UDC 339.7 Вестник СПбГУ. Сер. 5. 2016. Вып. 1

Sergey F. Sutyrin, Vladimir N. Kovalenko

INTERNATIONALIZATION OF CURRENCY IN EAST ASIA: PREMISES, IMPLEMENTATION, POSSIBLE PROSPECTS

This article covers the issues concerning the process of internationalization of currency in East Asia as represented by the Japanese Yen and the Chinese Yuan. The Japanese Government began to support the process of Yen internationalization in the 1980s. The main obstacle to the overall internationalization of the Yen was the immaturity of the financial market. Despite the initial success, the liberalization of Japan's financial system ultimately resulted neither in the further strengthening of the Japanese economic position on the global stage, nor in the strengthening of the position of Yen in the overseas markets. The main reason for this failure was US political pressure that imposed accelerated opening of financial markets and significantly reduced the capabilities of Japan to counter speculative capital inflows from abroad. At present the Japanese currency hasn't managed to become a real rival to the USD, which resulted from both external and internal reasons. The Chinese government began the same process in 2009. The internationalization of RMB has proceeded largely in line with deliberately designed strategy. At the moment the Chinese economy does not fully meet all the criteria for internationalization of its national currency, but national authorities have managed to move towards the goal of RMB internationalization, while simultaneously securing its financial system against risks. Despite the achieved success — the decision of IMF to include Yuan in the SDR basket on October 1, 2016 — the RMB hasn't achieved the status of an international reserve currency. Despite certain similarities between the Japanese and Chinese experiences, there is a principal difference in the approach to the formation of a developed financial market which is considered to be a key precondition for the success of national currency internationalization. Refs 47. Figs 8.

Keywords: Yuan, Yen, internationalization, financial markets, reserve currency.

С. Ф. Сутырин, В. Н. Коваленко

ИНТЕРНАЦИОНАЛИЗАЦИЯ ВАЛЮТЫ В ВОСТОЧНОЙ АЗИИ: ПРЕДПОСЫЛКИ, РЕАЛИЗАЦИЯ ПРОЕКТА, ВОЗМОЖНЫЕ ПЕРСПЕКТИВЫ

В статье рассматриваются вопросы, затрагивающие процесс интернационализации валюты в Восточной Азии на примере японской йены и китайского юаня. Правительство Японии начало целенаправленно осуществлять поддержку процесса интернационализации йены в 1980-е годы. Главным препятствием для полномасштабной интернационализации йены был недостаточно развитый финансовый рынок. Вопреки первоначальному успеху, либерализация японской финансовой системы в конечном итоге не привела ни к усилению позиций Японии в глобальной экономике, ни к укреплению позиций йены на зарубежных рынках. Главная причина неудачи состояла в чрезмерно ускоренном открытии финансовых рынков под политическим давлением США, в связи с чем возможности Японии противостоять притоку спекулятивного

Sergei F. SUTYRIN — Doctor of Economics, Professor, Head of the Department of World Economy at Economic faculty, St. Petersburg State University, 7/9, Universitetskaya nab., St. Petersburg, 199034, Russian Federation; s.sutyrin@hotmail.com

Vladimir N. KOVALENKO — PhD, External researcher at the Center of Asian Studies of Faculty of Economics Lomonosov Moscow State University; Head of Financial Markets Operations Department of Doncombank, 3, Novatorov str., Rostov-on-Don, 344038, Russian Federation; Vladsat@mail.ru

Сергей Феликсович СУТЫРИН — доктор экономических наук, профессор, заведующий кафедрой мировой экономики, Санкт-Петербургский государственный университет, Российская Федерация, 199034, Санкт-Петербург, Университетская наб., 7/9; s.sutyrin@hotmail.com

Владимир Николаевич КОВАЛЕНКО — кандидат экономических наук, внештатный сотрудник Центра азиатских исследований экономического факультета МГУ им. М. В. Ломоносова; начальник управления по работе на финансовых рынках ПАО «Донкомбанк», Российская Федерация, 344038, Ростов-на-Дону, ул. Новаторов, 3; Vladsat@mail.ru

капитала из-за границы были значительно снижены. Тем не менее в настоящее время японская национальная валюта по совокупности внутренних и внешних причин так и не смогла превратиться в реального конкурента доллара США. Китайское правительство инициировало подобный процесс в 2009 г. Интернационализация юаня в основном осуществлялась на основе тщательно проработанной стратегии. В настоящее время китайская экономика не в полной мере соответствует критериям готовности национальной валюты для интернационализации, но руководство страны, продолжая двигаться к заявленной цели, одновременно реализует меры, призванные снизить возникающие риски. Несмотря на достигнутые успехи — решение, принятое руководством МВФ о включении юаня в корзину валют СПЗ с 1 октября 2016 г., на практике юань все ещё не приобрел полноценный статус международной резервной валюты. Между японским и китайским опытом много общего, однако имеется и принципиальное отличие, которое отражено в разных подходах к формированию финансового рынка. Эффективное функционирование последнего является ключевым условием для успешной интернационализации национальной валюты. Библиогр. 47 назв. Ил. 8.

Ключевые слова: юань, йена, интернационализация, финансовые рынки, резервная валюта.

Introduction

In the XX century, national currency internationalization ultimately aiming at gaining the status of international reserve currencies becomes one of the most important features for the countries, pretending for the leadership in the global economy. This status provides respective states with a number of substantial advantages: first of all it reduces the sensitivity to external economic shocks, as well as promotes trade with other countries.

In the first half of XX century the USA managed to work this way up and after the Second World War the country became an undisputed leader of Western world, with the USD becoming main global reserve currency. Both the USA economic leadership and status of its currency remained unchallenged till late 1960s. Eventually, President Nixon decision to quit from gold cover of USD, economic shocks of 1970s, coupled with continuing war in Vietnam, generated demand for the new opportunities in allocation of foreign exchange assets.

During this period currencies of a certain number of countries had strengthened. Japan was among them. By the beginning of 1980s it politically remained the USA junior partner, while in economic sense in accordance with many parameters acquired the features of superpower. Simultaneously, internationalization of the Japanese Yen took place, which lead to the start of its transformation into one of international reserve currencies. Nevertheless, Japanese government didn't manage to sustain the initial impulse. Yen had never become a real rival to the USD. Famous Japanese economic success of 1980s was followed by the "lost decade" of 1990s.

In the XXI century PRC to a certain extent replicated the Japan's pattern of 1970–1980s. Meanwhile unlike the latter, China is far from being US junior political partner. More than that, RMB internationalization and liberalization of Chinese financial system is carried out on the basis of county's own vision and a strategy totally differing from Washington Consensus principles. Up to the present PRC government has managed to avoid pitfalls on its way to success. Nevertheless, PRC will have to face many serious challenges.

Within the context of this paper the authors aim to find out whether Japan and China fit some basic requirements for the internationalization of their national currencies, explore the character of measures taken, evaluate achieved results, as well as to assess possible prospects in the field.

1. Theoretical background

Internationalization of the national currency is a process of its expansion towards the level when the currency on a regular basis is used beyond the national borders both in "resident — non-resident" and "non-resident — non-resident" types of transactions. It is argued that national currency has successfully completed the process of internationalization, if it is able to perform internationally a range of functions. In particular Patricia S. Pollard [1997] defines three of them — unit of account, store of value, and medium of exchange. George S. Tavlas and Y. Ozeki [Tavlas, Ozeki, 1992, p. 2] add to this list yet another one, namely mean of payments. Besides, as Peter B. Kenen [2012] argues, it's important to distinguish between a country that hosts an international financial center and that has international currency.

More specifically:

1) To secure unit of account function, national currency shall be used for invoicing deals and denominating different financial market instruments.

