

# **Currency Conflict : Dollar Dominance, Contemporary De-Dollarization and The Chinese Yuan's Place in The Global Economy**

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## **Abstract**

*Despite the US dollar's century-long dominance in the global economy, a number of nations have begun undergoing efforts to de-dollarize their economy. Financially distressed nations like Argentina have started dropping the dollar in favor of the Chinese yuan. Given Argentina's high credit risk, this paper explores China's possible motivations for serving as a last resort lender for Argentina. This paper explores the question of what Argentina's current de-dollarization indicates about the Chinese yuan's changing role in the global economy and the future prospects of dollar dominance. Through an analysis of Argentine creditworthiness, Chinese interest in Argentine natural resources and the yuan's current barriers to hegemony, this paper identifies how tight the dollar's grip on global supremacy is and its likelihood to be supplanted by the yuan in the coming years.*

## **Introduction**

Accounting for nearly 85% of foreign exchange transactions and serving as the main currency for global trade denomination, the US dollar's importance on a global scale is remarkable.<sup>1</sup> Even while undergoing past challenges such as insufficiently liquid financial markets, the Great Depression, and the faulty Gold Standard system, the dollar has managed to hold on to its dominance for decades. Despite this, a number of nations in recent years have begun undergoing attempts to “de-dollarize” their economy. Many of these nations face financial difficulties, recession, distressed debt and even default. This paper will take Argentina as a case study, and focus on its specific methods and motivations for de-dollarization. While these instances of de-dollarization occur under different circumstances, they do tend to have at least one thing in common. This is the currency that the dollar is being dropped for: the Chinese yuan. When investigating these examples, it becomes very clear that China is undergoing a number of efforts to increase the usage of the yuan on a global scale, with the aim that it may be able to truly rival the dollar in the future. However, the situation becomes convoluted when bringing into consideration the specific strategies China is using, as well as the financial soundness and creditworthiness of the nations China is helping to de-dollarize. With this comes the question of what the specific case of Argentina's de-dollarization indicates about the yuan's evolving role in the global economy, as well as the changing landscape for dollar domination.

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<sup>1</sup> Eichengreen, B. (2010). *Exorbitant Privilege*. Oxford University Press.

## Background on the U.S dollar

In today's society, the dollar takes its place as the world's most globalized currency. Currently, over half of the world's central bank reserves are held in dollars, while citizens on nearly every continent use the dollar in daily transactions.<sup>2</sup> But arriving at this point of global dominance was neither quick nor easy for the dollar. The currency was officially created in the late 1700s, when Congress passed an act declaring the dollar as the official currency of the United States. At this time, the majority of global trade was settled in British pounds. The pound's dominance for much of the 18th and 19th century was a result of Britain's strong industrial raw material imports, as well as its housing of some of the most important commodity exchanges. At this point in time, the dollar was held back by factors like the United States' complete lack of a Central Bank, absence of liquid financial markets and a shortage of investors participating in the US trade acceptance market.<sup>3</sup> As the US began improving its financial markets and expanding its export markets, the situation for the dollar began to change.

After nearly two years of political debate, the US established a central bank in 1913, allowing US banks to gain an international presence and bringing the previously volatile financial markets to a stable and promising point. While the US began to dominate export trade throughout the world, simultaneously, the European Trade Credits Market began facing challenges. This pushed banks to start looking to US banks to obtain endorsed bills for their clients. In addition, New York banks offered an interest rate lower than that of their London counterparts, further adding to the dollar's emerging attractiveness. From this point, the dollar only continued growing with American banks beginning to issue European bonds to be denominated in dollars and marketed to US investors. Though many of these bonds ended up defaulting, the effects were felt far after the dollar had taken supremacy. By the 1920s the dollar had surpassed the pound in terms of its usage on an international scale. It managed to hold onto its place even while experiencing the Great Depression and innumerable bank runs that followed. As the world's main global exchange currency, the dollar became the main currency to invoice trade, quote prices and settle

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<sup>2</sup> Eichengreen, B. (2010). *Exorbitant Privilege*. Oxford University Press.

