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The role of London and Frankfurt in supporting the internationalization of the Chinese Renminbi¹

In *New Political Economy*, 2018

Ramon Pacheco Pardo (King's College London), Jan Knoerich (King's College London) & Li Yuanfang (Chinese Academy of Social Sciences)

Abstract

Why do foreign countries support the internationalization of the renminbi (RMB) by establishing offshore RMB centres? The Chinese government has openly stated that internationalization of the country's currency is one of its top priorities. International use of the RMB has already significantly increased in recent years. Yet, existing literature has almost exclusively focused on the structure of the Chinese economy and China's domestic politics to explain RMB internationalization. With this article, we seek to fill a gap in the literature by analysing the reasons why foreign countries support RMB internationalization. Using the cases of Germany and the UK, we show that a combination of economic and political factors, partly in response to inducements from Beijing, best explain why foreign countries support Chinese efforts to internationalize the RMB. Some of these factors are similar to both countries, but there are also differences regarding the reasons why they support this key Chinese goal. We use the case of the establishment of offshore RMB centres to conduct our analysis, given the clear political nature of foreign countries allowing China to open them in their own territory. We thus also show that the Chinese currency is starting to display the characteristics of negotiated currencies.

Keywords

China, renminbi, currency internationalization, negotiated currency, Germany, United Kingdom

1. Introduction

When a country rises to become a world leading economic and political power in the world, this is usually accompanied by aspirations for a greater international role of its currency. China is no exception in this regard. There are indications that the Chinese Renminbi (RMB) could become the third most internationalized currency in the world, after the US dollar and the Euro. In late 2015, the international importance of the RMB was confirmed when the IMF decided to include the RMB as the fifth currency in its Special Drawing Rights (SDR) basket (IMF 2015). But especially striking has been the pace with which the role of the RMB has strengthened over the past few years. While in 2012, the RMB was not even in the top 30 of most-used currencies in the world, it had already become the sixth most-used currency for global payments in 2017 (SWIFT 2017).² In 2015, the RMB became the main payment currency between China and the rest of Asia even though the Japanese yen, the US dollar and the Hong Kong dollar were more popular just three years earlier (Kynge 2015). How was it possible for the RMB to internationalize very effectively at such a fast pace?

The literature on RMB internationalization offers primarily Sino-centric approaches to answer this question, focusing either on economic determinants of currency internationalization and China's economic strength, or on domestic dynamics and power structures, attributing a proactive role to the Chinese government (Chey 2015). In this literature, it has been suggested that Beijing has a clear RMB internationalization strategy (Cohen 2012). Yet, existing studies largely overlook the role played by other countries, treating them as passive actors who simply accept the increasing global role of the RMB as a given international development of current times. But the RMB is unlikely to have undergone such a fast-paced process of internationalization had it not been for the endorsement and pro-active engagement of other countries.

In this article, we examine the role that other leading economies in the world – most notably Germany and the United Kingdom – have had in the process of RMB internationalization. Other countries might have opted to reject the idea of a rising RMB for geopolitical reasons or due to concerns about enhanced economic competition from China. Yet in practice, a number of countries have heavily endorsed the RMB and facilitated the establishment of so-called offshore “RMB centres” in places such as Frankfurt, London, New York and Singapore. We analyse why leading economies have embraced the Chinese currency and supported Beijing's efforts to increase its use, adding an important dimension to the existing scholarship on the causes of RMB internationalization. Crucially, we show that other countries are active and willing contributors to RMB internationalization.

A greater understanding of the reasons why these countries help advance RMB internationalization, and the nature and amount of support provided, is necessary to have a complete picture of the political process of currency internationalization. By focusing on the rationales of foreign states and leading global economies to support RMB internationalization, we move beyond most literature on this subject and examine a neglected area. Our research adds to the literature on the role of the state and international political power in currency internationalization, considered by Chey (2012) as yet “unexplored” in the currency internationalization literature.³ Thus, our analysis fills a gap in the extant IPE literature and provides a new dimension to the

examination of the determinants and effects of currency internationalization, which has received renewed attention in recent years. Moreover, in examining the political economy of currency internationalization, it addresses an area of growing interest in IPE research.

The rest of the article is organized as follows. In section 2, we review existing literature on currency and RMB internationalization. In section 3, we present our case studies, two hypotheses regarding support for RMB internationalization by foreign countries, and our methodology. In section 4, we analyse and discuss why Germany and the UK support RMB internationalization by hosting offshore centres. In section 5, we summarise our key findings.

2. Currency internationalization: Existing explanations

While economists have long studied the economic determinants underpinning a currency's internationalization (Chey 2012; Helleiner 2008), political economists have only more recently started to examine this phenomenon in detail. Importantly, political economists distinguish between four types of currencies: Master currencies emerge when a dominant country imposes the use of its currency on subordinates. Negotiated currencies are the result of a transaction, with the issuing country and its foreign counterpart involved in a diplomatic or economic trade-off between the domestic interests in both countries (Chey 2012). Master currencies may have faded with the dissolution of colonial empires, but negotiated currencies have not. Even the US dollar is perceived as a negotiated currency (Otero-Iglesias and Steinberg 2012). A top currency is the currency of the state with the world's strongest economy, whereas a neutral currency is the currency of a state whose strong economic position leads to its international use. Few currencies fit neatly within one of these four types (Otero-Iglesias and Steinberg 2012).

