump's strategy of 'demonising' China (Froomkin, 2020) backfired by fanning nationalism in China, which Beijing had skillfully exploited to further gain support from both the local and overseas Chinese in an alleged united front to fight the virus. Arguably, both Washington and Beijing had used the health crisis as a tool to engage in a new Cold War, which we shall discuss in a subsequent chapter in this book.

Sino-US tensions are going to remain as part of every country's life in the future, regardless of the US presidency or party. This will be a major global disruption. The trade war that President Trump waged against China in 2018 will not go away as it is a manifestation of the secular Sino-US strategic competition on technology, linking national security of the two countries in the fight. China used to admire the United States for its dynamism, creativity, innovative capacity, cultural influence and economic breath and opportunity. It still does and still recognises the United States as a great power, but the level admiration has gone down sharply since the US subprime crisis in 2008 which exposed significant fractures in the Western capitalist/democratic system. Western, especially American, provocations in recent years have only fuelled nationalism in China – this is the inside view from China, which runs against the view from the West.

So it is imperative to gain better understanding about China in order to manage the inevitable global disruption that it will bring. This book tries to serve this prime purpose by engaging in rigorous research-driven discussions with data and evidence, but not anecdotes, narratives and opinions out of thin air, as the backbone for the debates and arguments. It takes a critical approach to explore many of the may-be scenarios mentioned above by examining the changing structure of the Chinese economy and by questioning many conventional wisdoms about China. It combines the political and economic aspects of China and the world to articulate the hidden, and often misunderstood, themes and trends in China to gain better understanding of its impact on the world system.

The book starts with examining the world's two major concerns about China's global disruption – China's launching of an official digital currency in late 2019 and the COVID-19 crisis that hit China in late 2019 to early 2020 and developed into a global outbreak with significant global ramifications. The geo-political impact of the COVID-19 crisis leading to long-term global disruption will be explored in the first chapter and discussed again in the last chapter. The other chapters will examine the structural, political and economic factors that are

unfolding in China and assess their impact on the global system. A critical and research approach is used to assess conventional wisdom and distorted views and debunk myths that underlie the confusion and fears about China's global disruption and to reveal hidden trends and implications that have been overlooked.

In the case of a thriving China that creates concerns about the rise of a bully wreaking havoc on the global system, we shall (1) discuss and question the conventional wisdom of President Xi Jinping's power-grabbing move to achieve his 'Chinese Dream', which has invited international criticism on him reversing China's governance reform and trying to export China's autocratic model to the world; (2) examine the fears about China's technological advancement taking over the world; (3) assess the concern about China's global ambitions through the renminbi internationalisation programme and the Belt and Road Initiative; and (4) examine China's role in affecting the global growth cycle.

On the concerns about the global disruption caused by a collapsing China, we shall (1) assess the Sino-US trade war and its impact on China's growth and the global system; (2) debunk the myth about China's vulnerability to financial (debt and banking) crises sending seismic shock waves to the world; (3) examine the debate on China's debt problem and the flaws in analysing China's debt risk; (4) uncover the missing analysis on China's long-term growth challenge with respect to the middle income trap and demographic problems and their relevance to the world; and (5) evaluate the risk of China using a currency war as an escape route to solve its future growth problems.

The book concludes with some final thoughts on the serious possibility of a global disruption brought upon by the Thucydides Trap and an inherent tendency of the world to self-inflict systemic disruption even without China playing any role in it. Global disruption is becoming the 'new normal' of the future, but instead of being a negative force China at times can provide examples and lessons for the global community to think about managing the disruptions due to the world's geo-political and economic evolution.

Chi Lo
July 2020

Chapter 1

China's Global Disruption: From Digital Currency to COVID-19

China's emergence in the global stage as a new influential player has raised many concerns about its disruption to the global order in social, economic, financial and political aspects. The world will have to accommodate this new rising power. But it is confused and the contaminated information used by many media and analysts is not helping to gain better understanding of China's impact on the global system.

