Topic:
Structural Power and the Dollar Reserve System

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Introduction

International Relations (IR) as a discipline of study has traditionally been acutely focused on the interaction between states and the consequences of these interactions.¹ War, alliance making and the balance of power in the international system have long been considered a primary concern of many IR scholars. Since the end of World War II (WW2) however, the undeniable onset of globalisation has forced the discipline and all its various schools of thought to reassess the nature of the international system, its actors, and the significance of a range of new relationships between states and non-state actors. The most obvious and remarkable example of the globalisation of the international economy has been the rise of China as an economic powerhouse, and regional power in its own right. Since 1978, when China began to undertake a range of market reforms, it has maintained a Gross Domestic Product (GDP) growth rate averaging ten percent a year, lifting some 500 million Chinese from extreme poverty in the process.²

The unprecedented and rapid emergence of China as an increasingly significant player on the international stage has created a vast and multidisciplinary body of literature on the subject. Despite this, the dominant discourse on the rise of China has been characterized by the traditional clash of realism and liberalism, with two of IR’s most prominent figures; John Mearsheimer and G. John Ikenberry at the forefront of the debate. Mearsheimer, in the realist camp, forcefully argues that China cannot rise peacefully within the international system.³ Ikenberry, in the liberal camp, argues that China’s rise will be challenging yet ultimately peaceful.⁴ While framing China’s rise in purely security terms has theoretical and analytical value, it also obscures a range of important economic and political relationships worthy of attention. This thesis will demonstrate the importance of structural power as a theoretical concept for understanding the historical development of the International

Monetary System (IMS) and shifts in the distribution of structural power over time. Firstly, I will explore the development and history of the United States Dollar (USD) as a reserve currency in the IMS. Secondly, I will argue the ability of the U.S. to exercise structural power to maintain the role of the USD, leading up to and after the Global Financial Crisis (GFC), has been in relative decline. And finally I will evaluate the potential challenge of China’s currency, the Renminbi to the existing system. I aim to demonstrate that the historical role of the USD as the global reserve currency and the potential challenge of the Chinese Renminbi, understood from a structural power perspective, is an essential consideration when evaluating the rise of China and its future role in the world.

**Methodology**

The thesis is a primarily qualitative investigation of the IMS, past and present, and the U.S./China economic relationship. The thesis is explanatory and exploratory in design, with a focus on notions of structural power for understanding the changing relationship between the U.S. and China. Qualitative research methods typically involve focusing on a specific case study, and then providing an in depth analysis of that particular case study, through the use of a range of literature relevant to the chosen topic. As King, Keohane and Verba specify:

> “Such work has tended to focus on one or a small number of cases, to use intensive interviews or depth analysis of historical materials, to be discursive in method, and to be concerned with a rounded or comprehensive assessment of some event or unit.”

While the thesis itself is a qualitative research project, I draw on sources both qualitative and quantitative in design in order to provide a strong empirical and discursive basis to my central argument. While I argue the utility of one specific theoretical framework primarily-structural power, I also draw upon a range of different perspectives within the field of IPE.

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6 Ibid, 5, p.4
Benjamin Cohen describes the field as follows: “In other words, IPE is about the complex linkages between economic and political activity at the level of international affairs.”

The structure of the thesis consists of a literature review and three chapters. The literature review will provide a brief critique of traditional IR perspectives on China’s rise and an overview of IPE literature covering structural power and the IMS. The first two chapters of the thesis will provide an IPE based qualitative evaluation of the USD reserve system as it has evolved since WW2 and the impact of developments such as the ‘war on terror’, the GFC and the ‘Beijing Consensus’, on the credibility and operation of the IMS. The third chapter will be a discussion of the implications of China’s continued rise on the IMS based upon current trends within the IMS.

Ethics Considerations

The thesis did not require the completion of an ethics application. All sources used in the formulation of the project were from academic literature, government publications and newspaper articles and as such there were no ethical issues involved.

Literature Review

The purpose of this literature review is to provide an overview of the various bodies of literature that have addressed similar themes, debates and concepts to be explored in throughout the thesis. In providing an overview of literature covering the rise of China, U.S. hegemony and the role of the USD it will provide context for how my approach differs from existing literature, and why it is a useful contribution to the existing literature.

Traditional IR and the Rise of China

The popular discourse on the rise of China has typically been divided into two camps; realism and liberalism. With security considerations being a major focus of traditional IR the

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common theme in realist and liberal debates has been whether or not China can continue to rise peacefully. John Mearsheimer has been particularly vocal about his position that as China grows the potential for conflict with the U.S. and other major powers will become inevitable.\(^8\) Mearsheimer’s argument is based around a core realist assumption originally put forward by Robert Gilpin. In his widely referenced book *War and Change in World Politics* Gilpin argued that conflict between states arises from structural changes in how power is distributed amongst states over time.\(^9\) Despite the general assumption within the realist camp that China’s rise will be a serious cause for concern, there is disagreement about whether conflict is inevitable and how best to respond to its emergence as a global power.\(^10\) Mearsheimer is considered an ‘offensive’ realist and argues that the only way to respond to the rise of China is to adopt a policy of Chinese containment. From his perspective of ‘offensive’ realism he asserts that the only way in which states gain security in the international system is by being bigger and more powerful than other states. He suggests that by maintaining regional hegemony in Asia, the US can prevent the ensuing conflict that would arise from China being left to develop of its own accord.\(^11\) For realists such as Mearsheimer there is a tendency to analyse China’s rise in a way which is divorced from the unique political, cultural and economic factors relating to it. Much of this ‘system level’ analysis, in which all states are considered homogenous, rational, actors, within the international system, is the result of work by Kennith Waltz.\(^12\) As this thesis aims to show, the traditional realist perspective fails to highlight a range of dynamics at play between the U.S. and China that are historically, politically and economically unique.

In the liberal camp, scholars such as G. John Ikenberry have vocally challenged the notion that China cannot rise peacefully. Ikenberry focuses on the historical significance of the U.S. and the process through which the U.S. and other Western democratic states established an overarching ‘liberal world order’ consisting of rules, norms and institutions that shape the

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\(^8\) Ibid, 3, p.160  
Ikenberry sees a long-running process through which liberalism has developed and evolved to mean different things. He links the establishment of a ‘liberal world order’ with the efforts of Woodrow Wilson after World War 1 (WW1), followed by the efforts of Theodore Roosevelt after WW2 and sees it as an ongoing process in which its principles can continue to change to meet the demands of emerging states. He considers the liberal international order to be in a process of upheaval where governance may move away from the U.S. to international institutions such as the United Nations. He argues this process will be challenging, and China and the U.S. are likely to clash over competing interests, but the liberal order will ultimately prevail. While Ikenberry’s perspective on China is more open to the complexities of new political, economic and social connections between states, he attributes U.S. hegemonic power to a direct political process, without consideration of the more subtle and indirect ways in which U.S. power has become institutionalised within the international political economy.

U.S. Hegemony and ‘Declinism’

Within the field of IPE there has been a long history of literature that attempting to understand and explain the dominant role of the U.S. in the world. Since the GFC the idea of U.S. decline has become increasingly popular, but it is not the first time this debate has taken place. During the 1980s there was a widespread debate amongst academics about the future of U.S. hegemony. Numerous influential works covered the topic but contributions such as After Hegemony by Robert Keohane and The Rise and Fall of the Great Powers by Paul Kennedy stand out as defining contributions, both arguing the decline of U.S. hegemonic power as having occurred and likely to continue. While these two contributions presented considerably different assessments of why U.S. power had declined and what the way forward was, they are indicative of a wide-ranging body of literature from the period which concluded that U.S. hegemony had ended prematurely. Not everyone was convinced,
however. During the height of the first ‘declinist’ era, scholars such as Susan Strange were arguing strongly against the presumption that U.S. power was no longer hegemonic. In ‘The Future of the American Empire’ she put forward a strong argument that the way in which many ‘declinists’ were calculating power within the international political economy did not accurately represent the extent of U.S. hegemony. Central to Strange’s rebuttal of the ‘declinist’ position was their failure to take into account the role of structural power as a significant source of international influence for the U.S.\(^{17}\) In ‘The Persistent Myth of Lost Hegemony’ Strange goes into great detail establishing a definitional framework for what structural power is, the ways in which it is exercised, and how to observe changes in structural power distribution within the international political economy.\(^{18}\) In the substantive body of this thesis I will draw on this framework extensively, as it provides a unique and recently neglected approach for assessing the notion of U.S. decline and the rise of China. After the end of the cold war and the revival of the U.S. economy during the 1990s the idea of U.S. decline had seemingly been a storm in a teapot, and the idea of a unipolar world became increasingly accepted.