As one of the first to study the political origins of currency internationalization, Helleiner (2008) argues that there are two distinct channels through which politics can influence the international role of a currency. The first is indirect and refers to the impact of domestic politics on key economic currency internationalization determinants. The second channel relates to a country's direct support for international currency status for reasons unrelated to these economic determinants. Focusing on this direct currency internationalization support channel, Helleiner (2008) makes use of Strange's (1971) pioneering work that emphasized the importance of politics and the state in currency internationalization. According to Helleiner, master and negotiated currencies are especially influenced by politics and the state, which makes them inherently different from top and neutral currencies, whose attractiveness is predominantly economic. While it is not uncommon for a currency, including the RMB, to internationalize for a mixture of economic and political reasons (Helleiner 2008), we focus our analysis on the extent to which the RMB displays negotiated currency features as a result of direct political involvement by the Chinese state and its foreign counterparts. In doing so, we aim to shed a greater light on the process of "currency negotiation" and in particular the role played by the foreign state in this process.

A negotiated currency emerges when the issuing country provides inducements to foreign counterparts aimed at advancing the international adoption of its currency.

These inducements can be explicit, such as aid, a promise of market access or military protection (Strange 1971). But they can also be implicit, most notably the implicit understanding that support for the negotiated currency by another party will preserve the issuing country's political goodwill and access to its market (Stranger 1971; Helleiner 2008). The politics of negotiated currencies therefore can be based on the implied benefits of their adoption.

The concept of a negotiated currency does not neglect the fact that an international currency can have inherent economic attractiveness (Helleiner 2008). But it does draw our attention to the political considerations underpinning a currency's internationalization and adoption by other parties. In this respect, it is necessary to analyse the politics of both the issuing country and its counterparts to fully understand the reasons why a currency successfully internationalizes (Helleiner 2008). The latter is particularly important, for there are risks associated to providing support to a currency that one does not issue, most notably the value of said currency being contingent on the actions of multiple follower states (Strange 1971; Helleiner 2008). We examine why countries do risk supporting a currency issued by China as a newcomer to currency internationalization.

RMB internationalization

Economists have largely focused on the structure of the world economy and quantitative methods to analyse the internationalization of the RMB. This literature focuses on economic conditions as the main determinants of RMB internationalization. For example, Lai and Yu (2015) identify increased cross-border trade settlement invoicing as an important determinant of RMB internationalization. Lee (2014) and Wang et al. (2015) develop models and predict that the RMB will become a reserve currency. He and Yu (2014)'s model finds that foreign exchange network effects support RMB internationalization. Wang et al. (2015) suggest that institutional reforms form important preconditions for the increased use of the RMB. Chey (2013) and Kirshner (2014) complement these studies through qualitative examinations of structural power. These studies and other examples of this literature essentially argue that RMB internationalization is the result of China's growing economic power and centrality to the global economy.

Several IPE scholars and economists have centred on the role of domestic factors in explaining the internationalization of the Chinese currency. A first group of authors examines economic determinants. Dobson and Masson (2009) and Park (2010) evaluate the financial reforms that need to be implemented to liberalize the capital account, highlighting the necessity of full currency convertibility, exchange rate flexibility, and market-strengthening policies. Chen and Cheung (2011) and Wu et al. (2010) position such economic determinants of RMB internationalization within a wider set of characteristics and necessary reforms of the Chinese economy. Beijing's interventionism in economic management, so they argue, is a key reason why the internationalization of the RMB has in fact fallen behind China's international prominence as an economic power. Cohen (2014) places these economic determinants within a historical context by comparing the RMB with the Euro, the Japanese Yen, and the German Mark. He suggests that sustained economic policy effectiveness and economic reform will be necessary for the RMB to fully internationalize. Bowles and Wang (2013) examine these economic determinants in the context of the feasibility of

a bipolar monetary system. They suggest that RMB internationalization can be seen as a “normalization” process whereby the currency of the world’s second largest economy becomes more used.

A second group of authors focuses on the purely political determinants driving the internationalization of the RMB. Cohen (2012) examines both the strategic design and the means used by Beijing – in other words, the intentions and statecraft behind RMB internationalization. He argues that China’s RMB internationalization strategy is well conceived, but the means face political constraints because there is no big move towards surrendering control over the central government or the financial sector, making currency internationalization difficult to implement. Germain and Schwartz (2017) draw a similar conclusion. They find that the social costs of full RMB internationalization would be too high for Chinese elites to give their full support. Job and income losses linked to the provision of an international currency are too much to bear for the Chinese government. Similarly, McNally (2015) places RMB internationalization within the context of ‘Sino-capitalism’, explaining how the institutional arrangements and policy choices from the Chinese government resemble those in other economic sectors. McNally and Gruin (2017) also refer to RMB internationalization as part of a broader logic of Sino-capitalism. This entails a degree of state control over the exchange rate and capital flows, coupled with pressure on financial markets to accept this control. In other words, this literature suggests that the Chinese government is unwilling to make arguably painful economic policy decisions to support the internationalization of the RMB, which would be characteristic of a neutral currency.

Focusing specific political determinants of RMB internationalization, Helleiner and Malkin (2012) analyse the preferences of Chinese domestic actors – in areas including enhanced seigniorage, power and prestige – and find that they have limited influence on Beijing due to their context specificity. Examining the effects of domestic institutions, Eichengreen (2013) concludes RMB internationalization will be limited unless there is political liberalization, since foreign investors will be reluctant to support a currency whose value is determined by an unaccountable authoritarian regime. Finally, Subramanian (2011) argues that it is beneficial to policymakers who want to move away from mercantilism, but they do not necessarily dominate Chinese economic policy-making. This literature thus suggests that China will take a gradualist approach to currency internationalization, since there is no unanimous support for a neutral currency-type RMB. There is therefore ample scholarship examining Chinese domestic political determinants of RMB internationalization.

