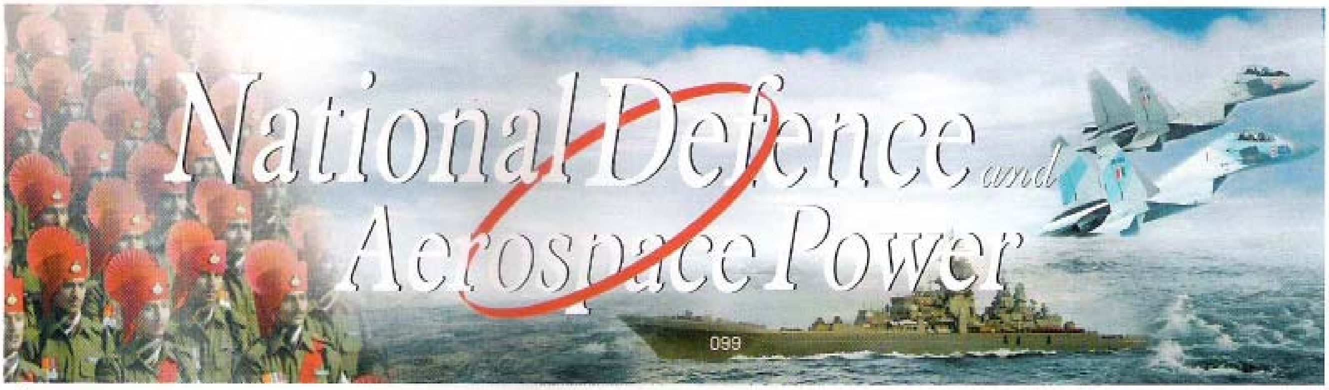

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CHINA'S YUAN PREPARING TO CHALLENGE US DOLLAR ?

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China's efforts over the past couple of years to have its currency, the RMB (Renminbi or Yuan), included in the IMF's Special Drawing Rights (SDR) slowly inched forward on March 31, 2011 at the G-20 Monetary Reform Seminar held in Nanjing. The proposal will undoubtedly be finally vetoed by the US, which needs to sell bonds worth at least a trillion dollars each year for many years to come to keep its economy afloat. In the interregnum Beijing, which has emerged as the world's largest exporter, has opted to broaden the acceptability of the RMB among its major trading partners through currency swap agreements.

A quick analysis of official Chinese media reports indicates that China's leadership has been determined, at least since the international economic crisis highlighted China's economic strengths, to explore ways of strengthening China's currency in order to optimize Beijing's international influence. Investing in countries of its interest and increasing the use of its currency are steps intended to help China move in this direction.

In this context, Chinese Vice Foreign Minister Cui Tiankai was quoted by the Beijing-owned Hongkong-based newspaper, 'Ta Kung Pao', as saying on March 5, that during his visit to Europe in November 2010, Chinese President Hu Jintao travelled to Portugal and France at a time when they were in economic difficulty and signed a US$ 20 billion industrial purchase deal. Cui Tiankai claimed this had given a setback to USA's strategic objective of 'besieging China in the Asia-Pacific region'. The newspaper added that both the European countries are focussed on using the G-20 forum as a platform to gradually break through and change governance by the US, 'which benefits itself at the expense of others, and the country's overbearing attitude as well'. Earlier in January 2011, China's Vice Premier Li Keqiang had revealed his country's intention of buying about Euros 6 billion of Spanish public debt. Other reports disclosed that China had purchased Portuguese and Greek debts amounting to Euros 6 billion as part of efforts to forge closer relations with Europe.

Ahead of the G-20 summit in April 2010, China had proposed the introduction of a new stable international reserve currency, through substantial increase of the IMF's Special Drawing Rights (SDR), for its considerable international reserve holdings which are mainly in US dollars. This year again, prior to the G-20 seminar in Nanjing, Xu Hongcai, Deputy Department Director at the 'China Centre', a major Chinese government think-tank, issued a report which candidly stated that 'nations around the world have no way of restricting dollar issuance by the Federal Reserve. The current international monetary system lacks both stability and fairness'. Xu Hongcai asserted that the world had fallen in to a 'dollar trap' and it would be prudent to reduce dollar holdings in official currency reserves. Beijing's efforts appear to have found some resonance, though they will be staunchly opposed by the US. The G-20 seminar has now agreed to study whether to include the Chinese Yuan within the basket of currencies that make up the IMF's Special Drawing Rights (SDR). French President Nicolas Sarkozy suggested on March 31, 2011, that given the importance of emerging economies such as China to global growth, their currencies should be added to the SDR basket. "Without rules and supervision, the world runs the risk of being condemned to increasingly serious and severe crises," said President Sarkozy. The US Treasury Secretary and French Finance Minister were, however, very guarded in welcoming

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the suggestion and insisted that China would first have to fulfill certain conditions. Yu Yongding, a former Chinese central bank adviser who also spoke at the conference, said applying such conditions was a contentious issue. The matter will be discussed at the G-20 Summit in November 2011 in Cannes.

