The China Quarterly (2025), 1–16
doi:10.1017/S0305741025000037

RESEARCH ARTICLE

The Logic of Partial RMB Internationalization: PRC Perspectives on "Financial War"

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Abstract

Drawing on untapped, open-source commentaries from elite Chinese commentators, we show that since 2018, China has become fixated on preparations for a potential "financial war" with the United States. China appears to have adjusted its renminbi (RMB) internationalization strategy – and broader approach to financial regulation – accordingly. China's perceived vulnerability to dollar sanctions increases the urgency of RMB internationalization but also makes it unacceptably risky to liberalize the capital account. The sources suggest that China's solution is to pursue partial RMB internationalization by keeping the capital account tightly regulated while encouraging trade partners to sign up for RMB settlement platforms. As more foreign banks sign up for RMB payment systems, China is gaining confidence that its financial system could weather the sudden imposition of dollar sanctions. However, China remains vulnerable in principle to a "monetary sniping" attack on the offshore RMB market.

摘要

通过采用尚未分析过的中国精英之公开评论，本文发现，自 2018 年以来，中国已开始专注于为可能与美国发生的 "金融战争" 做准备。因此，中国似乎已经相应调整了人民币国际化战略以及更广泛的金融监管方针。中国在美元制裁威胁下所感知的脆弱性增加了人民币国际化的紧迫性，但也同时使资本账户自由化的风险变得不可接受。此文所分析的评论指出中国的解决方案是推行部分人民币国际化：对资本账户保持严格监管，同时鼓励贸易伙伴参加人民币结算平台。随着越来越多的外国银行注册人民币支付系统，中国对其金融体系能够经受美元制裁突袭的信心日益增强。然而，中国原则上仍然易受到离岸人民币市场的 "货币狙击"。

Keywords: RMB internationalization; financial war; financial sanctions; dollar hegemony; US–China competition

关键词: 人民币国际化; 金融战争; 金融制裁; 美元霸权; 中美竞争

China has long desired to internationalize the renminbi (RMB).[1] The People's Bank of China (PBoC) publishes an annual "progress report" on the topic.[2] At the 20th Party Congress in October 2022, Xi Jinping 习近平 called for "promoting RMB internationalization in an orderly manner."[3] If the RMB were widely held and used for trade settlement overseas, Chinese firms would no longer have to hedge currency risk and Chinese capital markets would deepen. Growing global adoption of the RMB could help to transform the current reserve system from one of dollar hegemony to a more stable (and, in China's view, equitable) multi-currency reserve

1 Dai 1999.
2 PBoC 2022.
3 Xi 2022.

system.[4] Growing RMB adoption overseas would also degrade the United States' (US) ability to influence China through the threat of dollar sanctions.

The main barrier to *full* RMB internationalization is the Chinese Communist Party's (CCP) reluctance to liberalize China's capital account and relinquish some control over the RMB exchange rate. China learned the value of capital controls in the Asian financial crisis of 1997, when the banking systems of neighbouring countries collapsed but China's did not.[5] US-based scholars have long argued that China will eventually liberalize the capital account because it is committed in principle to RMB internationalization for both practical and status reasons.[6] According to this argument, the RMB cannot become a major global currency to rival the dollar if it is not fully convertible, so Beijing will eventually have to step back if it wants to achieve its stated goals.[7] So far, however, predictions of capital account liberalization have not panned out. After 2015 and 2016 saw large capital outflows, the government re-imposed strict capital controls.[8] Nearly a decade later, capital outflows are still tightly regulated.[9]

The English-language literature on this topic offers various explanations for why China is reluctant to expose its financial system to the free movement of capital. Michael Pettis has argued that free capital flows would impose market discipline, which would challenge China's model of domestic political economy.[10] Eswar Prasad assesses that China's "end game" is "a capital account that is largely open but still subject to some degree of administrative control," presumably because the state wants to preserve the ability to halt capital flight during financial panics.[11] Christopher McNally and Julian Gruin even argue that history dictates that China has no choice in the matter: as China rises, full capital account liberalization is becoming unnecessary because "path dependencies generated by Sino-capitalism" are forcing the international monetary system to "accommodate" RMB "internationalization without full convertibility."[12] The varying perspectives in the English-language literature have a common theme: they interpret RMB internationalization as a story of political economy rather than national security. The tension is supposedly between the CCP's desire for global economic power and prestige on the one hand, and its fear of losing market discipline on the other. Indeed, most of the English-language literature on the Chinese economy generally focuses on conventional economic competition and peacetime state–market dynamics, rather than China's financial preparations for great power conflict.[13]

But what if China's RMB internationalization strategy is driven more by fear of financial conflict with the US than fear of compromising market discipline? China has good reason to conduct such financial contingency planning. Between the Korean War's outbreak (1950) and the normalization of relations with the US (1972), China was cut off from the dollar system and placed under a total US trade embargo, forcing it to conduct essential trade using pounds sterling, or through barter.[14] In the past 15 years, the US has demonstrated its willingness and ability to use crushing financial sanctions against Iran, North Korea, Venezuela and Russia. Since 2018, the US has launched a "trade war," rallied the G7 to pledge to "de-risk" trade with China, and adopted an "integrated deterrence" strategy that implicitly threatens financial punishment if China moves against

4 Zhou 2009.

5 Nolan 2021.

6 Prasad 2021.

7 Gerding and Hartley 2023; Eichengreen 2022.

8 "China steps up capital controls, tightens investment rules for state firms." *Reuters*, 18 January 2017, https://www.reuters.com/article/business/china-steps-up-capital-controls-tightens-investment-rules-for-state-firms-idUSKBN1520UJ. Accessed 8 August 2023.

