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Renminbi liquidity arrangement between China and Bank for International Settlements and the International Monetary and Financial System

Acuerdo de Liquidez en Renminbi entre China y el Banco de Pagos Internacionales y el Sistema Monetario y Financiero Internacional

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Abstract

China recently signed the Renminbi Liquidity Agreement with the Bank for International Settlements (BIS) to establish a fund that can provide liquidity support in times of financial volatility to its participants. The agreement initially included countries in Asia and the Pacific region. The agreement is part of the People's Bank of China's stated policy of currency internationalization. This paper, using bibliographical and documentary methodology, analyzes said policy, as well as the recent agreement and the current geopolitical situation in the world, based on Keynes' theory of the centrality of money in capitalist dynamics and post-Keynesian theory, which explains the hierarchical functioning of currencies in the International Monetary and Financial System. As this is an object of research whose developments are still ongoing, some of the considerations are rather analytical. Notwithstanding, we propose that the possibilities created by China's measures are capable of, if not breaking, at least distorting the dollar's hegemony in world financial transactions.

Keywords: Renminbi Liquidity Arrangement; China; Currency Hierarchy.

Resumen

China firmó recientemente el Acuerdo de Liquidez en Renminbi con el Banco de Pagos Internacionales (BPI) para establecer un fondo que pueda brindar apoyo de liquidez a sus participantes en tiempos de volatilidad financiera. El acuerdo incluía inicialmente a países de la región de Asia y el Pacífico. El acuerdo es parte de la política declarada de internacionalización monetaria del Banco Popular de China. Este artículo, utilizando una metodología bibliográfica y documental, analiza dicha política, así como el reciente acuerdo y la situación geopolítica actual en el mundo, basándose en la teoría de Keynes sobre la centralidad del dinero en la dinámica capitalista y en la teoría postkeynesiana, que explica el funcionamiento jerárquico de las monedas en el Sistema Monetario y Financiero Internacional. Como se trata de un objeto de investigación cuyos desarrollos aún están en curso, algunas de las consideraciones son más bien analíticas. No obstante, proponemos que las posibilidades creadas por las medidas de China son capaces de, si no romper, al menos distorsionar la hegemonía del dólar en las transacciones financieras mundiales.

Palabras-clave: Acuerdo de Liquidez en Renminbi; China; Jerarquía Monetaria.

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Introduction

China's economic success has been widely commented on in recent years, as it is the country with the most sustained growth and is currently the world's leading exporter. Conversely, its currency internationalization has not kept pace with the country's core macroeconomic indicators. Although China's extensive participation in international trade is remarkable, the Renminbi, its currency, is not one of the most sought-after currencies internationally, even though its participation has grown significantly in recent years.

However, after the onset of the financial crisis in 2008, many debates demonstrated that China has taken a firmer stance on expanding its currency internationalization. Representatives of the People's Bank of China have declared this to be an objective of the country's policy, mainly because they see room and opportunities for growth given the difficulties the American economy is facing. Since then, to expand its monetary and financial relations with the rest of the world, many measures have exemplified the country's reforms and institutional creations.

More recently, the Renminbi Liquidity Agreement, signed with the Bank for International Settlements (BIS) in June 2022, has been in the spotlight. This is an initiative between the BIS and the People's Bank of China to establish a reserve fund to provide liquidity to its members in times of heightened financial volatility and uncertainty. So far, countries from Asia and the Pacific have joined the Agreement. *A priori*, the rules stipulate that each country in the Agreement must deposit 15 billion Renminbi or dollar equivalent. This amount will be held by the BIS. In this way, countries have access to their own deposits and, if necessary, to a financing line from BIS-managed resources.

The problem that motivates this article is whether this measure is yet another institutional element in the list of measures that the People's Bank of China is taking to expand the internationalization of the Chinese currency. To this end, the work uses bibliographical and documentary methodologies. Two sets of theories considered relevant for the analysis were adopted as theoretical references. First, from the Keynesian (1985) perspective, we emphasize the distinct role of currencies in monetary production economies, both at the national and international levels. We also use post-Keynesian contributions from authors dealing with the hierarchy of currencies within the international monetary and financial architecture. With this broad theoretical spectrum, we believe it is possible to discuss the current configuration of the internationalization of the Chinese currency, although this object of analysis is still in progress.

