>\\THE DIGITAL ASSET BATTLEFIELD BETWEEN THE UNITED STATES AND CHINA-

-By Michael B. Greenwald

United States dollar dominance has underpinned American economic and geopolitical leadership since the Second World War. The tremendous structural and geopolitical advantages the United States derives from the hegemony of the dollar have contributed substantially to Washington's military power, alliances, and strong hand in trade relations with other states. However, the convergence of a shifting international balance of power and the accelerated digitalization of the world economy will have major implications for this pillar of American strength. China's Digital Currency Electronic Payment (DCEP) program places Beijing above the United States in terms of digital currency innovation. Combined with its expanding global economic presence via the Belt and Road Initiative (BRI) and Digital Silk Road Initiatives (DSR), China's efforts could result in a proliferation of the digital yuan and an erosion of the dollar's position abroad.

The primacy of the dollar and its so-called "exorbitant privilege" as the international reserve currency has afforded the United States numerous points of leverage in the international system. It has allowed the United States to impose sanctions on adversaries and punish them without utilizing military force and has enhanced Washington's capacity to combat terrorism, money laundering, and cyber fraud. Global dependence on the dollar also permits the United States to support financial infrastructure, such as common rules of behavior and legal frameworks, data sharing, and policy coordination, thereby strengthening the reliability and resilience of the global financial system. The dollar's status as the world's reserve currency allows — and even requires — the United States to run a trade deficit and a financial account surplus, which in turn allows the American government to borrow more at lower interest rates and attract foreign direct investment.[274] This also leads to greater global demand for the dollar, which results in a stronger dollar, cheaper imports, and less domestic inflationary pressure. The dominant dollar — and America's willingness to spend it — has historically allowed the United States to shape international norms, encouraging more nations to embrace the free-market and democratic customs of the Western world. It also grants the United States significant influence over international bodies such as the United Nations, the International Monetary Fund, and the World Bank. Additionally, the abundance of the dollar and its ease of use has led it to dominate trade in certain critical commodities, which gives the United States outsize leverage in these markets. In short, America's superpower status is dependent on the dollar remaining the world's reserve currency.

While debate continues regarding China's ability to unseat the United States as the world's dominant economic power, what is undeniable is China's status as a great economic power and its ambition to continue its ascent. China has invested substantially in physical, social, political, and financial infrastructure across the globe, methodically forging global trade and economic partnerships, expanding its military presence, and boosting its domestic technical prowess. Most importantly, the People's Bank of China (PBOC) has gone all-in on its development of the digital yuan, striving for first-mover advantage and the geopolitical benefits that will accrue. Admittedly, the yuan has thus far failed to depose the dollar. The dollar still accounts for approximately 59 percent of foreign exchange reserves, greater than 60 percent of international trade, 40 percent of international payments, and 85 percent of foreign exchange transactions.[275] America's large and diverse economy, deep and liquid capital markets, independent central bank, and traditionally strong rule of law buoys dollar dominance. China has yet to possess all these attributes. However, American complacency, the global pivot to digital finance, and the PBOC's development of a central bank digital currency (CBDC) weaken the dollar's position. As CBDCs proliferate, the era of unchallenged dollar dominance gives way to one of competition and choice among a basket of currencies, most importantly the digital yuan. Meanwhile, the United States is stuck in preliminary discussions about a digital dollar, falling behind its largest rival. To preserve the strength of the dollar, U.S. policymakers must prioritize dollar innovation as a key national security objective. This innovation must be built on confidence, trust, and proactivity that secures America's leadership of the global monetary system.

>//SIX TRENDS TO WATCH FOR THE DIGITAL YUAN

China is making inroads in its push for a more decentralized global financial system. The following are six geoeconomics trends that will be key to its success in internationalizing the digital yuan.

1. The Rise in Domestic Chinese Use of the Digital Yuan

As of late 2021, Beijing had injected more than USD 23 million worth of digital yuan (RMB 150 million) into the Chinese economy, and the number of individuals with digital yuan accounts had increased to more than 140 million, with over 10 million corporate accounts created.[276] This gradual introduction of the digital currency is accompanied by its new acceptance as a form of payment by well-known retailers like JD.com. This retail giant has already begun using the digital yuan for transactions like business-to-consumer (B2C) payments on its website, business-to-business (B2B) payments to partner firms, cross-bank settlements, and payroll distribution. In January 2022, WeChat also announced that it would make digital yuan payments available to its user base of over 800 million.[277]

2. BRI Digital Yuan Payments

As China further develops the BRI, Beijing may initiate cross-border exchanges and debt payments to occur by

way of its DCEP system. More than 140 countries have signed a memorandum of understanding with China regarding the BRI. The ease of all BRI partners operating on the same platform and utilizing the same currency could prompt a natural shift, to the benefit of those countries wishing to avoid the dollar. Indeed, China has already begun cross-border testing a bank-to-bank version of the digital yuan with the United Arab Emirates, Thailand, and Hong Kong,[278] and has integrated the digital yuan into Hong Kong's Faster Payments System.[279]

If China can convince current trade partners and emerging market economies to conduct business in the digital yuan, Beijing can reduce the number of transactions that occur in dollars. This could "immunize China's business along the BRI from U.S. sanctions"[280] and substantially enhance its financial surveillance capabilities. While domestically this information could be used "to wield punitive power over Chinese citizens in tandem with the social credit system,"[281] it would also put Beijing at the forefront of financial technology innovation and further propel its rise in the global financial regime.