Two events in late 2019 and early 2020 have heightened the China disruption. The first is the launching of a national digital currency by the People's Bank of China (PBoC), the central bank, in December 2019. The move makes the world nervous about a potential digital currency war between China and the United States rocking the global financial system. For China, a national digital currency could help deepen the renminbi internationalisation process and challenge the prevailing international monetary order that the US dollar dominates. The second is the COVID-19, or coronavirus, outbreak between December 2019 and early 2020 in China that ground the Chinese economy to a halt and hit global growth, even before it became a pandemic as declared by the World Health Organisation in March 2020 (BBC, 2020), by hurting global tourism and breaking the global supply chains. This health crisis certainly speaks volumes about the China disruption to the world economy.

The Rise of a Chinese Digital Currency

China has been working on creating a national digital currency since 2014, but Facebook's intention to launch a cryptocurrency, Libra,¹ in 2019, seemed to give China a push to get ahead of the competition. The PBoC launched in December 2019 a national digital currency called the Digital Currency Electronic Payment (DCEP), involving the Big Four State Banks² and Big Three Telecoms companies³ in Shenzhen and Suzhou as pilots.

¹At the time of writing, Libra is still waiting for regulatory approval.

²The Big Four Banks are the Industrial and Commercial Bank of China, China Construction Bank, Bank of China and Agricultural Bank of China.

³The Big Three Telecoms companies are China Telecom, China Mobile and China Unicom.

2 *China's Global Disruption*

In general, cryptocurrencies have raised concerns by global regulators about their potential risks in disrupting monetary policy and financial stability and controlling money laundering, terrorist financing and other illicit usages (Araya, 2018). But the PBoC's cryptocurrency is different. When it creates the DCEP, it can see everything and anything because it is the regulator and the clearing house for the digital currency's transactions so that illicit usage can be properly controlled, in principle. By jumping the gun by creating DCEP, China has inspired many developed-world central banks to accelerate their programmes to provide digital currencies for general usage and to strengthen their regulatory oversight of cryptocurrencies. This competition is not simply on reaping the seigniorage, it is also on the government's ability to regulate and tax the economy globally.

Arguably, the worry about China's DCEP disrupting the global monetary order stems from the strategic competition between China and the United States and the lack of trust between the two countries. In the short term, the rise of a Chinese digital currency is not going to undermine the US dollar dominance of global trade and finance, at least the large part that is legal, regulated and taxed. America's deep and liquid capital markets, strong institutions and the rule of law will trump Chinese efforts to achieve any financial dominance in the medium term (Smart, 2018). Crucially, the fact that despite China's rising economic clout, there is still so little acceptance of the renminbi by the international community speaks volumes about the renminbi's lack of credibility.

China will have to sort out its policy for the renminbi's convertibility first before it can push its internationalisation ambition further. It will be a long process for China to sort out its market distortions due to capital controls, lack of transparency, governance problems and restrictions on foreign ownership of Chinese assets before the renminbi could displace the US dollar as the premier global currency. But the DCEP's challenge to the US dollar dominance is real and intensifying (Lo, 2020) as it may serve as a catalyst for prompting changes in China.

However, when it comes to managing the unofficial and non-mainstream activities, especially those that China and the United States do not share any common interests, the threat of a widely used, state-backed, Chinese digital currency could indeed make a big difference to the world order. For example, in the case of a US-regulated digital currency which is traceable by US authorities, if some countries on the US sanction list were to use it to finance illicit activities, the US authorities could potentially block the transactions and catch offenders under US laws.

However, if the cryptocurrency were to come out of China, the United States would have little levers to pull. Of course, the United States and other Western regulators could ban the use of the Chinese cryptocurrency in their respective jurisdictions, but they would be powerless to stop it from being used/abused in other parts of the world where US regulations do not apply or are not followed closely. This oversight problem could even extend to underground activities in the United States and the rest of the world (Araya, 2018).

