Policy Research Center
Research Project
Accomplishment Report

Project Leader: Hyoung-kyu CHEY
Associate Professor
GRIPS

Research Project Title:
Bringing the Central Bank into the Study of Currency Internationalization

Project duration:
2014/4/1 ~ 2016/3/31, 2 years

Project Participants:

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Affiliation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leader</td>
<td>Hyoung-kyu CHEY</td>
<td>Associate Professor</td>
</tr>
<tr>
<td>Participant 1</td>
<td>Yu Wai Vic LI</td>
<td>Assistant Professor</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The Hong Kong Institute of Education</td>
</tr>
</tbody>
</table>

Project aims and goals:
The outbreak of the global financial crisis of 2008-2009 reignited vibrant debate over the future of the global monetary system. One particularly important issue is the question of whether the Chinese renminbi will evolve into a consequential international currency, competing with or even replacing the US dollar as the dominant international currency. The answer to that question ultimately relies on understanding which factors affect currency internationalization.

Economists have long addressed this issue by presenting a list of determinants of currency internationalization. Meanwhile, political economy research on the subject has been growing since the crisis, although it is still at an early stage.

However, the literature—including both economics and political economy—on currency internationalization neglects the role of the central bank in the process of currency internationalization. This is a crucial problem, given that the central bank is one of the core stakeholders in currency internationalization in its role as the issuer of currency. Moreover, the role of the central bank regarding currency internationalization is rather unclear inasmuch as theory and actual practice are at odds. From a theoretical viewpoint, one of the major costs of currency internationalization for the issuing state is constraints on domestic monetary policy, which implies that the central bank is likely to be opposed to or reluctant about the internationalization of its currency. In contrast to such a theoretical expectation, however, history reveals quite the opposite: the People’s Bank of China (China’s central bank) has been one of the most enthusiastic advocates for renminbi internationalization. In addition, the Federal Reserve (the US central bank) played crucial roles in dollar internationalization during the early 20th century when the dollar began to emerge as an international currency, and today the Fed remains very positive about the role of the dollar as the dominant international currency.

In this context, this research aims to provide an innovative political economy analysis of the preference for or against implementing currency internationalization and the subsequent role of the central bank therein, thus bringing the central bank into the study of currency internationalization.
Accomplishment of Project (in 400 words):
We have conducted an analysis of the current level of the internationalization of the RMB as one of the first steps of this research project. Although the internationalization of the RMB has made a substantial progress in recent years, the use of the RMB in ordinary foreign economies is still very marginal. These findings were presented as a conference paper (“The Renminbi in Ordinary Economies: A Demand-Side Study of Currency Globalization”) at the 2015 International Studies Association Annual Convention, New Orleans, February 18 to 21, 2015. A different version of the paper (“The Renminbi in China’s Next-Door Neighbor”) has been also accepted by the journal The Review of Northeast Asian Studies to be published in May 2015.

We have extensively reviewed the economics, as well as political economy, literature on the impact of currency internationalization on domestic monetary policy effectiveness. The conventional argument is that the internationalization of a country’s currency tends to reduce its monetary policy autonomy. Our comprehensive literature survey has found, however, that the impact of the internationalization of a country’s currency on its monetary policy is not necessarily negative. The internationalization of a currency may even strengthen the issuing country’s monetary policy autonomy.

We have conducted an extensive survey on the literature on internationalization of the RMB, and identified the major existing explanations for why China has actively promoted RMB internationalization. The major explanations include: to reduce China’s reliance on the US dollar, to strengthen its international influence and status, to accelerate its domestic financial reform, and so on.

We have built the main hypotheses of this research: (1) the internationalization of a currency is likely to strengthen the central bank’s policy autonomy from both markets and the government; and (2) a central bank with low policy autonomy is likely to pursue internationalization of its currency as a means to strengthen its policy autonomy.

We have analyzed the independence of the People’s Bank of China (PBOC). The PBOCs independence is still limited. However, it does have its own policy preferences, although it has to struggle with other policy makers in order to reflect its preferences in actual policy outcomes. In fact, the independence of the PBOC has increased substantially over the recent years.

We have undertaken investigation of the roles of the PBOC in internationalization of the RMB. The PBOC has been enthusiastically pushing ahead with RMB internationalization, acting as its key supporter.

We have begun examination of the preferences of other central banks, including the Bank of Japan (BOJ) and the US Federal Reserve, regarding the internationalization of their currencies. The BOJ had been reluctant in promoting the internationalization of the yen in the past, but has recently changed its position to support it. The Fed has not been against the status of the US dollar as the key international currency.

Accomplishment:
Please fill in the list of Accomplishment

Other things to report:
None.
List of Accomplishment
(including forthcoming)

<table>
<thead>
<tr>
<th>Author</th>
<th>Title</th>
<th>Publisher</th>
<th>Start page</th>
<th>Finish page</th>
<th>Referee Report (check the box)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hyoung-kyu Chey</td>
<td>The Renminbi in Ordinary Economies: A Demand-side Study of Currency Globalization</td>
<td>The 2015 International Studies Association Annual Convention, New Orleans, February 18 to 21 (peer-reviewed academic conference paper)</td>
<td>2015</td>
<td>-</td>
<td>1</td>
</tr>
</tbody>
</table>