



# What Happens to the Dollar If the Chinese Digital Yuan Goes Global?

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The convergence of a shifting international power balance and the digitization of the world economy will have tremendous implications for two of the world's great powers – China and the United States – as they grapple with evolving, modernized systems. With their “Digital Currency Electronic Payment” (DCEP) program in its early trial stages and growing presence on every continent through their Belt and Road (BRI) and Digital Silk Road Initiatives (DSR), China has showed significant interest in taking over as a world leader in the coming years. The rolling impact of new technologies that revolutionize the global economy from automated supply chains to digital currency lead us to believe that the United States has a lot of work to do to adapt to the coming tide.

Though many stand on both sides of the aisle when it comes to determining the potential for a Chinese rise to international prominence, it is certainly difficult to argue that they are not relevant as a global power in today's world. China has laid substantial infrastructure across the globe in physical form (aiding the development of emerging economies and interconnecting global trade systems) and in social and political forms (developing long term relationships with global leaders and giving aid on the occasion of world crises). However, those who take the stance of China as a rising global power hypothesize various timeframes for anticipating when their true challenge to American prominence will occur. Though some argue for a rapid change in global influence and a call to arms from the American side, it is incredibly hard to imagine some significant change occurring on the scale of less than 5 years. China has played the long game in their development, showing patience in seeking global partnerships, negotiating trade, building military presence, and developing technical prowess to become a modernized economy – why would that change now? In reality, China is in no rush to push the United States out of their global spotlight, even though they certainly seem to have high aspirations.

## **Infrastructure, Influence, and Finance**

There have been numerous monographs written on the various ways China has grown its influence in the world. However, it is critical to keep one thing in mind that determines all behaviors of an economic-focused entity – money. The financial system based around the United States that helped it rise to dominance in the mid-1900s has been envied by the world's other aspiring powers. It is fairly easy to see that the international system, incentivized by strong international trade and exchange of currencies, has had tremendous benefit for the United States. As this system has gone through various ebbs and flows, it has shown some of its volatility, which numerous countries from Russia to China to Iran blame on its US-centricity. This has led the call for a global financial system that no longer relies so heavily on the dollar as its preferred currency for foreign exchange reserves or cross border trade. The US has gained much of its economic prowess and international trust from its long standing as the world's global partner in these everyday financial processes. However, a long-term shifting of the preferred international currency could erode this strength over time.

The importance of being relevant in the modern global economy as an economic power cannot be overstated. As China builds out its physical infrastructure across the world, it is keeping an even gaze on the push for a less centralized global financial system. With their development of the DCEP program, they are showing their ability to adapt to rapidly occurring changes in technology, as well as a desire to lead. With these things in mind, it is important to focus our approach to the “China problem” on how they can influence the financial system across international groups that it is a member of. While it can certainly affect the way exchange occurs in their bilateral partnerships, their true long-term goals will only be achieved through a large scale changing of the international preference for the dollar.

However, as noted by former US Treasury Senior Official Brian O'Toole, “For the digital yuan to truly compete, China needs to take a more hands off approach with its banking sector, especially with regard to foreign banks working in China, and loosen its capital controls. The attraction of the dollar is how simple it is to use and how deep the market is. That isn't true in China and Beijing doesn't get there without those big money supply questions being answered.” This point is echoed by Atlantic Council Geoeconomics Center Senior Fellow JP Schnapper-Casteras, who said “On the European front, one question is when major retailers or consumer chains start accepting DCEP -- either through AliPay / WeChat or through another app or bonus/trial program.” He explained that these factors should also be in consideration with whether DCEP is bought, sold, or promoted on exchanges where other stablecoins are listed. There are certainly roadblocks ahead for the internationalization of the digital yuan, however they are by no means insurmountable over time.

### **Geoeconomic Areas to Watch If China Internationalizes its Digital Yuan:**

1. Rise in Chinese Use of Digital Yuan: Approximately 15 million people in China are currently using the digital yuan as a result of initial giveaways from the People's Bank of China (PBoC). In the next 12 months, 50 million people in China will be using it. For an up-to-date glance on the progress of digital renminbi currently in circulation through China's pilot “giveaway” programs, see ‘Forkast.news1’ above. The Director of the Atlantic Council Geoeconomics Center, Josh Lipsky, sees this rapid upscaling of

over 100 million in digital yuan as being attributed to China's push to "reach over a billion digital yuan in circulation within 10 months, for the opening ceremonies of the Beijing Winter Olympics."