<sup>3</sup> Ibid

transactions. Some fifty years later, the 1970s proved a challenging time for the dollar which faced stark devaluations. However, this devaluation did not cause a shift away from the dollar, as many expected. Instead, central banks continued holding on to their dollar reserves and the dollar held on to its relevance in international trade and transactions. The US economy's exponential growth contributed toward the dollar's ability to withstand challenges like devaluation. It is because of this that the dollar's main weakness has never been the threat of central banks clearing out their dollar reserves, but has instead been the potential of other currencies to become more valuable.

At this point in time, the dollar has now held onto its dominance for nearly a century. But with changing times comes changing threats and challenges to the dollar. One of the main threats the dollar is currently facing is shifts away from the dollar within nations sanctioned by the US. Russia has remained a prime example of this, following its annexation of Crimea several years ago. Along with sanctioned nations, financially distressed nations are also at the top of the list. Following periods of economic recession, falling exports, unemployment and rapidly increasing inflation, nations like Argentina have begun to de-dollarize economies and shift toward the Chinese yuan.

## **Case study: Argentina's De-dollarization**

A nation once poised for promising economic growth, Argentina's past few decades have been met with a variety of economic and financial difficulties. To better understand Argentina's recent choice to de-dollarize its economy and shift toward the yuan, it is important to recognize its troubled history of pegging its currency to the dollar.

In the year 1991, Argentina passed the Convertibility Law of 1991. The law was just one of the several initiatives implemented at the time in order to fight the skyrocketing inflation. Spearheaded by its leader at the time, Carlos Menem, this law would go on to fuel one of Argentina's worst economic disasters in history.<sup>4</sup> The Convertibility Law pegged the Argentine peso to the U.S dollar at par value and

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<sup>4</sup> *Argentina Recalls Nation's Worst Ever Crises, 20 Years on.* (2021, December 18). Buenos Aires Times. Retrieved June 25, 2023, from <https://www.batimes.com.ar/news/argentina/>

prohibited indexing of the peso. This move was chosen, despite the fact that Argentina was a very poor candidate to do so. This was mainly because its economy relied heavily on its non-tradables sector, and needed a nominal exchange rate to correct imbalances within relative prices of non-tradables and tradeables.<sup>5</sup> Additionally, the monetary policy of the United States was not well suited for Argentina and its trade partners. The Argentine peso became overvalued while Argentine exports began to lose competitiveness abroad. The one-peso-to-one-dollar exchange rate, in combination with policies to privatize the economy and liberalize trade and capital accounts, acted as the catalyst for the crises that would later emerge. The law also entailed a requirement for the Central Bank to back 70% of its monetary base with international reserves. This essentially created a currency board within the Central Bank. Pegging the peso to the dollar at par value and removing indexing resulted in a severely overvalued peso. Just one year later, the Central Bank Charter of 1992 was passed. This law separated the Central Bank and Legislative/Executive branches into separate institutions.<sup>6</sup>

At first, this plan seemed great for Argentina and its citizens, who were able to purchase luxury goods with their immensely overvalued currency. Inflation began to decline as well. The situation started turning around in the Mexican crisis of 1995, which caused a high number of runs on Argentine banks and the Peso.<sup>7</sup> With this, Argentine bank deposits fell by nearly 20%. In response, Argentina implemented reforms within its financial system, to uphold its convertibility regime. This resulted in some temporary improvements, recognized through the sound liquidity of the banking system into the year 2000. During this time, significant increases in dollarization occurred within the economy, in nearly all sectors including public debt and private debt. Specifically, there were increases in the amount of mortgage loans,

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<sup>5</sup> De La Torre, A., Levy Yeyati, E., Schmukler, S., Ades, A., & Kaminsky, G. (2003). Living and Dying with Hard Pegs: The Rise and Fall of Argentina's Currency Board. *Economia*, 3, 43-107. <https://doi.org/2003>

<sup>6</sup> Pou, P. (2000, March). *Argentina's Structural Reforms of The 1990s*. International Monetary Fund. Retrieved June 22, 2023, from <https://www.imf.org/external/pubs/ft/fandd/2000/03/pou.htm#:~:text=The%20convertibility%20law%20fixed%20the,monetary%20base%20with%20international%20reserves>

<sup>7</sup> De La Torre, A., Levy Yeyati, E., Schmukler, S., Ades, A., & Kaminsky, G. (2003). Living and Dying with Hard Pegs: The Rise and Fall of Argentina's Currency Board. *Economia*, 3, 43-107. <https://doi.org/2003>

private debt contracts and public sector bank credit denominated in dollars.<sup>8</sup> Argentina was left in a situation where its currency was immensely overvalued, and the government had a lot of debt it couldn't pay, all while economic growth was stagnating.