The second phase of ‘declinist’ literature has emerged mainly since 2008 in response to the failures of the ‘war on terror’, the rise of the developing world, and the economic impact of the GFC on the developed West. As Mark Beeson aptly notes, “How times change. During the 1990s it became almost obligatory to describe the US’s position in the international system as unprecedented and ‘unipolar’.”\(^{19}\) The new era of U.S. decline literature has been largely defined by the argument that there will be a gradual move away from ‘unipolarity’, towards a multipolar international system. In Layne’s ‘This Time It’s Real: The End of Unipolarity and the Pax Americana’ he argues that the concerns held by 1980s declinist have now been vindicated. Amongst his detailed analysis he suggests that the main factors driving U.S. decline have been overconsumption, increasing budget deficits and the continual expansion of trade and current account deficits.\(^{20}\) Other contributions, such as

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Schweller and Pu’s ‘After Unipolarity: China’s Visions of International Order in an Era of U.S. Decline’ make up a consensus among realist scholars that the work of prominent figures such as Robert Gilpin (about the uneven growth of states leading to wars) will be shown to be correct. As will be further discussed in the chapters that follow, these factors are essential considerations in assessing U.S. power and the rise of China, but can be explained from a number of perspectives that do not conform with the realist perspective. In exploring the role of the USD the ‘declinist’ perspective has also increasingly been applied to the future of the IMS and the influence economic policy making has had over its widespread use internationally.

Since the GFC there has been increasing interest in China as a source of new economic and development policy. The rise of China and the idea of a ‘Beijing Consensus’ has been used as a contrast to the declining influence of U.S. economic policy, particularly in the area of development assistance. Sarah Babb for example has argued that the neoliberal economic policies commonly associated with a ‘Washington Consensus’ was a transnational policy paradigm, which is only recently being challenged by new ways of considering economic development. Other contributions have argued that the Chinese model of development is merely a continuation of neoliberal style economics with a slightly different twist. In arguing the structural impact of knowledge and ideas on the role of the USD, I tend towards agreeing that the Chinese model represents a shift away from the U.S. style of development, but not entirely which will be elaborated on in the following chapters.

The USD, Reserve Currencies and the Future of the IMS

In response to the GFC and the rapid emergence of China as a global power there has been a growing body of literature which focuses specifically on the IMS and the changing dynamics within it. One of the pioneering scholars of IPE in this area has been Benjamin Cohen, from which many contemporary works draw influence. In his 1971 work, The Future

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of Sterling as an International Currency he outlines a categorization model of international currencies which has been applied extensively as an effective way of determining the role of a currency internationally.24 His model outlines six roles of international currency, a mixture of three private and three official functions. In his recent work ‘The Yuan Tomorrow? Evaluating China’s Currency Internationalisation Strategy’ he applies this model to the Chinese Renminbi to assess how far along the currency is in becoming international. Applying his well-established approach he concludes that the Renminbi is unlikely to become international any time soon.25 Recent work by Bowles and Wang drew similar conclusions about the relative importance of the Renminbi, arguing that the internationalization process has been motivated by economic crisis rather than a specific Chinese desire to replace the USD26 While Cohen’s model has been widely accepted within the field, other scholars such as Eric Helleiner have argued that international reserve currencies are determined by more than just economic factors. In attempting to build upon Cohen and Strange’s work he has argued that international currency’s should be determined by a range of both political and economic factors, and that neither by themselves is sufficient for determining the future role of a currency.27 In the chapters that follow I draw on Helleiner’s work in this area as it is a useful supplement to the limitations of Strange’s structural power framework.

From a historical perspective, arguably the most important contribution to the literature on the USD has been Barry Eichengreen’s 2011 book, Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System.28 In a vast historical assessment of the role of the USD from its development in the 19th century, through to the early 21st century he not only explains how the USD gained prominence in the IMS but also looks to the future in light of its loss of credibility since 2008. In providing a historical

background for the history of the USD I draw on Eichengreen’s work extensively throughout the thesis as his attention to detail is unmatched elsewhere in the literature.

While this literature review has only provided a fairly brief overview of the literature covering U.S. decline, the rise of China, and the IMS, the aim has been to provide context for the investigation that follows. In outlining the areas of academic literature above I hope to make clear that applying Susan Strange’s framework of structural power, to the current debate about USD decline and Renminbi internationalization, is a unique and useful contribution to the broader literature in this field of study.

Chapter 1. The development of the USD reserve system and U.S. hegemony

The role of the USD as the world’s global reserve currency has been an important feature of international system since the end of WW2 and increasingly so in the post-cold war period. In what has famously come to be known as America’s ‘exorbitant privilege’, as declared by former French finance minister Valery Giscard d’Estaing, its position as issuer of the global reserve currency comes with a range of economic and political benefits worthy of consideration. The historical context through which the USD became a reserve currency, the translation of this ‘exorbitant privilege’ into structural power and the unique economic relationships stemming from the current IMS are all specific and important factors that should be taken into account when considering China’s emergence on the global stage. In this Chapter I will investigate the history of the USD reserve system and the consequences of this system for American power. By examining the development of the USD reserve system through an examination of the IMS from the end of WW2 up until the end of the 20th century it will become apparent that U.S. power has and continues to be closely linked to its role as issuer of the global reserve currency. The relationship of the U.S. with its allies and the developing world has to some extent been shaped by its ability to exert structural power in a range of ways.

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Ibid, 28, p.4
Theoretical Background

Before examining the history of the USD and its role within the IMS it is necessary to establish a definition for the purpose and function of the IMS in the international system. Paola Subacchi describes the IMS as, “the set of rules, standards, practices and institutions that govern the flow of money and access to international credit, provide stability to the foreign exchange markets and facilitate the adjustment of balance of payments disequilibria.”30 Essentially the purpose of the IMS is to provide readily available money that is a safe store of value, as well as readily available for global use, so that international trade and investment can take place efficiently and smoothly across state borders.31 The three essential features of an international currency can be summed up as; a store of value, a medium of exchange and a unit of account.32 The extent to which the IMS does operate smoothly or undergoes changes is largely dependent on the political interaction between states, as well as economic factors influencing the space in which political interactions take place. Trade-offs between the national interest of the most powerful states in the system and their international obligations are relevant calculations in the governance of the IMS and explains why the IMS is dynamic and constantly changing.33 The role of structural power is a central concept for understanding these trade-offs between national and international interests.

The concept of structural power and its manifestation in the IMS has been explored and defined in a number of ways. I will draw on two theoretical frameworks for understanding structural power and its influence over the IMS. The first notion of structural power I will draw on is Susan Strange’s definitional framework. For Strange, structural power is drawn from four specific capabilities. She suggests the four capabilities can be applied to family, community or state levels of analysis alike.34 The first feature of her framework is the ability to control the physical security of other actors in a system. The second feature is the ability

31 Ibid, 30, p.669
33 Ibid, 30, p.669
34 Ibid, 18, p.565
to control the system of goods and service production through which trade takes place. The third feature is the ability to determine the structure of finance and credit through which an actor can acquire purchasing power within a system. And finally, the ability to have the most influence over knowledge and information within a system.\textsuperscript{35} For Strange, a dominant power such as the U.S. can exert these forms of structural power because it has “the power to decide how things shall be done, the power to shape frameworks within which states relate to each other, relate to people, or relate to corporate enterprises.”\textsuperscript{36} By exploring the four points of her framework in relation to the history of the U.S. as issuer of the global reserve currency it will demonstrate the important link between structural power and the configuration of the IMS.