Therefore, to achieve these objectives, this paper is structured in three sections, as well as an introduction and the final remarks. The first section presents a theoretical discussion of the meaning of currency and the hierarchy of currencies at the international level. In the second section, we present the main recent measures taken by China as part of its currency internationalization policy, as well as two main perspectives on this policy. Finally, in the last section, we discuss the features of the Renminbi Liquidity Agreement and its potential impact on the Chinese currency's position in the currency hierarchy.

Currency and its hierarchy in the International Monetary and Financial System

Keynes' conception of the distinct role played by money in the economic system, not confined to the *General Theory*, but throughout his major works, represents an important break with the neoclassical perspective[1] . The author's theoretical construction on the subject evolved throughout his main economic writings, namely A Tract on Monetary Reform (Tract), A Treatise on Money (Treatise), and The General Theory of Employment, Interest and Money (TG). This break is expressed in conceptual terms, as well as in the consideration of what functions money performs in capitalist

[1] The neoclassical approach has dominated economic discussion for years. The so-called Keynesian revolution was the result of a theoretical breakthrough in terms of explaining economic dynamics. Keynesian theory is based on the realization that full employment, in a capitalist economy is not a permanent or unique situation of equilibrium. On the contrary, involuntary unemployment can not only exist, but can also be a persistent condition, extending over time, which would characterize it as being equilibrium. This fact implies that the free market may not automatically lead to full employment, at least in the short term, and therefore justifies economic policies against unemployment (DATHEIN, 2002, p. 18).

economies, and the very way in which money, as an asset, influences the entire macroeconomic dynamic of generating employment, product and income. This rupture is expressed in the functions of currency in capitalist economies and how currency, as an asset, influences the entire macroeconomic dynamic of job, product, and income generation. In this new vision, the currency serves as a unit of account and a store of value, in addition to mediating exchange. In this sense, as a store of value, money has the potential to be demanded by economic agents to preserve wealth over time. However, economic agents forgo some of their consumption and investment when they demand money, which can constrain the level of effective demand relative to the realized supply that contracts the volume of work (*ex-ante*).

The store of value function can be understood in terms of what Keynes (1985) describes as the peculiarities of the currency. These peculiarities relate to the elasticity of production and the elasticity of substitution of money in chapter 17 of *General Theory*, both of which are negligible. The first refers to the fact that the money supply is scarce, so its production does not change when its price changes. However, this scarcity is not absolute, "(...) but relative to demand, which does not change when the price of money changes: its elasticity of substitution is negligible. Thus, the money supply is scarce relative to a constant demand, which guarantees the currency 'value' over time" (DORNELAS; TERRA, 2021, p. 145-146). Therefore, given the negligible elasticities of production and substitution, it is understandable how currency plays the role of store of value. In this way, currency mediates exchanges at any time, constantly serving as a unit of account, referencing prices and contracts, which, as they last over time, emphasize its ultimate function – to reserve value.

Given that economic agents make their decisions in an environment of uncertainty, the currency represents an asset capable of linking the present and the future while maintaining its value in the process. This makes the dynamics of monetary production economies subject to a greater or lesser demand for money since uncertainty cannot be quantified (KEYNES, 1985). In other words, "for Keynes, fluctuations in effective demand and in the level of employment occur because, in a world in which the future is uncertain and unknown, individuals prefer to hold on to money and, consequently, their spending decisions, whether consumption or investment, are postponed" (FERRARI FILHO, 2006, p. 10).

The speculative nature that can be associated with the demand for currencies should also be highlighted. This is because economic agents may show a greater or lesser preference for the liquidity offered, depending on their motivations for demanding it, such as transaction, precaution, speculation, and financing[2]. The transaction motive expresses the demand for currency for current transactions, from personal purchases to business transactions. The precautionary motive deals with the search for currency as a means of dealing with unexpected events, whether negative or positive, such as a possible opportunity for financial gain. The finance motive, on the other hand, reveals the demand for liquidity on the part of entrepreneurs as they seek funding for their investment plans. Finally, the speculative motive, which has a significant impact on the dynamic of capitalist economies, refers to the demand for money, where in order to obtain profits, the interest rate is the determining factor (KEYNES, 1985).