2) To secure store of value function, non-residents — both physical and legal entities — shall have a possibility to keep without any limitations their savings either in this currency or financial tools denominated in this currency. In their turn, residents of the country of issue shall have a right to offer their financial tools denominating in national currency at the foreign markets. At the same time, all their public offers denominated in national currency shall be judicable in respective foreign countries. Besides, laws and rules, existing there, shall allow any non-resident companies, as well as physical entities, to issue shares and debt securities in the currency of the country, assuming that issued securities are regulated by laws of the country of issue. Ultimately, all these factors should promote establishing of the Euromarket of internationalized currency.

3) To secure medium of exchange function, the state shall eliminate all restrictions on the freedom to buy or sell its country's currency by resident or non-resident, whether in the spot or forward market, i. e. provide free convertibility of the national currency. At the same time this condition allows existence of restrictions, introduced by national financial regulator, such as open foreign-currency position requirement for resident banks.

4) To secure mean of payments function, existing regular business practices in the respective country shall assume that resident companies issue invoices in national currency for the exported goods (with exception for standard exchange commodities traditionally being priced in USD, e. g. oil).

Resulting from successful internationalization, national currency gradually begins to perform a function of international reserves. The states issuing reserve currencies first of all enjoy a privilege to finance emerging balance of payment deficits not only with the official gold and currency reserves, but also with their own moneys. Gaining the status of reserve currency de facto implies interest-free credits for respective country from other members of international community. On top of that, wide range of international investors (first and foremost foreign governments, large transnational companies and banks) purchase state securities of the respective country. In other words, the country in commend over one of world reserve currencies inevitably begins to play a role of the global banker. According to G. Tavlas and Y. Ozeki [Tavlas, Ozeki, 1992, p. 2] "…the nation is in position to accept short-term liquid deposits denominated in its currency from, and

to supply long-term loans and investments in its currency to, the rest of the world. It is the process of international liquidity transformation, whereby nation provides liquidity to the rest of the world, because of the willingness of foreigners to hold its liquid liabilities, while providing loans and investments to the rest of the world that underlies the notion that a country can serve as word banker".

A right to become the global banker is really a privilege open to just few. R. Mundell [1983, p.189] emphasized this point arguing that 'it is a fact of historical tradition that the top currency is provided by the top powers'. Actually promotion of the USD up to the global reserve currency took place not just in the process of the American economy transformation into the most developed one in the world, but also within the shift from Pax Britanica concept to Pax Americana one.

In order to carry out our study it is necessary to define main criteria of maturity of a certain national currency for internationalization. For that purpose we would first of all refer to the opinion presented by R. Mundell [1983, p.189] in his "International Monetary Options". This approach was specified with respect to Chinese currency by G. Frankel [2011] in a paper "Historical Precedents for Internationalization of the RMB". The latter in particular claims "Three fundamentals determine whether a currency is suited for international status. The first is the size of the home economy, as measured by GDP or trade. The second is confidence in the value of the currency, as measured by the long-term trend in its exchange rate, the variability of the exchange rate, the country's long-term inflation rate, and its position as an international net creditor. The third is the development of its financial markets, particularly depth, liquidity, dependability and openness".

These three criteria will be used further in a present study.

2. Internationalization of Japanese Yen

By the end of the II World War Japanese economy suffered significantly. More than that, the country lost its national sovereignty being occupied by the USA. In spite of the fact that Japan had its own government, the latter was under the permanent American control. A range of substantial reforms was implemented in the country in 1945–1947. In particular, in 1945 dissolution of Zaibatsu took place, destroying the largest national conglomerates, such as Mitsui, Mitsubishi, Sumitomo, Yasuda, and some others. That made the whole Japanese business less dynamic and internationally competitive, especially *vis-à-vis* American companies. Agricultural reform resulted in redistribution of land from large landholder estates in favor of renters with the state playing a role of mediator. In 1945 a law on labor unions legalized struggle of the employees for their rights. School reform increased compulsory education from 6 to 9 years.

All these transformations took place in the extremely difficult economic conditions. Breakdown and economic chaos of the first post-war years forced Japanese authorities to use extensively administrative tools, in particular price control over basic consumer goods, energy and a range of raw materials. This policy was also supported by the occupation authorities as it allowed to decrease public discontent under conditions of inflation. S. M. Nikitin and M. P. Stepanova [Nikitin, Stepanova, 1992, p.11] sensibly argued that "In its development Japan widely used some kind of a "planned-market" economy concept. The country didn't reject the policy of powerful, including administrative, state

regulation, just because it has certain elements of planning, such as priority ranking, task oriented benefits, concentration of resources at strategic goals. A set of methods affecting entrepreneurs' decisions concerning allocation of resources aiming at the expansion of certain industries while contracting the others was developed and successfully used. These methods didn't substitute market mechanism, but supported, completed and adjusted its functioning".

In 1947–1949 the country experienced fast economic growth accompanied the significant expansion of demand for raw materials and capital. In 1949 so-called "stabilization" or, in fact, shock therapy was performed. It included in particular balanced budget with drastic reduction of subsidies to manufacturing industries and fixed exchange rate of 360 JPY/USD [Reuters, 2010]. Joseph Dodge, economic advisor of occupation administration, became an ideologist of all these measures. They resulted in a recession, fortunately a short-term one. Korean War (1950–1953) generated substantial US demand for the Japanese industrial products, allowing the country to launch a mechanism of revival.

Lengthy export boom of 1950s–1970s, lead to the accumulation of a large stock of USD. Thanks to that Japan in 1964 was able to introduce free convertibility of Yen for current transactions and gradually began active operations at the international financial markets. At the same time full-scale financial liberalization was not yet on agenda. In particular, transactions with outside world were still regulated by the law No. 228 of December 1949 [Cabinet secretariat of Japan, 1949]. It stipulated foreign exchange control procedure, mainly seriously restricting possibilities for national business to invest abroad. At the same time, it allowed Japan to use available foreign exchange reserves efficiently in accordance with national priorities, first of all to finance import of technologies and sophisticated equipment.

It is well known, that Bretton-Woods system existed for more than 25 years, up to the American Administration decision of 15 Aug. 1971 to terminate of dollar-to-gold convertibility. That provided Japan and some European countries with new opportunities presented by emerging demand for alternative to USD reserve currencies. Meanwhile it took the Land of the Rising Sun some time to start exploiting these opportunities.

By the beginning of 1980s Japan accumulated significant financial resources consisted of both households and corporate savings. Simultaneously, foreign exchange reserves also increased substantially from 4,399 bln USD in 1970 up to 25,232 bln USD in 1980 [Statistics Bureau of Japan, 2014]. Success of Japanese business in trade with the USA resulted in constantly growing deficit of American foreign trade balance. Under the circumstances the US Government again and again required from Japan to appreciate Yen against USD (in order to reduce competitiveness of Japanese industry), as well as advocated Japanese financial markets liberalization.

2.1. Liberalization of Japanese financial system

Japan started partial liberalization of its financial system already in 1970s. International experience clearly demonstrated that opening of domestic financial market for the foreign investors was always accompanied with a risk for the country to depend upon foreign speculators. Taking into consideration long-term forced Japanese dependence from the United States in many key economic aspects, it is far from being strange that suggestions of comprehensive financial liberalization were strongly opposed by some representatives of national elite. Nevertheless, in 1980 the first significant step was made — Foreign

Exchange and Trade Control Act canceled substantial part of previously existed restrictions (except those directly connected with national security) [Roderick, Seaman…, 1985]. It was followed by some other measures aimed at capital market liberalization. At least some of them should be named separately [Hosh, Rashyap, 1999]:

1981. Warrant bonds were introduced.

1982. Criteria for the issuance of unsecured bonds by Japanese residents in overseas market were clarified.

1983. Eligibility standards for issuance of unsecured convertible bonds were relaxed.

1984. "Real Demand Rule" for foreign exchange was lifted; permission of swap agreements and hedging of forward foreign exchange transactions was introduced; collateral requirement for non-resident issue of Euro-yen bonds was dropped; standards for issuing Samurai Bonds by private companies were relaxed.