Secondly, I will draw upon Eric Helleiner’s framework for categorizing the indirect determinants of reserve currencies in the international system. Helleiner argues that there are specific economic and political factors that influence the international status of a currency.\textsuperscript{37} He outlines three main indirect economic factors that determine reserve currency status. Firstly, foreign states (and private actors within them) must have confidence in the ability of the reserve currency to retain its value. Secondly, the issuing state of the reserve currency must have highly developed and open financial markets. And thirdly, the issuing state must have an expansive transactional network around the world to facilitate easy acquisition and use of the currency.\textsuperscript{38} By drawing on both Helleiner and Strange’s frameworks this chapter will investigate the history of the USD and its development throughout the 20\textsuperscript{th} century.

**Historical Development of the Dollar Reserve System**

The rise of the USD to reserve currency status took place over a long period marked with many bumps and setbacks along the way. Surprisingly, the use of the USD in international trade and finance took much longer to establish than the rapid development of the country in other areas. By the 1870s the U.S. had surpassed the United Kingdom (U.K) in production

\textsuperscript{35} Ibid, 18, p.565
\textsuperscript{37} Ibid, 27, p.355
\textsuperscript{38} Ibid, 27, p.358
of goods and services, and by 1912 had also overtaken the U.K. in the export of merchandise. Despite having become a leading world economy by the early 1900s the USD had no international role at all.\(^{39}\) The reason for this was partly due to domestic reasons and partly due to the well-established banking system in the U.K. For banks giving loans to overseas merchants they needed the ability to acquire information on their activities. This was not a problem for U.K. banks as they had branches all over the globe as a result of British colonial exploits. Meanwhile, in the U.S., regulations prevented domestic banks from establishing branches across domestic state lines, let alone overseas.\(^{40}\)

The role of the U.K. as the issuer of the reserve currency during the early 20\(^{th}\) century is an important confirmation of Helleiner’s framework of indirect structural power. Despite the U.S. having overtaken the U.K. in military and economic power, the well-established and far reaching global transactional network of the U.K. banking system made it a far more suitable issuer of the reserve currency. As will be discussed further in later chapters, the lack of indirect structural power possessed by China, due to its undeveloped and tightly regulated financial markets, will be a major challenge in any attempt to supplant the USD as the world’s leading currency.\(^{41}\) Despite its late arrival, when the USD did finally arrive on the international scene its role increased rapidly. By 1924 the USD had come to account for more foreign exchange reserves in central banks and governments than the reserve currency of the time, the pound sterling.\(^{42}\) Just as it was gaining momentum, however, it all came crashing down with the Great Depression of 1930. Not until after WW2 would it take its place as the primary reserve currency.

In 1944, with the end of WW2 only a year away, the Bretton Woods conference established a new IMS that placed the USD at its centre. The entire system established at Bretton Woods relied on the continued ability of the U.S. to convert its USDs into gold at a fixed rate.\(^{43}\) The sudden importance of the USD reflected the outcome of WW2, after which only

\(^{39}\) Ibid, 28, p.17  
\(^{40}\) Ibid, 28, p.17  
\(^{41}\) Ibid, 27, p.358  
\(^{42}\) Ibid, 28, p32  
the U.S. had increased its power and stood head and shoulders above the rest of the world in both military and economic might.\textsuperscript{44} The International Monetary Fund (IMF), formed at the conference and tasked with the role of overseeing and facilitating the new IMS, authorized member countries to define their currency’s exchange rate in relation to USDs.\textsuperscript{45} This effectively cemented the importance of the USD, as it became the unit of measurement to which the value of other currencies would be compared. With almost no other options for a reserve currency and with gold being in limited supply, foreign central banks and governments had little choice but to begin accumulating USDs.\textsuperscript{46}

After the USD became the official link to gold the ability of the U.S. to directly exercise structural power within the IMS increased dramatically. By becoming the official link for other states to define their currency, the U.S. had satisfied Strange’s third requirement for structural power; determining the structure of finance and credit through which other actors acquire purchasing power in the international system. In order for other states to engage in international trade and investment it became essential for them to accumulate USDs, as the USD had become the currency used to settle cross border transactions and foreign currency exchanges. By the 1960s the acute awareness of the benefits bestowed upon the U.S. was creating political tension, with the French president Charles DeGualle, for example, campaigning strongly against the USD reserve system and the ‘extraordinary advantage’ it gave the U.S.\textsuperscript{47} The French and others were becoming increasingly concerned with what has come to be known as the ‘benign neglect’ exercised by the U.S. towards its ‘balance of payments’ position. The term describes the ability of a reserve currency issuer to spend more than it earns in-lieu of the fact that it controls the supply of currency.\textsuperscript{48} The problem for other states during the Bretton Woods era was that the USD in principle was supposed to be exchangeable for gold at a fixed rate of $35 per ounce.\textsuperscript{49} With the U.S. increasingly exercising its structural power by expanding its trade deficit and spending more

\textsuperscript{44} Ibid, 30, p.671  
\textsuperscript{45} Ibid, 28, p.39  
\textsuperscript{46} Ibid, 28, p.40  
overseas than it was earning, it was becoming clear that it would be impossible for the U.S. to exchange USDs into gold in large amounts if the need actually arose - there simply was not enough gold.

By 1973 the gold-exchange standard had officially been abandoned by the U.S. and replaced by a system of floating exchange rates, where the USD would no longer peg itself to the fixed rate of $35 per ounce of gold. The result was a sharp decline in the value of the USD throughout the 1970s, its value dropping from $35 per ounce to $100 per ounce in 1973 and over $200 per ounce by 1974.\(^\text{50}\) While the 1970s marked an era of relative monetary instability in the U.S. it also signified an important turning point from which critics of the USD reserve system could no longer claim they were being involuntarily held hostage by its link to gold. With the link from gold removed the continued role of the USD as a reserve currency confirmed that the USD remained to be the only suitable reserve option, further expanding the ability of the U.S. exercise ‘benign neglect’ with its fiscal policy.

With the floating exchange rate system, ‘benign neglect’ became an institutionalised feature of U.S. monetary policy. Because of the continued widespread use of the USD by other states and central banks the U.S. became able to consistently run a ‘balance of payments’ deficit that other states would be unable to without massive repercussions to their domestic financial markets.\(^\text{51}\) As long as there remains a demand for USDs, then the U.S. can continue to spend more money on importing goods and services than it earns from exporting goods and services. The result of this advantage has been an ever increasing discrepancy between the US’ external debt (the money it owes to creditors outside the US) and its GDP. For example, in 2005, the U.S. external debt totalled approximately 25% of its GDP. It is estimated that by 2015 it will reach 50% of GDP and by 2030 an astounding 100% of GDP.\(^\text{52}\) The advantage of being able to run an ever increasing ‘balance of payments’ deficit is not only significant; it is completely unique to the US. For any other country in the world running a large trade deficit is a major cause for concern. For the U.S., however, it has consistently been a major source of economic advantage, and for as long as the USD

\(^{50}\) Ibid, 47, p.423
\(^{51}\) Ibid, 47, p.425
\(^{52}\) Ibid, 47, p.420
remains to be seen as the safest monetary asset it affords the U.S. the ability to infinitely print more money. In view of this, it should be no surprise that by the late 1980s the U.S. was beginning to exercise its structural power in new ways to further cement the role of the USD in the world.