In this sense, currency and its price – interest – determine the pace and direction of the dynamics of monetary economies. Investment decisions, capable of job and income generation, are made in an uncertain environment, in which entrepreneurs compare the marginal efficiency of capital[3] with the interest rates that remunerate financial assets. For productive investment to occur and, therefore, for jobs and income to be created, capital assets must have a marginal efficiency of capital that is at least equal to interest rates. However, there is no condition that guarantees such equality. On the contrary, interest rates are highly volatile. This affects the volatility of productive investment. In this particular

[2] The finance motive for currency demand was contemplated by Keynes after the publication of the *General Theory, in Alternatives theories of the interest rate*, published in 1937.

[3] A term developed by Keynes (1985) to highlight the entrepreneur's calculation when making his investment decision: he calculates the expected return of the investment over its cost.

case, the speculative demand for currency highlights the possibility of a preference for financial assets, which can be easily converted into currency, over productive assets. This, in turn, contributes to a contraction in aggregate demand.

Although they were based on a theoretical framework designed to explain the functioning of closed economies, the operational peculiarities of monetary production economies expressed by Keynes (1985) can be extended to the analysis of open economies. Above all, we must consider that different national currencies are assets and that, like any other asset, are demanded for different purposes. Thus, by applying the concept of liquidity to the analysis of currencies in the International Monetary and Financial System, we can characterize the greater demand for certain currencies over others in scenarios of greater global uncertainty. This analysis becomes clear when we consider, for example, the difference in the relative value of currencies worldwide. This is even more evident when we look at the high demand for currencies considered to be ‘safer’ and ‘stronger’ internationally in unstable scenarios, such as those recently represented by the 2008 crisis and the COVID-19 pandemic.

These attributes reinforce the point that national currencies react to varying levels of liquidity and confidence at the international level, resulting in greater or lesser demand for them in comparison to other currencies. In addition, the speculative bias of global currency demand has become even more pronounced due to technological and informational developments. As a result, micro- and macroeconomic imbalances in national economies have become increasingly frequent, leading to the “occurrence of currency crises and speculative attacks and a reduction in the degree of freedom of domestic economic policies, with profound effects on the real variables of the economy” (PAULA, 2009, p. 3).

Given the relevance of the currency at the national level and its scale of liquidity preference at the global level, we look at how currencies are ranked in the International Monetary and Financial System. Post-Keynesian authors stand out in this approach, especially in explaining and discussing the implications of the hierarchical position that currencies occupy on the international stage.

Prates and Cintra (2007) state that Keynes already identified this monetary architecture in the *Treatise on Money*, in which he discussed the different degrees of monetary policy autonomy between creditor and debtor economies in between wars. In the same book, Keynes proposed an international monetary-financial reform, suggesting the creation of a world central bank (*Supernational Bank-Money*). Ferrari Filho (2006) adds that, at the end of the 1930s, Keynes proposed the creation of the *International Clearing Union*, which shows his clear concern for regulating the convertibility of currencies worldwide. Therefore, the importance of money in dictating the course of a capitalist economy is evident in Keynes’ theorizing and is fundamental in explaining the dynamics of the international economy.

As Prates and Cintra (2007) analyze, the hierarchical position of currencies within the International Monetary and Financial System is related to the power relations countries have to abide. It is no coincidence that the dollar’s hegemony as the central currency after the Bretton Woods agreement is based on the United States’ power relations – political, economic, and military – during this period.

For De Conti (2011), in addition to the geopolitical power of countries, the size of the national economy and its commercial and financial integration with the rest of the world, together with political will, are the main determinants of the international use of currencies at a global level. The hierarchical position of currencies does not result from mere economic and political country-specific decisions. However, it is worth noting that political voluntarism is conditioned by these policies. Thus, the desire to internationalize its currency is not sufficient for a country; it must act as a representative issuer, both economically and politically, at a global level.

In addition, Eichengreen (2013) identifies three factors influencing global currency convertibility: stability, scale, and liquidity. Stability means the currency’s ability to uphold its value over time. Scale refers to the international scope, encompassing both commercial and financial dimensions, that a currency achieves through its transactions with the rest of the world. Lastly, liquidity is a distinctive attribute of currencies at the national level that indicates the currency’s ability to buy and sell a wide range of assets denominated in it at the international level without incurring significant transaction costs.

Eichengreen (2013) outlines attributes that emphasize that currency convertibility requires the fulfillment of its three main functions at an international level: serving as a unit of account for pricing and contracts, functioning as a medium of exchange, and acting as an international store of value. Adding the analyses of Prates and Cintra (2007) and De Conti (2011), which delineate diverse determinants influencing the global use of currencies, it becomes evident that the demand for currencies within the International Monetary and Financial System is not homogeneously configured. This variability stems from the pronounced disparities in power and economic relations across the globe.