China's efforts to challenge the 'global financial hegemony' of the US dollar has also been the subject of recent articles in authoritative official Chinese publications. The articles simultaneously reflect the negative mood about the US within Chinese leadership circles and their deep rooted suspicion of US intentions. Two articles are especially pertinent.

'Zhongguo Qingnian Bao', the official newspaper of China's Central Communist Youth League (CYL), which claims a membership of nearly 75 million and counts a number of former members among China's current top leadership echelons, recently published a lengthy article by Qiao Liang. The 7,009-word article published on March 8, 2011, focusses entirely on the financial aspect of US' global domination. It appeared to buttress the arguments advanced in another signed article, published earlier on December 10, 2010 in the authoritative Chinese Communist Party (CCP) theoretical magazine '*Qiu Shi*' (Seeking Truth), but sounded a strong note of caution. The lengthy *Qiu Shi* article had recommended counter-measures, in the economic and strategic spheres, to neutralize US efforts to dominate China and prevent it from realizing its aspirations. Recent initiatives and statements by senior Chinese leaders now suggest that the views expressed in the '*Qiu Shi*' article probably reflect the prevailing trend of opinion among China's leaders.

This *Qiu Shi* article discussed, inter alia the manner in which China should deal with the issue of its huge US Treasury Bill holdings . Arguing that the US itself loses nothing by increasing the number of dollars in circulation, it said the only way that countries holding US dollars can restrain the US from printing more currency is by not purchasing US dollars. To achieve this it would be necessary for these countries to either arrive at a consensus not to buy any more US dollars, or for one country to take the lead and not purchase US dollars.

This *Qiu Shi* article discussed, inter alia the manner in which China should deal with the issue of its huge US Treasury Bill holdings — currently estimated at US$ 1.16 trillion — and how it should try and undermine the US' position as a 'financial super power' attained by virtue of the US dollar being designated the world's reserve currency. It asserted that China's 'most powerful weapon today' is 'our economic power, especially our foreign exchange reserves. The key is to use it well. If we use it well, it is a weapon; otherwise it may become a burden'. It described the US government's action of increasing the number of dollars in circulation, thereby devaluing the value of the dollar, as harmful to countries with high foreign exchange reserves who possess US dollars. Arguing that the US itself loses nothing by increasing the number of dollars in circulation, it said the only way that countries holding US dollars can restrain the US from printing more currency is by not purchasing US dollars. To achieve this it would be necessary for these countries to either arrive at a consensus not to buy any more US dollars, or for one country to take the lead and not purchase US dollars.

It observed that to reach a consensus China, Japan, the U.K., India, and Saudi Arabia need to align their thinking. 'Japan is constrained by the Japan-U.S. Security Treaty and will not break away from the U.S., so the probability of Japan cooperating is very low. Great Britain has always followed the U.S', but Prime Minister Cameron has adopted 'a new strategy toward China that increases the possibilities for cooperation, making it a more likely player than Japan'. 'India has stayed closely allied with the U.S. in recent years, and Obama promised to support India for a permanent membership in the UNSC. Thus, the probability for India to cooperate with China is also not great. India's purchasing power of foreign exchange reserves is very limited anyway, so it cannot influence the overall situation much. Saudi Arabia does not have much political interest in the U.S.; its purchase of foreign exchange reserves is purely commercial. So they are more likely just to follow the market'. The article concluded that the idea of reaching a consensus was, therefore, unrealistic and China should accordingly muster the courage to take the lead. It could either sell its holdings of US dollar reserves or decide not to purchase any dollars for a certain period of time. It said the first option might lead to devaluation of the US dollar leading to a severe loss for countries like China, which have large US dollar holdings. China would have to examine whether it can sustain such a loss.

The second option is for China to use its foreign exchange reserves, presently stated to be US$2.8 trillion, to buy the Euro, British Sterling, Japanese Yen, Indian Rupee, Russian Ruble and Brazilian currency. Describing this as a cost effective move, it said such an initiative will 'help promote good relations and economic and trade relations with these countries and enhance China's economic influence in these countries'. China's action will have a demonstration effect and other countries are 'very likely to follow'. It added that since excess dollars once printed cannot be sold leading to accelerated depreciation of the dollar, the adverse impact on America's wealth will be 'enormous'. Stressing that the crucial issue is whether China has the 'necessary courage and determination' to withstand US pressure, it said that such a move will show just how much the US needs China and the 'US will start to fear us'.