During the 1980s the U.S. began to exercise structural power over the international political economy broadly, and the IMS specifically, through what Strange outlines as the ability to influence and control knowledge and information within a system. It did this by leveraging its monopoly over technical economic knowledge through its influence over key IMS institutions such as the IMF and World Bank. The rise of this particular school of economic knowledge, which has come to be popularly known as the ‘Washington Consensus’, has been a major contributing force to the depth and influence of the USD in the world economy. The ‘Washington Consensus’, as originally defined by John Williamson in 1989, was what he perceived to be a general consensus among U.S. policy makers, economics professors and the Bretton Woods institutions for how best to achieve economic growth in the developing world.\textsuperscript{53} Williamson outlined ten specific policy prescriptions which he considered to be central to the consensus. These included things such as privatization of public services, removal of state control over interest rates, liberalization of trade and opening markets to foreign direct investment to name a few.\textsuperscript{54}

Sarah Babb has expanded on Williamson’s original definition and argues that the ‘Washington Consensus’ should be understood as a transnational policy paradigm, through which the IMF and World Bank became the institutional tools used to disseminate the market-liberalizing policy objectives that were favoured by the U.S.\textsuperscript{55} The loans given by these institutions (to developing states) known as ‘structural adjustment programmes’, were defined by conditionality. In exchange for financial assistance states were required to adopt the ‘Washington Consensus’ reform program.\textsuperscript{56} The adoption of market reforms by IMF and World Bank debtor states had the direct result of increasing the importance of the

\textsuperscript{54} Ibid, 53, p.10
\textsuperscript{55} Ibid, 22, p.275
\textsuperscript{56} Ibid, 22, p.276
USD as a reserve currency for several reasons. For developing states the USD increasingly became a crucial source of protection against the threat of economic instability that came along with opening poorly developed markets to foreign investment and exchange rate volatility.\(^{57}\) By accumulating USDs it reduced the potential dangers of sudden capital flight and currency devaluation in their domestic economies—dangers that came about by following the ‘Washington Consensus’ development model. The flow on effect of the accumulation of USDs as an insurance policy is that states gain a vested interest in protecting their investment. Maintaining the value of the USD became a national interest for states that were compelled to accumulate it, further cementing the continued importance of the USD’s role in the IMS.\(^{58}\) As will be discussed in chapter 2 and 3, the massive accumulation of USD reserves by China in recent years is also a vital consideration when assessing China’s changing role in the international system.

The extent to which developing states adopted the ‘Washington Consensus’ style reforms was largely dependent on the ability of the U.S. to exercise structural power over the control the dissemination of knowledge and information in specific countries. During the Latin American debt crisis of the late 1980s for example, IMF based reforms were consistently adopted throughout the region, because many political elites in the region were trained in U.S. tertiary institutions.\(^{59}\) Having received American training they would return to their respective countries with a strong support for the kind of neoliberal economic policies that the U.S. was intent on spreading. As Babb points out, the influence of U.S. trained political elites in domestic politics had an impact on the political contestation of power in several Latin American countries. The withholding of resources by the IMF and World Bank to governments unwilling to adopt ‘Washington Consensus’ reforms put them at a political disadvantage to political actors who were willing to adopt such policies in exchange for much needed economic assistance.\(^{60}\)

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\(^{58}\) Ibid, 48, p.112

\(^{59}\) Ibid, 22, p.279

\(^{60}\) Ibid, 22, p.279
The unquestioned dominance of ‘Washington Consensus’ economic policy ideas continued from the late 1980s through the 1990s. It was not until the Asian financial crisis of the late 1990s, however, that the conditionality of IMF and World Bank loans, as well as the questionable success of policy reforms began to see its dominance unravel. When the Asian financial crisis hit in 1997 countries such as Malaysia, Thailand, Indonesia and South Korea all saw the value of their currencies diminish by between 50 and 70 percent within six months. The rushed liberalization of their economies, which allowed rapid inflows of foreign investment, had initially caused their currencies to increase significantly in value. When investors became aware that these developing states were borrowing too much money they pulled their investments and caused both massive currency devaluation and major spikes in interest rates in their domestic economies. The issue of ‘hot money’ flows into undeveloped economies soon after market-liberalizing reforms has been one of the main criticisms of neoliberal economic policy. While initially the newly opened economy sees a boom in investment, resulting in a stronger currency and lower interest rates, when the speculative investors fuelling the boom withdraw their money it has the immediate impact of sudden currency devaluation and interest rate spikes. As the Asian financial crisis showed, the apparent disconnect between the unquestioned validity of the ‘Washington Consensus’ and its real world application has continued to raise questions about its validity as a policy model. By the early 21st century developing countries and a range of academics, including Nobel laureate for economics Joseph Stiglitz, had become increasingly sceptical of the soundness of the prevailing neoliberal style economics being promoted by the U.S and IMS institutions. The growing scepticism of ‘Washington Consensus’ style economic policy leading up to the GFC of 2008-2009 is an important consideration when assessing the ability of the U.S. to continue exercising structural power within the IMS.

The aim of this chapter has been to demonstrate the historical development of the USD as an international currency and the ways in which the U.S. has strengthened its position as the main international currency. The concept of structural power is central understanding

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61 Ibid, 22, p.279
63 Ibid, 62, p.280
64 Ibid, 22, p.282
the importance of the USD in the international system, as the ability of the U.S. to exercise structural power within the international political economy and the IMS has been instrumental in promoting U.S. interests abroad. In the next two chapters it will become apparent that recent developments in Chinese monetary policy should not be understood in a vacuum. The role of the USD, from the point it overtook the pound sterling as the reserve currency, up until the Asian financial crisis of 1997, provides a powerful historical example for examining the continued role of the USD and any potential challenge to this system from China. Having established the importance of structural power as a theoretical tool for understanding U.S. power in the IMS I will continue to apply this IPE perspective in relation to the years leading up to and following the GFC to demonstrate the impact this crisis, as well as other factors, have had on the role of the USD and U.S. power in the international political economy.

Chapter 2. Wars and Crises in the 21st Century: U.S. Credibility in Doubt

In the years leading up to and after the GFC of 2008-2009 there have been a number of significant changes in the distribution of structural power within the international system. These changes have had a direct impact on the credibility of the USD as a reserve currency. This chapter will investigate the four elements of Strange’s structural power framework in order to demonstrate the ways in which the U.S. ability to exercise structural power going forward is changing. While the USD still retains a central role in the IMS, the U.S. ability to exert structural power as a hegemonic state has undoubtedly been brought into question. By looking specifically at the U.S. involvement in Iraq and Afghanistan, the growing gridlock within the World Trade Organization (WTO), the impact of the GFC on U.S. financial credibility and the rise of a new ‘Beijing Consensus’ model of economic development I aim to demonstrate that there is growing evidence that U.S. ability to exert structural power, as a way of maintaining the USD’s position as a reserve currency, is declining.
As discussed in Chapter 1, according to the first point in Strange's framework, structural power within a system lies, "with the person or group able to exercise control over-that is, to threaten or to defend, to deny or to increase-other people's security from violence..." In terms of maintaining the role of a reserve currency this form of structural power is extremely important. The ability of the issuing state to defend its own economy as well as provide physical security to other states that choose to participate in its reserve system can have a direct political and economic effect on the ability of the reserve currency to maintain its value. If confidence in the issuing state’s ability to maintain the system falters, then the function of its currency as a store of value begins to disappear. In the 21st century, the ability of the U.S. to meet this requirement of structural power has increasingly come into question. The endlessly publicized ‘war on terror’, initiated by the U.S. in response to the September 11, 2001 terrorist attacks against the World Trade Centres, has challenged the ability of the U.S. to use its military power as a tool for enhancing its own and other states security. The foreign occupations of both Afghanistan and Iraq are worthy of investigation as they demonstrate the tangible failure of the U.S. to achieve its stated objectives for pursuing the wars.

