Africa and the Digital Yuan: Helping China Break U.S. Hegemony Over the Global Financial Order

By:

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One of the lessons of the sovereign debt crisis spurred by the COVID-19 global pandemic is that China now plays an outsize role in the African economy, having displaced Western governments and key international organizations to become Africa’s largest bilateral creditor, source of foreign direct investment, and trading partner. After four years of not-so benign neglect Washington’s attention is again focused on Africa, largely to curb the rising influence of China on the continent. However, the United States may discover that in this 21st century “scramble for Africa” many states have already chosen to align their economic interests with Beijing, with serious implications for Washington’s position at the apex of the global financial order. Nowhere is this more clear than in China’s unveiling of its e-currency, the digital yuan, and the potential it has for helping displace the U.S. dollar as the world’s reserve currency.

Much of China's economic expansion into Africa has been under the framework of the Belt and Road Initiative (BRI), with an eye towards securing commodity supplies and developing a global network of infrastructure. Under BRI, China has transferred nearly $150 billion to African governments and state-owned enterprises over the last two decades. Although the pandemic has caused a decrease in BRI-related lending, China's commitment to BRI as the centerpiece of its foreign policy was reaffirmed in its 14th Five-Year Plan adopted in March 2021.

A key component of BRI is the Digital Silk Road (DSR), China's push to improve "recipients' telecommunications networks, artificial intelligence capabilities, cloud computing, e-commerce and mobile payment systems, surveillance technology, smart cities, and other high-tech areas" through the use of Chinese technology and services. China has capitalized on Western reluctance to invest in Africa's internet, communications, and technology sector and through DSR now provides the backbone of much of the continent's digital infrastructure. The US campaign against Huawei and other Chinese tech companies falls on largely deaf ears in Africa, which has strategic implications as China rolls out its digital currency.

The digital yuan is China's foray into developing a central bank digital currency (CBDC) which, at its most simple, is a digital form of cash issued by a central bank. Unlike a cryptocurrency, the hallmark of which is its decentralization, a CBDC is a fiat currency backed by the sovereign which issues it and subject to the regulation and monetary policies of that government. Moreover, a CBDC's legal status as a payment system is not in doubt and the issuing sovereign can mandate its acceptance as legal tender while proscribing that of a cryptocurrency, as recently happened in Nigeria with Bitcoin.

Although a number of countries are experimenting with CBDCs, including the Bahamas, Sweden, and Turkey, none are as far ahead as China, nor do any of them match China's economic muscle. One country conspicuously absent from that list is the United States. In a recent interview, U.S. Federal Reserve Chairman Jerome Powell showed a certain lack of concern when questioned about lack of progress on a digital dollar. "We're in a great place with our currency," he told CBS News. "We are the world's reserve currency. Meaning that people use dollars even if they have no connection to the United States.

They use dollars to pay for things all over the world." This is true, for now. One of the weapons that China looks to unleash in order to chip away at the global dominance of the U.S. dollar is the digital yuan, and one of the battlefields on which it will be first tested will be in Africa.

Powell’s confidence in the strength of the dollar is not unwarranted. To a degree unprecedented in history, the U.S. is able to impose its economic will on friend and foe alike by virtue of being home to the world’s reserve currency and determining on what terms states, institutions, and individuals may access its financial system. China, therefore, has a tremendous interest in having a viable alternative to the U.S. financial system, particularly as Beijing worries that a worsening of tensions over Xinjiang, Hong Kong, or Taiwan may cause Washington to tighten the economic screws.

An example of Washington’s unrivaled hegemony over the global financial system, and an area of growing concern to Beijing, concerns the manner in which banks communicate with each other across borders. The Society for Worldwide Interbank Financial Telecommunication (SWIFT), headquartered in Belgium, provides the network which enables banks and financial institutions worldwide to send and receive messages regarding financial transactions in a standardized manner. Though many people could live their entire lives without knowing about SWIFT, the service it provides is critical to the functioning of the global economy. At its most basic, SWIFT allows consumers and businesses to send payments and currencies from one bank to another virtually anywhere in the world.

As a Belgian entity, SWIFT is not subject to U.S. law, however the United States maintains a tremendous amount of influence over the organization, due in no small part to the role of the dollar as the world’s reserve currency. How the U.S. accomplishes this is through the threat of levying sanctions against SWIFT itself, thus barring it from the U.S. financial system, unless it shuts out other countries it has sanctioned from the SWIFT network. Although SWIFT itself is not a payment settlement service, rather a messaging network, the international system of correspondent banks that rely on SWIFT require access to the U.S. Federal Reserve in order to clear their dollar-denomiated accounts. Therefore, by acting as gatekeeper to the Federal Reserve, Washington wields an economic hammer of unprecedented strength in the history of global finance.