Analysis of foreign counterparts in supporting RMB internationalization are broadly missing from this literature, even though they would be helpful in understanding how Beijing can gain support for its gradualist approach and given its reluctance to make its currency a neutral currency. One exception is Liao and McDowell (2016), who quantitatively analysed the reasons behind the diversification of foreign exchange portfolios by 37 central banks to include more RMB holdings. Their analysis shows that political considerations related to a preference for a less US-centric international order correlates with increases in such holdings. Another notable exception is Chey’s (2015) pioneering analysis of the policies implemented by South Korea to enhance the use of the RMB. In spite of limited market demand, Seoul has pursued RMB-friendly policies to benefit from China’s economic expansion and to stabilize the domestic

economy. Our study complements Chey's work and advances it much further by focusing on countries that are not located in close geographical proximity to China and are less dependent on their economic links with it.⁴ Our article also differs in that we look at the establishment of offshore RMB centres – a policy not yet implemented at the time of Chey's research.

3. Case studies, hypotheses and methodology

The internationalization of the RMB encompasses different policies. A key policy has been the establishment of offshore RMB centres for trade settlement and yuan-denominated product issuance (Cohen 2012). By late 2012, this policy became central to RMB internationalization. Officially establishing offshore centres is a necessary part of the RMB internationalization strategy because China still controls its capital account. Thus, RMB in overseas markets cannot freely be brought back to the onshore market, and vice versa. Therefore, a market infrastructure is needed for the purpose of RMB circulation outside of China. A formal liquidity provision channel is also needed to support the offshore use of the RMB.

Offshore RMB centres serve as an excellent case study to analyse foreign counterparts' support for RMB internationalization, as they are central to Chinese policy in this area, allow establishing cross-country comparisons, and have a clear political component. On this last point, the foreign counterpart has to sign a currency swap agreement with China and China designates a state-owned commercial bank to act as a clearing bank for RMB transaction settlement within the centre.

[Table 1 goes here]

We analyse two offshore centres, London and Frankfurt, for three reasons. Firstly, Germany and the United Kingdom are the two largest economies in the world to have established an offshore RMB centre at the time of our research – the United States only established one in late 2016 and Japan has yet to establish a centre. Secondly, Germany and the UK are the first two non-Asian countries to establish RMB centres. As countries external to the region, the incentives for them to support the internationalization of the RMB are less obvious than for East Asian economies increasingly dependent on Sino-centric economic relations. European countries are less affected by Asian regional politics, and both Germany and the UK cultivate strong political and economic alliances with the US, one of China's main rivals.

Thirdly, while both are highly-developed, Western European countries, the structures of the German and UK economies differ in meaningful ways. Germany's economy is dominated by export-oriented multinational corporations and small and medium-sized enterprises specialising in the manufacturing of high-tech goods and components, resulting in the second largest overall trade surplus in the world (WTO 2016). Financing is dominated by regional banks. Meanwhile, the economy of the UK is dominated by services and the financial sector, with the second biggest overall trade deficit in the world being partially offset by the second highest surplus in services trade (WTO 2016), with financial services trade playing an important role. Financing is dominated by capital markets and large, multinational banks. Consequently, the roles of Frankfurt and London as financial centres differ. Frankfurt is a second-tier financial centre, best described as a German centre serving the domestic economy but

with increasing complementarities across Europe. Differently, London is one of the very few truly world-leading financial centres serving the global economy (Cassis and Collier 2010). Both countries and their financial centres are sufficiently different to provide an interesting comparison of the reasons to support RMB internationalization.

Key players in the Frankfurt and London financial centres

A country's political and economic structure determines the extent to which players can influence the government's decision-making process, including on financial policy (Lutz 2004). A more open political system and more decentralized state offers greater opportunities for more players to influence decisions. Meanwhile, the deeper and more concentrated the financial sector is, the stronger its influence will be (Lutz 2004).

Frankfurt and London are no different in this respect. The key players in each of these two financial centres and their degree of influence are largely determined by Germany's and the UK's political system and state structure, as well as the importance of finance for each country's economy. In terms of their political system, both Germany and the UK have open systems involving consultation with a range of public and private actors (Benz and Broschek 2013; Jeffery 2013). As for the structure of the state, Germany is constituted as a federal state in which different layers of government hold significant power – especially regional governments – and consultation and negotiation between the central and regional governments is necessary (Benz and Broschek 2013). Differently, the UK is a unitary state with power in some areas devolved to its regions. Consultation between the central and regional governments is thus minimal (Jeffery 2013).

Regarding the importance of finance for their economies, in the case of Germany it is secondary to trade and manufacturing, which results in a fractured financial sector with a large number of regional banks. In sharp contrast, finance is the most important industry for the UK's economy, resulting in a strong concentration of the financial sector in mostly London-based big banks (Cassis and Collier 2010).