In this sense, the hierarchical arrangement of currencies in the International Monetary and Financial System is a manifestation of these unequal dynamics. Carneiro (1999) and Prates (2002) propose a classification of this hierarchy into two categories. Firstly, there are currencies capable of fulfilling all three functions at an international level—these are referred to as convertible currencies or key currencies, using the didactic term employed by De Conti (2011). At a lower hierarchical level, there are currencies that, although effective at the national level, fall short of simultaneously performing all three functions internationally and are consequently used on a marginal basis. These are called convertible currencies or peripheral currencies (DE CONTI, 2011).

Despite the binary typification presented by the authors, the degree of currencies' convertibility leads to diverse positions within each group. Historically, the US dollar has held preeminence as the most widely used currency in the world, fully representing all three functions and securing its status as the key currency in the system. Other central currencies, albeit with secondary demand, encompass the Euro and, to a lesser extent, the currencies of the United Kingdom, Japan, Switzerland, Canada, and Australia. Meanwhile, other national currencies are relegated to a peripheral status due to their limited or nearly non-existent international demand (CARNEIRO, 1999; PRATES, 2002).

This paper aims to explore whether the declared policy of Renminbi internationalization, coupled with China's distinctive political and economic position in recent years, has the potential to reshape the currency hierarchy. In other words, the Renminbi's transition from a peripheral to a central currency threatens the enduring dominance of the dollar as the primary currency in the International Financial and Monetary System. Therefore, the following section discusses the Renminbi's internationalization policy.

Renminbi's recent internalization policy

The global roles assumed by currencies, along with the consequent hierarchy they inhabit, have spurred many countries to internationalize their currencies. This pursuit aims to achieve a certain level of influence that positions them closer to the status of a key currency in the International Monetary and Financial System. According to Eichengreen (2013), the rise of a currency on the international stage can occur rapidly, facilitated by the intervention of national authorities. In this sense, clear actions are being taken to enhance national currencies' convertibility, liquidity, and denomination in transactions that go beyond a country's borders.

Taking a "power relations" perspective, Fiori (2014) analyzes the internationalization and increased use of a currency at a global level based on the political and military dominance of the issuing nation. In line with this argument, "the international currency is not adopted because it is competitive, but it is competitive because it derives from a previous process of expansion, domination, and imposition that created the conditions for the currency to be adopted internationally" (SANTOS, 2019, p. 41).

Combining both approaches, we can discuss the Bank of China's recent and declared policy to internationalize its currency, especially after the 2008 financial crisis. It is worth noting that China had already emerged as a global economic powerhouse in the early 2000s, alongside other emerging economies such as Brazil, India, Russia, and South

Africa (BRICS), recognized for their growth potential. Speculation at that time suggested that their combined potential could surpass the gross domestic product of the G-6[4] countries by 2050.

From this perspective, China has maintained an average annual growth rate of approximately 9.5% over the past two decades – a remarkably high-level exceeding that of other countries. In terms of trade and world trade connectivity, China currently stands as the largest exporter and second-largest importer (IMF, 2022). Santos (2019) notes that, in the pre-pandemic scenario, the Chinese banking system held the world's largest asset stock, with its domestic debt market ranking as the third largest. Additionally, out of the top ten global companies in the 2018 Fortune 500 Global ranking, three were Chinese, reinforcing the increased economic and political standing of this country, not only in Asia but on a global scale.

Therefore, China has distinguished itself through economic growth, active participation in global trade dynamics, and a notable political and military presence. These factors align with the three main attributes for the broader use of its currency on the international stage: geopolitical power, the scale of the national economy, and commercial and financial integration with the rest of the world (DE CONTI, 2011). As Eichengreen (2013) states, the internationalization of the Renminbi is also influenced by the deliberate actions of national authorities; in other words, political voluntarism.

In line with this last point, Santos (2019) points out that the Renminbi internationalization by indirect means faces strong limitations, above all due to the prevailing dominance and reliance on the dollar in the global financial system. The expectation is that market agents will be inclined to demand more of this currency through changes in economic structures. The potential for successful internationalization lies in the direct route, involving reforms to the international financial architecture through changes to existing institutions and the establishment of new international institutions.