Another important consideration is the leverage that the DCEP system will give China over its debtor nations in the BRI. China's approach to supplying infrastructure development, foreign investment, and debt has been accompanied by an updated approach to dealing with foreign economies that strives to make partner countries reliant on China — especially in times of hardship. Though the COVID-19 pandemic has made countries reconsider supply chain risk and reliance on individual countries for essential products and services, nations around the world still have a distinct need for the development services China provides. This is evidenced by the many countries that have chosen to overlook the long-term implications of debt agreements to access the infrastructure development and modern technologies offered by China. Integration of the digital yuan into these partner nations and their economies will only make them more dependent on China.

3. OPEC Turning to The Digital Yuan

As China gains influence among the Organization of Petroleum Exporting Countries (OPEC) through its partnerships with Iran, Venezuela, and Russia, it could begin purchasing its oil imports using the digital yuan. For instance, China and Iran last year signed a 25-year comprehensive cooperation agreement that details an extended promise of oil for infrastructure development.[282] The PetroDollar system created a direct link between oil prices and the value of the dollar, a system which emerged in the 1970s in large part due to America's strong demand for OPEC oil imports. China is now the world's dominant oil importer, so a switch to the PetroYuan is not farfetched. The PetroDollar is a keystone of America's longstanding privilege to spend and borrow without the fear of default; a shift away from the use of the dollar in the oil market would play a central role in the reconsideration of domestic economic decisions. The use of a digital yuan in a traditionally dollar-denominated commodity market would also bypass American intermediaries, significantly weakening the U.S. sanctions program. Since the United States has frequently turned to financial sanctions to reign in the behavior of rivals — including China, Iran, and Russia — this is a particularly attractive concept for adversaries of the United States.

4. Europe Turning to The Digital Yuan

As China expands its digital yuan development program and begins to see success at the domestic level, European Union (EU) member states may call on it for help in developing their own programs. In a modernized world, interconnected technical systems for trade and finance will be deemed critical to development. China's experience in constructing such networks and its willingness to invest has already led it to undertake similar projects in countries as diverse as Sri Lanka, Zambia, Laos, and Tajikistan. Such projects are likely to be attractive to European countries, as well.

While EU member states are also looking for other partners to expand the EU's own markets and infrastructure, few can match the economic heft of China and the comprehensiveness of its development plans. The United States has been a long-time economic partner of the United Kingdom and the EU; however, Washington's relatively slow process for passing legislation and its recent imposition of tariffs and sanctions on other economic partners has made it at times a thorn in the side of even friendly nations. In contrast, China can achieve rapid consensus in negotiations and development under its authoritarian government structure. China's value as an economic partner to EU member states was made clear by the December 2020 Comprehensive Agreement on Investment and the entrance of two-thirds of EU member states into the China-led Asian Infrastructure Investment Bank.[283]

With this kind of economic and financial relationship growing, it seems the stage is set for a large-scale shift to the use of the digital yuan. If China becomes the dominant player in infrastructure development and financial investment in the region, it could simply require European countries to use the digital yuan for debt payments. On top of this, the BRI and DSI already extend into Europe, providing corridors for these transactions outside of American oversight. It is also

important to note that every debt contract China has signed since 2014 contains "a sweeping confidentiality clause that compels the borrowing country to keep confidential its terms or even the loan's existence" and "obligate[s] the borrower to exclude the Chinese debt from any multilateral restructuring process".[284] Both features could have significant implications for undermining the public trust in countries with close economic relationships to China and force them to remain dependent on China in times of financial stress.

5. SWIFT Expanding its Relationship with the Digital Yuan

The gradual integration and greater use of the digital yuan will drive its assimilation into the Society for Worldwide Interbank Financial Telecommunication (SWIFT) system. Notably, in January 2021, SWIFT and the PBOC established a joint venture involving a clearing center and digital currency research institute.[285] As multilateral trade transacted in the digital yuan increases, the complex and long-term commercial relationships that result will necessitate the integration of DCEP with legacy financial systems. Though these changes are unlikely to occur rapidly, the Chinese can and will patiently wait for influence and economic gains.