Apart from that, significant pro-liberalization changes affected the banking sector. In particular they included [Hosh, Rashyap, 1999]:

1980. Permission of medium and long-term impact loans for foreign exchange banks.

1982. Permission to lend yen overseas on a long-term basis (previous priority system for overseas Yen lending was abolished).

1983. Permission of over-the-counter sale of government bonds to the general public; permission for banks to affiliate with mortgage securities companies.

1984. Securities licenses to subsidiaries/affiliates of some foreign banks with branches in Japan (equity stakes limited to 50 %); permission for foreign and Japanese banks to issue Euro-Yen certificates of deposits (CDs) with maturities of 6 months or less; permission for banks to deal on their own account in public bonds.

Due to implementation of these measures, Japanese financial market began to integrate into the global market. In other words, Japanese got a right to invest abroad almost without restrictions, while foreigners got a right to work actively at the Japanese financial market. All of that took place against the background of continuing export expansion of Japan as well as extension of the area, where Yen was used for the settlements with foreign economic agents.

In order to estimate whether Japan was mature enough for the internationalization of its currency before the conclusion in May 1984 of an agreement between Japan and the USA on liberalization of Japanese financial markets, let's make an analysis using offered above criteria.

Size of the national economy

In 1970s Japan became one of the leading global economic powers. Figure 1 demonstrates this fact clearly enough.

Existing data suggest that during the period when the British pound sterling was the main international reserve currency (1870–1913), UK accounted for about 9 % of the global GDP. In its turn the USA increased its respective share from 9 % in 1870 up to 19 % in 1913. Under the circumstances there was no surprise that after the end of the I World War USD strengthened its position in contest for the status of No1 international reserve currency. In a way during second half of XX century the Land of the Rising Sun started to replicate US leap increasing its share in the global GDP from 3 % in 1950 up to 10 % in 1980 and later (after the beginning of financial liberalization) up to the peak of 17 % by 1988. In addition to that, by 1983 Japan became No3 exporting country on the globe in comparison with 6th place (8 %) in 1965 [Norrlof, 2010, p.23].

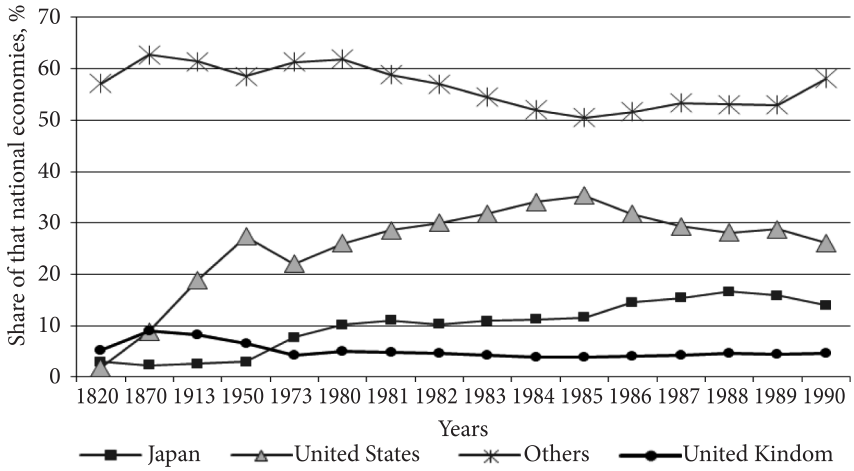

Figure 1. Dynamics of share change of the largest economies into the global GDP in 1820–1990s, %

Note: Calculations of the authors. Sources: [IMF, 2014; Maddison, 2007, p. 382].

Taking all these facts under consideration one might conclude that in general Japan met the first out of three above-mentioned criteria to check the maturity of its national currency for internationalization.

Confidence in a value of the currency

1. The long-term trend in the exchange rate

In order to get more comprehensive perception in addition to retrospective USD/Yen exchange rate data we shall use also USD/£ exchange rate data for the same period of time.

Figure 2 indicates that Japanese currency strengthened *vis-à-vis* American one up to 1977. Initially it was not a matter of any serious concern for the government of

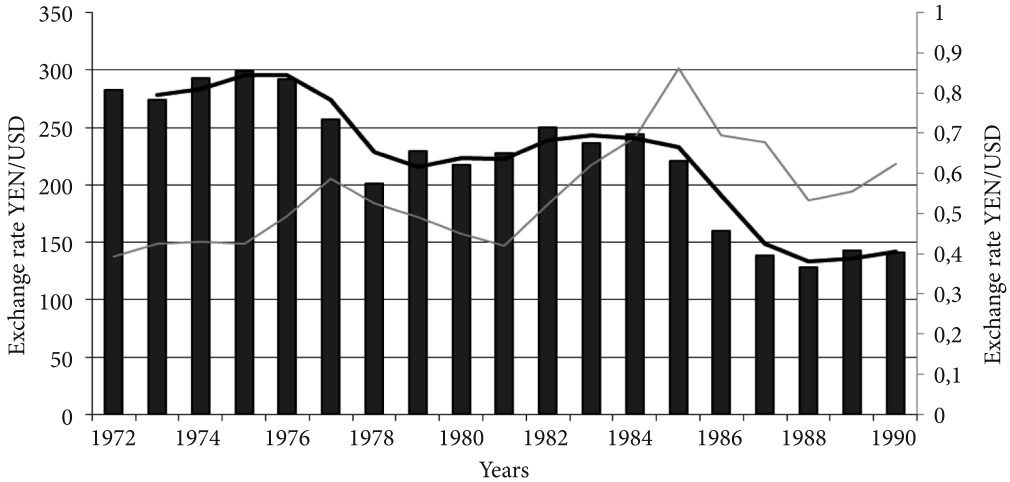

Figure 2. USD/Yen (column) and USD/Great Britain Pound sterling (line) in 1972–1990

Sources: [Bank of Japan, 2014; Currency converter, 2014].

Japan. Meanwhile, as late as 1976–1977 monetary authorities started active currency interventions to prevent further Yen appreciation that might have negatively influenced the competitiveness of national exporters. Nevertheless, in general during 1970s–1980s Yen tended to strengthen against USD in contrast to respective dynamics of British pound. The latter also appeared to be more volatile.

2. The long-term inflation rate

The authors of the present paper share frequently expressed view that consumer price index (CPI) allows to assess stability of national currency fairly enough. Respective data for Japan, United States, and Great Britain are presented below (Figure 3).