On this last point, Deus, De Conti, and Terra (2019) discuss the BRICS Bank (New Development Bank, NDB), created in 2014, and its potential to influence the currency hierarchy, especially of peripheral currencies of member countries. As the authors point out, the NDB, as a supranational entity associated with economically significant countries, especially China, could alter the status quo of currency architecture, making these countries less dependent on central economies.

In this sense, the recent Renminbi Liquidity Agreement, signed by China with the BIS, appears akin to the creation of new international institutions with interests related to the reform of the global monetary and financial architecture, prompting considerations about the potential influences of such developments. Before analyzing the central features of the agreement, it is important to acknowledge that discussions about the role of other currencies in the International Monetary and Financial System gained momentum after the 2008 financial crisis. During this period, the ascent of the Chinese currency in international transactions became notably apparent. Considering the pre-pandemic period, from October 2010 to December 2018, the Renminbi surged from 35th to 5th place as the most demanded currency for global payments (SWIFT, 2019).

The more assertive positioning towards the internationalization of the Chinese currency aligns with the context of a supposed relative weakening of the American economy after 2008. It also reflects China's strategic pursuit of new opportunities in the world economy, encompassing aspects of the monetary and financial architecture. In 2011, China, acting through the BRICS, petitioned the International Monetary Fund (IMF) to improve the International Monetary and Financial System by creating international reserves that could provide stability and security for emerging countries (SOUSA, 2020). Furthermore, a series of measures were implemented:

> (...) the continuity of the Go Global policy for the internationalization of Chinese companies, with a wave of mergers and acquisitions facilitated by the financial crisis; the execution of ALcs and cepAs

[4] This phenomenon is exemplified by the influence of the United States, England, Japan, France, Germany and Italy at the time.

> with various countries; the establishment of the Asian Infrastructure Investment Bank (Aiib), and, linked to the BRICS, the New Development Bank (NDB) and the Contingent Reserve Arrangement (acr); the realization of the Chiang Mai Multilateralization Initiative (cMMi) of AseAn+3 (China, Japan and South Korea); the launch of the One Belt, One Road Initiative (bri); and the intensification of the internationalization of Chinese banks, including some of them offering loans in rMb [Renminbi] (SOUSA, 2020, p. 16).

Torres Filho and Pose (2018) add that the Renminbi internationalization policy, although more pronounced after 2008, was already evident in the early 2000s. From that year onwards, various international agreements and measures to increase convertibility were launched, such as the program allowing qualified foreign investors to purchase Chinese debt bonds launched in 2002. An initiative in 2003 aimed to create offshore markets, enabling Hong Kong residents to buy and hold Chinese currency, within certain limits.

While the measures listed have had little impact on the international use of the Renminbi compared to those implemented after the financial crisis, Cintra and Martins (2013) highlight the program launched in 2009. This program allowed all Chinese trade to be settled in the national currency, along with the ongoing integration achieved by the offshore market with the rest of the world. In addition, Andrade and Cunha (2011) reiterate China's heightened political determination to internationalize its currency, especially after promoting several swap agreements with other countries after 2009. The promotion of swap contracts is an interesting one, as it involves a direct exchange between national currencies and the Renminbi, without the intermediation of the dollar.

Oliveira and Noije (2019) highlight another significant step in the internationalization of the Renminbi: its inclusion in the IMF's Special Drawing Rights (SDR) basket in 2015. This basket comprises the most commonly used currencies in international trade and the foreign exchange market, meaning that the currency in question is widely used to settle transactions and in foreign exchange negotiations. This designation positions the Chinese currency among the most widely used and, consequently, one of the most important currencies globally.

In the same year, the creation of the China International Payment System (CIPS) marked a clear attempt to offer an alternative, if not replacement, for the exclusive use of the dollar-denominated global payment system, the Society for Worldwide Interbank Financial Telecommunication (SWIFT). The impact of this measure, in macroeconomic and geopolitical terms, has been significant in contemporary times, particularly within the context of adopting sanctions in response to Russia's declared war on Ukraine. The purpose of these sanctions is to hinder the convertibility of economic and financial transactions conducted by the Russian economy with the rest of the world. Although Russia cannot solely depend on the CIPS due to its still low liquidity and interdependence, the existence of an alternative international payment system to the dollar offers possibilities, especially for Asian countries. These nations are already contemplating potential changes in the status quo of the international monetary and financial architecture.