The invasion of Afghanistan by the U.S. and the ‘coalition of the willing’ in 2001 represented the beginning of a war against global terrorism that continues to this day. While the initial objective of removing the Taliban from power took only a matter of months, the ability to establish an effective government and reduce the threat of terrorism has so far proven to be unsuccessful. For example, in 2005 there were only 15 suicide terror attacks in Afghanistan, while in 2006 the number jumped to 90, and by 2007-2010 the number of suicide attacks stabilised at roughly 100 per year. The invasion of Iraq in 2003 paints a similar picture. After quickly removing Saddam Hussein from power the situation in the country has consistently deteriorated. The number of suicide terror attacks between 2003 and 2006 for example reached a total of 443 separate attacks, a similar level to that of

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65 Ibid, 18, p.565
66 Ibid, 27, p.357
Afghanistan during the same period. These figures, when compared to earlier rates of suicide terrorism, where between 1980 and 2001 there was a total of 188 suicide attacks globally, suggests that the ability of the U.S. to exert ‘hard’ power may no longer be as useful in a globalised world. While it’s clear the threat of terrorism in Iraq and Afghanistan increased as a result of the invasion perhaps that does not give the full picture on how successful the U.S. campaign against terrorism has been.

Another metric for how successful the ‘war on terror’ has been was set out by former U.S. Secretary of Defense, Donald Rumsfeld. He suggested that the U.S. would be winning the war if they were successfully killing more terrorists than the number of terrorists being recruited. In this regard the picture not any better. The terrorist organization ISIS (also known as ISIL and Islamic State), which was originally an off-shoot of Al-Qaeda in Iraq, has been steadily increasing its control over Iraq, with CIA estimates suggesting the group has approximately 30,000 fighters throughout the organisation, several thousand of which are Westerners. The ability of ISIS to take control of large areas of Iraq, including large cities such as Mosul almost immediately after the U.S. began to withdraw troops from the country is a damning indication that the invasion can in no way be measured as a success.

There is an important link between ‘hard’ power such as that exercised by the U.S. in the ‘war on terror’ and its ability to exercise ‘soft power’ through its hegemonic status. ‘Soft power’ is the ability to influence states and non-state actors through non-violent means such as ideas. As Robert Cox argues, ‘soft power’ and the ability to exert it can be directly linked to the way ‘hard’ power is exercised. The unilateral pursuit of wars of democratization by the U.S. has had a major impact on the influence of American ideas abroad, particularly in the case of terrorism, where polls have consistently shown that even

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70 Piven, Ben. ‘Who, what and where is ISIL? Explaining the Islamic State’ Al Jazeera American, 18 September 2014, Internet, Accessed 9 October 2014
71 Ibid, 69, p.4
moderate Muslim populations around the world are highly sceptical of U.S. foreign policy.\textsuperscript{73}

While the ‘war on terror’ is still ongoing, and may in time be ‘won’, despite how unclear the path to victory may be, it has to-date had a negative impact on U.S. credibility and power. The inability of the U.S. to establish effective and legitimate governments in Iraq and Afghanistan is an important consideration when assessing the role of the USD in the IMS. Confidence in the hegemonic status of the U.S. and its military supremacy has historically been an important reason for the USD’s widespread use, and any indication that the U.S. is becoming unable to pursue its security interests abroad will further impact on confidence in the USD reserve system. Both the threat of ISIS and the Russian annexation of Crimea are unfolding events that have the potential to further damage confidence in the ability of the U.S. to defend the system it is responsible for creating, of which the USD is significant part.

The second point in Strange’s framework suggests that structural power lies, “with those able to control the system of production of goods and services…”\textsuperscript{74} The extent to which the U.S. retains its position as the largest manufacturer of goods and services then is an important consideration in its hegemonic status in the world, and the continued role of the USD as a reserve currency. By looking specifically at the success of WTO trade meetings in the 21\textsuperscript{st} century and U.S. share of global manufacturing over time it will highlight whether U.S. power of this kind is stable. In a comprehensive collection of G20 economic data from 2013, the global share of GDP per country (adjusted to purchasing power parity) provides a useful comparison of the relative economic power of the U.S. and China over time. In 2013 the U.S. GDP made up 19.31\% of global GDP, while China’s GDP accounted for 15.40\% of global GDP.\textsuperscript{75} In 2003 the U.S. GDP was 22.97\% of global GDP, while China’s was only 8.79\%.\textsuperscript{76} Going back even further to 1988, U.S. GDP made up 25.44\% of global GDP with China only making up 3.81\%.\textsuperscript{77} Even though the U.S. economy still accounts for a significant percentage of the global economy, it is evident from these figures that the landscape is changing. With the rest of the world gradually catching-up, and China potentially soon to

\begin{itemize}
\item \textsuperscript{73} Ibid, 69, p.5
\item \textsuperscript{74} Ibid, 18, p.565
\item \textsuperscript{75} ‘GDP as a share of world GDP at PPP by country’ Quandl, Accessed at https://www.quandl.com/c/economics/gdp-as-share-of-world-gdp-at-ppp-by-country, 8 October 2014
\item \textsuperscript{76} Ibid, 75
\item \textsuperscript{77} Ibid, 75
\end{itemize}
overtake the U.S. in raw economic size, the ability of the U.S. to dictate the structure of global trade is likely to continue decreasing, if current trends in economic growth remain the same.

The inability of WTO members to reach agreement over key trade issues in recent years further illustrates what appears to be a decline in the ability of the U.S. to exercise structural power over the terms of trade in the world economy. The Doha round of trade talks began in 2001, with the WTO and its members hoping to establish an international consensus on a range of global trade issues ranging from agriculture in the developing world, to intellectual property, antitrust and foreign investment rules. By 2012, the talks were widely declared a failure, with the member states having failed to reach an agreement on a range of different issues. The impasse in trade negotiations is largely representative of the growing number of participants in the talks, in contrast to when global trade negotiations began soon after WW2. In 1947, when the first global trade talks began, only 23 countries were involved, while the Doha round had 155. The combination of the U.S. share of global GDP declining, and the incorporation of many new member states into the WTO has and will continue to impact on the ability of the U.S. to exert structural power within the international system. The flow on effect of this has potential implications for the USD, as a relative decline in economic size and influence for the U.S. will weaken the stability of the USD as a store of value, and its usefulness as a medium of exchange. If the U.S. is but one of many large developed economies in the world then the USD retains no unique economic reason for it being used by other states. With the USD system relying so heavily on the size, depth and openness of the U.S. economy, the economic rise of China will become an increasingly relevant consideration for how the IMS should be governed.

The third point in Strange’s framework for evaluating structural power suggests it lies, “with those able to determine the structure of finance and credit through which (in all but the most primitive economies) it is possible to acquire purchasing power without having either

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78 Anonymous. ‘Goodbye Doha, hello Bali’ The Economist, 8 September 2012, Internet, Accessed 8 October 2014
79 Ibid, 78
to work or to trade it..." As was covered in Chapter 1, this aspect of structural power historically has provided the U.S. with a range of advantages, most notable of which has been the ability to run an ever expanding ‘balance of payments’ deficit. This section then shall evaluate the extent to which the U.S. still retains the ability to dictate the use of its USD as the global reserve currency and whether there are indications that the structural monetary power of the U.S. may be changing. To determine the current status of the USD leading up to and after the GFC it is useful to apply Strange’s model for categorizing the different types of international currency and their characteristics. The four types of international currency she identifies are, Top Currencies, Master Currencies, Passive or Neutral Currencies, and Political or Negotiated Currencies. She notes that the U.S. for example has in the past had characteristics that fit all four of her categories, but the extent to which a particular category most accurately describes the role of the currency is a useful way to understand its position and purpose in the IMS. For the purposes of this evaluation the two types of currency worthy of consideration are ‘top’ and ‘negotiated’ currencies. For Strange, a top currency is the currency which is issued by the largest economy in the international system. Its role as a reserve currency is not necessarily dependent on its usefulness as a store of value, so long as it retains a hegemonic position as a medium of exchange. A negotiated currency by contrast is one which requires political coercion to ensure its continued use. Strange suggests that a range of political inducements may be employed by the issuer of a negotiated currency, such as guarantees of military security or financial concessions, among other things. When a currency becomes a negotiated one it is typically symptomatic of an issuing country that is in relative decline in terms of economic size and political influence in the world.