9 Clayton et al. 2023.

10 Pettis 2022.

11 Prasad 2020, 360.

12 McNally and Gruin 2017, 623.

13 Huang, Yukon, and Slosberg 2023; Wang, Tao 2023.

14 Schenk 2004; Shu 2002.

Taiwan. Chinese historiography emphasizes that the US has frequently used financial warfare to cripple the economies of past rivals, including Japan in the 1980s.[15] It is inconceivable that Chinese financial elites are not taking the risks of more extreme conflict scenarios into account.[16]

We use untapped open sources to assess Chinese elite thinking about the sensitive topic of financial warfare. Since the Chinese government does not comment publicly on crisis scenarios, we restrict our discussion to two dozen commentaries by senior scholars and former officials from China's top universities and Party and state institutions, including the military.[17] To capture a diversity of viewpoints, we selected these materials from a broader sample of papers pulled from the academic database, CNKI. After searching for combinations of relevant keywords, we filtered out irrelevant material and works by less prominent scholars and researchers at less influential institutions. Thereafter, we selected works from highly credentialed individuals with substantial academic, military and/or economic policymaking experience, aiming for a broad sample of relevant institutional affiliations. All but the National Defense University is responsible – directly or indirectly – for one or more key aspects of China's financial stability.

These sources do not agree on every detail, but the differences are in shades, not colours. Some commentators in our sample, such as Huang Yiping 黄益平 and Chen Weidong 陈卫东, are reform-minded economists who may be invoking national security to support policy programmes that lean towards liberalization. Others, such as Qiao Liang 乔良, who is famous for co-authoring *Unrestricted Warfare* (1999), are hardline military professionals with only limited understanding of global finance and may genuinely believe in conspiracy theories about the US government's influence over global financial markets. We do not "weigh" some sources more than others since we lack the space to parse them all in detail. Nor do we elaborate excessively on points of divergence since our sample is too small to ascertain whether the reasons for disagreements are technical, political, ideological, inter-bureaucratic or personal. Our interest, rather, is to identify common themes that cut across the entire discourse.

When read as a corpus, these sources present a basic consensus that a US financial attack on China is likely, if not inevitable, as bilateral relations deteriorate in the longer run. This attack could take two forms: traditional "financial war" (*jinrong zhanzheng* 金融战争) through dollar sanctions, or what Chinese commentators call "monetary sniping" (*huobi juji* 货币狙击) – a speculative attack on the offshore RMB directed by the US government and implemented in collaboration with private market actors. While these commentators occasionally use the terms interchangeably in the direct quotations cited, our analysis distinguishes them clearly. These two grim possibilities follow from Marxist-inflected financial historiography, which emphasizes Washington's supposed long track record of weaponizing dollar hegemony and manipulating currency markets to thwart rivals. Given the high political profile of the Chinese individuals we cite, and the wide range of institutions and technical specialties they represent, we contend that the CCP leadership shares the fears they express and is approaching RMB internationalization for these reasons, using the strategy that they articulate.

In this elite debate, partial internationalization is seen as a compromise strategy. Under ideal conditions, full RMB internationalization would resolve both risks, blunting the efficacy of dollar sanctions while reducing the RMB's vulnerability to a speculative attack. However, as long as

15 Huang, Zhiling 2019, 38. Huang is the chief economist of China Construction Bank.

16 Liu 2023, 71–73.

17 These are the Central Party School, China Foreign Affairs University, Chinese Academy of Social Sciences (CASS), Shanghai Academy of Social Sciences (SASS), National Defense University, Peking University, Renmin University; Bank of China, China Construction Bank, China Development Bank, Export–Import (ExIm) Bank of China, PBoC; China Insurance Regulatory Commission, People's Liberation Army, the State Council's Financial Stability Committee; Bank of China Institute, China Center for International Economic Exchanges, China Institute of Foreign Exchange, CITIC Reform and Development Institute, Evergrande Research Institute, and the State Planning Commission's Economic Research Center.

https://doi.org/10.1017/S0305741025000037 Published online by Cambridge University Press

these two risks loom, China's RMB internationalization strategy faces a catch-22. If the US can trigger a "sniping" attack at any time, China cannot liberalize the capital account, or it would risk making itself vulnerable to financial attacks during the transition period. Yet so long as the RMB is not fully convertible, it is unlikely to de-throne the dollar's hegemonic status – and thus reduce its vulnerability to dollar sanctions – since if presented with a choice, savers would rather hold a fully convertible currency than a non-fully convertible one. Based on a close study of the aforementioned sources, we interpret China's solution to be as follows: first, China must defer a potential financial war with the US until it has established the ability to break free of the dollar financial system expeditiously and without suffering financial collapse. This means China must exercise tactical restraint in relations with the US to stop trade tensions from escalating into the financial domain. Second, China must sign up as many banks as possible around the world to the RMB payment ecosystem. Once this is achieved, if Washington imposed dollar sanctions, China's bilateral trade could shift quickly and seamlessly into RMB. Thus, the debate about whether the RMB will compete with the dollar for global hegemonic status in the far future misses the point of China's current strategy. McNally and Gruin are correct that China seeks *partial* RMB internationalization without capital account liberalization.[18]

This strategy parsimoniously explains several Chinese financial policies that previous scholarship has not identified as interlinked. These include: (1) the contradiction between China's increasingly vocal support for RMB internationalization and its evident lack of interest in liberalizing outbound capital flows; (2) the less-than-proportional retaliation against US tariffs and export controls; (3) Chinese firms' compliance with US sanctions on Russia and Iran; (4) the intense effort to strengthen and centralize financial regulation; (5) the crackdown on cryptocurrencies; (6) the sustained and well-documented intervention in foreign exchange (FX) markets to prevent the RMB weakening; (7) Xi Jinping's personal involvement in expanding RMB swap lines and bringing major trading partners onto the Cross-Border Interbank Payment System (CIPS) for cross-border RMB settlement; and (8) the effort to diversify and conceal its FX reserves, while holding tightly onto a sizeable volume of dollars.