An analysis of these main measures indicates that the Chinese government has acted strongly towards the internationalization of its currency. However, this pursuit deviates from conventional market logic, which anticipates broad and unrestricted convertibility of the country's capital and financial accounts in its balance of payments. As previously pointed out by Santos (2019), the success of this process is more likely to be achieved through the direct route, involving reforms to existing institutions and the creation of new international institutions, given the enduring hegemony of the dollar.

In line with this analysis, Oliveira and Noije (2019) point out that, historically, during the internationalization processes of currencies such as the dollar, the pound sterling, and the Japanese yen, a strong state presence in the economy was not as prominent as is the case of China. The combination of a strong policy and the relative liberalization of the country's capital and financial account allows us to consider that "(...) the internationalization of the RMB [Renminbi] may be more associated with the Chinese government's strategies to qualify its currency worldwide and less with the spontaneous reaction of the markets" (OLIVEIRA; NOIJE, 2019, p. 16).

The peculiarities of Renminbi internationalization highlight two different perspectives regarding China's positioning or even its intentions, which will be discussed subsequently.

Theoretical Perspectives on the Renminbi Internationalization

The economic analysis of the internationalization of the Chinese currency allows us to distinguish between two main perspectives on China's motives for spreading Renminbi's reach worldwide. On one hand, we investigated whether this whole process could be understood as China aiming to converge with the international order, which requires its financial system to adapt to the international market. On the other hand, we wonder if this process does not refer to a form of contestation of the global economic and financial order, the hierarchy of currencies as well as, more specifically, the dollar's hegemonic role as a systemic key currency and its resulting implications.

Regarding the first perspective, Torres Filho and Pose (2018) emphasize that the Renminbi internationalization policy should not be interpreted as a strategy to compete directly with the dollar, much less to overthrow its hegemonic position. To the authors, China seeks to reduce its dependence on the dollar as a way of protecting itself and resisting possible instabilities inherent to the current monetary and financial standards.

The authors justify this position through the slow and gradual pace with which China has been promoting its internationalization, showing a certain caution towards decision-making. This cautious stance is currently observed in the so-called liberalization of the country's capital and financial accounts—which is essential when discussing the reach Renminbi has been achieving in the hierarchy of currencies. Thus, although many determinants for the country having a convertible currency have been observed, "China has so far not even managed to establish its currency among the most important in the system, let alone as a competitor to the dollar. In fact, this goal is not part of the Chinese objectives" (TORRES FILHO; POSE, 2018, p. 19).

Following the same perspective, Andrade and Cunha (2011) argue that, due to the slow pace of reforms in the Chinese financial and banking markets and the convertibility regime, the strategy is clear: to maintain high growth with macroeconomic and political stability. However, it is unlikely that the Renminbi will pose a threat to the dollar in the coming years, given the path the authors believe is necessary for this currency to play a key role internationally. Therefore, controlled convertibility to maintain high economic growth makes the configuration of Chinese policy closer to the regionalization of the Renminbi than to internationalization itself (CINTRA, MARTINS, 2013; CINTRA; PINTO, 2017; SANTOS, 2019).

Conversely, authors such as Oliveira and Noije (2019) argue that Renminbi internationalization reflects the importance of the Chinese economy globally, as well as the strong willingness of the Chinese government to influence the current monetary structure. In their words:

> On the visible horizon, it seems increasingly clear that the international economy is converging towards a multi-currency arrangement, that is to say, other currencies are emerging to play the role of global reserve assets. However, Renminbi differs from other currencies that perform this function as its internationalization process occurred in a context where China lacked deep, liquid, and open financial markets, which are important aspects for qualifying any currency internationally. Moreover, there is no precedent for a currency for global use that is not issued by a central country, so, to some extent, Renminbi expansion may be associated with the better stability properties that this currency has shown compared to the other central currencies of the SMI (OLIVEIRA; NOIJE, 2019, p. 17).

Sousa (2020) shares this view and argues that a precise analysis of the set of measures taken by China, especially after the 2008 financial crisis, signals the outlining of a long-term strategy. This strategy is aimed at its expansion into the International Monetary and Financial System, in which Renminbi plays an important role, but mediated in such a way that the country maintains relative control over the capital account. Thus, we observe not a convergence of the Renminbi to the traditional processes of currency internationalization, but rather "(...) an attempt by the Chinese government to control the instruments of internationalization, even if the results of such monetary insertion are penalized in the short term” (SOUSA, 2020, p. 25).

