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Book Review

One Currency, Two Markets: China's Attempt to Internationalize the Renminbi, by Edwin L.-C. Lai, Cambridge University Press: United Kingdom, 2021, 307pp. ISBN: 978-1-108-49168-6

China is now the second largest economy and the largest exporter of goods in the world. As China's economy has grown very fast and China has gradually been liberalising its financial system, many expect that China's currency, the renminbi (RMB), will emerge as a truly global currency. In particular, many have questioned the "exorbitant privilege" of the United States dollar (USD) and urged the reform of the international monetary system towards a more 'diversified' structure. Following this, China has been trying to internationalise the RMB. China has adopted several proactive policy reforms to foster the pace of RMB internationalisation.

In recent years, many influential studies about RMB internationalisation have been conducted. Unlike earlier studies, Lai's book contains several features that make it unique. First, his book is written in a casual conversational tone through a storytelling style. Lai has rigorously explained economic theories in simple form and related these theories to RMB internationalisation for general readers. My favourite part of this book is that Lai has related the content to real-world issues. This style opens up readers' minds to understand the topic more deeply. Second, besides qualitative assessments, Lai included quantitative assessments in his book. He conducted an empirical analysis by employing the Society of Worldwide Interbank Financial Telecommunication (SWIFT) data set, and he projected that the RMB would be a distant third payment currency by 2030. Third, Lai proposed that capital account liberalisation and the domestic financial sector reform positively affect each other. This proposal indicates that the RMB's internationalisation can force domestic financial sector reform. Finally, Lai has provided comprehensive information about the offshore RMB market in Hong Kong. He compared in detail the onshore and offshore RMB markets.

The book comprises nine chapters. It opens with an introductory chapter, starting with a real event, where China devalued the RMB on 11 August 2015 as part of its strategy to join the Special Drawing Rights (SDR) basket. Lai started his content by explaining why China wanted to internationalise its currency. He introduces the international monetary system (IMS) and its history. Then, he relates it to the "exorbitant privilege" of the United States (US), how the USD was set as the reserve currency in the Bretton Woods conference, the attractiveness of the USD as an international currency and the problem of the USD-based IMS under the post-Bretton Woods system.

On the one hand, several major crises have shown that the USD-based IMS could be fragile, which has prompted China to internationalise the RMB so that China can use its currency in international transactions and payments. On the other hand, according to the open-economy trilemma, China cannot maintain a stable exchange rate, autonomy in monetary policy and a high degree of capital mobility simultaneously when internationalising the RMB. China must make a trade-off between the three. The introduction is a very nice touch, providing readers with an entry into the topic.

From Chapter 2 onwards, Lai provides an in-depth assessment of RMB internationalisation from various perspectives. In Chapter 2, Lai focuses on the stability of China's exchange rate. He first explains the importance of a stable exchange rate for China. In the early years of China's reform and opening, China had cheap labour and little capital. During that time, China encouraged inward foreign direct investment (FDI), and expanded its external demand by exporting to keep its labour employed. Hence, a stable and undervalued exchange rate versus the USD was very important to China, especially during its early development. Consequently, China has played an important role in international trade over the past decades. Hence, Lai describes this stable exchange rate policy as a double-edged sword; it was a cornerstone of China's initial development strategy, but later it became a stumbling block to China's RMB internationalisation strategy.

Chapter 3 discusses China's motivations to internationalise the RMB. Lai listed eight motivations as follows: minimise exchange rate risk; reduce reliance on foreign currencies and foreign countries; able to use its currency to borrow internationally; lower interest rates when borrowing large amount abroad in RMB; benefits the domestic banking and financial sectors; independence in international monetary affairs; greater political influence, and force internal reforms. Moreover, Lai compares China with Japan to understand China's motivations to internationalise the RMB in a much deeper and broader way. Specifically, he discusses why Japan did not internationalise its currency even though it had a better-developed financial system than China. In this Chapter, Lai emphasizes his point of view by linking it to various current hot topics, making the content very interesting and persuasive.

In Chapter 4, Lai further discusses China's strategy of internationalising the RMB. As China is a developing country, its financial system was not well-developed, and its currency was not fully convertible in the capital account. In this case, government policy was important to facilitate RMB internationalisation. Hence, the Chinese government practised its "one currency, two markets" approach. They created an offshore RMB market (CNH), which was not integrated with the onshore market (CNY) but the currency was fully convertible. Lai illustrates this policy as building a firewall between onshore and offshore markets so that China need not open its economy fully but could internationalise its currency. In addition, Lai listed a few other policies implemented by China that had turned out to be highly successful. These include trade settlement in RMB, bilateral currency swap agreements with many countries, capital account liberalisation, and further development of the international payment system.

Chapters 5, 6 and 7 focus on the policy measures taken by the Chinese government. Specifically, these three chapters discuss in detail the importance of capital account openness, financial sector reform, and the offshore markets in determining the international use of a currency. These three chapters are not an easy read; they are the most academic chapters of this book that involve many economic theories. Nevertheless, these three chapters contain important information to understand China's current capital, financial and banking development levels.

Chapter 8 explores the potential of the RMB to serve as an international medium of exchange through a detailed quantitative analysis. To do so, Lai first estimates the determinants of RMB internationalisation. He regresses RMB's share in total international payments (as an indicator for RMB internationalisation) on four factors: GDP, exchange rate stability, financial development, and capital account openness. Utilising a proprietary data set owned by SWIFT (inter-country payments flows data) that needs special permission to use, he finds that financial development and capital account openness play a bigger role than the GDP. Later, Lai uses the same model to predict the future payment share of the RMB in 2030. He conjectures that the RMB will become the third largest payment currency by 2030 if China significantly reforms its financial sector and opens its capital account. In the same chapter, Lai also discusses the impacts of China's Belt and Road

Initiative on the RMB's share in total international payments.

Finally, Lai concludes his book with a chapter containing numerous big ideas for the reader to take away after interpreting the content. Lai proposes the prospects of RMB internationalisation in Chapter 9. He concludes by giving a few reasons for pessimism and optimism about RMB internationalisation. His professional opinions are very pertinent. He selects ideas worthy of highlighting and consistent with the title of his book. The content is a valuable entry point for learning about China's attempts to internationalise its currency.

In a nutshell, Lai has written a book I admire greatly and will strongly recommend to my colleagues and students.

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