To what extent then, in the years leading up to and following the GFC, has the role of the USD changed from a top currency to a negotiated one? Helleiner suggests that in recent years, particularly since 2008, the USD has been increasingly taking on the qualities of a negotiated currency. The main area this has become evident has been in the massive

80 Ibid, 18, p.565  
82 Ibid, 81, p.221  
83 Ibid, 81, p.220  
84 Ibid, 27, p.386
accumulation of USD reserves by East Asian states. China alone has over $1 trillion in USD reserves, while Japan has over $800 billion.\textsuperscript{85} Taking on these USD reserves has been crucial in maintaining the role of the USD, as the ability of the U.S. to continue expanding its ‘balance of payments’ deficit requires an ability to spend more USDs abroad than it earns from trade. The motivation of East Asian states in accumulating the reserves has been largely political, as the relationship between the U.S. and countries like China has been mutually beneficial. In what Niall Ferguson and Moritz Schularick have famously coined ‘Chimerica’- the economic relationship between the two states has increasingly been one of political compromise on both sides in the pursuit of mutually beneficial interests. By accumulating massive USD reserves China has been able to maintain incredible growth rates in its domestic export sector.\textsuperscript{86} Similarly, by having China and other East Asian states fund the U.S. trade deficit the U.S. has been able to keep interest rates artificially depressed, which has maintained consumer demand for Chinese imported products.\textsuperscript{87} While the relationship between the two great powers has been mutually beneficial the impact of the GFC may have realigned the calculation of political interest for China ways which will see them gradually move away from their dependence on USD reserves. For instance, it has been widely suggested that the economic relationship between the U.S. and China was a significant contributing factor to the GFC.\textsuperscript{88} The artificial suppression of interest rates in the U.S., due to East Asian USD accumulation, was partially to blame for the property bubble that sparked the GFC. By keeping domestic interest rates depressed, U.S. consumers gained access to cheap credit which was then funnelled into speculative property lending.\textsuperscript{89}

As a result of growing awareness of the danger of these economic imbalances the U.S. has been putting increasing pressure on China to revalue its currency against the USD. By increasing the value of the Renminbi in relation to the USD it has the effect of reducing the real value of their USD reserves. In response to global pressure the Renminbi has been allowed to gradually appreciate between 2005 and 2008, and again since 2010, but in

\textsuperscript{85} Ibid, 27, p.386
\textsuperscript{86} Ferguson, Niall and Schularick, Moritz. ‘‘Chimerica’ and the Global Asset Market Boom’ International Finance, Vol. 10:3, (2007), p.228
\textsuperscript{87} Ibid, 86, p.228
\textsuperscript{88} Ibid, 48, p.118
\textsuperscript{89} Ibid, 48, p.118
historical context remains closely pegged to the USD.\textsuperscript{90} For obvious reasons China has been hesitant to undertake policy reforms which will hurt the value of its foreign investments. While there is no indication that China will move away from the USD any time soon, these factors indicate that the role of the USD is in some ways dependant on the continuation of Chinese monetary policies which are largely political in calculation. China’s decision to let the value of the Renminbi appreciate since the GFC has not been the result of direct structural influence by the U.S., rather it has been the result of political calculation by China that the USD system remains beneficial to its own interests. As will be discussed further in Chapter 3, there are strong indications that China does not see the continuation of the USD system in its own interest in the medium to long term.

The final structural consideration of the USD’s role has been the ability of the U.S. to influence knowledge, and control information in relation to how states should manage economic policy. By looking further at the decline in the ‘Washington Consensus’ in the 21\textsuperscript{st} century and the emergence of a new economic development model, commonly known as the ‘Beijing Consensus’, it will become apparent that U.S. dominance over technical economic thought has become contested, particularly since the GFC. Strange defines structural power in this context as lying with, “those who have most influence over knowledge, whether it is technical knowledge, religious knowledge, or leadership in ideas, and who control or influence the acquisition, communication, and storage of knowledge and information.”\textsuperscript{91} As was shown in Chapter 1, the dominance of U.S. technical knowledge in the field of economics has historically had a tangible effect on continued support and influence of the USD reserve system. In 2004, however, a new discourse on economic development policy emerged which in many ways has been seen as a direct competitor to the neoliberal economic principles so commonly associated with the ‘Washington Consensus’. In his 2004 Financial Times article, Joshua Ramo outlined what he saw as the emergence of a ‘Beijing Consensus’ model for economic development. He argued that the rapid emergence of China and India, two countries which have historically avoided reliance on ‘Washington Consensus’ institutions (the IMF and World Bank) were creating their own


\textsuperscript{91} Ibid, 18, p.565
development model with a far stronger track record of success.\textsuperscript{92} Ramo suggests that the core principles of the Beijing model have been the pursuit of equitable and high-quality economic growth, an extremely cautious approach to privatization and market liberalization, and a ruthless willingness to innovate and experiment in the application of economic policy.\textsuperscript{93} While the success of these policies has been evident within China itself, the export of Beijing model development to other states is arguably the best indicator of the extent to which other developing nations are moving away from the U.S. dominated IMF and World Bank system.

Within the developing world, the Beijing model has received overwhelmingly positive feedback. In a 2010 World Bank report, it noted that China, at that time, was engaged in infrastructure and finance projects with over 35 countries throughout Africa.\textsuperscript{94} Of the countries involved, Nigeria has been one of the main recipients of Chinese development aid, with $5 billion for example being committed in 2006 for the construction of a hydroelectric power station, and towards the upgrade of its railway system.\textsuperscript{95} The positive reception to this ‘no strings attached’ approach to development aid has been reflected in public opinion polls within Nigeria. A 2010 survey of the Nigerian population found that its citizens are increasingly favourable of Chinese involvement, with 85% of respondents viewing China favourably in 2009, up from 79% in 2008.\textsuperscript{96} The lack of ‘conditionality’ attached to Chinese aid reflects a difference in approach that has been unique to China. China’s motivation to build lasting economic partnerships with the developing world fits within a broader strategic goal of exporting Chinese values and ideas abroad, which will continue to have an impact on its ability to exert structural power over both the international political economy generally, and the IMS specifically. It also reflects structural limitations that China is currently bound by that the U.S. is not. For China, the ways it can provide development assistance is limited by the current role of the USD in the IMS. Because of the USD’s dominance in settling international transactions, the Chinese are unable to provide credit to the developing world.