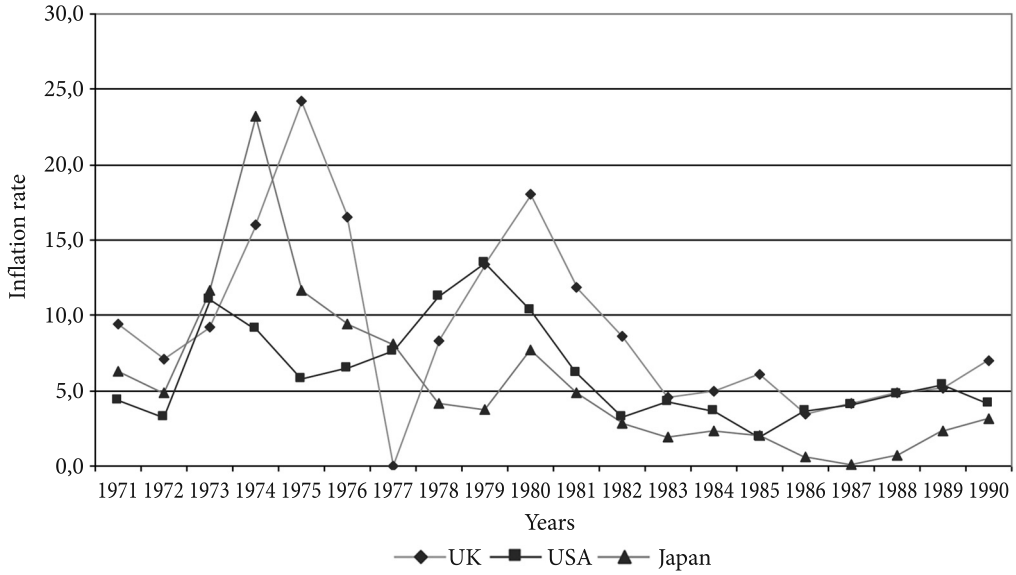

Figure 3. Inflation dynamics in Japan, Great Britain and the USA in 1970–1990, %

Sources: [E-Stat. Portal of official statistics of Japan, 2014; US Inflation calculator, 2014; Historical UK inflation rates …, 2014].

During 1971–1979 average CPI for Japan equaled to 9.24 % in comparison with 8.02 % — for the USA and 11.57 % for the UK. Meanwhile, starting from 1980 Japan experienced the lowest inflation rate among three countries under review.

3. The position as an international net creditor

In this case Net Assets of International Investment Position indicator is the most suitable as a criterion for the purpose of our analysis.

Figure 4 clearly demonstrates for the period since the second half of 1980s permanent increase of Japanese Net Assets of International Investment Position. In other words Japan was gradually transforming into the large-scale international creditor. At the same time respective US indicator not just contracted but turned into negative.

Taking all these facts under consideration one might conclude that in general Japan met the second out of three above-mentioned criteria to check the maturity of its national currency for internationalization.

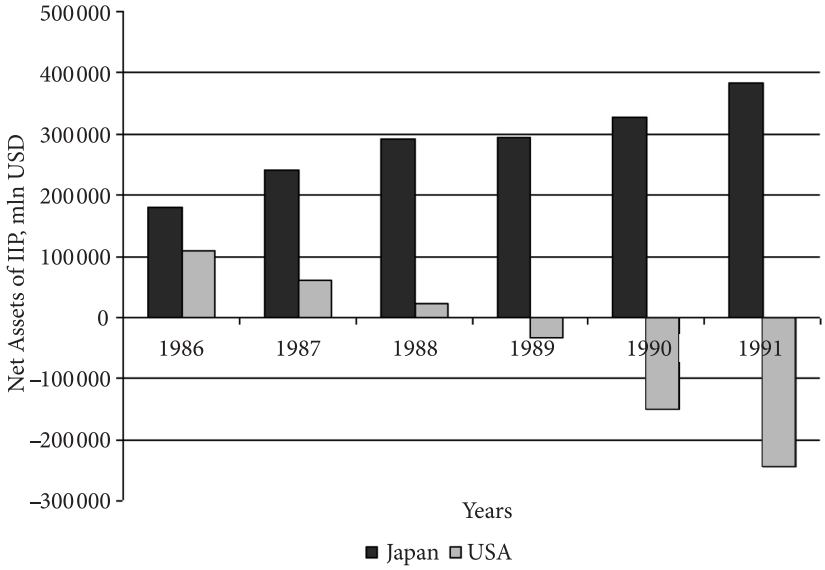

Figure 4. Net Assets of International Investment Position of Japan and USA in 1986–1990, mln USD

Sources: [Ministry of Finance of Japan, 2014; e-Statistics Portal, 2014].

2.2. Maturity of Japanese financial markets

During 1970s some objective factors pushed the Japanese government towards a path of financial market liberalization. After 1973 oil-price shock, national economy rate of growth seriously contracted and the investment activity in a corporate sector slowed down. Under these conditions accompanied by budget deficit the public sector became a net borrower. So the government had to redirect the personal savings of citizens from commercial investments to government bills. As S. Eken [Eken, 1984, p. 506] claimed, the amount of government bonds outstanding rose eightfold in absolute terms for the period of 1974/75–1981/82 fiscal years (from 7 % up to 32 % of gross national product).

All that stimulated a fast development of Japanese bond market (both primary and secondary). To contain the debt-servicing burden, state-controlled interest rates on new issues were often kept below market-clearing level, leading to lower profit for the banks [Eken, 1984, p. 508]. So the latter lost in competition with other financial institutions. At the late of 1970s Japanese leadership in order to counteract this trend started to liberalize domestic financial market. Among most significant pro-liberalization measures there were in particular the following ones: 1) permission for the syndicated banks to resale government bonds; 2) development of the repo market of government bonds; 3) development of the market for CDs (unregulated interest rates).

At the same time, even implementation of the Foreign Exchange and trade Control Law in 1980 didn't eliminate various restrictions. For example, any real Euro-Yen market did not operate: the residents couldn't buy Euro-Yen certificates of deposit issued by non-resident bank, Euro-Yen commercial paper market didn't exist as well. Euro-Yen lending was strictly regulated in particular with respect to issue of Euro-Yen bonds and forward foreign exchange

transactions. A significant number of reporting and preliminary approvals required for some other transactions. The existence of strict foreign exchange control made free movement of capital impossible preventing creation of a market with sufficient liquidity and transparency.

All in all, at this stage Japanese financial markets were largely isolated from the external counterparts. In other words, being in line with the first and second criteria to check the maturity of its national currency for internationalization Japan did not meet the third one.

2.3. Did Japan succeed in internationalization of its currency?

In the first half of 1980s the USA experienced serious economic problems and newly elected president Ronald Reagan started to implement a new economic course, which was later called "reaganomics". The most important components of this course were tax reduction, attracting of foreign investment, growth military expenditures, as well as certain measures aimed at the reduction of deficit in trade with Japan. As a matter of fact the United States were really interested in a radical liberalization of Japanese financial markets, as in this case capital inflow would induce appreciation of Yen, what in its turn could decrease US trade balance deficit. Besides, the Japanese investors would get much better opportunities to invest into the USA economy, even in case of shortage of long-term financial resources at the territory of their own country.

In such a situation Japan had a variety of options. In fact, it was a choice between different forms of national financial system liberalization. According to Shinji Takagi, the Japanese "…preferred a much slower pace of reform than the Americans were willing to accept" [Takagi, 1994]. However the decision was made in favor of a radical one. According to Russian experts A. Anisimov, N. Vasiliev and A. Nagorniy [Yena i dollar, 2001] "…that was the choice, to which the USA stirred Japan, as the USA realized its advantage in financial manipulations. Liberalization came in as an "external rush" of Japanese capital. That was a "trap", in which political and financial leadership of the USA tried to stir its Japanese "partners" by stimulating myths about attractiveness of American stock market as well as by means of exaggerating of real "power" of Japanese financial and industrial structures".

The most significant step was made in May 1984 when Japan and the USA signed an inter-governmental agreement on liberalization of the Japanese financial markets. The Agreement stipulated the following measures [Osugi, 1990]:

1) Liberalization of international banking business. Active development of Euro-Yen market resulting in appreciation of Yen *vis-à-vis* USD.

2) Liberalization of a debt market. Permission for non-residents to issue their own bonds denominated in the Japanese Yen. Promotion of Euro-Yen bond market.