2. Belt and Road Initiative Digital Yuan Payments: As China develops the BRI, we could anticipate that it could begin to call for cross border exchanges and debt payments to occur by way of their DCEP system. As Josh Lipsky has stated, "Longer term, the true test of internationalizing is whether the yuan is used to settle bilateral debt between China and borrower countries. Serious progress in this project will be if the PBoC continues to make arrangements with other central banks for digital currency exchange." With the ease of all BRI partners being on the same platform and utilizing the same currency, this shift could feel very natural and be to the benefit of those countries wishing to avoid the dollar. For reference to the expanding relevance of these relationships, around 140 countries have already signed Memoranda of Understanding with China and its BRI.

3. OPEC Turning to Digital Yuan: As it gains increasing influence in trade groups such as OPEC through its partnerships with Iran and Venezuela (among others), we could see its oil imports start to be purchased utilizing the digital yuan.

4. Europe Turns to Digital Yuan: As China speeds up its digital yuan development program and begins to see success at a domestic level, other European countries may call on it for help in developing their own programs. Since the BRI plans to be extended all the way to Europe, this idea does not seem so far off. In a modernized world, interconnected technical systems for trade and finance will be deemed critical to development.

5. SWIFT Expands Relationship with Digital Yuan: This gradual integration and greater use of the digital yuan would inherently also mean the beginning of deeper assimilation into the Society for Worldwide Interbank Financial Telecommunication (SWIFT) system. Enhanced multilateral trade occurring through the digital yuan will naturally push many large-term projects into motion. Though we will likely not see these changes occurring rapidly across the international financial system, as with everything they do, they are willing to be patient for influence and economic gains. Notably, on January 16, 2021, SWIFT and the PBoC established a joint venture with its clearing center and digital currency research institute. This is a significant sign of progress toward the strategic geopolitical aims of China.

6. The Wave of Momentum Strikes Dollar Denominated Foreign Reserves: As discussed in prior pieces, a long-term impact of adopting Central Bank Digital Currencies (CBDCs) could be a wave of foreign central banks retreating from the use of the dollar as the preferred reserve currency. According to a statistic from the Wall Street Journal, citing the International Monetary Fund (IMF) this past week, "the dollar's share of global reserves has decreased to its lowest level since 1995. The currency now stands at 59% of global reserves as of December 2020." To further highlight this trend, Russian officials issued a statement on April 8th that disclosed how a complete launch of their own digital ruble could be targeted for 2023. Unsurprisingly, "The (Russian) CBDC will also have a two-tiered system, akin to China's digital yuan, wherein the central bank distributes the CBDC to third-party firms like commercial banks that then distribute the CBDC to users." This is a great example of the cascading benefits a first mover (China) has in this space, as other countries tack themselves on to their existing infrastructure.

## True Impacts

In the near future, we will not see an unseating of the United States from the center of the financial system. Being at the crux of the global economy for so many years, the United States has entrenched its position. However, as the digital yuan is developed and the international community modernizes its infrastructure, it could present substantial opportunities for growth. In turn, this will provide an alternative to US dollar-based transactions, which will likely transition to a more diversified use of these two currencies in the broad scheme of international trade/cross border transactions.

While some may be tempted to push off the increasing influence of China in the global economy and shrug off the idea of eroding US influence on the international financial system, we must also think about the adaptation and development of norms for emerging technology. As we well know, authoritarian regimes have vastly different terms of agreement for using their technological innovations. A China increasing its global influence means a China more integrated into international decision-making bodies for standards and regulations when it comes to technology. Currently, the digital yuan is already being used in three cities in China, 5 years after its initial phases of development. As stated earlier, money is essential to the decision making of every economic body and will always hold vast potential for extending influence. The digital yuan is on its way to being a critical technology of influence abroad.

## Essential questions to consider now are:

1. How fast can DCEP scale?
2. Can China leverage the DCEP system over countries that are in debt to it?
3. What are the true implications for Western countries as China's influence in international regulatory bodies grows?
4. And, of course, What can the United States do to adapt for the coming tide? Which we have addressed here.

China's rise may be slow, but it is not without careful consideration and planning. This is made evident through their development of initiatives like the BRI and the DSR. The US would be wise to weigh the long-term challenges associated with a shifting of global financial power and develop ways to stay the preferred partner in the international economy.

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