\textsuperscript{92} Ramo, Joshua C. ‘China has discovered its own economic consensus’ The Financial Times, 7 May 2004, p.19
\textsuperscript{93} Ibid, 92, p.19
\textsuperscript{95} Ibid, 94, p. xiv
\textsuperscript{96} Anonymous. ‘The Beijing consensus is to keep quiet’ The Economist, 6 May 2010, Internet, Accessed 11 October 2014
in Renminbi’s. Economic determinants of international money, namely, the extent to which the issuing country has deep and open markets has continued to hamper widespread use of the Chinese currency. As a result, China has tended toward bilateral investment projects, such as in Nigeria, as a way of utilising its large trade surpluses without directly providing financial credit.\(^{97}\) Ironically, the dominance of the USD in international trade settlements has been a contributing factor to the unique and well-received model of development assistance pursued by China. The excess of Chinese technical capability— in the form of engineers and skilled workers, combined with an economic imperative to make use of its trade surpluses will continue to contribute to the relative weakening of U.S. structural power over knowledge and information internationally. Both the British Empire in the 19\(^{th}\) century, followed by the U.S. in the 1920s and post-WW2, made similar use of massive trade surpluses in large-scale infrastructure projects throughout the developing world.\(^{98}\) The recent $10 billion partnership between China and Argentina to rebuild its dilapidated rail network, initially established with the help of British engineers, indicates that China is following a well-trodden path to greater international influence over technical knowledge and information.\(^{99}\)

Having considered the four aspects of Strange’s framework for evaluating structural power the aim has been to demonstrate the historically significant change in U.S. power leading up to and since the GFC. By looking at the failures of U.S. foreign policy in the ‘war on terror’, the breakdown of multilateral cooperation in international trade, the increasingly negotiated status of the USD, and the rise of a Beijing model of economic development it indicates that the ability of the U.S. to exert structural power over the international system has declined relative to other states. The aim has not been to suggest that the U.S. is no longer a superpower, or that the role of the USD as a reserve currency is over. Neither of these things could be argued, because quite clearly it would not be accurate. The U.S. and the USD are likely to be central features of the international political economy for some time to come. What is clear, however, is that as a result of this relative decline in global influence China has begun to undertake a range of policies which seem to indicate a long-

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\(^{98}\) Ibid, 97, p. 497

\(^{99}\) Ibid, 97, p. 496
term awareness that the gap between itself and the U.S. is likely to get smaller. While the USD system has been an important source of Chinese economic growth, the GFC fundamentally damaged Chinese confidence in the U.S. as the issuer of a global reserve currency. In the following Chapter I will conclude my thesis by evaluating the specific steps China is now undertaking which indicate a strong interest in making the Renminbi an international currency. By looking at these developments from a structural power perspective it will confirm the underlying argument of this thesis, that structural power as a concept provides a useful way of understanding the role of the USD and the rise of China and why the USD system persists despite changes in power distribution within the international political economy.


In evaluating the historical development of the USD reserve system two important structural consequences have become clear. Firstly, the ability to establish and maintain the USD as a global reserve currency has been contingent on the ability of the U.S. to exercise structural power in a range of different ways. Secondly, by successfully establishing an international role for the USD, the U.S. has gained a range of political and economic advantages which help to preserve its position as an economic, political and military superpower. Since the GFC, however, the credibility of the U.S. and its ability to exert structural power has been in relative decline. In many areas China is catching up. In response to the relative decline of the U.S., China has been displaying increasing interest in policy which will increase its own structural power, as well as establish an international role for its own currency, the Renminbi. This chapter will evaluate the steps China is taking to internationalize the Renminbi, the ways China has been strengthening its structural power internationally, and the obstacles China will face in establishing an international role for the Renminbi. By looking closely at developments in Chinese policy in these areas it will be shown that a significant international role for the Renminbi is unlikely in the near future but seemingly inevitable in the long-term. If China continues to bridge the gap between the U.S. in areas such as, global trade, financial liberalization and technical economic knowledge then a greater international role for the Renminbi is guaranteed.
Before considering the specific steps being taken by China to internationalize the Renminbi it is useful to highlight that it has indeed become an increasingly overt objective in Chinese strategic planning. As was covered briefly in Chapter 2, the GFC and the global imbalances in trade and finance revealed by it, has resulted in the emergence of Chinese concern over the role of the USD, and the irresponsible governance of this reserve system by the U.S. In 2009, the governor of the People’s Bank of China published a statement regarding the role of the USD as a reserve currency, in which he airs a range of concerns about the effectiveness of the current IMS for global stability. As he notes, “The frequency and increasing intensity of financial crises following the collapse of the Bretton Woods system suggests the costs of such a system to the world may have exceeded its benefits. The price is becoming increasingly higher, not only for the users, but also for the issuers of the reserve currencies. Although crisis may not necessarily be an intended result of the issuing authorities, it is an inevitable outcome of the institutional flaws.”100 He goes on to recommend a shift away from the USD reserve system to one in which Special Drawing Rights (SDR), issued by the IMF, would become a super-sovereign currency and the main unit of international trade and finance.101 The proposal for an increased role of SDR has not gained much political support but the sentiment of Zhou’s statements is indicative of the growing concern that the USD backed IMS is having a negative impact on China’s long term development strategy.

The most obvious, yet also most challenging obstacle for China establishing the Renminbi as an international currency has been convincing foreign central banks and investors to use it internationally. Essentially, in order to ensure financial stability and consistent export-oriented growth China has historically chosen to intervene in its financial markets through the use of a pegged exchange rate and capital controls.102 By keeping the value of the Renminbi closely pegged to the USD it prevents the value of the Renminbi from appreciating indefinitely with no predictable point at which its value would stabilise. As McKinnon and Schnabl point out, the artificial repression of the exchange rate is a by-product of the USD system. If China were simply to float its exchange rate and remove capital controls there

101 Ibid, 100
102 Ibid, 90, p.15
would be an influx of foreign investment into the country causing the Renminbi to inflate uncontrollably with dire consequences for its domestic economy. At the same time, however, a fixed exchange rate prevents the Renminbi from satisfying one of the key economic requirements of a reserve currency- a freely floating exchange rate to which other economies can peg their currency. A reserve currency must be able to hold a stable value as determined by the market, not by artificial state control. In the years since the GFC China has begun to address this problem with a gradual and calculated revaluing of its currency, as discussed briefly in chapter 2. The extent of the latest managed revaluation saw the Renminbi appreciate against the USD by approximately 5% in 2010, with very little change in value since. The increasing stability of the Renminbi through this revaluation process indicates that the Chinese economy may soon be developed enough to float its exchange rate indefinitely.

The process of carefully allowing the currency to appreciate is an important, albeit prudent, first step to gradually liberalizing the Chinese economy. Despite it not being a full liberalization of its exchange rate, foreign central banks have begun to see value in holding Renminbi as a reserve currency. For example in 2011, Nigeria; a large recipient of Chinese development aid, announced it would begin to hold approximately 5-10 percent of its foreign reserves in Renminbi or Renminbi denominated assets. Similarly, in 2012, Japan announced it had obtained permission to purchase some 65 billion Renminbi, which would account for almost 1% of Japan’s foreign exchange reserves. By comparison, however, in 2014, the USD still accounted for approximately 60% of all foreign exchange reserves held in central banks globally. In this context Renminbi holdings are still materially insignificant; but, they represent an important process of transformation for the currency on its path to becoming a more significant part of the IMS, and one which other countries will increasingly see as a safe store of value. In terms of increasing China’s relative structural power within the IMS it is clear that the U.S. still has an enormous advantage in this area. Despite this, the

103 Ibid, 90, p.23
105 Ibid, 26, p.1365
106 Ibid, 26, p.1365-1366
fact the Renminbi has gone from no international role at all to being held as foreign reserves (albeit in small amounts) in a relatively short time is a noteworthy development. If more central banks continue to accumulate Renminbi moving forward it will be an increasing source of structural monetary power for China.

Having begun the gradual process of limiting state intervention in its currency’s exchange rate, China is also beginning to address other obstacles to a more international role for the Renminbi. As has been discussed in earlier Chapters, the depth and openness of an issuing state’s financial markets is also crucial for a currency to become widely used internationally. The British pound and the USD both gained primary reserve status at various stages throughout history in part as a result of the unparalleled depth and openness of their financial markets.\textsuperscript{108} For China, this has historically been an area of its economic development that has remained a significant and obvious gap between itself and the U.S. Because the Renminbi is not fully convertible internationally there has been little reason for China to develop its financial markets.\textsuperscript{109} In order to address this problem China has in recent years started experimenting with using Hong Kong as an ‘offshore’ financial market through which international trade and investment, denominated in Renminbi can be settled. Since 2011, China has allowed Foreign Direct Investment (FDI) to enter its economy denominated in Renminbi. Hong Kong has a central role in this new development as the FDI is funnelled through its financial hub, exchanged into Renminbi, and then flows into mainland China.\textsuperscript{110} By using Hong Kong as an offshore intermediary for investment inflows it will help to alleviate the typical dangers of financial liberalization, such as inflation and speculative investment bubbles that had such devastating effects on other Asian economies during the crisis of 1997.