3) Liberalization of the internal foreign exchange control. Cancellation of limits for swaps.

4) Elimination of the restrictions for Japanese residents to purchase foreign debt securities.

5) Better access to the Japanese market for foreign financial institutions.

6) Establishing of off-shore Yen market.

7) Liberalization of domestic financial markets. First of all, elimination of any deposits interest rate limits as well as elimination of barriers between commercial and investment banking.

Implementation of above-mentioned pro-liberalization measures at the first stage led to the ambiguous results. On the one hand, Yen/USD exchange rate increased from 244.17 in

1984 up to 141.26 in 1990 (see: Figure 4). Japanese gold and foreign exchange reserves grew from 26.31 bln USD in 1984 up to 77.05 bln USD in 1990 [Statistics Bureau of Japan, 2014]. Yen's share in overall international reserves increased in 1991 up to 9 % [Frankel, 2011]. On the other hand, "economic bubbles" appeared on several speculative markets.

As for foreign investment, international speculative capital came to the Japanese stock market resulting in impressive growth of Nikkei index from 8016 in 1982 [Siddiqui, 2012] up to 38916 in 1989 [Economics&Finance, 2012]. At the same time significant and fast growing financial resources moved from Japan to the variety of foreign countries. Thus, Japanese FDI outflows increased from about 8 bln USD in 1982 up to almost 70 bln USD in 1989. Total stock of Japanese outward investments in 1990 equaled to more than 300 bln USD with the USA accounting for more than 136 bln USD [Bayoumi, Lipworth, 1997]. All that took place against the background of relocation of main Japanese domestic investment flows from industry to the financial sector and real estate.

In spite of that, the Japanese banking sector did not avoid certain problems. Before the liberalization in 1980s banks were the main suppliers of financial resources for corporate sector as corporate securities market was overregulated and public offering of bonds overseas was prohibited. After this prohibition was abandoned at the end of 1980s and public offering of corporate bonds and other securities was allowed both domestically and abroad, this type of financing became the most attractive for large Japanese companies due to relatively low cost of the resources.

Under the circumstances Japanese banks found themselves in a rather difficult situation of a drastic reduction of loans provided to the most solvent customers accompanied by a stable amount of deposits made by Japanese investors. To balance their assets and liabilities the commercial banks had to start giving loans to less reliable debtors. Ultimately when a "speculative bubble" in the stock market burst up in April 1990, the problem of bad debts became highly relevant for the Japanese bank system opening a new stage in the economic life of the country.

Many experts and politicians considers that 1990s was a "lost decade" for Japan [Meckler, Weisman, 2009]. Particularly it is proved by the data, provided by analyst V. Crag in 1998 «…during the late 1980s, monthly trading volumes in Tokyo and New York were approximately equal; today (1998) Tokyo's volume is approximately 20 percent of New York's…approximately 18 percent of total trade in Japanese equities is now done in London, a threefold increase in the past five years» [Craig, 1998].

So, the Japanese version of accelerated financial liberalization realized in 1980s with the further "speculative bubble blowing-off" and a long-term stagnation of the country in 1990s did not lead the process of Yen internationalization to the expected positive outcome. Yen's share in the international reserves was 3.9 % [IMF, 2014] in 2013 in comparison with 9 % in 1991. In 2013 Yen accounted for roughly the same as the British Pound 4 % [IMF, 2014] in overall international reserves. According to J. Ross[1] "….in 1980 Japan accounted for almost as high a share of world trade as all the other developing countries in Asia combined. Since 1986 the share of Japan in world exports has declined sharply — falling from 10.3 per cent in that year to 5.3 per cent in 2007. In 1980 the developing Asian countries, including China, accounted for 8.3 per cent of world exports and Japan for 6.5 per cent. By 2006 the developing Asian economies, including China, accounted for

[1] Senior Fellow at Chongyang Institute for Financial Studies, Renmin University of China.

23.7 per cent of world exports and Japan for only 5.3 per cent. In 1980 Japan's exports were equivalent to 78 per cent of those from the developing Asian countries, while by 2006 Japan's exports were equivalent to only 22 per cent of those of the combined exports of the developing Asian countries" [Ross, 2014].

On the basis of all above mentioned we would argue that regardless of the initial success, the Japanese Yen failed to challenge global dominance of USD. Nevertheless Yen became one of the most important reserve currencies of the second tier competing with the British Pound, the Australian dollar, and the Swiss franc. This fact strongly correlates with the relative decline of Japanese role in the international political and economic hierarchy of 1990s–2000s.

3. Internationalization of the Chinese Yuan

Unlike Japan, China turned out to be among the winning countries after the World War II. Nevertheless, until comprehensive reforms were launched in 1978 Chinese economy has largely been an autarchic one with financial system isolated from the external world.

At the first stage of reforms, a multi-level banking system began to be gradually erected. It started with establishing of specialized state-owned commercial banks and the People's Bank of China insensibly abandoning the functions not connected with regulation and control. Besides, since from the beginning of reforms individuals and enterprises started to save and were ready to invest their money in order to get additional income. Substantial efforts aimed at introduction and further development of financial market tools were introduced.

In 1981 the People's Bank of China issued state bonds. During 1980s commercial bills had been circulated actively. In 1987 short-term bonds markets for enterprises were opened in 29 cities. In December 1990 and July 1991 stock exchanges were founded in Shanghai and Shenzhen. In the 1990s China went through the process of establishing a full-scale modern financial system. When during the period of 1991–1995 legislation stipulating the performance of commercial banks came into effect, the foundations of currently existing five-level banking system were formed. In accordance with the law on Central bank adopted in 1995, the People's Bank of China has full autonomy with respect to monetary policy tools.

In 2003 the acting legislation was amended to strengthen a role of the People's Bank of China in the sphere of effective monetary policy. In addition to that, China Banking Regulatory Commission (CBRC), China Securities Regulatory Commission (CSRC) and China Insurance Regulatory Commission (CIRC) were founded. The PRC had almost completed the foundation of all required infrastructure for the full-scale functioning of financial markets by 2008. At the same time, despite all achievements the Chinese financial system still continued to be relatively closed *vis-à-vis* outside world. Internationalization of the RMB was rather a subject of discussions on a future promising project than an issue on a practical agenda. But subsequent events changed the situation drastically.

3.1. Liberalization of the Chinese financial system in 2009–2015

Great Recession of 2008–2009 with USD credibility crisis as one of its dimensions generated substantial additional demand for a new reserve currency. So the Chinese leadership decided to use this opportunity. Within historically a very short period of time

a range of active steps aimed at Yuan liberalization was made. These steps had to secure for CNY at least the status of regional reserve currency.

With respect to capital market liberalization the most significant measures included the following [Avdokushin, Kovalenko, 2011, p. 43–49]:

2009 May. Foreign banks pioneered by HSBC and Bank of East Asia were allowed to issue bonds denominated in the Chinese Yuan.

2009 September. China purchased 50 bln USD packages of the IMF bonds paying RMB instead of the USD.

PRC Government started placing of 6 bln CNY (875 mln USD) state bonds denominated in Yuan in Hong Kong.

2010 July. The People's Bank of China and Bank of China (Hong Kong) signed an agreement according to which non-bank financial institutions got permission to open accounts in RMB without any limitations. Besides, all Yuan holders (both corporate and private) were allowed to transfer funds for any purposes from/to their accounts in CNY in different Hong Kong banks.

2010 August. PRC Government announced that non-resident banks (Central banks, clearing banks and banks taking participation into cross-border trade) under certain conditions would be allowed to purchase bonds denominated in Yuan at the domestic Chinese market.