At last, a conformation of both visions can be perceived. If, on one hand, Renminbi internationalization demonstrates a clear result of Chinese economic development and prominence, given that this currency has already overcome its peripheral position; on the other, this process represents a defense strategy by China to protect its economic development against dependence on the dollar. At the same time, it is seen as an offensive strategy, “(...) in the sense that it aims to promote a change in the international monetary hierarchy” (PIRES, 2021, p. 211).

In addition, there are studies that seek to understand the process of internationalization of the Renminbi not from the supply side, as the perspectives developed so far consider, but from the demand side, that is, to understand the motivations that different countries have for demanding a greater quantity of Renminbi, especially those that do not have a univocal political relationship with China. In this regard, two major works stand out, Chey (2015) and Liao and Mcdowell (2016).

Using a qualitative approach and gathering government documentation and interviews with policy makers, Chey (2015) studies the case of South Korea's demand for the Chinese currency. Chey's (2015) study forcefully suggests that politics in foreign economies, together with market forces and economic and political conditions in China itself, are relevant factors for the future internationalization of the Renminbi.

In a complementary way, Liao and Mcdowell (2016) seek to analyze factors that lead countries to demand the Chinese currency, but they do so with a focus on the presence of this currency in the reserve portfolio of Central Banks. Considering an essentially geopolitical analysis, the authors move in three main directions: a) geopolitical considerations are systematically related to states' preferences for the reserve currency; b) the change in the international monetary system, defined as the emerging demand for the Renminbi as a reserve currency, is linked to preferences about the political order; c) geopolitical forces influence the trajectories of new reserve currencies. In this sense, states' preferences regarding the international order - the rules, principles and institutions that govern interactions and behavior between countries - influence decisions to diversify reserves into the Renminbi.

Given the various measures and different theoretical perspectives surrounding Renminbi internationalization, in the next section, we will discuss the possibilities brought on by the recent signing of the Renminbi Liquidity Agreement.

Renminbi Liquidity Agreement: possibilities in the light of the currency hierarchy

On June 25, 2022, the People’s Bank of China signed the Renminbi Liquidity Arrangement with the Bank for International Settlements (BIS). This agreement stipulates the creation of a reserve fund capable of providing liquidity to its participants in times of high financial volatility and instability. Initially, the agreement included a group of central banks from Asia and the Pacific, as well as China, Indonesia, Malaysia, Hong Kong, Singapore, and Chile. The document calls for each of these countries to contribute the equivalent of 15 billion Renminbi, or the equivalent in dollars, to a reserve fund held by the BIS (BIS, 2022).

The main idea of the Agreement is to provide additional monetary resources to member countries in times of need. In addition to the possibility of countries withdrawing the amounts of their initial deposit, there is also the possibility of accessing additional funding through a liquidity window operated and guaranteed by the BIS. In this way, the countries’ cooperativism in the region is combined with the prospect of safeguarding these economies in times of heightened financial uncertainty.

Although the analysis of the creation and implications of the Agreement here are somewhat speculative, since we are dealing with an object whose developments and results are ongoing, it is possible to think about the configuration of this reserve fund from the two theoretical references.

Firstly, the initiative by countries to unite and form a monetary fund, whose purpose of use is conditional on the possible difficulties caused by financial volatility and instability, highlights the particular role that currency plays in capitalist economies. As Keynes (1985) pointed out, the non-neutrality of money is expressed in the recurring shortfalls in effective demand, based on the greater or lesser demand for money to the detriment of productive assets in a monetary economy of production. As a result, there is no full employment equilibrium as a rule in the real dynamics of economies. Furthermore, when the notion of liquidity preference is expanded to the international arena, it becomes clear that national economies, especially those that issue peripheral currencies, are subject to instability and volatility.

China's initiative to create the reserve fund with the BIS can therefore be seen as a preventive policy against possible—statistically probable—crises of insufficient effective demand, whatever the root causes. Whether these crises are specific to national economies, which can face them in isolation, or systemic, such as an international financial crisis, a pandemic event, or even geopolitical conflicts (e.g. the 2008 crisis, the Covid-19 pandemic and the recent war between Russia and Ukraine, respectively).