The combination of factors present led to a disaster. By 2000, citizens had developed a mass distrust of their banks and their government. In attempts to prevent a further worsening of the situation, economic minister Domingo Cavallo began putting restrictions on the banking system. These restrictions left most citizens unable to withdraw their funds from banks, adding to the citizens' distrust and anger toward banks. At this point, the poverty rate had reached nearly 60% and unemployment levels were at 20%.<sup>9</sup> At the situation's worst point in December of 2001, Argentina's leader Fernando De la Rúa resigned and fled the country. Congress appointed Adolfo Rodríguez Saá to take over, who lasted only a week in power.

In 2002, the economic situation for Argentina was completely unmanageable. In addition to record levels of unemployment, poverty and inflation, the government was dealing with an amount of outstanding public debt that it was in no position to afford. One of Rodríguez Saá's only acts while in power was to declare a debt default of over \$100 billion, or nearly three quarters of Argentina's debt liabilities at the time. In one of the worst sovereign debt defaults in history, Argentina began taking steps to mitigate the situation. With the help of the IMF, it was able to cancel debt default payments and restructure its bonds at a 70% discount. Over 90% of its creditors accepted the deal. The small percentage of bondholders who didn't, became known as a group of U.S hedge funds, later called "Vulture Funds".<sup>10</sup> These funds came in immediately after default and purchased Argentina's distressed debt at a very low price. For several years, Argentina refused to pay back these Vulture Funds at full price. But the funds

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<sup>8</sup> De La Torre, A., Levy Yeyati, E., Schmukler, S., Ades, A., & Kaminsky, G. (2003). Living and Dying with Hard Pegs: The Rise and Fall of Argentina's Currency Board. *Economia*, 3, 43-107. <https://doi.org/2003>

<sup>9</sup> *Argentina Recalls Nation's Worst Ever Crises, 20 Years on*. (2021, December 18). Buenos Aires Times. Retrieved June 25, 2023, from <https://www.batimes.com.ar/news/argentina/argentina-recall-nations-worst-ever-crisis-20-years-on.phtml>

<sup>10</sup> Guzman, M., & Stiglitz, J. (2016, April 1). *How Hedge Funds Held Argentina for Ransom*. The New York Times. Retrieved June 25, 2023, from <https://www.nytimes.com/2016/04/01/opinion/how-hedge-funds-held-argentina-for-ransom.html>

held firm on their decision and brought their situation to New York federal courts in 2012. The judge ruled in the Vulture Funds favor and required Argentina to pay them back at full value. The ruling also specified that the Vulture Funds needed to be paid back in full before Argentina would be allowed to pay back the other creditors who accepted the restructured bonds. While the majority of the creditors saw losses of 70% on their Argentine bonds, the vulture funds saw a return on investment of over 1200%. It was these Vulture Funds who, in forcing their repayments and using litigation to gain repayment before all other creditors, ended up causing Argentina's sovereign debt default of 2014. Specifically, the default occurred after a missed interest payment to these Vulture Funds. It was not until 2016 that the funds were paid back in full.<sup>11</sup>

While the 2001 default was Argentina's most significant debt default, it was just one of the nine defaults the nation has gone through. Two happened in the 1800s with four more following into the 1900s. The most recent three occurred in 2001, 2014 and 2020, respectively.<sup>12</sup> While these defaults all happened at different times, they tended to follow similar patterns. The majority were caused in situations where Argentina simply borrowed too much, without the necessary monetary and financial policy to be in a situation of repayment.