That is why global regulators have a strong incentive to rein in cryptocurrencies by prohibiting their general usage. The regulatory barriers make existing digital currencies highly illiquid and, thus, limit their circulation. If the United States and the West can work with China on regulating digital currencies, the emergence of a Chinese government-backed digital currency, like DCEP, would just be a market development under Chinese regulatory oversight. It should not be a concern for global disruption.

But not so for China and the United States (and the West) when they do not share the same interests. In the hypothetical case of a US-regulated digital currency, the United States may be able to prohibit its usage to finance North Korea's nuclear development programme, for example, but it would not be able to do so if the digital currency were to run out of China. An incentive incompatibility problem arises here as China and the United States do not share a common policy interest in dealing with North Korea and they do not trust each other when pursuing their respective policies (Albert, 2019; Calamur, 2017a).

By jumping the gun by creating DCEP, China has inspired many developed-world central banks to accelerate their programmes to provide digital currencies for general usage and to strengthen their regulatory oversight of cryptocurrencies. This competition is not simply on reaping the seigniorage, it is also on the government's ability to regulate and tax the economy globally.

From the US perspective, having a cryptocurrency is also a competition with China on boosting one's currency as the dominant global reserve currency to advance the country's foreign policy claims. Just as technology has disrupted business and finance, media and politics, a digital renminbi could disrupt America's ability to pursue its broader national interest by leveraging faith and general acceptance in the US dollar. The United States certainly wants to defend the *status quo* of a dominant global US dollar while China's crypto-renminbi is catching up fast to challenge that dominance (Lo, 2020).

Chinese President Xi Jinping's 'Chinese Dream' is intended to spread China's global influence through his Belt and Road Initiative (BRI) that covers almost 70 countries and has extended more than USD1 trillion in foreign loans since inception in 2013.⁴ The BRI is supposed to work with the renminbi internationalisation efforts on building an empire for a global renminbi (Lo, 2017). The creation of DCEP is part of this grand expansion plan to facilitate the realisation

⁴In this nationalistic framework, President Xi Jinping seeks to combine national and personal aspirations in order to 'reclaim national pride and enhance personal well-being'. In economic terms, this amounts to creating incentive compatibility between the state and the people to maximise national and individual interests, subject to political and resources constraints. President Xi is in fact driving home the point of structural rebalancing from export-led growth to consumption-led growth: In his vision, China has been manufacturing and exporting products to meet the consumption appetite of the West for more than three decades. Now China is ready to consume what it produces and to realise the materialistic aspect of the Chinese Dream.

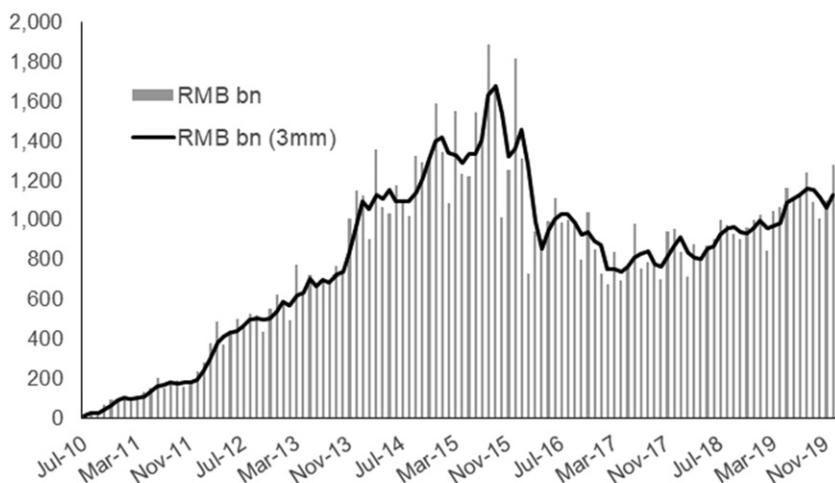
of the Chinese Dream in the long term. In other words, Beijing hopes that launching DCEP will help boost the BRI and renminbi internationalisation efforts simultaneously. But this has created a jittery about a new global power shaking up the world system.