2011 January. The People's Bank of China allowed the Chinese companies and banks participating in the program of cross-border trade settlement in Yuan to use RMB for direct investments abroad.

2011 December. Investors from Hong Kong — subsidiaries of the Chinese companies with the status of Renminbi Qualified Foreign Institutional Investor (RQII) — were allowed to use Yuan from their accounts outside of the continental China for investments into the PRC stock market (including inter-bank bond market). Previously, in order to make these investments the companies had to receive permission from China Security Regulatory Commission (CSRC) and the State Administration of Foreign Exchange (SAFE).

2012 April. HSBC Holdings PLC issued the first RMB denominated bonds in London with the total amount of 1 bln CNY.

2013 March. List of investors from Hong Kong operating as RQIIs was extended to include subsidiaries owned by banks and insurance companies from the continental China as well as securities companies with Hong Kong residence. In addition to that, the People's Bank of China allowed Qualified Foreign Institutional Investors QFIIs[2] to invest in the interbank bond market. Thus, by March 2014 sixty [ICBC, 2014] companies received the right to invest in China as RQIIs (total quota was 580 billion Yuan [ICBC, 2014]). On top of that by June 2015–289 [China XBR, 2015] financial institutions have been approved by the CSRC as the Commissioners of QFIIs. The total size of the investment quota for the QFII scheme participants was $ 80 billion USD [CSRC, 2012].

[2] According to http://finance.mapsofworld.com. The Qualified Foreign Institutional Investor (QFII) system was started in China in 2002. The system was designed and implemented by People's Bank of China and China Securities Regulatory Commission. This system provided huge opportunity to the foreign institutional investors in the Chinese capital markets. The rules regarding the entry of foreign institutional investors in Chinese market have been modified in 2006 in order to bring more foreign investors in the China capital markets to add much width and depth to the market.

Certain initiatives relating to the range of permissible activities for Yuan international payments were also very significant from the point of view of RMB internationalization. Most significant of them were the following:

2009 April. The State Council of China announced a program of using Yuan as a clearing currency for international trade.

2010 June. The People's Bank of China issued a draft project on application of Yuan in settlements with all countries of the world. The list of regions and cities whose residents were given the right to make payments to foreign countries in Yuan was expanded from five cities to 20 administrative units.

2010 August. The PRC government declared that the non-resident banks (Central banks, clearing banks and banks moderating cross-border trade), under the certain conditions would be able to purchase bonds denominated in Yuan in the Chinese internal market.

2010 December. The PRC government abolished the obligation for exporters to convert their foreign currency earnings into Yuan in order to reduce inflationary pressure.

2011 March. Premier Wen Jiabao at the NPC session said that during the current year the right to use RMB in international trade settlements would be given to all enterprises and companies throughout the PRC. That right was actually granted.

2011 December. Japan and China decided to support application of their national currencies (instead of USD) in transactions between the Chinese and the Japanese companies.

2012 April. The People's bank of China announced plans to launch a new payments system called China International Payment System (CIPS) modeled on the U. S. CHIPS network.

2012 June. The operating hours of the RMB real-time gross settlement system in Hong Kong were extended to 15 hours from 10 hours a day to meet rising demand for payments and settlements.

2012 August. China and Taiwan signed an agreement to establish RMB and Taiwan dollar (TWD) clearing system. The Taipei branch of Bank of China was designated as a clearing bank in Taiwan in December.

2013 February. China's central bank appointed the Singapore branch of the Industrial and Commercial Bank of China Ltd the RMB clearing bank in Singapore; beginning of transactions in Yuan between authorized financial institutions in Taiwan and China.

2014 June. China Construction Bank was designated as a clearing bank for CNY transactions in London.

2014 July. China and South Korea agreed to set up a RMB clearing system in South Korea.

2015 March. The establishment of the Asian Infrastructure Investment Bank (AIIB)

2015 October. China International Payment System (CIPS) was launched by 8th October.

Policy aimed at reduction of various restrictions on international settlements in CNY logically enough resulted in a rapid increase in number of Yuan swap agreements concluded between the People's Bank of China and the Central banks of various countries. Significant steps in this direction are listed below.

2009 March. China's State Council decided to transform Shanghai into an international financial center by 2020. The People's Bank of China signed six-currency swap agreements

totally amounting to 650 billion CNY (with Argentina, Belarus, Hong Kong, Indonesia, Malaysia and the Republic of Korea).

2011 April. The People's Bank of China signed an agreement on reciprocal currency swaps with the Reserve Bank of New Zealand (25 billion CNY) and the Central Bank of the Republic of Uzbekistan (700 million CNY).

2012 January. The People's Bank of China signed an agreement on currency swaps with the Central bank of United Arab Emirates (35 billion CNY).

2012 March. The People's Bank of China signed an agreement on currency swaps with the Reserve Bank of New Zealand (25 billion CNY).

2012 June. REPO transactions in RMB were launched in Hong Kong.

2012 August. Heads of the Central banks of China and Taiwan signed a memorandum of understanding regarding start of transactions in Yuan.

2013 March. The People's Bank of China signed an agreement on currency swaps with the Central Bank of Brazil (190 billion CNY) and the Central Bank of Australia (31 billion USD).

2013 June. The People's Bank of China and the Bank of England signed an agreement on currency swaps (200 billion CNY).

2013 September. The People's Bank of China signed an agreement on currency swap lines with the Central banks of Albania (2 billion CNY) and Hungary (10 billion CNY).

2013 October. The People's Bank of China and the European Central Bank signed an agreement on currency swaps (350 billion CNY).

2014 October. The People's Bank of China and Central Bank of Russia signed an agreement on currency swaps (150 billion CNY).

2014 November. The People's Bank of China and Bank of Canada signed an agreement on currency swaps (200 billion CNY).

2015 November. The People's Bank of China and the South African Reserve Bank signed an agreement on currency swaps (30 billion CNY).

According to Mr. Hu Xiaolian [China Securities Journal, 2014], deputy governor of the People's Bank of China at the end of 2014 China signed bilateral agreements on mutual currency swaps (in most cases with 3-years duration) for 3 trillion CNY with twenty-eight Central banks and Monetary authorities of different countries. This policy started to generate tangible results fast enough. By September 2015, the RMB strengthened its position as the forth-ranked global payments currency with a new record-high activity share of 2.8 % (from 2.06 % in January 2015) [BOFIT, 2015]. According to SWIFT's latest RMB tracker [SWIFT, 2015], Yuan is at the moment the second often used currency between Japan and China/Hong Kong with the RMB accounting for 7 % of settlements, by value, compared to 3 % two years ago. As a kind of culmination of this upward trend IMF in November 2015 decided to include Yuan in the SDR basket on October 1, 2016 with currency weight equal to 10.92 %.

Nevertheless the RMB's internationalization process is not a faultless one. So, according to Zacks Equity Research [NASDAQ, 2015] The People's Bank of China recently warned several foreign banks (among them most likely — Citigroup Inc. C, Deutsche Bank AG DB, HSBC Holdings plc HSBC, Standard Chartered PLC SCBFF, Australia and New Zealand Banking Group, and BNP Paribas SA), asking them to suspend some of their foreign-exchange activities (related to onshore-offshore operations in RMB) for a three-month period ending in March 2016. This decision of the regulator aimed to cut increasing

spread between onshore and offshore exchange rate of RMB. It has been widening since Yuan devaluation in August 2015 reaching 1.8 % by the end of December 2015 [NASDAQ, 2015]. Besides, notwithstanding efforts of Chinese money authority Yuan still is out of the group of key reserve currencies. According to Global Finance share of "other currencies" (including RMB) in composition of global foreign exchange reserves in mid-2015 equaled to just 3.11 %, compared to 5.56 % [Global Finance Magazine, 2015] three years earlier.