If our analysis is correct, this resilience strategy is making progress, and Beijing is growing more confident that it could weather a major strategic confrontation involving financial war with the US. If Chinese commentators believe that China could stabilize its state banking system from a sudden exogenous shock and use capital controls to stem outflow pressure, then they have reason to believe that it could weather the imposition of dollar sanctions without facing financial collapse. If these commentators, many of whom are decision makers themselves, develop confidence that many of China's trading partners could be persuaded to find workarounds to dollar-payment channels if necessary, it does not necessarily matter that the CIPS currently constitutes only a small share of the global payments market. As the share of China's trade denominated in RMB has grown – surpassing dollar trade for the first time in the summer of 2023 – China's greatest fears about US financial warfare have seemingly receded. The Achilles' heel of this strategy is that partial internationalization nevertheless leaves China vulnerable to a monetary sniping attack on the offshore RMB market.

The balance of this paper proceeds in three parts. First, we review the Chinese analyses of US economic warfare and explain why Chinese commentators expect Washington to escalate from trade war to financial war. Next, we discuss Chinese views of domestic vulnerability to US dollar sanctions and the dilemma that monetary sniping risks pose for RMB internationalization. Finally, we discuss what these commentators propose as China's possible strategy to strengthen domestic financial resilience, while promoting limited RMB internationalization through the trade channel, and show how this strategy is paying dividends.

18 McNally and Gruin 2017.

https://doi.org/10.1017/S0305741025000037 Published online by Cambridge University Press

Fears of Containment, Decoupling and Financial War

Chinese commentators have long linked economic and financial security with national security. If national security is a building, financial security is the "cornerstone" (*jishi* 基石), Major General Zhu Hongda 朱洪达, chief of the PLA Air Force Logistics Department, argued in 2011: it "directly affects the stability of the national superstructure."[19] "Economic security in globalization is closely related to all types of warfare and is bound to affect our military strategy," he added.[20] Huang Zhiling 黄志凌, chief economist of China Construction Bank, put it this way: China must guard its "economic security" with the same focus and dedication as it guards the "spatial security" of its land, airspace and territorial waters.[21] Xi Jinping has made "financial security" a personal priority.[22]

When the Trump administration launched the trade war in 2018, prominent Chinese commentators warned against overreacting. A new era of "trade frictions" had arrived, Huang Yiping 黄益平, a prominent economist and vice-president of Peking University's National School of Development, observed in July 2018.[23] Unlike in previous episodes, it was not just US companies who were complaining about China's supposedly unfair practices: US officials now seemed to believe that "past US government policies supporting China's reform and opening have failed," he noted.[24] A growing community of US security experts had also begun to describe China as a "competitor challenging US leadership" in a broader sense.[25] Huang was relatively unconcerned that the trade war itself might derail China's long-term development. China "does not have to fear the trade conflict" and should "retaliate where it is necessary to retaliate, reform where it is necessary to reform, and ignore where it is necessary to ignore," he counselled.[26] The overriding concern, rather, was that the trade war would escalate to a financial war.

It was widely believed that Trump's trade war was not intended to address the current account deficit but to derail China's economic rise. Noting that the Democrats did not seem to oppose Trump's trade war, the former Bank of China president, Li Lihui 李礼辉, foresaw in 2019 that "whether we treat the US as a strategic rival or otherwise," its "long-term policy orientation" will be towards confrontation.[27] "This will not be fundamentally altered by changes of party in the US."[28] Indeed, China's aspiration to shape the international economic order to accommodate China's interests reflected the assumption that the US would not allow China to rise within the existing order. As Wang Fan 王帆, president of the China Foreign Affairs University, noted in 2022, the "US strategic community is basically unanimous in its judgment" that China seeks to be a regional hegemon in the Asia-Pacific, and ultimately a global hegemon.[29] Wang argued that the likelihood of "systemic war" was small.[30] However, "the risk of a major military conflict … has not been completely eliminated" and "the likelihood and frequency of conflict between

19 Zhu 2011, 5. Zhu was the chief of Air Force Logistics and a member of the National Committee of the 12th Chinese People's Political Consultative Conference.
20 Ibid., 7.
21 Huang, Zhiling 2020, 24.
22 Liu 2023, 71–73.
23 Huang, Yiping 2018, 26. Huang is the Jinguang chair professor of finance and economics and vice-president of Peking University's National School of Development. He was formerly a member of the PBoC's Monetary Policy Committee.
24 Ibid., 26.
25 Ibid.
26 Ibid., 27.
27 Li, Lihui 2019, 22. Li is a senior researcher at the CITIC Reform and Development Institute and was previously president of the Bank of China.
28 Ibid.
29 Wang, Fan 2020, 140. Wang is the president of the China Foreign Affairs University's Institute of International Relations.
30 Ibid., 141.

https://doi.org/10.1017/S0305741025000037 Published online by Cambridge University Press

China and the US will be high," especially in areas short of kinetic war.[31] Other Chinese commentators broadly agreed. A hot war between the US and China was unlikely, although not impossible.

More likely than war, and certain to accompany any war that might occur, was a concerted US effort to "strategically contain" (*zhanlüe ezhi* 战略遏制) China through economic means. This effort, it was argued, might follow the playbook supposedly used against Japan in the 1980s.[32] According to Chinese historiography, the US forced Japan to open its capital account, then manipulated its currency through the Plaza Accord of 1985 and finally arranged for the popping of the Japanese asset price bubble in 1991.[33] As early as 2011, Zhu Hongda warned that the US might use a similar playbook to force RMB appreciation, "making Chinese manufacturing uncompetitive" and "setting back China's economy by ten years … just like it did with Japan in the 1980s."[34] The common assumption was that China should study "previous US strategic containment practices" for clues about what was coming.[35]

Chinese commentators expressed confidence that China could sustain its development despite US "containment" – so long as economic tensions did not escalate quickly. By "formulating a correct response strategy," including self-reliance in critical supply chains and strong ties with foreign trade partners, Huang predicted that China could "crack" the US containment strategy.[36] Another reason for confidence was that full economic decoupling (*tuogou* 脱钩) – the defining feature of the original Cold War – seemed neither realistic nor desirable for the US.[37] In May 2020, the Politburo Standing Committee announced the "dual circulation" concept, which closely matched this logic.