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Emphasising that the US dollar's position as the world's reserve currency is what makes the US a financial superpower, the article recommended that China explore ways of confronting the US and challenging the US dollar. It enumerated ways in which the Renminbi (RMB) could also become the world's reserve currency thus putting pressure on the US dollar.

The more recent article in the *'Zhongguo Qingnian Bao'* by Qiao Liang has been described by him as an effort to examine economic and financial issues from the perspective of military affairs and strategy. Currently a Major General in the People's Liberation Army Air Force (PLAAF) and Professor at the Air Force Command College, Qiao Liang rose to prominence with the publication in February 1999 of the quasi-official book, 'Unrestricted Warfare'. A Senior Colonel in the PLAAF at the time, Qiao Liang co-authored the book with another PLA Senior Colonel, Wang Xiaogui. The book examines the advantages of a weaker nation waging asymmetric warfare against a stronger adversary. It states that, 'the first principle of such warfare is that there are no rules and there are no limitations'. Since then, Qiao Liang has continued exploring different aspects of asymmetric warfare.

Qiao Liang's article claims to detail the USA's rise as an economic power and attributes this primarily to the world's currencies being pegged to the US dollar and, till August 15, 1971, the US dollar being pegged to gold. Protecting the status of the US dollar, he says, protects the 'global hegemonic status' of the US. The other 'pillar' of US hegemony is its powerful S&T innovativeness. Qiao Liang claimed that in October 1973, the US Treasury Secretary William Simon successfully persuaded the Saudi Minister of Petroleum to agree that all global trading in oil would be in US dollars. This move ensured the emergence of a 'new financial colonial empire never before seen in the history of empires' because regardless of how high the price of oil rose, the US would not be adversely affected as it would lead to an increased global demand for US dollars which the US could easily print. As evidence, he pointed out that USA's GDP in the two hundred years prior to 1990 never exceeded US$ 7 trillion, but in the past twenty years it had burgeoned to US$ 14 trillion. He added that the US had taken into account the reality that 'hot money' requires a safe place for investment. To ensure that the US remains a safe destination for such funds and because the global internet has accelerated the flow of funds, the Pentagon is presently engaged in establishing a 'prompt global strike system'. The objective, the author explains, is to strike militarily at countries that become attractive destinations for such funds thereby prompting the funds to be pulled out and re-invested elsewhere. At the time the war broke out in Kosovo, the article claimed, 'hot money' valued at almost US$ 700 billion was floating around in Europe. After the commencement of the war nearly US$ 200 billion found its way to the US leading to an 'unprecedented ninety months of prosperity'. Another US$ 200 billion went to Hongkong. The 'mistaken' bombing by the US of the Chinese Embassy in Belgrade, Qiao Liang asserts, ensured that China was no longer viewed by investors as a safe investment destination resulting in these funds also being diverted to the US from Hongkong. Reiterating that the US is an 'empire founded on currency' and the US has to maintain the 'hegemony' of the dollar, Qiao Liang concludes with the warning that 'it now seems that the United States has no efficacious tools to achieve this other than military methods'. Qiao Liang's article appears to caution China's financial strategists to guard against the possibility of attracting hostile US action.

As a major step towards making China's currency acceptable in international trade, Beijing has concluded sizeable currency swap agreements with a number of countries that are its trading partners. These include Argentina, Belarus, Brazil, Hong Kong, Indonesia, Malaysia and South Korea. The swap agreements enables these countries to pay for Chinese exports in Yuan rather than dollars.

Meanwhile, China has been examining the options available to it to secure the value of its huge US dollar holdings, estimated by the US Treasury in its annual report in December 2010, at US$ 1.16

trillion. The latter has additionally been a topic of public concern. A report in the Guangzhou Ribao (March 7) said that: 'China's holdings of US Treasury Bonds have become a topic of concern for all citizens....Unfortunately we still have not seen any information released by the relevant Chinese authorities on changes in China's holdings of US Treasury Bonds. State foreign exchange reserves are the common wealth of the masses, and the masses have a right to know'. The US Treasury's report separately noted that China's dollar holdings had dropped from the US$ 1.164 trillion in November 2010. The Chinese authorities have simultaneously been trying to diversify investments of their foreign currency reserves. Accordingly, Beijing began using its foreign currency reserves to purchase Euros. At the same time any sudden reduction in holdings by these countries would weaken the dollar and dilute the value of their assets.

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