In order to estimate whether China was mature enough for the internationalization of its currency, let's make an analysis using criteria offered above.

Size of the national economy

Chinese contribution to the global GDP since the beginning of a new millennium increased substantially. Figure 5 clearly illustrate this fact.

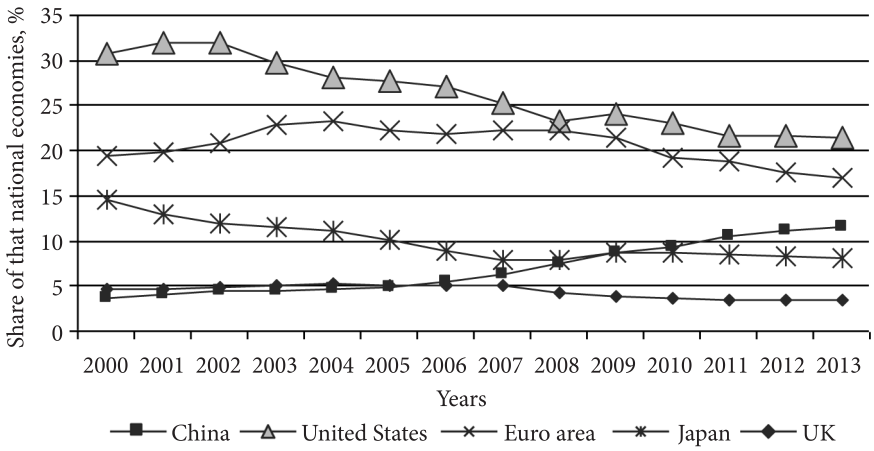

Figure 5. Share of the largest national economies in the global GDP in 2000–2013

Source: [IMF, 2014].

In 2010 for the first time China officially became the second largest economy on the globe after the USA, moving Japan to the third position. In addition to that, starting from 2009 China has had No1 rank in the list of leading merchandise exporters, while in 1990 the country had occupied the 14th place [CSD SAR HKG, 2012]. In 2013 Chinese share in the global merchandise export equaled to 14.7 % [WTO, 2015].

Available historical experience suggests that as soon as the share of a certain country in the international trade exceeds 8–10 %, the role of its currency in the world starts to increase sharply. Indeed, when the USA's share in world trade had exceeded 10 %, USD began to displace British pound as the world reserve currency. Similarly, after the share of Japan in global merchandise exports exceeded 8 %, Yen started its active internationalization.

Taking all these facts under consideration one might suggest that China met the first out of three above-mentioned criteria to check the maturity of its national currency for internationalization.

Confidence in a value of the currency

1. The long-term trend in the exchange rate.

One of the most important factors defining the confidence of foreign investors in respective national currency is stability of its exchange rate against the major world currencies in the historical retrospect.

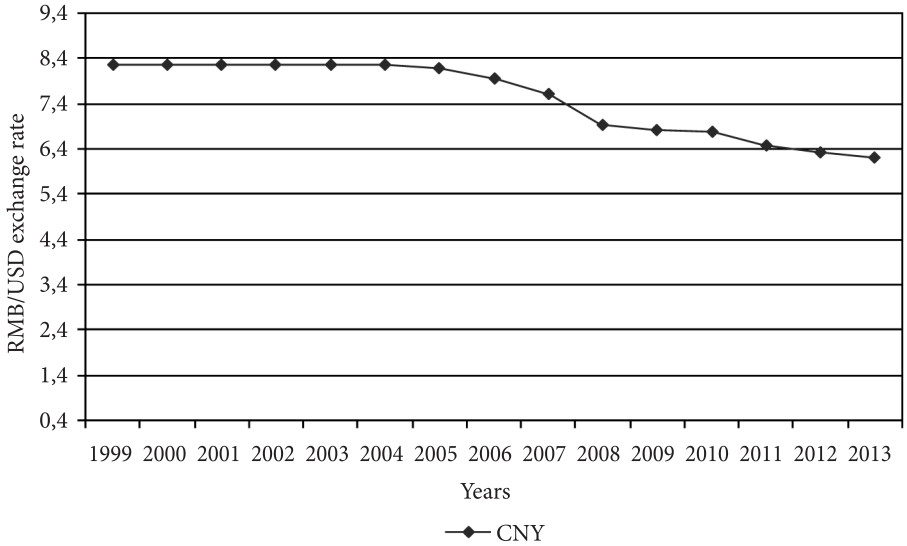

Figure 6. RMB/USD exchange rate in 1999–2013

Sources: [National Bureau of Statistics of China, 2015; State Administration of Foreign Exchange, 2015].

The graph (Figure 6) demonstrates that the exchange rate under review in 1999–2004 had not changed at all. Then, in 2005–2008, RMB — due to impressive growth of the Chinese economy as well as policies of the People's Bank of China aimed at maintaining macroeconomic stability — had been getting stronger. Nevertheless, we cannot claim that above mentioned requirement is completely fulfilled as a foreign exchange market in China has operated under a strict government control.

At the moment Yuan has not reach the level of full convertibility being convertible for current account transactions since 1996. That allowed foreign companies to carry out foreign trade operations as well as to carry out the repatriation of their profits. Chinese authorities stated that RMB would become fully convertible currency only after the state could effectively regulate the financial markets. The State Council statement of 25.03.2009 that declared a plan to promote Shanghai up to the status of international financial center by 2020 can serve as an indirect indicator of the prospects of Yuan convertibility. Thus, this requirement is likely be completely fulfilled by not earlier than 2020.

2. The long-term inflation rate

As mentioned above, the authors of the present paper share frequently expressed view that consumer price index (CPI) allows to assess stability of national currency fairly enough. Respective data are depicted on Figure 7. On average Chinese annual inflation rate in 1999–2013 equaled to 2.08 % in comparison with 2.41 %, in case of the USA and

2.14 % in case of EU. At the same time, Chinese inflation rate demonstrated much higher volatility than American and European ones generating certain concerns and reservations with respect to fulfillment of this criterion.

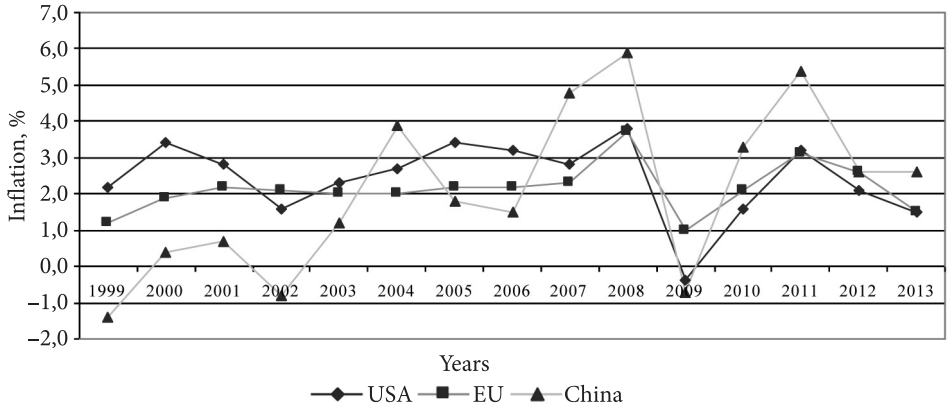

Figure 7. Inflation in China, the USA and the European Union in 1999–2013, %

Sources: [Eurostat, 2015; National Bureau of Statistics of China, 2015; US Inflation calculator, 2015].

3. The country's position as an international lender.

Figure 8 shows a significant increase in surplus of Chinese capital transactions during last decade. This trend is twice as significant against the background of growing American deficit turning the United States into a net importer of capital.