The main reason for such optimism was the expectation that third-party countries were expected to oppose the US if it tried to force full trade decoupling. If Washington attempted to sever "decades-old ties" and "integrated supply chains between the world's two largest economies," it would be "bound to lead to chaos," Wang noted.[38] With "emerging economies now accounting for 70 per cent of the world's economy … even if China … breaks off economic cooperation with the developed countries, they could form a complete system on their own."[39] Huang Zhiling agreed. He predicted that "even under extreme circumstances," such as an economic blockade, "we can ensure sustained economic growth of at least 5 per cent by relying solely on our own domestic demand and accelerating supply-side reforms."[40] This prediction also rests on the assumption that many other countries, including major European ones, would not be "led by the nose" into participating in US "containment."[41] Wang may have been gesturing at this idea when he sardonically observed that the US strategy seemed to be regressing from "wanting to decouple" (*xiang tuogou* 想脱钩), to "not being able to decouple" (*buneng tuogou* 不能脱钩), to "not daring to decouple" (*bugan tuogou* 不敢脱钩).[42]

The US threat of selective and gradual decoupling was more credible, albeit more of a long-term challenge to China's competitiveness than an immediate risk. Hu Xiaopeng 胡晓鹏 and Su Ning 苏宁 of the Shanghai Academy of Social Sciences pointed out in 2022 that the push for decoupling had "made a comeback in the Biden administration" in the form of the "small yard, high fence" strategy

31 Ibid.
32 Huang, Zhiling 2019, 38.
33 Xu, Shanda 2019, 28. Xu Shanda is a senior researcher at the CITIC Reform and Development Institute and former deputy director of the State Administration of Taxation; Niu 2022, 42–43.
34 Zhu 2011, 6. Zhu was actually correct on both counts.
35 Huang, Zhiling 2019, 41.
36 Ibid., 42.
37 Wang, Fan 2020, 142.
38 Ibid.
39 Ibid.
40 Huang, Zhiling 2019, 42.
41 Ibid., 42–43.
42 Wang, Fan 2020, 145.

https://doi.org/10.1017/S0305741025000037 Published online by Cambridge University Press

(*xiaoyuan gaoqiang* 小院高墙).[43] Its goal was to "reduce the linkage between the two countries' economic relations as a starting point," focusing on science and technology.[44] Biden's approach could present a problem for China's development, particularly if other advanced economies followed the US. The silver lining was that the US embrace of selective decoupling seemed implicitly to acknowledge that rapid, full decoupling was unlikely.

A more immediate and significant risk was that trade disruptions might harm China's financial stability. These could follow four pathways. First, tariffs would hurt China's export sector and drive away foreign direct investment.[45] Second, tariffs would harm China's terms of trade, potentially pushing China's balance of payments into deficit and increasing market pressure "for a new wave of capital flight" and eventual currency devaluation.[46] Third, a slowing economy could weaken domestic confidence, increasing the risk of bank runs. Multiple commentators noted that these "risk contagion mechanisms" or "risk amplification mechanisms" deserved close scrutiny by regulators.[47] Fourth, Chinese asset markets are managed, so they do not always reflect perfect information about market participants' expectations. This exposes China's financial system to the risk of a sudden stop, or "Minsky moment," in which the market forms irrational expectations, leading to sudden mass sell-offs of assets.[48] Altogether, Huang warned, trade war could "significantly increase … the risk of a systemic financial crisis."[49]

Some commentators feared that the US might deliberately expand the trade war into the financial domain. "Most of the financial wars we have seen" since the end of the Bretton Woods system have been state actions, Qiao Liang, another PLA major general, argued in 2016. "Basically, all of them have been launched by one country: the US."[50] Trump's erratic policies made this a mainstream view. To be sure, a full-blown financial war was seen as unlikely in peacetime. As Li Ruoguo 李若谷 of CITIC and China ExIm Bank argued in 2019: "If the dollar is used as a weapon against China, the US stands to lose much unless the two sides really fight; then it will be a hot war. Until there is a hot war, there is no need to use the dollar as a weapon."[51] Xiao Chen 萧琛 of Peking University agreed that "the conditions for both sides to fight a financial war" were currently "far from sufficient."[52] Nevertheless, the risk was not zero – and it seemed to be growing, especially given the growing tensions over Taiwan. Huang Zhiling elaborated on the financial war scenario in a 2020 paper dedicated to the subject.[53] Huang Yiping predicted that economic conflict with the US would continue for the long term and would "not be limited to the trade area, but a full range."[54] Some degree of escalation was therefore inevitable.

Financial wars are categorically different from trade wars, Chinese economists have emphasized. Trade wars involve "many economic entities with their own interests and are often difficult to sustain in the long run, especially between large economies with highly interdependent markets."[55]

43 Hu and Su 2022, 29. Hu and Su are, respectively, deputy director and associate researcher at the Institute of World Economy, SASS.
44 Ibid., 30.
45 Tang 2018, 63. Tang is a senior researcher at the Center for Global Economics and Finance, Institute of Finance and Banking, CASS.
46 Huang, Yiping 2018, 27.
47 Tang 2018, 63; Huang, Yiping 2018, 27.
48 Qi, Juniper and Zhang 2015.
49 Huang, Yiping 2018, 27.
50 Qiao 2016, 70. Qiao is a professor of strategy at the National Defense University and a retired PLAAF Major-General. He is the author, with Wang Xiangsui, of *Unrestricted Warfare*. See Qiao and Wang 1999.
51 Li, Ruogu 2019, 33. Li is a senior researcher at the CITIC Reform and Development Institute and former president, chairman and Party committee secretary of China ExIm.
52 Xiao 2019, 8. Xiao is head of the international economics department of Peking University.
53 Huang, Zhiling 2020.
54 Huang, Yiping 2018, 26.
55 Huang Zhiling 2020, 25.