In the 2020 default, Argentina brought in billions of new financing and painted a picture of financial soundness through its proposed plans of market liberalization and reduced government spending, in order to spearhead GDP growth. However, these proposed plans ended up stuck in Congress and were never actually passed. Because of this, the growth the Argentinians were aiming for, simply never occurred. To account for this, Argentina was able to receive a credit line from the IMF in 2018, worth just under \$60 billion.<sup>13</sup> In 2020, Argentina's leftist leader Alberto Fernandez came into power. With investors then sensing the predestined default the, prices of Argentine bonds tanked to \$0.50 to \$1. The default

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<sup>11</sup> Bartenstein, B., Maki, S., & Gertz, M. (2019, September 11). *One Country, Nine Defaults: Argentina is Caught in A Vicious Cycle*. Bloomberg. Retrieved June 25, 2023, from <https://www.bloomberg.com/news/photo-essays/2019-09-11/one-country-eight-defaults-the-argentine-debacles>

<sup>12</sup> Ibid

<sup>13</sup> Bartenstein, B., Maki, S., & Gertz, M. (2019, September 11). *One Country, Nine Defaults: Argentina is Caught in A Vicious Cycle*. Bloomberg. Retrieved June 25, 2023, from <https://www.bloomberg.com/news/photo-essays/2019-09-11/one-country-eight-defaults-the-argentine-debacles>

happened in May of 2020, following a missed payment on its bonds.<sup>14</sup> After restructuring, it was able to reduce its debt payments by just over 25%.<sup>15</sup> With the Covid-19 pandemic having just started, creditors were encouraged by a number of parties to be generous in restructuring negotiations.

Despite Argentina's historical reliance on the dollar, it has begun undergoing efforts recently to de-dollarize its economy. In response to record-low dollar reserves, Argentina has assumed multiple efforts to reduce the significance of the dollar within its economy.<sup>16</sup> Argentina is attempting to lower the amount of dollars entering into its economy. One way it has done this is through prohibiting oil companies within the country from accessing official dollars.<sup>17</sup> In addition, these oil companies will now be required to wait up to 90 days in order to finance their imports. With this decision, Argentine oil companies will be unable to utilize central bank reserves to settle their import payments. Instead, these companies must turn to international banks to obtain financing.<sup>18</sup> However, this rule is only set for the next 90 days and could change if Argentina were to increase its dollar reserves. Argentina has also made the decision to start settling more trade agreements in the yuan. For example, as of April 2023 it has decided that future Chinese imports will be settled in the yuan, not the dollar which had previously been used.<sup>19</sup>

Repeatedly, Argentina has assumed billions in debt and set a plan for growth that never ends up taking off. The government once again narrowly avoided default in February of 2023, in a situation of

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<sup>14</sup> Politi, D. (2020, May). *Argentina Tries to Escape Default as It Misses Bond Payment*. The New York Times. Retrieved July 6, 2023, from <https://www.nytimes.com/2020/05/22/world/americas/argentina-default.html>

<sup>15</sup> Yeyati, E. (n.d.). *After the Default: Argentina's Unsustainable '20/80' Economy*. Brookings. Retrieved July 6, 2023, from <https://www.brookings.edu/articles/after-the-default-argentinas-unsustainable-20-80-economy/>

<sup>16</sup> Goschenko, S. (2023, May 27). *Argentina to Expand De-Dollarization Efforts; Seeks Extension of Yuan Based Swap Line with China*. Bitcoin.com. Retrieved June 25, 2023, from <https://news.bitcoin.com/argentina-to-expand-de-dollarization-efforts-seeks-extension-of-yuan-based-swap-line-with-china/>

<sup>17</sup> Ibid

<sup>18</sup> Doll, I. O., & Gilbert, J. (2023, May 24). *Argentina to Restrict FX Access for Oil Companies' Imports*. Bloomberg. Retrieved July 8, 2023, from <https://www.bloomberg.com/news/articles/2023-05-24/argentina-hauls-in-oil-firms-for-meeting-amid-dollar-shortage>

<sup>19</sup> Semonsen, R. (2023, April 28). *De-Dollarization: Argentina to Pay for Chinese Imports in Yuan*. The European Conservative. Retrieved June 25, 2023, from <https://europeanconservative.com/articles/news/de-dollarization-argentina-to-pay-for-chinese-imports-in-yuan/>



debt swaps and buybacks, given insufficient economic planning to pay back its debts.<sup>20</sup> Specifically, Argentina's Central Bank began buying back its own debt securities while also swapping its own peso securities, in attempts to push back maturity dates. Argentina conducted these buybacks and swaps to buy more time on their payments without having to actually expand the terms of the payments which would result in a default.<sup>21</sup> The "serial defaulter" has been trapped in a cycle of default.