Crypto-renminbi to Challenge the US Dollar

China's incentive to climb the global ladder is indeed strong. It overtook the United States as the world's largest goods trading country in 2013, and has since been in the top two positions as the world's largest trading nation. There is a clear disconnect between the highest proportion of the world's trade going through China and the trade's denomination in US dollar.

Back in 2009, China launched the renminbi internationalisation programme to promote its foreign trade role. In 2010, just 1.0% of China's foreign trade was denominated in renminbi. That jumped to 27.8% in 2015. The PBoC even set up China's own international payments system, the China International Payment Service (CIPS), in 2015, to facilitate cross-border renminbi settlements and as an attempt to break the dominance of the US dollar-dominated payments system. Participants in CIPS include global banks such as HSBC, JP MorganChase, Citibank, BNP Paribas and Deutsche Bank.

However, deliveries of these expansion initiatives have not been satisfactory for China. After 2015, the renminbi's share in foreign trade settlement has shrunk (Fig. 1.1). Furthermore, the bulk of the renminbi trade settlement came from Hong Kong, meaning that its usage was quite limited in other countries. On the



* Mainland China, HK, Taiwan

sources: CEIC, author

Fig. 1.1. Greater China* RMB Trade Settlement.

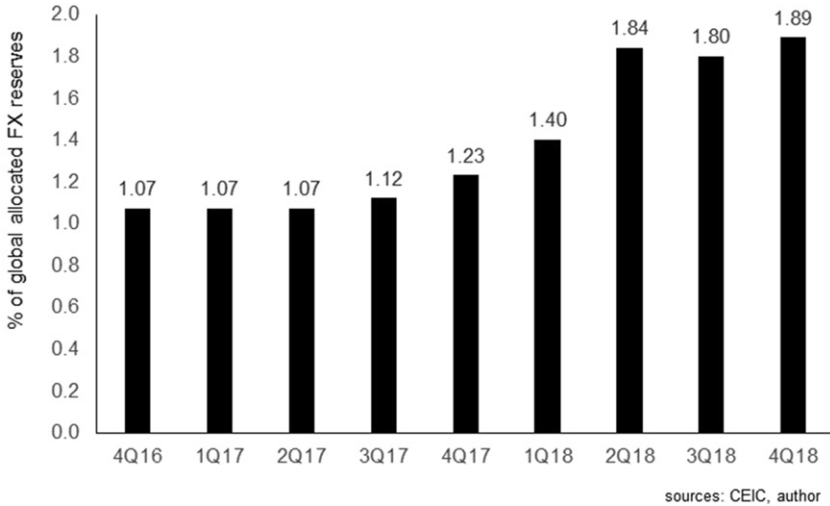


Fig. 1.2. Renminbi's Share in Global Foreign Exchange Reserves.

international payments front, compared to Society for Worldwide Interbank Financial Telecommunication (SWIFT),⁵ the US-dominated messaging system for international payments, CIPS is much smaller. It only had 900 members as of 2018, compared to SWIFT's 10,000 membership. SWIFT data also show that the renminbi's share of international payments was just 1.9% in 2019, despite 10 years of internationalisation efforts.

The International Monetary Fund (IMF) added the renminbi to its Special Drawing Right (SDR) basket, an international reserve asset, in October 2016. China regarded that move as an international recognition of its progress on financial liberalisation. SDR inclusion has also made the renminbi an official reserve currency, though a minor one, as the SDR is held by all IMF member central banks in their foreign exchange reserves. While the renminbi's share in total global reserves has moved up the ranks steadily from zero percent in 2009, it has remained tiny and stagnant under 2.0 % (Fig. 1.2).