Nevertheless, the key players in the financial systems of Frankfurt and London are quite similar. The governments in both countries, as represented by the German Chancellery and the Office of the Prime Minister in the UK, play important roles in providing overall direction of economic and financial policy. In both countries, the Ministry of Finance and the Treasury, respectively, assume great powers in regulating the financial systems and making finance policy decisions. In the UK, the Bank of England is an actor with major influence, being responsible for an independent monetary policy and having influence on other decisions affecting the financial sector and financial flows in and out of the UK. In Germany, the Bundesbank had to yield powers over monetary policy to the ECB in 1999, but in other areas, including those affecting the financial sector, it remains relevant. Both the City of London and Stadt Frankfurt promote the interests of their respective financial centres, and in Frankfurt, the State of Hessen is also politically involved in promoting Frankfurt's financial sector. The London Stock Exchange is one of the biggest exchanges in the world, and the Frankfurt Stock Exchange ranks in the global top ten. Other central government departments are also part of the financial policy-making process in both countries. In the UK, regional and local governments play a secondary role in financial policy, as

do chambers of commerce. In Germany, the financial system is overall less centralized in a single city.⁵

Hypotheses

We form hypotheses to understand the reasons why other countries support the internationalization of the RMB based on the concept of negotiated currency, and building primarily on the work by Strange (1971), Helleiner (2008) and, to an extent, Chey (2012). We develop two hypotheses related to the self-interest of foreign counterparts. Beijing's reasons for supporting internationalization of the RMB, studied extensively in the previous research outlined above, are drawn on to inform our analysis.

Extant literature suggests that, in the case of negotiated currencies, there is bargaining between the issuing and counterpart countries (Strange 1971). This bargaining process is a political process in which inducements are directly or indirectly offered by the issuing country (Strange 1971; Helleiner 2008; Chey 2012). The economic benefit that might come from supporting an issuing country's currency is secondary to – or at least only as important as – the political bargaining process between countries. Political factors such as high politics, the management of diplomatic relations, competition among states or the role of domestic constituencies with international ties can all determine support – or lack thereof – for the internationalization of another country's currency (Helleiner 2008).

Countries will support a negotiated currency if they accrue benefits from doing so. These can be economic benefits such as lower transaction costs or larger investment inflows. For example, financial liberalization and RMB internationalization should boost and diversify the Chinese economy away from trade in goods and domestic investment (Xia 2011). This should open up opportunities for foreign firms to sell products to China's growing middle class, provide more capital-intensive and high-tech goods to China or to attract Chinese firms' and households' excess savings.

When establishing a RMB centre in Europe, Beijing commonly offers a package consisting of the establishment of currency swaps between central banks as a backstop for RMB market liquidity; the official appointment of an RMB clearing bank in each centre to provide a more direct link to RMB liquidity; and greater RMB Qualified Foreign Institutional Investor (RQFII) quotas (Bank of England, 2013; HM Treasury, 2013; Bank of England, 2014). Especially the RQFII quota functions as a direct inducement by the Chinese government as it gives foreign investors greater access to China's capital markets, and other inducements may exist that are less evident. In addition, China has provided EU countries with an indirect political inducement with its support to the euro. Beijing has significantly expanded its holdings of euros as part of its foreign exchange reserves, purchased sovereign bonds of heavily indebted European countries, and accumulated European Financial Stability Facility (EFSF) bonds (Li, 2014; Regling, 2013).

But a country will also consider its own security and political interests when formulating its stance towards the internationalization of another currency. A case in point were the politics and security considerations of countries during the internationalization of the US dollar and the development of a US dollar-centric

monetary system (Broz and Frieden 2001). For example, Germany had its own security in mind when supporting the US dollar during the Vietnam War (Zimmermann 1996). Similarly, the internationalization of the euro in its surrounding region has deepened relations between the Eurozone and neighbouring countries. The latter now consider their political ties to the former in their decision-making process (McNamara 2008).

Since there is no Chinese equivalent to the American military umbrella protecting countries such as Germany during the Cold War, it is less clear whether countries focus on political or just economic benefits when supporting the RMB. Scholarship on negotiated currencies might suggest that diplomatic benefits are an important consideration. Our first hypothesis thus reads:

H1. Countries agree to host offshore RMB centres in anticipation of gains from the direct and indirect political and economic inducements made by China to advance its currency internationalization.

International power matters for a negotiated currency (Strange 1971; Helleiner 2008). The issuing country's overall power and power relations with other countries influence the internationalization process (Helleiner 2008; Chey 2012). Indeed, both hard and soft power influence the international monetary system (Helleiner 2008). Measuring power is problematic, and determining a causal relationship between a country's power and another's actions is difficult in practice. But it cannot be denied that there are currencies which have benefited from the international power of their issuer.

A case in point is the US dollar. The internationalization of the US dollar cannot be explained without attending to the ascendancy of Washington over the Western bloc during the Cold War (Broz and Frieden 2001). Furthermore, the soft power exercised by successive American governments and the Federal Reserve is intrinsically linked to the internationalization of the US dollar (Helleiner 2008). There is confidence that US authorities will not take any decision that will significantly jeopardize access to the US dollar or the liquidity of US dollar-denominated markets. But as the US dollar's top currency status is more questioned in recent times, Washington's international power is crucial for its future as a negotiated currency (Helleiner 2008; Chey 2012).

At this time, the standing of the RMB is still affected by the weaknesses in China's economic policies. Economic and financial decision-making is considered non-transparent and difficult to predict (Cohen 2012). The country's capital account is still beset by controls (Chinn and Ito 2006). And transactional networks still lag behind other countries' after decades of restrictions (Cohen 2012). These issues affect Beijing's soft power in the area of international monetary relations.