This now brings us to Argentina's current situation. The nation has been in recession since 2018, with inflation at over 100%.<sup>22</sup> Recent economic difficulties were largely fueled by an unprecedented drought which destroyed its grain exports, the nation's largest source of dollar revenue. Because of this, its dollar reserves fell to record-low levels. With a recent Fitch Ratings long-term issuer default rating of CC, Argentina holds significant risk to any possible creditors.<sup>23</sup> On top of this, Argentina owes over \$10 billion to the IMF in 2023, which it appears unable to pay back. Argentine officials are currently in negotiations with the IMF to alter the terms of the loan.

Yet despite this lack of creditworthiness, China has stepped in and offered loans through the means of a yuan-based currency swap line. The swap line is a single tranche, low-interest-rate credit line that Argentina can use to finance its operations. Originally, the swap line was issued in 2009, before being adjusted again in 2020 and 2023. The total credit line is worth around \$20 billion, but China periodically gives more access to use amounts of the line. Argentina is currently authorized to use up to \$10 billion as of June 2023, but has not used much of it.<sup>24</sup>

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<sup>20</sup> *Argentina Avoids Default Event, but Faces Mounting Vulnerability*. (2023, February 1). Fitch Ratings. Retrieved June 25, 2023, from <https://www.fitchratings.com/research/sovereigns/argentina-avoids-default-event-faces-mounting-vulnerability-01-02-2023>

<sup>21</sup> *Argentina Avoids Default Event, but Faces Mounting Vulnerability*. (2023, February 1). Fitch Ratings. Retrieved June 25, 2023, from <https://www.fitchratings.com/research/sovereigns/argentina-avoids-default-event-faces-mounting-vulnerability-01-02-2023>

<sup>22</sup> Doll, I. O. (2023, May 24). *Argentina Seeks Bigger China Swap Line to Curb Peso Selloff*. Bloomberg. Retrieved June 25, 2023, from <https://www.bloomberg.com/news/articles/2023-05-24/argentina-seeks-bigger-china-swap-line-to-prevent-peso-selloff?leadSource=uverify%20wall#xj4y7vzkg>

<sup>23</sup> *Argentina Credit Ratings*. (n.d.). Fitch Ratings. Retrieved June 25, 2023, from <https://www.fitchratings.com/entity/argentina-80442219>

<sup>24</sup> Raszewski, E. (2023, June 2). *Argentina Doubles China Currency Swap Access to \$10 bln*. Reuters. Retrieved June 25, 2023, from [https://www.reuters.com/markets/currencies/argentina-renew-expand-china-currency-swap-line-2023-06-02/#:~:text=The%20bank%20said%20that%20the,billion%20yuan%20\(%249.9%20billion\)](https://www.reuters.com/markets/currencies/argentina-renew-expand-china-currency-swap-line-2023-06-02/#:~:text=The%20bank%20said%20that%20the,billion%20yuan%20(%249.9%20billion))

In early July of 2023, Argentina utilized its swap line to pay over \$1 billion it owed to the IMF.<sup>25</sup> This was the first time it has used the yuan to settle its payments owed to the IMF. Another \$1.7 billion of its owed IMF payments were made through the use of Special Drawing Rights (SDRs). But as a nation with a clear reputation as a serial defaulter that has consistently been unable to pay back loans, the question arises of why does China seem to have such an interest in serving as a creditor to Argentina?