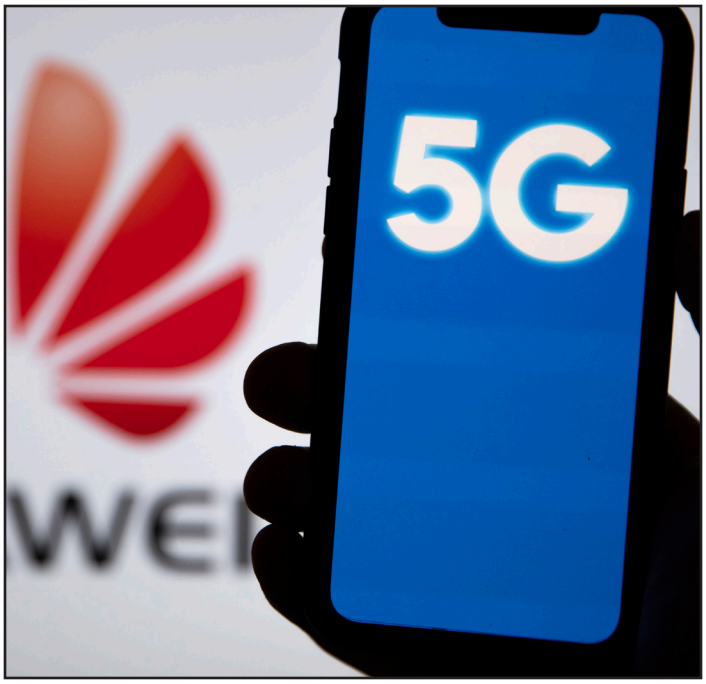
6. The Wave of Momentum Striking U.S. Dollar Denominated Foreign Reserves

The long-term impact of adopting CBDCs could be foreign central banks retreating from the use of the dollar as the preferred reserve currency. Although the dollar remains hegemonic, the margin of its dominance is already diminishing, with its share of global reserves having recently fallen to the lowest level since 1995.[286] Furthermore, China is not the only country pursuing a CBDC to decouple from the dollar-dominated financial system. For instance, Russian officials issued a statement in early April 2021 disclosing how a launch of that country's 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."[287] This is a great example of the cascading benefits accruing to China as a first mover in the space, whereby other countries copy and tack themselves on to its existing infrastructure.

>//IMPLICATIONS FOR GLOBAL FINANCIAL LEADERSHIP AND U.S. POLICY

It is unlikely that the United States will be unseated from the center of the financial system in the immediate future. However, as the digital yuan is developed and the international community modernizes its infrastructure, it could present a credible alternative to dollar-based transactions and will likely encourage a transition to a more diversified use of these two currencies in the broad scheme of international trade and finance.

What will China's increasing financial influence mean for the international community? During the COVID-19 pandemic, the world watched the World Health Organization contort itself to appease Beijing. China implemented punitive tariffs and import restrictions on Australian goods after Prime Minister Scott Morrison called for further investigation into the origins of COVID-19. It is not hard to imagine how this behavior will compound as China's leverage over the global economy increases. Greater Chinese influence in international bodies will expand the reach of its ideals through technologies



that reinforce its dominance. In Africa, China has already begun to conduct deals with countries that are implementing its enhanced surveillance technologies, reportedly often built directly into telecommunications infrastructure like 4G and 5G.[288] In fact, Huawei and other Chinese firms are responsible for over 70 percent of this infrastructure development on the African continent and have long-term relationships with many African governments. The inclusion of a digital financial payments system will only serve to further solidify the grip of authoritarian governments on their respective domestic populations. Additionally, although CBDC initiatives in other countries, such as Russia's digital ruble, are only in the early stages of development, Chinese success in this area may encourage their acceleration. This could lead to a splintering of the global financial order orchestrated by America's adversaries.

The ascendancy of the digital yuan is not a foregone conclusion, however. American economic dominance and international trust in the American-led system has been reinforced by decades of domestic political consensus that maintaining this dominance and trust is of vital interest to the American people and their security. The fundamental role of the United States cannot be supplanted overnight, but the world is changing. A peer competitor unlike any other challenges the American-led economic order, and the rapidly evolving digital economy seems to advantage the decisiveness of an authoritarian government. For the United States to maintain its advantage in global financial leadership, the federal government must support and prioritize a national security strategy for dollar innovation. In doing so, the United States should first turn to its traditional strength in allies and establish a third iteration of Bretton Woods — one that is tailored to the twenty-first century. The Biden administration should establish a presidential-level working group with European leaders to frame a digital Bretton Woods. This transatlantic vision should establish guidelines that address the unique financial and technological hurdles of the coming decades, generate stability, and guarantee Western centrality. The United States and EU should also establish a technocratic working group to create a "digital wall of innovation" against China. This working group should coordinate key standards of interoperability, privacy, cybersecurity, and illicit finance, and build a new framework with the Financial Action Task Force for combatting money laundering and terrorist financing. U.S. and EU standards can fill the current vacuum and de facto become the global norm. Rather than assert influence via dollar dominance, the United States will lead the way via dollar innovation. Lastly, dollar innovation should be enshrined as a core objective in the 2022 U.S. National Security Strategy. Such a step would not only signal recognition of the strategic importance of global financial leadership to America's geopolitical position, but also resolve to counter the growing threat posed by the digital yuan.

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