And yet, China's economic performance in recent decades suggests an ongoing shift in international economic power away from the United States. China is gaining power and this has an effect in the international monetary system (Chey 2012; Cohen 2012). Even though the US is more powerful and influential globally and has a larger financial sector (Eichengreen 2011), Beijing has accrued significant international power. China is set to overtake the United States to become the largest economy in

the world. Beijing's increasing role in global financial governance has been observed in many areas (Pacheco Pardo 2014), as is exemplified by the successful launch of the Asian Infrastructure Investment Bank (AIIB) (Knoerich 2015). Equally important, there is a strong political drive in China to maintain high rates of economic growth and internationalize the Chinese economy, with a view at moving away from perceived over-reliance on the US dollar (Campanella 2014). There seems to be an agreement among scholars that there is a rebalancing of political and economic relations at the global level, with China making significant gains in hard power (Chan 2007; Liff and Ikenberry 2014). We therefore formulate our second hypothesis:

H2. Countries agree to host offshore RMB centres in reaction to changing international power dynamics.

Methodology

To test these hypotheses, we employ content analysis of RMB internationalization-related official documents issued by the German and UK governments and central banks (see table 2), and of the Frankfurt and London stock exchanges, which we consider an adequate proxy for the financial sector of Germany and the UK, respectively. In total, we analysed 76 German and 73 British documents available in English or German.

[Table 2 goes here]

We complemented this data with elite interviewing, targeting officials from the above-mentioned institutions who had first-hand knowledge of RMB internationalization-related activities in the centres. We used the interviews to triangulate the data from the documents accessed. In addition, we interviewed private financial institution professionals working in areas related to RMB internationalization. The semi-structured interviews were comprised of open-ended questions, to allow interviewees to express their views and feel less constrained by the interviewers. We interviewed a total of 23 experts.⁶

The time period covered was 2010-15, as Beijing only became enthusiastic about RMB internationalization in late 2009 (Chey 2012; Cohen 2012). To ensure the robustness of our chosen time period, we searched for pre-2010 documents, and found no meaningful RMB internationalization-related documents prior to that date. Interviews were conducted between December 2015 and October 2016. Our content analysis revealed a series of reasons for Germany's and the UK's engagement with RMB internationalization.

When analyzing our findings in the next section, we have limited ourselves to reasons behind RMB internationalization that appeared at least ten times across documents and/or interviews. We chose this threshold because it amounts to at least ten per cent of the sources that we accessed, on average, for Germany and the UK. We consider this a strong signal that a particular reason holds significance. We should note that all the reasons that appeared ten times were discussed by at least two institutions. This further strengthens the robustness of our results.

4. Analyzing RMB internationalization through the establishment of offshore centres

Considering the economic and political differences and similarities of these leading Western European economies, we would expect Germany and the UK to have some similar and some differing reasons for supporting internationalization of the RMB. In this section we analyse whether this is the case with reference to the two hypotheses outlined above.

[Table 3 goes here]

Inducements and the anticipation of political and economic and gains

There are several reasons why both Germany and the UK proactively sought to host offshore RMB centres. Both believe that offshore RMB centres bolster their trade with China, which links to the notion that there are good economic reasons to support the internationalization of a negotiated currency such as the RMB. This implicit economic inducement is a very frequently mentioned rationale behind Berlin's support, but only the third most important reason from a British perspective. This makes sense if we attend to the structure of each country's economy, since trade is more integral to the German economic model than to the UK's.

For Germany, strengthening trade links with China was a particularly strong reason for its decision to host an offshore RMB centre. This view was widely shared across a large variety of institutions in Frankfurt, from government and chambers of commerce to banks and financial institutions, and was confirmed by many interviewees. Lutz Raettig (2013) of the IHK Frankfurt Chambers of Commerce, for example, mentioned the intense trade relations between China and Germany and the strong connection between the financial sector and industry as practiced in Germany. The Economics Minister of the State of Hessen, Tarek Al-Wazir, emphasized that "economic and trade facilitation is definitely at the centre of the RMB Initiative" (State of Hessen Ministry of Economics, Energy, Transport and Regional Development 2014).⁷ One interviewee suggested Frankfurt was a platform for the 'real economy' to make better use of the RMB; the RMB-Hub (or "Initiative", as it is often referred to in Frankfurt) was there for international trade.⁸ London is number one as a financial centre, whereas Frankfurt has the trade relations, suggested an interviewee from a private bank.⁹ In fact, there was broad agreement that Frankfurt not only as a RMB centre, but as an entire financial centre, is there to support the real economy and further strengthen Germany in international trade. For the government and other institutions with interest in promoting the broader economy through strengthened financial systems, this issue was key for their engagement with RMB internationalization. Only the institutions whose purpose was purely within the domain of finance and cross-border capital flows (such as Clearstream) paid a somewhat lesser attention to trade, due to its irrelevance to their particular activities.

Documents from the Bank of England, Foreign and Commonwealth Office (FCO) and Treasury refer to boosting Sino-British trade as one of the reasons behind their support for London becoming an offshore RMB centre. This proves that a range of important players consider that there are tangible economic benefits for the UK in supporting RMB internationalization. Chancellor of the Exchequer George Osborne,

for example, referred to the appointment of the China Construction Bank (CCB) as the RMB clearing bank for London, and UK Export Finance providing guarantees for transactions denominated in the Chinese currency, as “a huge boost for UK business looking to export to China” (Osborne 2014). Noticeably, no UK interviewee mentioned it, which suggests a disconnect between the government’s official message and the views from experts involved in making London an offshore RMB centre. An explanation why trade was less important for the UK may be that while boosting trade is an official government policy in light of a strong trade deficit, the actual value of a RMB hub in boosting UK exports to China can be questioned.