To further push the international usage of the renminbi, China undertook numerous financial liberalisation efforts in 2017. They included expanding the Stock Connect scheme, which links the Hong Kong stock market with the Shanghai stock market, to include the Shenzhen stock market for direct trading without foreign exchange controls, reforming the renminbi-US dollar fixing mechanism to make the renminbi-US dollar exchange rate more market-driven,

⁵SWIFT provides a network that enables financial institutions worldwide to send and receive information about financial transactions in a secure, standardised and reliable environment.

establishing a Bond Connect scheme to allow direct bond trading between Hong Kong and Mainland China, just to name a few (China Daily, 2017).⁶

Meanwhile, the BRI aims at bolstering trade and investment between China and almost 70 countries. Under the Initiative, China would provide large loans to fund expansion of the foreign trade network and international infrastructure projects, such as power grids, industrial parks, railways, water works and highways. Economically, the spending of huge sums of renminbi loans and investments abroad is a way to internationalise the Chinese currency. Politically, it allows China some leverage over the recipient countries by tying their economic being to Chinese influence.

However, despite the push of renminbi financing, there was not much acceptance. Only 14% of the BRI trade and investment was denominated in renminbi in 2017 (Yicai, 2017). This creates another disconnect between China's economic prowess and the international usage of the renminbi as a funding currency. In most cases, the countries involved only used the US dollar as the funding currency even though China was funding their trade and investment projects.

Despite more than a decade of internationalisation efforts, and despite China's rising economic and financial clout, the slow BRI development and the renminbi's small international role are certainly dissatisfactory and frustrating for China's ambitions. To accelerate and deepen these internationalisation efforts, China needs to create a significant non-trade demand for the renminbi so that it will be used as an investment and a funding currency by the BRI and other countries. To create this secondary demand, China has to create the incentive for holding and trading the renminbi, and for that to happen the renminbi will have to be fungible, among other fundamental conditions that it will have to fulfil (Lo, 2017, Chapter 9).

Beijing hopes that the launching of DCEP will help boost the BRI and renminbi internationalisation efforts. By coming in as an easily accessible exchange of value with clear international ambitions, China's digital currency could boost its effort to challenge the dominance of the US dollar by fulfilling the fungibility condition (Lo, 2020). The PBoC created DCEP with the purposes of promoting renminbi internationalisation in the BRI policy environment, improving the convenience of renminbi cross-border payments, enhancing the renminbi as a tool for international trade settlement and invoicing and as a store of value.

So it is clear that DCEP was created as part of the financial infrastructure to achieve the Chinese Dream. Arguably, the erosion of the basic functions of money (as a unit of account, a medium of exchange and a store of value) of the G3 currencies (the US dollar, the euro and the Japanese yen) since the Global Financial Crisis in 2008–2009 has opened up a window of opportunity for the renminbi to rise to challenge the world monetary order (Lo, 2017, Chapter 10).

⁶Every morning, the PBoC sets a so-called daily mid-point fix for the renminbi–US dollar exchange rate, based on the renminbi's previous day closing level and quotations taken from interbank dealers. The exchange rate is allowed to trade within a narrow band of 2% above or below the day's mid-point rate (the fixing).

And Facebook's intention to launch Libra just gave China a push to jump the gun and launch its government-back digital currency, as China was afraid that Libra might threaten its internationalisation efforts (Huillet, 2019). The official Chinese cryptocurrency will keep the world on its toes in the coming years.

The COVID-19 Disruption

The other event that has rocked the world with a China disruption is the COVID-19, as the World Health Organisation officially called it, or the coronavirus outbreak between December 2019 and early 2020. Its devastating global effect spoke volumes about the impact of a China shutdown when China closed most of the country for two months to prevent the epidemic from spreading. The health crisis tragically illustrated that economic interdependence was a double-edged sword that could confer enormous benefits as well as exact colossal costs to their champions.

Champions of globalisation have long preached the benign benefits of international division of labour, which amounts to economic interdependence among nations. But such benefits can quickly turn into devastating costs when things go wrong. This is especially so in the context of asymmetric interdependence, when a big core economy such as China suffers a sudden calamity and sends shock waves to peripheral economies which have become overly reliant on the core. The COVID-19-induced disruption came in three major ways: (1) decline in tourism, (2) contraction in international trade, which was also due to (3) disruption to the global supply chains.