https://doi.org/10.1017/S0305741025000037 Published online by Cambridge University Press

History also suggests that trade restrictions can be circumvented by smuggling, and that the sanctioning party often incurs "self-inflicted injuries."[56] By contrast, financial wars are prosecuted by a small number of professionals and oligarchs "whose interests are much more compatible with politicians."[57] They also inflict more asymmetrical damage, emerge faster and with less warning and can be harder to evade without careful advance preparations.[58]

These arguments evoke the Marxist emphasis on the link between financial capital and imperialist hegemony. As Niu Wenxin 钮文新 from the State Council's Financial Stability Committee argues, "financial plundering" is the common thread connecting the privateers of the 17th century, such as Sir Francis Drake, to the Opium Wars, and to the US hedge-fund managers trading in emerging markets today.[59] Imperialism and capitalism are self-reinforcing phenomena: "Capital supports the war effort, the war effort opens up markets, and the markets support capital plunder."[60] Niu argues that the era of financial capital began in the First World War, when Britain focused on "destroying the opponent's financial capacity" to weaken its war effort.[61] When Trump's trade war inevitably fails to derail China's development, the US will inevitably turn to financial war. "Judging from the past practice of the US in containing its competitors," Huang Zhiling observed, Washington "ultimately creates financial crises through financial wars in order to achieve the effects that cannot be achieved by trade wars."[62]

In the PLA, which does not primarily work on macroeconomic issues, Marxist doctrine has long encouraged such conspiratorial thinking. In 2011, Zhu Hongda claimed that "US financial institutions take advantage of a country's financial market deficiencies and regulatory loopholes to create financial turmoil and siphon off the country's wealth through a series of financial operations."[63] He added that the US had used these tools to "subdue Mexico, punish South-East Asia, attack Russia and hit Western Europe hard."[64] Qiao Liang made identical arguments in his presentation in Beijing to senior economic officials in March 2016.[65] Qiao explained that "US financial warfare is characterized by the creation of trends … When a trend is formed, financial speculators [such as George Soros] make profits for themselves while enabling the US to achieve its strategic interests."[66] Qiao claimed that the capital cycle itself is such a trend. When the Federal Reserve lowers interest rates, it opens the "floodgates," allowing capital to flow into developing countries. When it raises rates, the gates close and capital flows reverse.[67] This pattern was repeated in Latin America between 1971 and 1980, in South-East Asia between 1987 and 1997 and in China between 2002 and 2012.[68] In each case, Qiao alleged, the US used the capital cycle not only to enrich its investors but also to weaken the affected countries and force them to accept US hegemony. Several very senior economists in attendance responded affirmatively and in detail to Qiao's presentation, according to the rapporteur's report. None contested his claims.[69]

56 Ibid., 26.
57 Ibid., 25.
58 Ibid., 26.
59 Niu 2022, 16–36.
60 Ibid., 24.
61 Ibid.
62 Huang, Zhiling 2019, 43.
63 Zhu 2011, 6.
64 Ibid.
65 "Jinrongzhan yu xiandai zhanzheng ji wojun biange qianjing zhanwang" (Financial and modern warfare and the prospects for the transformation of our military). Speech given by Qiao at the CITIC Foundation for Reform and Development Studies on 16 March 2016.
66 Qiao 2016, 70.
67 Ibid.
68 Ibid., 73–75
69 In attendance were Huang Jin, president of China University of Political Science and Law (CUPL), and three CUPL senior academics, among others.

https://doi.org/10.1017/S0305741025000037 Published online by Cambridge University Press

Even among serious Chinese economists, although admittedly less extreme, there is evident paranoia about the US government's ability to steer financial markets to advance its geopolitical interests. Chen Weidong of the Bank of China has warned that "the US has considerable soft power" over the "discourse of international finance," which it supposedly exercises in part through the credit ratings agencies.[70] Ren Zeping 任泽平, chief economist of the China Evergrande Group, has accused the US government of influencing the credit-rating agencies S&P and Moody's to downgrade the ratings of US adversaries to trigger capital flight.[71] In 2019, Chen accused Citi Bank and Merrill Lynch of "lowering the valuation of Chinese financial institutions" by characterizing Hong Kong as a risky place for foreign investors.[72] Zhu Hongda, of the PLA, has similarly claimed that the ratings agencies exploit their "discourse hegemony" to act as "behind-the-scenes 'crisis pushers'," destabilizing the financial systems of US adversaries from within by undermining market confidence in their creditworthiness.[73] This fear extends to the financial research products produced regularly by Western sell-side banks. Niu blames a Morgan Stanley research note for popping the Japanese asset bubble in 1991.[74] Even if serious Chinese economists do not believe these claims, it reveals something about the politics of elite conventional wisdom that they felt compelled to repeat them.

The American "Sniper"

Of all the financial conflict scenarios, Chinese commentators appear most concerned about the risk of monetary sniping. In the Chinese security literature, the term refers to strategically motivated currency wars. Powerful private interests, sometimes working in coordination with states, engage in highly profitable attacks against the financial systems of sovereign countries. "Snipers" operate stealthily, coordinating via informal measures and rarely publicly announcing their moves. They leverage market psychology, activating the market's "panic mechanism" and producing "contagion."[75] Rapid shorting, for instance, sends a market signal of an impending crash, and the resulting capital flight can make the short trade a self-fulfilling prophecy. When paired with financial warfare that suddenly shuts down financial transactions and payment clearing channels, snipers can cause the "sudden death" of the target country's financial system within a "short period."[76] A "long-term financial war" of sustained dollar sanctions can also push a country's economy into a "long period of stagnation," of course.[77] However, not all such wars are long.