The main benefit to international trade emphasized in German sources and by interviewees was the reduction of transaction costs for companies trading with China, rather than an expansion of exports. Companies trading with or investing in China would have the option to conduct RMB clearing in Frankfurt instead of the more time-consuming and complex effort of clearing via Hong Kong after converting euros into US dollars.¹⁰ This was an explicit inducement offered by Beijing. “The nomination of a clearing bank means that it will be possible for renminbi payments to be cleared directly, eliminating the costly need to route them via other financial centres. The PBoC will allow the clearing bank to access onshore RMB liquidity and its payment system”, explained a press release from the Deutsche Bundesbank (2014a). Lothar Meenen from the Deutsche Bank also mentioned benefits to Chinese firms: “Renminbi billing allows Chinese companies to reduce cost increases in currency exchange or currency hedging and often to realize savings that they can pass on to customers” (Deutsche Bank AG 2014).¹¹ Again, this was widely shared among government institutions at various levels, business-supporting institutions and banks.

Another reason for establishing a RMB centre in Frankfurt is the facilitation of financial flows in general. Several institutions and a small number of interviewees refer to it, but given the greater relevance of this issue to finance, it was emphasized in particular by financial institutions such as banks, the stock exchange and Clearstream. Florian Rentsch (2013: 25) from the Ministry of Economy of Hessen explained that the government of the state of Hessen was “aiming at a broad level of exchange and at making progress in developing opportunities for RMB payments. The goal is to increase liquidity, product diversity and the usability of the RMB for the real economy.”¹²

In the UK, by far the most important reason to establish the London RMB centre, mentioned regularly in the documents analysed and overwhelmingly by interviewees, was to make London a world leader in RMB trading and keep the city at the forefront of RMB internationalization. This was seen as vital in order to safeguard London’s status as world-leading financial centre. As such, it is a political goal rather than merely an economic objective. Prime Minister David Cameron referred to London as “the western hub for the Renminbi” (Cameron 2012), and the Chancellor of the Exchequer, George Osborne, almost replicated these words by talking about London “acting as the Western hub for renminbi business” (Osborne 2013).

A key factor why Cameron and Osborne wanted to make London a or the world-leading financial centre was competition with New York. Helleiner (2008) points out that competition among states is beneficial for negotiated currency internationalization. London financial sector players consider New York to be their

only serious competitor for the position of world-leading financial centre.¹³ Since New York was only granted an RMB offshore centre in September 2016 – more than two years after London – the British city had a significant advantage in the competition with its American counterpart. At the time of writing, London is the second largest offshore RMB centre behind Hong Kong. Successive UK governments have not refrained from supporting London in this competition (Morgan 2012). Neither did Cameron and Osborne in the area of RMB internationalization.

Other players had a similar view. A high-ranked Bank of England official talks about his institution “[welcoming] the development of the offshore RMB market [in London]” (Salmon 2013), and the LSE glosses about the support from both the British and Chinese government to make London “as the main RMB trading hub in the Western time zone” (London Stock Exchange 2015b). A senior manager at the City of London concurs, arguing that his institution wants London to be the world leading financial centre and being an offshore RMB centre is an important part of this strategy.¹⁴ Maintaining London’s international status, and the competitive edge it has over other financial centres, was therefore an important rationale establishing a RMB centre.

Germany also supported the establishment of Frankfurt as a RMB centre to promote it as a financial centre, but with much less urgency than London as Frankfurt clearly views itself as a second-tier player in the international competition. In a speech, Joachim Nagel explained that “German financial institutions and enterprises as well as government representatives were delighted by the announcement of a renminbi clearing bank in Frankfurt. They are hopeful that the choice will provide a boost for the banking metropolis and, above all, for the real economy” (Nagel 2014). “Frankfurt must become the leading location in the Eurozone for the settlement of business in the Chinese currency RMB”, said Florian Rentsch (IHK Frankfurt 2013).¹⁵

In the UK, the fact that Cameron and Osborne prioritised making London a world-leading RMB centre is linked to high politics. As Helleiner (2008) explains, high politics is one of the political reasons why countries support the internationalization of another country’s currency. In the case of Cameron and Osborne, RMB internationalization through London was linked to what they labelled a ‘golden era’ in UK-China relations (Cameron 2015a), even though this expression was not always used. Indeed, several interviewees pointed out that it was Osborne and Treasury, with the acquiescence of Cameron, who more strongly pushed for London becoming a hub for RMB internationalization.¹⁶

German documents from central, state and local institutions also addressed the politics of Sino-German relations, suggesting that the position of Frankfurt as an offshore RMB centre has the added bonus of creating stronger diplomatic links between both countries. As an example, Peter Feldmann, Mayor of the City of Frankfurt, argued that the decision to establish the RMB centre in Frankfurt would be beneficial to both sides, enabling “the growing good relations between China and Germany at national level to be used at local level as well” (Stadt Frankfurt am Main 2014).¹⁷ This point was made primarily by government entities, as they are mandated to consider the broader political dimension of engaging with RMB internationalization.