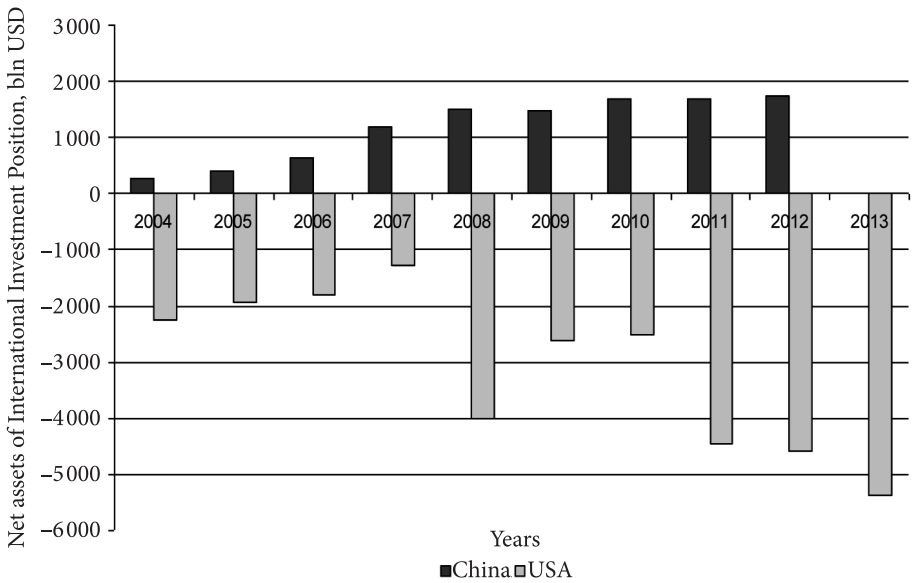

Figure 8. Net assets of International Investment Position of China and the USA in 2004–2013, bln USD

Sources: [State Administration of Foreign Exchange, 2015; The Statistics Portal, 2015].

Taking all these facts under consideration one might conclude that in general China with certain reservations was very close to meet the second out of three above-mentioned criteria to check the maturity of its national currency for internationalization.

Naturity of Chinese financial markets

In spite of all discussed above, measures aimed at liberalization of the Chinese financial system, in particular development of primary and the secondary capital markets, increasing their liquidity as well as degree of transparency, these markets in China are still immature in comparison with international standards. This fully applies to both stock and bond markets characterized by certain restrictions for financial intermediaries. Furthermore, market participants carry out high transaction costs. Comparative analysis made by the China Securities Regulatory Commission [CSRC, 2014] showed that the average transaction costs of operations at Shanghai and Shenzhen stock exchanges equaled to 50 basis points against 21 basis points in case of developed markets. The main obstacle to a real internationalization of the RMB is a system of foreign exchange control which prevents free movement of capital into and out of country and does not allow setting up sufficiently liquid and transparent market.

3.2. Does China succeed in internationalization of its currency?

To sum up, one might argue that being totally in line with the first and largely corresponding to the second criteria to check the maturity of its national currency for internationalization China do not meet the third one. In other words, the Chinese financial system is roughly as ready for a complete liberalization of RMB as the Japan's system was in 1984 prepared for Yen liberalization. Meanwhile, unlike Japanese counterparts Chinese authorities are on their own original conceptual track and manage to avoid accelerated liberalization of national financial system. Thanks to that they are better equipped to prevent both massive inflows of "hot money" from abroad and the emergence of speculative bubbles. At the same time, no complete control exists as there is a substantial segment of financial intermediaries in the domestic market operating formally beyond the jurisdiction of the People's Bank of China.

In order, on the one hand, to solve partial RMB convertibility and financial market immaturity problems, on the other hand, unwilling to put the latter into dependence upon foreign financial institutions, the Chinese leaders decided to create a market of "offshore Yuan." In a sense, this is a new currency issued by the same People's Bank of China and circulating outside of the mainland China, especially in Hong Kong, Singapore and London. International experts informally assigned "offshore Yuan" under conditional code CNH[3]. Its main sources are [City, 2012]:

1. Import contracts payments (in case Yuan is a currency of the contract) as well as RMB foreign investment.
2. Export of cash overseas by investors or tourists.
3. Purchases of Yuan by Hong Kong residents for subsequent placement in deposits in Hong Kong' banks.
4. Clearing transactions of the People's Bank of China with HKMA (Hong Kong Monetary Authority).

[3] Chinese Yuan delivered in Hong Kong.

Thanks to establishing and enhancing of "offshore Yuan" China is able to enjoy the benefits of a mature efficient market. At the same time, monetary authorities so far manage to maintain relative financial stability in the mainland China. Nevertheless, even taking under consideration above-mentioned decision to include Yuan in SDR basket[4], resulting from "offshore Yuan" inability to build up fast enough a significant amount of liquidity in RMB, that would not allow Yuan to begin in the nearest future the real competition with USD for a status of reserve currency in East Asia, say nothing about global competition with USD and EUR.

Meanwhile, currently the world economy is very unstable; the probability of a new wave of the global financial crisis is high enough. In this dramatic case, relative share of financial resources needed to serve international trade might increase substantially. Assuming the fact that nowadays "offshore Yuan" mainly supports trade in goods, above-mentioned flaw might turn into advantage. Under the circumstances one cannot totally exclude a sharp increase of interest in this currency for diversification of foreign exchange risks. This would substantially accelerate the ongoing process of Yuan internationalization.

Conclusion

The initial stage in internationalization of the Japanese Yen in the 1970s occurred without deliberately designed participation of national authorities. This issue came into the agenda of the Japanese Government only in the 1980s within the framework of financial system liberalization, after the country had become the second largest economy of "the West". The main obstacle to the overall internationalization of the Yen was immaturity of the financial market. Despite the initial success, the liberalization of Japan's financial system (launched by the intergovernmental agreement between Japan and the United States in 1984) ultimately resulted neither in further strengthening of Japanese economic position on the global stage, nor in strengthening of the position of Yen in overseas markets. The main reason for this failure was US political pressure that imposed accelerated opening of financial markets and largely reduced capabilities of Japan to counter speculative capital inflows from abroad. The latter ultimately displaced long-term internal productive investments. As a consequence, in the early 1990s global expansion of the Japanese banks and corporations stopped; the country experienced progressive outflow of capital and stagnation of the national economy for more than two decades. Currently, there are no real prospects for strengthening of Yen as an international currency.

The internationalization of RMB since 2009 has proceeded largely in line with deliberately designed strategy. A core of the latter is an idea of a parallel co-functioning of two financial circuits. The first one is external. It supplies Chinese foreign trade and serves as the main channel of the RMB circulation outside China. The second circuit is internal, primarily serving the domestic market. Yuan exiting from the second circuit and ending up outside the mainland China — "offshore Yuan" — can without any restrictions circulate on international financial markets, both as a medium or payment and a reserve currency. The "offshore Yuan" may return into the first circuit (transforming into "ordinary Yuan"), either in a form of material resources imported into China or in

[4] It could be considered as a direct support by US government (as a key decision-maker in the IMF) of Chinese policy aimed at RMB internationalization and encouragement to accelerate the process.

a form of investments under the state control. Despite the fact that Chinese economy at the moment does not fully meet all criteria to check the maturity of its national currency for internationalization, national authorities manage to move towards the goal of RMB internationalization simultaneously securing its financial system against excessive risks. At the same time, regardless of the IMF decision to include Yuan in SDR basket, RMB in the nearest future will not be able to compete with USD for a status of reserve currency in East Asia, say nothing about global competition with USD and EUR.

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Статья поступила в редакцию 20 января 2016 г.