The US itself has supposedly used monetary sniping on numerous occasions to crush its enemies and derail the growth trajectory of its strategic rivals. In the post-Bretton Woods era, "all financial wars are usually fought between one currency and another through exchange rates and exchange systems," Xiao Chen argued in 2019.[78] Capital flight crashes the target country's currency, forcing it to deplete its FX reserves. Private speculators then "take advantage of the fire to seize huge profits." Xiao cites several examples: the Mexican peso crisis of 1994, the Thai baht crisis of 1997 and the 1999 "samba crisis" in Brazil.[79] In each case, the US government and private capital supposedly colluded to bring about financial ruin.

70 Chen, Weidong 2019, 36. Chen Weidong is a senior researcher at the CITIC Reform and Development Institute and president of the Bank of China Research Institute.

71 Ren et al. 2019, 2; Chen, Weidong 2019, 36. Ren, one of China's most famous economists, is the former chief economist of China Evergrande Group and deputy director of the macro research department of the State Council's Development Research Center.

72 Chen, Weidong 2019, 36.

73 Zhu 2011, 6.

74 Niu 2022, 42.

75 Huang, Zhiling 2020, 25.

76 Ibid., 24.

77 Ibid.

78 Xiao 2019, 7.

79 Ibid.

https://doi.org/10.1017/S0305741025000037 Published online by Cambridge University Press

Monetary sniping tends to target countries that have recently liberalized their capital accounts. According to Niu, the US tricked the South-East Asian countries into opening themselves up in the years leading up to 1997, just as it had tricked Japan in the previous decade.[80] Similarly, East European countries in the 1990s faced "disastrous" consequences when they yielded to Western pressure to liberalize their capital accounts prematurely, according to Gao Xingwei 高惺惟 of the Central Party School.[81] Capital controls were also the fundamental reason why China's financial system survived the 1997 and 2008 financial crises and the 2015 stock market crash.[82]

Despite its closed capital account, China's trade dependence and offshore RMB render it vulnerable to a combination of dollar sanctions and currency sniping. According to Huang Zhiling, a trade-dependent economy such as China's "is inseparable from global trade, clearing, payment, investment and financing," so it will suffer a devastating blow to its overall economy if it is cut off from the international financial markets."[83] This view became widespread among Chinese elite financial circles around 2019, as elite opinion about relations with the US began to harden. "We need to beware of the risks brought by US financial sanctions to China," argued Gao. "Their influence is greater than trade sanctions, but more likely to be implemented and harder to circumvent."[84] Despite the threat of dollar sanctions, Huang warned that "financial warfare" as a concept also includes "currency sniping" that exploits "serious loopholes in the financial system."[85]

If Washington is capable of forcing rapid moves in the offshore RMB exchange rate, it could either force appreciation, thereby hurting China's trade competitiveness, or short the RMB to trigger capital outflows and destabilize China's financial system.[86] Which strategy Washington might choose would depend on how quickly it wanted to destroy China's economy. As Huang Zhiling put it, Washington "does not want your currency to depreciate when fighting a trade war, but it's different when it comes to financial war, when the goal is to destroy your currency."[87] In 2019, Chen Yuan 陈元, a former governor of China Development Bank, argued that China's FX reserves were "the primary battlefield of a potential 'financial war' between China and the US because the US may exert pressure on China through the exchange market."[88]

Sniping risks therefore pose a dilemma for RMB internationalization. On the one hand, full RMB internationalization would insulate China against sniping risks and, in the long term, is the best possible guarantee against sniping. However, relaxing capital controls means liberalizing the exchange rate. As Gao puts it: "the process of internationalization is itself a process of deregulation. The internationalization of the RMB will have an impact on the foreign exchange market, which will lead to exchange rate fluctuations."[89] In the period before the RMB became both fully convertible *and* widely adopted overseas, China would be vulnerable to a sniping attack for a certain period of

80 Niu 2022, 43.

81 Gao 2019, 65. Gao is an associate professor at the economics department of the Central Party School and a researcher at Renmin University's International Monetary Institute; Li, Kemu 2019, 35. Li is a senior researcher at the CITIC Reform and Development Institute. He was the vice-chairman and deputy Party secretary of the China Insurance Regulatory Commission.

82 Gao 2019, 65.

83 Huang, Zhiling 2020, 24.

84 Gao 2019, 62.

85 Huang, Zhiling 2020, 24.

86 Ren et al. 2019, 3; Chen, Weidong 2019, 36. Ren and Chen make similar arguments.

87 Huang, Zhiling 2019, 50.

88 "Chen Yuan: yao jiaqiang renminbi de guoji diwei jiaqiang huilu de tanxing he renxing" (Chen Yuan calls for strengthening the international status of the renminbi and strengthening the flexibility and resilience of exchange rates). *Finance.sina.com.cn*, 10 August 2019, https://finance.sina.com.cn/money/bank/bank_hydt/2019-08-10/doc-ihytcitm8187120.shtml. Accessed 8 August 2023, quoted in Liu 2023. Chen was the chairman of the China Development Bank from 1998 to 2013. He is the son of former vice-premier, Chen Yun.

89 Gao 2019, 65.

https://doi.org/10.1017/S0305741025000037 Published online by Cambridge University Press

time. Full RMB internationalization could take place only in a "stable macro-financial environment" – and such an environment no longer exists, if it ever did.[90]

Policy Responses

Based on the above analysis, it follows that China should exercise restraint in the face of US economic pressure while it prepares for the risk of more extreme financial conflict. This section explains some of the policy implications of that conclusion and shows how they match a broader fact pattern of Chinese economic policy behaviour. While the Chinese commentators, owing perhaps to their respective expertise and beliefs, differ in their threat assessment and policy recommendations, they constitute a comprehensive playbook with significant explanatory power when taken together.