Another reason behind the support for RMB internationalization is the development of RMB-denominated products, which interviewees considered to be a business decision separate from the just-described political goal of maintaining London's status as a world-leading financial centre. There is a perception that the market is not fully exploited because of a lack of products rather than due to low market demand. The UK's Consul General to Hong Kong makes this case:

“[...] this rise of London as a centre for RMB trading is about more than just RMB-denominated FX or trade payments. The RMB ecosystem in London is thriving.” (Wilson 2015)

The issuance of RMB-denominated products was also of interest in Germany, although possibly of lesser importance than in the UK. Tarek Al-Wazir considered the issuance of the first RMB bond in Frankfurt to be an important milestone. The Ministry of Economy of Hessen saw in this a manifestation of Frankfurt's ambition not only to become a leading centre for RMB trading, but also for the issuance of bonds (Ministry of Economy of Hessen 2014).

One final reason behind the British government's decision to establish London as an offshore RMB centre is the generic aim of strengthening the UK economy, which is another economic goal. A small number of documents, especially from the Treasury and the FCO, and several interviewees make reference to this argument. A senior manager in an international bank explains that the British government saw the size of the Chinese economy and rapid growth and wanted a piece of it.¹⁸

Reaction to changing international power dynamics

Our research suggests that political and economic self-interest was the main reason why Germany and the UK supported the internationalization of the RMB. In addition, reactions to international power dynamics also featured in both cases. Both governments, however, focused on shifting international economic power dynamics rather than political power dynamics. This could be because they are more affected by China's growing economic rather than political power or because they do not want to acknowledge China's political influence.

An important rationale in Germany for setting up the RMB centre was addressing currency system trends. There was a general recognition amongst a variety of institutions and some interviewees that the RMB would be an important international currency in the future. Joachim Nagel, a Bundesbank Executive Board member, suggested the RMB had the potential to become a future global reserve currency (Deutsche Bundesbank, 2013). China's policy decisions to promote RMB internationalization and the increase in global use of the RMB in statistics evidenced this trend. Accordingly, an interviewee from the local Chamber of Commerce emphasized that in recognition of the growing global importance of the RMB, the German government and the State of Hessen agreed on the need to participate in this trend.¹⁹ After all, increasing global importance of the RMB would have implications at the bilateral level between China and Germany. In a press release, the Deutsche Bundesbank stressed that it supported RMB clearing in Frankfurt, considering that “expanding trade and investments between Germany and China are projected to

further increase the volume of renminbi-denominated payments” (Deutsche Bundesbank, 2014b).

The UK’s focus was on facilitating greater use of the RMB at the international level as China’s economy grew, as mentioned both in documents and by some interviewees. Foreign Secretary Philip Hammond’s speech is a case in point. He explained how the CCB becoming the clearing bank for transactions in London, and the first clearing bank outside of Asia, underscored the support of the UK government to the internationalization of the Chinese currency (Hammond 2015).

In this respect, the UK has been supportive of a greater role for China and the RMB in the international economic system. George Osborne openly and publicly supported the inclusion of the RMB in the IMF’s SDR basket (Osborne 2015). Another clear example is the UK becoming the first major Western country to join the AIIB (Yueh 2015). The UK also sought to become the first Western country to host an RMB offshore hub, even though it was beaten by Frankfurt by a day (Ross 2014). In 2017, in his newest role as Chancellor, Hammond stated that the UK is a “natural partner” for the Belt and Road Initiative (Hammond 2017). In other words, the UK is aware of the shifting balance of international economic power and, as a result, supports RMB internationalization as part of its policy of seeking to benefit from China’s growing economic strength.

5. Conclusions

Why do countries help advance and support the internationalization of the RMB through the establishment of offshore RMB centres? The two hypotheses we formulated based on pre-existing literature on currency internationalization have been confirmed by our empirical findings – foreign governments respond to inducements by China and also react to changing power dynamics. Apart from RQFII quotas and purchase of foreign treasure bonds, the inducements made by China tended to be implicit and came with the untold truth that positive engagement with the world’s largest market would yield economic – and potentially political – benefits. This was the case for both Germany and the UK, which had similar overall motivations to support RMB internationalization despite variations in terms of importance given to each motivation.

In Germany, concerns centred primarily around the question how establishing a RMB centre in Frankfurt can support the German real economy. Focus was on strengthening trade links between Germany and China by simplifying foreign exchange procedures and transaction costs for companies. In the UK, the focus was on maintaining London’s leading position as a global financial centre. The British government and other actors sought to make London a world-leading RMB trading hub ahead of other global financial centres. Yet, the UK was also interested in strengthening trade with China, while Germany sought to enhance the international role of Frankfurt as a financial centre and offer RMB liquidity and bonds. Both countries sought to enhance diplomatic ties with China through the move to back RMB internationalization. In other words, while there is a causality between the structure of the German and British economies and their *main* rationale for supporting RMB internationalization, the overall motivations for both countries to establish RMB centres were similar. Both Frankfurt and London can be seen as primarily driven by

economic self-interest and responsive to China's explicit and implicit inducements. Germany was, *inter alia*, induced by the prospect of improvements in trade, whilst the UK was primarily induced by the prospect of strengthening London's international role. For China, catering to these differing main interests of different foreign localities has helped promote the internationalization of its currency.

This confirms that the RMB displays the characteristics of a negotiated currency. There is an economic rationale for supporting its internationalization which is underpinned by explicit or implicit inducements from China. All this happens against the background of China's rise and the associated evolution in international power dynamics that urges countries to cultivate and improve bilateral relations with China. Both European countries see the potential economic and, to a lesser degree, political benefits in supporting RMB internationalization and thus have taken the decision to facilitate it.