During the COVID-19 outbreak, Asia's tourism was hit harder than many other regions with negative implications on the region's current account positions.⁷ The impact on the global supply chains stemmed from the world's dependence on China both for its demand for and supply of intermediate goods. China's shutdown also hit countries with large direct investments and production facilities in the country and cut off the supply of intermediate goods to them. This risk was unprecedented and could have prompted a structural change in the global supply chains by prompting foreign firms to reassess their China exposure.

The far-reaching impact on the global system is still unknown at the time of writing. Time will tell how the global supply chains will evolve after this health crisis. What is certain is the global impact of a China disruption is much bigger today than it was during the SARS outbreak in 2002–2003. China now accounts for 18.7% of the global economy, 12.4% of global trade and 12.0% of

⁷In economics, a country's current account is one of the three components of its balance of payments, with the other two being the capital account and the financial account. The current account consists of the balance of merchandise trade, net factor income (earnings on foreign investments minus payments to foreign investors) and net unilateral transfers that have taken place over a given period of time.

global oil demand, compared to only 8.2%, 5.0% and 6.0%, respectively, in 2003. And the world had no idea about this global domino effect until the COVID-19 crisis hit China.

Tourism and beyond

Tourism is perhaps the most immediate propagation channel from China to the world, as Chinese tourists have driven a major tourism boom across the world, especially in Asia. But China's USD270 billion annual outbound tourism turned from a spending boon for the recipient countries to a bane during the coronavirus crisis with its tourists staying home. The negative impact on global tourism had actually gone beyond the direct impact of a reduction in tourist arrivals, as third-country tourists cancelled or postponed their trips for the fear of contagion. The spillover effect on other sectors included transportation, accommodation, food services, retail sales and financial services such as insurance and foreign exchange transactions.

During the crisis, more than 130 countries imposed travel restrictions on passengers to and from China. Asia felt most of the effects, as over 90% of Chinese tourists travelled within the region. Those economies that received the largest number of Chinese tourists were hit especially hard, including Hong Kong, Taiwan, South Korea, Vietnam and Japan (Fig. 1.3). But the ultimate economic impact depends on the share of Chinese tourist spending in the local economy (Fig. 1.4). The impact on Hong Kong was the biggest, as Chinese tourist spending accounted for 4.8% of its gross domestic product (GDP). Excluding this outlier, the GDP of Thailand, Vietnam and Singapore all suffered more than average due to the loss of

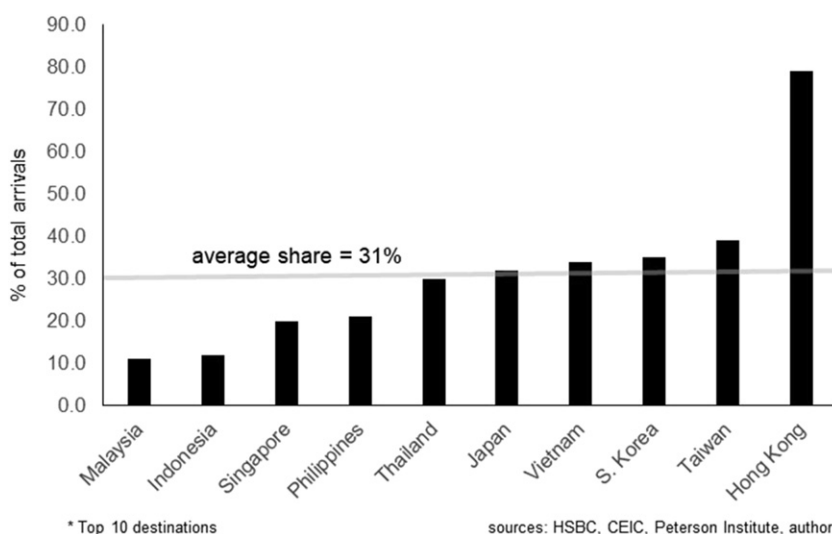


Fig. 1.3. Share of Mainland Chinese Tourist Arrivals* (2018).