The first major implication is that China must avoid an escalating cycle of economic and financial retribution with the United States. Huang Yiping put it this way: "Before deciding on a countermeasure, one should make a judgment on the big picture."[91] Zhang Ming 张明 of CASS avers: "It would be foolhardy to extend the trade war into the financial domain, where the gap between China and the US … is much larger, and China is even more exposed to US retaliation."[92] Instead, China should "hide its brightness and bide its time" (*taoguang yanghui* 韬光养晦).[93] Above all, China's strategy should be to "keep the trade friction … in the 'trade area' as much as possible, and to maintain positive cooperation … in the financial area to avoid expanding trade friction to the financial area."[94] These arguments explain China's less-than-proportionate responses to the Trump administration's trade war and the Biden administration's semiconductor export controls, and they anticipated the announcement of the "dual circulation" policy in 2020.[95]

One of the most important forms of restraint is to comply with US sanctions on friendly countries. Li Lihui argues that Chinese institutions should strive to follow US laws whenever possible. "Even if we do business in China," she warns, "we have to be careful not to get involved with the US Office of Foreign Assets Control (OFAC) sanctions list."[96] In line with this analysis, Chinese businesses have respected US sanctions on Russia and Iran, acknowledging the Biden administration's implicit threats of secondary sanctions. However, pushing back against the US government's use of "long-arm jurisdiction" (*changbi guanxia* 长臂管辖) *inside* China is seen as unlikely to invite US financial retaliation.[97] In the two years after Li's article was published, China's legislature promulgated a raft of new laws, such as the Anti-Foreign Sanctions Law of 2021, to restrict US courts' ability to control economic activity inside China.

The second policy implication is that the CCP must strengthen and centralize its control over the broader financial system, not just the capital account. Since the pandemic, China has kept its capital account extremely tight, in line with what former vice-chairman of the China Insurance Regulatory Commission, Li Kemu 李克穆 and others, mentioned above, recommended (but contrary to Western experts' pre-pandemic expectations).[98] In September 2021, Chinese regulators also cracked down hard on cryptocurrency mining and trading, tightening control over cross-border financial flows. Xi Jinping's work report at the 20th Party Congress in October 2022 noted that "many major issues need to be resolved in order to guard against financial risks" and announced the

90 Ibid.
91 Huang, Yiping 2018, 27.
92 Zhang et al. 2018, 2. Zhang is director of the international investment research department, Institute of World Economy and Politics, CASS.
93 Huang, Zhiling 2019, 45.
94 Ibid., 46.
95 Zhang et al. 2018, 1.
96 Li, Lihui 2019, 25.
97 Savio et al. 2021; Li, Lihui 2019, 23.
98 Li, Kemu 2019, 35; Gao 2019, 62; Ren et al. 2019, 3.

https://doi.org/10.1017/S0305741025000037 Published online by Cambridge University Press

creation of the National Administration of Financial Regulation (*Guojia jinrongjiandu guanlizongju* 国家金融监督管理总局) – a reorganized super-regulator.[99]

Third, China should intensify its efforts to sign up as many countries as possible to RMB payment platforms. Beijing has been aware that this strategy is a potential dollar sanctions hedge since Russia and China first set up their own financial messaging systems (Russia's System of Transfer of Financial Messages (SPFS) and China's CIPS) in 2014 and 2015, respectively.[100] Huang Zhiling called SPFS a "necessary backup mechanism in international conflicts" and advised China to "take the initiative to dock with it."[101] As Gao Xingwei noted in 2019, CIPS would allow Iran and other countries under US sanctions to buy Chinese goods with RMB.[102] What is new is that since China reopened after the COVID-19 pandemic, Xi himself has begun to participate actively in the effort to sign up foreign partners to CIPS. Xi's first post-pandemic trips out of China were to Russia and Saudi Arabia, where he signed major energy deals with both countries and agreements to settle trade in RMB, an arrangement that seemed like a quid pro quo. The first major Western leader Xi received in Beijing after the pandemic reopening, French president Emmanuel Macron, agreed to encourage more French banks to join CIPS. Early data suggest that these efforts are paying off. The RMB share of global payments is still small, rising from 0.98 per cent in December 2017 to 1.67 per cent in March 2023, according to Bloomberg.[103] The RMB's share of global trade finance rose from 2.5 per cent to 4.5 per cent in the same period. However, the metric that matters most – the share of China's cross-border transactions settled in RMB – exeeded 50 per cent for the first time in 2024.[104]

Fourth, China should maintain a stable exchange rate versus the dollar: "Maintaining the relative stability of the RMB exchange rate" is important for managing the risk of US financial warfare, Zhu noted in 2011.[105] In particular, China cannot show weakness by allowing its currency to depreciate sharply – even when market forces push strongly for it – because a strong currency is its own insurance policy, whereas a weakening currency invites a sniping attack. This overriding concern for stability explains why China intervened to prevent RMB appreciation in 2020 and 2021, and then to prevent depreciation between 2022 and 2024.[106]

Fifth, China has diversified its FX reserves while obscuring the precise breakdown of its holdings. China is not holding dollar assets in order to dump them in retaliation for US financial warfare, as some commentators have speculated.[107] If China were to do this, the prices of the assets it was trying to sell would plummet, and would ultimately "suffer the greatest loss," Gao Xingwei has warned.[108] China instead needs to hold dollars because it may need them to defend the RMB against a US-directed sniping attack. At the same time, putting "all the eggs in one basket" is "hugely risky," given that US sanctions might make it hard for China to exchange its dollars in a crisis.[109] According to Chen Wenling 陈文玲 of the China Center for International Economic Exchanges, the dilemma is that "to defend against possible financial risks, China must hold onto

99 Xi 2022.

100 Xu, Wenhong 2019, 27–28. Xu is an associate researcher in the department of the Russian economy, CASS. See also "Sistema peredachi finansovykh soobshcheniy" (Financial messaging system). *Cbr.ru*, 2023, https://www.cbr.ru/PSystem/fin_msg_transfer_system. Accessed 8 August 2023.