This “weaponization of the dollar” is at the heart of the U.S. economic sanctions regime. Through the threat of cutting off access to the U.S. financial system, in the same manner as it threatens SWIFT, Washington compels foreign compliance with its various sanctions blacklists. Thus, banks and financial institutions throughout the world are commandeered into the service of the U.S. Treasury Department’s Office of Foreign Assets Control (OFAC) at risk of facing the “death penalty” and being barred from the U.S. Federal Reserve system. China increasingly bristles under this system, not only with the leverage that U.S. global financial hegemony gives it to inflict pain on China, but the extent to which that leverage acts as a curb on its own global ambitions.

SWIFT is the Achilles heel of Chinese economy because China, like every other major country, relies on the SWIFT network for the overwhelming majority of its cross-border financial transactions. Although China established the Cross-Border Inter-Bank Payment System (CIPS) in 2015 as an alternative to SWIFT to clear and settle RMB denominated transactions, its relatively modest uptake has meant that most financial transactions are still routed through SWIFT.

How does the digital yuan fit into this picture? Although Beijing may not put it so brazenly, the digital yuan is designed to get around the U.S. system and break the dollar’s dominance as the global reserve currency. That, quite simply, is the rationale for working so hard to get there first. By being first, China will have an advantage in setting the technical standards for using a CBDC across any number of platforms. Moreover, there is a greater chance of early acceptance by consumers if there is not a digital dollar available as a viable alternative.

Ultimately, a digital yuan helps to get around U.S. sanctions by providing a payment system without needing to pass through the U.S. financial system. Although U.S. officials claim that a recent joint venture between SWIFT and the People’s Bank of China (PBOC) is not geared towards this end, cooperation between SWIFT and the PBOC is a strong indication that the digital yuan is designed to be a cross-border payment system. As a means of building familiarity with the digital yuan, working within the SWIFT network may eventually encourage foreign financial institutions to join CIPS and whatever architecture China develops to support global use of the digital yuan.

Africa will no doubt be one of the major testing grounds for the unveiling of the digital yuan as a cross-border payments system. Singapore's DBS Bank noted in December 2020 that the proportion of RMB settlement across the continent rose from 5% in 2015 to 12% in 2018 as a result of increased bilateral ties. They note that Huawei and other Chinese smartphone vendors are already shipping devices into Africa pre-equipped with a digital yuan wallet. The success of mobile money systems such as M-Pesa and Orange Money indicate how digital payment systems can foster financial inclusion and help people safely send and receive remittances from abroad. As China's WeChat Pay and Alipay payment systems are already linked with these networks, it is but one small step to include the digital yuan and increase the use of the RMB as recognized legal tender in these communities. Moreover, with no African country working to develop a CBDC of its own, in its absence the digital yuan may carve out a space as a continental digital alternative.

While the use and reception of the digital yuan on the individual retail level is important, the truly game-changing behavior stands to take place on the level of sovereigns and financial institutions as they come to accept the digital yuan, particularly those too who are looking to avoid the watchful eye of OFAC. Africa remains the most heavily sanctioned continent in the world, with the U.S. alone having 9 separate countries under sanction. This means that there are number of governments, corporations, and powerful individuals who would welcome the opportunity to be able to clear international financial transactions and conduct business without having to rely on the dollar or seek Washington's blessing. It is this group that could be particularly keen to see the success of the digital yuan in becoming a global reserve currency.

Nevertheless, reserve currencies do not get knocked off their pedestals lightly. Only once before in history, when the dollar replaced sterling, has one reserve currency been bumped by another. According to macroeconomist Barry Eichengreen, "Currencies are more prized as reserve assets when they satisfy two conditions: first, when they are stable, liquid and widely used in international transactions; and second, when they are backed by a country to which another state has important security links." Africa is poised to play a key role in helping China's digital yuan meet these conditions.

However, this is high stakes game, with China attempting to dislodge the U.S. dollar as the world's reserve currency at the same time that Washington continues to maintain unprecedented coercive power over the global financial order. Despite its inequities, opacity, and arbitrariness, the U.S. takes the enforcement of its economic sanctions regime seriously, irrespective of who is the occupant of the White House. Particularly in regard to China, the Biden Administration may disagree with the tenor and vitriol of the Trump years, but not the substance. The competition with China colors almost every aspect of President Biden's foreign and domestic policy. Therefore, as China unveils the digital yuan and seeks Africa's assistance in making it a success, governments will need to think strategically, as decisions made by finance ministers and central bankers will have a direct impact on the global balance of power and consequences to match.

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