The literature examining the reasons why countries actively support Chinese efforts to internationalize the RMB is scant. Our research filled this gap by drawing attention to the reasons underpinning this support. It uncovered a variety of reasons why China receives such widespread local support for its currency internationalization, not only in Asia, but also in distant economies and non-allied countries. It required a small-n study such as ours to uncover the complexity of motivations countries have when they decide to support the internationalization of China's currency.

¹ We would like to thank two anonymous reviewers for their helpful comments.

² See RMB Tracker: <https://www.swift.com/our-solutions/compliance-and-shared-services/business-intelligence/renminbi/rmb-tracker> (last accessed 27 April 2017).

³ Next to domestic actors' preferences, financial liberalization (Chey 2012).

⁴ According to WTO data, only 6 percent of German exports and 10 percent of its imports and 4 percent of UK exports and 9 percent of its imports are with China. In contrast, China takes 26 percent of South Korean exports and accounts for 22 percent of its imports, 19 percent of Japanese exports and 27 percent of its imports, 14 of Singaporean exports and 16 percent of its imports, and 13 percent of Malaysian exports and 22 percent of its imports (WTO 2016). Besides, China is at the centre of East Asia's production chains, with many of its exports going outside of East Asia including components from elsewhere in the region (Chia 2013). In contrast, China is not at the centre of German or UK production chains, which are European in nature.

⁵ This information was gathered from interviews conducted for this research. For a detailed analysis of the functioning of London as a financial centre and its key players, see Coggan (2015). For a discussion of key players in Frankfurt as a financial centre, see Grote (2008).

⁶ We should note that we refrained from using Chinese documents and interviewees because our focus was on German and British views.

⁷ Translated from German.

⁸ Interview with Bank of China official, Frankfurt, 31 August 2016.

⁹ Interview at Helaba, 16 December 2015.

¹⁰ Interview with a representative of Frankfurt Main Finance, 17 December 2015, and with a representative of IHK Frankfurt am Main, 26 October 2016.

¹¹ Translated from German.

¹² Translated from German.

¹³ Interview with City of London senior manager, 11 February 2016; interview with international bank senior manager, 14 November 2016.

¹⁴ Interview with City of London senior manager, 11 February 2016.

¹⁵ Translated from German.

¹⁶ Interview with HM Treasury official, London, 2 February 2016; interview with City of London senior manager, 11 February 2016; interview with Bank of England official, 21 February 2016

¹⁷ Translated from German.

¹⁸ Interview with international bank senior manager, 10 May 2016.

¹⁹ Interview with representative of IHK Frankfurt am Main, 26 October 2016.

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Table 1. List of offshore RMB centres as of June 2017

Location	Establishment	Clearing bank
Hong Kong	December 2003	Bank of China (BoC)
Macau	September 2004	BoC
Taiwan	December 2012	BoC
Singapore	February 2013	Industrial and Commercial Bank of China (ICBC)
Germany	June 2014	BoC
UK	June 2014	China Construction Bank (CCB)
South Korea	July 2014	Bank of Communications (BoCom)
France	September 2014	BoC
Luxembourg	September 2014	ICBC
Canada	November 2014	ICBC
Qatar	November 2014	ICBC
Malaysia	January 2015	BoC
Thailand	January 2015	ICBC
Australia	February 2015	BoC
Chile	May 2015	CCB
South Africa	July 2015	BoC
Argentina	September 2015	ICBC
Zambia	September 2015	ICBC
Switzerland	October 2015	CCB
United States	September 2016	BoC

Sources: China Daily, People's Bank of China

Table 2. German and British documents entirely or partially discussing RMB internationalization, 2010-15

Institution	Germany	UK
Office of the Head of Government	The Government of Germany (4)	Office of the Prime Minister (7)
Ministry of Finance	Bundesfinanzministerium (3)	HM Treasury (29)
Ministry/Department of Trade	N/A	UK Trade & Investment (1)
Ministry of Foreign Affairs	N/A	Foreign & Commonwealth Office (14)
Export agency	N/A	UK Export Finance (1)
Chamber of Commerce	Industrie- und Handelskammer Frankfurt (4), German Industry & Commerce (1) Frankfurt Main Finance (8)	N/A
Regional government	State of Hessen Ministry of Economics, Energy, Transport and Regional Development (7)	N/A
Local government	N/A	N/A
Municipal government	City of Frankfurt (2)	City of London Corporation (6)
Central bank	Deutsche Bundesbank (14), European Central Bank (ECB) (12)	Bank of England (11)
Stock exchange	Deutsche Börse Group (6), Clearstream (14)	London Stock Exchange (6)

In parentheses: number of documents

Table 3. German and British views on the reasons behind the establishment of offshore RMB centres

	Germany	UK
<i>Country's reaction to inducements and anticipation of economic and political/diplomatic gains</i>		
	1. Support trade (47) 2. Cutting international transaction costs (43) 3. Promoting Frankfurt and its banks/stock exchange (31) 4. Facilitate financial flows (24) 5. Strengthening Sino-German relations (14)	1. Establishing London as the world-leading offshore RMB centre (47) 2. Developing RMB-denominated products (27) 3. Support trade (13) 4. Strengthen UK economy (11)
<i>Foreign country's reaction to changing international power dynamics</i>		
	1. Addressing currency system trends (35)	1. Addressing currency system trends (15)

In parentheses: number of times reason was mentioned