101 Huang, Zhiling 2019, 52.

102 Gao 2019, 66.

103 "Brazil takes steps to transact in yuan as China ties grow." *Bloomberg*, 30 March 2023, https://www.bloomberg.com/news/articles/2023-03-30/brazil-takes-steps-to-transact-in-yuan-as-ties-with-china-grow. Accessed 8 August 2023.

104 Sandlund 2024.

105 Zhu 2011, 5.

106 Setser 2023.

107 Setser 2018.

108 Gao 2019, 62.

109 Ibid.

https://doi.org/10.1017/S0305741025000037 Published online by Cambridge University Press

a certain amount of dollars … but if we hold too many, the risks will increase accordingly."[110] Chen Weidong recommends increasing the share of gold reserves.[111] China therefore needs to strike a balance in reserve composition, while keeping the precise currency breakdown of reserves opaque, as a form of deterrence against currency sniping. This logic explains the fact pattern. China's State Administration of Foreign Exchange (SAFE) has taken these recommendations on board: it revealed in 2019 that its share of dollar assets had declined from 79 per cent in 1995 to 58 per cent in 2014.[112] In 2020, it pledged to diversify them further "steadily and prudently."[113] However, it has not released precise numbers for a decade.

Sixth, China has aimed to deter a sniping attack by obscuring the true size of its FX reserves. In April 2023, Chen Weidong called for "hiding FX among the people" (*canghui yumin* 藏汇于民).[114] In addition to this measure, there is also evidence of the institutional obscuring of reserves. Two months later, Brad Setser published calculations revealing that China had trillions of dollars of unacknowledged FX reserves in its state banking system, which it had accumulated through years of misreported balance-of-payments data.[115] Setser speculated that China may be using these reserves to manage the exchange rate (and potentially cover up leakage through the capital controls) without attracting attention. Possibly, China simply wants to avoid being labelled a currency manipulator. However, obscuring the size of dollar reserves held in the state banking system and using them for stealth exchange rate interventions might also help to deter or respond to currency sniping.

Conclusion

This paper has shown that China's elite experts and decision makers appear far more afraid of a concerted financial war with the US than autonomous market forces. These elite individuals always doubted that the Trump trade war would escalate to full trade decoupling, which explains why China did not concede to the Trump administration's key demands. However, they anticipated that the underlying goal of the trade war was strategic containment, that it could easily expand to the technological and financial domains, and that while this process may be inevitable, it must be delayed at all costs. This explains why China exercised restraint in the use of retaliatory tariffs and moved quickly to bolster domestic self-sufficiency in technology and strengthen its financial supervisory capacity, while abiding strictly by US sanctions on other countries. The strategy was to buy time to build financial resilience.

The sources suggest that China's approach is, to a degree, rooted in historical analysis, drawing lessons from Japan in the 1980s, South-East Asia in the 1990s and Russia since 2014. The assumption is that the US has a standard playbook for financial warfare, which it may use against China in a crisis. Notably, Chinese commentators express optimism that the US probably would not dare to try to strike China off from the global trading system, since third-party countries would surely resist. However, if the US did restrict China's access to the SWIFT and CHIPS and use its familiar sniping tactics to attack the RMB, China could find its ability to conduct essential cross-border trade badly disrupted. According to this logic, if China liberalizes its capital account, it risks playing into the hands of the US "sniper." Thus, rather than seeking full RMB internationalization, China appears to be laying a foundation of institutions and relationships that would allow it to stabilize the exchange rate and shift international trade quickly off the SWIFT and CHIPS should dollar

110 Chen, Wenling 2023, 97. Chen is chief economist of the China Center for International Economic Exchanges and a former professor at Peking University.

111 Chen, Weidong, Xiong and Zhao 2023, 15.

112 Ito and McCauley 2019.

113 Yeung 2020.

114 Chen, Weidong, Xiong and Zhao 2023, 15.

115 Setser 2023.

https://doi.org/10.1017/S0305741025000037 Published online by Cambridge University Press

sanctions be imposed. This is the core logic of partial RMB internationalization: it is not a *waypoint*, it is the *destination*.

Over the past five years, China has adopted nearly all the policy recommendations that the commentators cited here have proposed. It has reorganized and centralized domestic financial regulatory authority to build resilience against a potential sniping attack.[116] It has taken no steps to liberalize the capital account, even tightening capital controls over time. It has intervened in the FX markets to prevent RMB depreciation and has promised its trade partners that it will maintain a stable currency. It has optimized its FX reserve composition. Finally, and most importantly, it has promoted RMB internationalization aggressively, but only through the trade channel, by striking bilateral agreements to move trade immediately onto CIPS. The success of this strategy along many dimensions provides reason to believe that the deterrent value of the US threats of financial punishment has declined since the early Trump administration.

The sources also imply that China's lingering vulnerability, which will persist as long as its currency remains non-fully convertible, is an attack on the offshore RMB market. A payments-only approach to currency internationalization can work only if China can credibly guarantee to maintain a stable exchange rate and liquid offshore RMB market.[117] In other words, even if the onshore RMB is not fully convertible into dollars, the offshore RMB must be – and the market must be liquid enough that the exchange rate is somewhat predictable. An attack on the RMB would be no small undertaking. If Setser's calculations are correct, China has up to $6 trillion in FX that it could theoretically use to defend the currency. It is, therefore, hard to imagine that the US could or would mount such an expensive and damaging attack outside of a wartime context. In principle, however, it is conceivable that a sufficiently motivated US government could weaponize the dollar-printing machine against China by using the Federal Reserve or a special Treasury Department facility to short the RMB. This would be the monetary sniping scenario that Chinese commentators fear most.

Acknowledgements. The authors are grateful to the anonymous reviewers for their constructive and insightful feedback.

Competing interests. None.

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116 He 2022.

117 Eichengreen et al. 2022.

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Cite this article: Freymann E, Heng C (2025). The Logic of Partial RMB Internationalization: PRC Perspectives on "Financial War". *The China Quarterly* 1–16. https://doi.org/10.1017/S0305741025000037