In recent years China has also been promoting trade settlements in Renminbi. The purpose of currency swap agreements is to facilitate trade between China and its trading partners, as it allows local central banks to sell Renminbi to importers that wish to buy Chinese products. To date, Hong Kong has been the main partner with China in bilateral currency swaps. In

\textsuperscript{108} Ibid, 27, p.357-358
\textsuperscript{109} Ibid, 90, p.15
2009, when China initiated the first currency swap agreement with Hong Kong they agreed to exchange currency to the value of 200 billion Renminbi. The agreement was renewed in 2011 for an additional 400 billion Renminbi.\textsuperscript{111} In the global context, since 2008 Renminbi reserves to the value of 270 billion USD have been swapped between China and twelve other states, including Australia.\textsuperscript{112} Major developed economies have also been showing interest in increasing the international use of Renminbi for trade settlements, with the Bank of England announcing in 2013 it would be partnering with the People’s Bank of China in a three year currency swap agreement valuing approximately 200 billion Renminbi (~34 billion USD).\textsuperscript{113} Clearly, China’s goal of promoting a greater international use for the Renminbi has gained momentum rapidly since the GFC. In structural power terms, use of Renminbi in cross-border trade settlement and FDI are both ways in which China can gain more influence over the IMS. But once again, it is necessary to consider these developments in relation to influence the USD still retains over this area of the international political economy. The actual volume of offshore currency trades in Renminbi is estimated to have peaked at approximately 200 million (70 million USD) in March and June 2011, and has fluctuated at lower levels since.\textsuperscript{114} By comparison currency trades in USD are estimated to exceed 4 trillion on a daily basis.\textsuperscript{115} While it has been shown that U.S. structural power is in relative decline, the role of the USD in the IMS, especially as a unit of exchange, seems unlikely to be surpassed by the Renminbi any time soon. To date these have been the main areas in which China has been pursuing the internalization of the Renminbi. While it is still a long way from fully liberalizing its economy, it is taking the necessary steps to increase the viability of its currency in a cautious and calculated way.

As Strange’s framework outlines, however, ascendance of a currency to international reserve status is not only influenced by structural power over finance and credit. China’s structural capacity in relation to Strange’s three other elements of structural power are also relevant in the future use of its currency. One of the other major developments for Chinese

\textsuperscript{111} Ibid, p.113
\textsuperscript{112} Ibid, p.1366-1367
\textsuperscript{113} Anonymous. ‘UK and China in £21bn currency swap deal’ BBC News, 23 June 2013, Internet, Accessed 16 October 2014
\textsuperscript{114} Ibid, p.113-114
\textsuperscript{115} Ibid, p.114
Structural power has been its ability to gain influence over the terms of global trade and technical economic knowledge. The development of Chinese trade and development partnerships has been an increasingly important area in which they have increased their structural power relative to the U.S. As was covered in Chapter 2, the relative decline of the ‘Washington Consensus’ policy paradigm (and the emergence of the Beijing model), in combination with the relative decline of U.S. economic share of global GDP has created an environment in which China has significantly increased its influence over global trade and technical economic knowledge. The formation of the BRICS (Brazil, Russia, India, China and South Africa) in what Shaun Breslin refers to as an ‘alliance of the dissatisfied’ is a telling example of China moving away from traditional power structures in pursuit of its own institutional platform through which it can gain influence over global trade and economic development internationally. In July 2014 the BRICS states officially opened the BRICS development bank, which is stationed in Shanghai, one of China’s biggest urban centres. The bank is made up of two component institutions, the New Development Bank and the Contingent Reserve Arrangement, purposed with providing finance for sustainable developments projects as well as assisting members facing financial difficulties. With approximately $150 billion USD in initial capital it will perform a similar role to the IMF and World Bank for its members. With China as the de facto leader of the BRICS group of states, its development signifies what is generally understood as a growing sense by China that it is being underrepresented within the traditional Bretton Woods institutions. Similarly, China’s commitment to its own unique model of bilateral development assistance has also been a significant way in which China is increasing its structural influence over global trade and economic policy. The positive reception of Chinese development aid, as previously covered, has had a strong impact on the formation of new economic partnerships between China and the developing world. More specifically, China’s export-import bank, which has been at the forefront of its development assistance in Africa and South America, is estimated to now have greater operational assets than the World Bank. Historically the

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118 Ibid, 117
119 Ibid, 116, p.629
120 Ibid, 90, p.14
IMF and World Bank have played an important role in the dissemination of U.S. economic policy interests, and so it only follows that the rapid emergence of China in this area will continue to enhance its ability to establish its own global ‘knowledge network’ in states that engage with it. As its position as a leader of the developing world becomes more institutionalised within the international political economy the Renminbi is likely to become increasingly attractive as an alternative to the USD.

As such, this final chapter has tried to demonstrate the specific areas in which Chinese currency internationalization is moving forward, and the extent to which it has succeeded to date. The main obstacle for making the Renminbi a more attractive currency has ironically been one of the main sources of China’s rapid development. State intervention in its exchange rate and strict controls over foreign investment has allowed its export industry to fuel economic growth for several decades. But in order to increase international use of the Renminbi the process of liberalizing its financial markets is gradually being pursued, mainly since the GFC. So far, in relation to the USD, the Renminbi remains an insignificant currency in the IMS. Nonetheless, if the current process continues its international importance is likely to increase. Separate to global finance the emergence of the BRICS as well as bilateral Chinese development programs has continued to increase China’s ability to influence trade and economic policy throughout the developing world. The combination of these developments, from a structural power perspective, seems to indicate that the Renminbi is likely to gain international influence in the same ways the USD did leading up to and after WW2. While the dollar remains dominant the Renminbi will struggle to establish a firm footing within the IMS but China is making sure in the long-term it stands a reasonable chance of widespread use.

**Conclusion**

In line with the central argument of this thesis it should now be clear that the role of the USD as a reserve currency has and will continue to be closely connected to U.S. structural
power within the international political economy. Historically, the military and economic supremacy of the U.S. gave it the ability to shape the environment in which states interact with each other. Through the establishment of the Bretton Woods system, the USD became an integral feature of the IMS. In what increasingly appears to be a self-perpetuating advantage, the role of the USD provides the U.S. with a range of advantages that allow it to sustain its position as a leading world power even in the face of a relative decline in global credibility and influence. As the U.S. ‘balance of payments’ deficit continues to expand the result is an ever increasing global reliance on USD as a way to protect developing economies from the instability the system itself appears to create.

As such, any consideration of the rise of China and the future of the U.S. should place significant attention on these economic and political connections. Despite the range of ways in which U.S. power appears to be declining, for structural reasons the USD retains a central role in the IMS. China’s massive reliance on USD to sustain its export oriented growth model means that both the U.S. and China will for the time being remain stuck in a relationship where their dependence on one another cannot easily be removed. Since the GFC, China seems to have become increasingly uneasy about this interdependence, and has begun to take tangible steps towards reducing its reliance on the USD. In evaluating the steps toward Renminbi internationalisation it is clear that it will be some time before it is a significant currency internationally. The main question that emerges from these developments is, will China’s efforts ultimately be in vane? If the USD can survive the calamity of the GFC and come out stronger then it would not be unreasonable to assume that it is simply too integral to the international political economy to be replaced.


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