In addition to its preventive nature, the creation of this fund has defensive implications, both politically and economically. Politically, China's power and influence are growing in the Pacific region and, as a result, gradually across the globe. Economically, the Renminbi could rise in the hierarchy of currencies, if this fund is made up of reserves predominantly made up of the Chinese currency, along with the additional resource of borrowing with the local currency as collateral, and interest as a reference.

Signing the agreement with the BIS, then, can provide China with benefits that go beyond easier access to a reserve fund in times of financial instability. The expansion of its geopolitical power could represent tactical possibilities for positioning itself in the current global geopolitical context; said power is even more prominent in the face of the power struggle that Russia is imposing in the region, together with its greater political and economic influence—which are already part of its development strategy. Furthermore, just as was observed when the NDB was created, China's initiative to set up a fund to provide liquidity to peripheral countries shows a concern with dialoguing with these countries to provide aid in a different way from the traditional multilateral institutions. Regarding the second theoretical framework discussed, the creation of the Renminbi reserve fund, even though it allows deposits in both Renminbi and dollars, is already part of the declared policy of internationalization of the Chinese currency. Therefore, we see the possibility that the countries participating in the fund will start using the Renminbi to a greater extent than the dollar, at least when they request access to these resources. As a result, dependence on the dollar may gradually decrease, as the Chinese currency gains scale in international exchanges.

In line with what is presented by De Conti (2011) and Eichengreen (2013), it expands the possibilities for China to gain greater geopolitical power, increases the size of its national economy, and its commercial and financial integration with the rest of the world. In addition, the political voluntarism of the national authorities' intervention to make the Renminbi more international is evident. For the authors, the requirements for greater demand for a currency at a global level are facilitated by the creation of the fund.

Added to this approach is what Santos (2019) pointed out when he analyzed the greater chances of the internationalization of the Chinese currency through the direct route, seeking to reform the international financial architecture through changes to existing institutions, as well as the creation of new international institutions.

In this paper, we understand that, in addition to the measures mentioned in the second section, China is creating institutions capable of altering the current functioning of the international monetary system by expanding the possibilities of using its currency worldwide through the recent Renminbi Liquidity Agreement. Although it is too early to say whether this configuration could threaten the hegemony of the dollar, the fact is that this hegemony is no longer the same as it was for so many years. Today, there are real possibilities for changes in the hierarchical position of currencies, as the Renminbi has been well-represented in recent years. The continuity of measures, although considered timid by some authors in the sense of Renminbi internationalization, seems to show one result: this policy is progressing successfully, even if the steps are taken with caution.

Final remarks

This paper aimed to analyze the recent creation of the Renminbi Liquidity Agreement between the People's Bank of China and the BIS in the light of the hierarchy of currencies theory, at the global level. We first discussed the importance of money in monetary economies of production, emphasizing that all economic dynamics are subject to a greater or lesser preference for liquidity, as explained by Keynes (1985). Given the peculiarities of the currency, it represents a particular asset, capable of fulfilling three functions: unit of account, medium of exchange, and store of value.

By extending this analysis to the international scope, we have been able to relate the preference for liquidity in different national currencies to the hierarchy they occupy in the international monetary and financial architecture, and its resulting implications. This arrangement can be reconfigured, even though the dollar has represented this architecture as a key currency over the years, and the euro and the pound sterling have been central currencies, with other currencies as peripheral.

The main determinants of the international use of currencies considered here are related to the geopolitical power presented by countries, the size of the national economy and commercial and financial integration with the rest of the world, as well as political voluntarism (DE CONTI, 2011). Furthermore, Eichengreen (2013) points to three factors capable of making currencies convertible worldwide: stability, scale, and liquidity.

Based on this theoretical view and the measures China has taken in recent years, we can see that the creation of the Renminbi Liquidity Agreement represents the creation of yet another institution capable of expanding its geopolitical and economic power, at least initially in Asia. However, as the reserve fund develops and most of the deposits are denominated in Renminbi, the very scale and liquidity of this currency could increase internationally. So, we see yet another potential measure adopted by China to internationalize its currency, making it more in demand, without losing control of its capital account. As has already been pointed out, the continuity of these measures, although for some authors they are too timid in the sense of the internationalization of the Chinese currency, seems to highlight an unconventional example of the insertion of a currency internationally and demonstrates a gradual expansion of its space.

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