## The Chinese Yuan

The Chinese yuan first came into circulation in December of 1949.<sup>26</sup> Issued by the People's Bank of China, the currency fluctuates under a floating exchange rate regime. From 1997-2005, the yuan was pegged to the dollar until the peg was replaced for the floating exchange rate regime.<sup>27</sup> This move was well received from the international community who believed that the dollar peg led the yuan to be immensely undervalued, in turn giving Chinese companies a financial advantage. As of 2023, the yuan is the fifth most common currency to be held in foreign exchange reserves.<sup>28</sup> Though its significance in comparison to the dollar is slim, the currency has been making strides to uphold its importance in the global economy. The yuan's usage in settling Chinese cross-border payments increased by 15% from 2021-2022. In addition, the international usage of the currency increased by 27% in 2022.<sup>29</sup> These statistics make clear the increasing usage and importance of the yuan on a global scale.

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<sup>25</sup> Centenera, M. (2023, July 1). *Argentina Uses Yuan for The First Time to Settle Part of Its IMF Debt*. El Pais. Retrieved July 6, 2023, from <https://english.elpais.com/economy-and-business/2023-07-01/argentina-uses-yuan-for-the-first-time-to-settle-part-of-its-imf-debt.html>

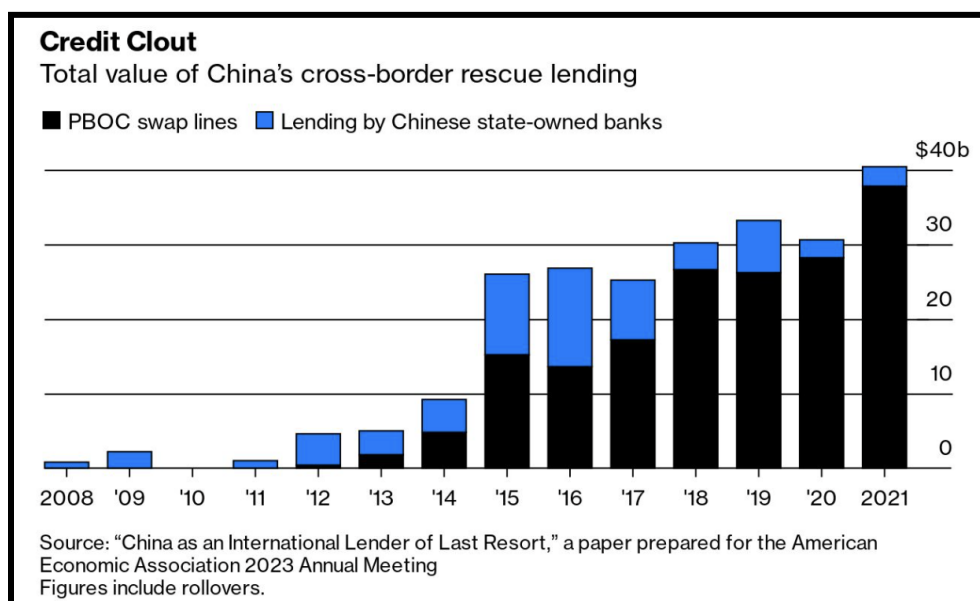
<sup>26</sup> Reuters Staff. (2009, November 16). *Timeline: The Past, Present and Future of China's Yuan*. Reuters. Retrieved July 8, 2023, from <https://www.reuters.com/article/us-yuan-timeline/timeline-the-past-present-and-future-of-chinas-yuan-idUSTRE5AF03C20091117>

<sup>27</sup> IE Staff. (2005, July). *China Removes Yuan's Peg to The US Dollar*. Investment Executive. Retrieved July 8, 2023, from <https://www.investmentexecutive.com/news/research-and-markets/china-removes-yuans-peg-to-u-s-dollar/>

<sup>28</sup> Semonsen, R. (2023, April 28). *De-Dollarization: Argentina to Pay for Chinese Imports in Yuan*. The European Conservative. Retrieved June 25, 2023, from <https://europeanconservative.com/articles/news/de-dollarization-argentina-to-pay-for-chinese-imports-in-yuan/>

<sup>29</sup> Semonsen, R. (2023, April 28). *De-Dollarization: Argentina to Pay for Chinese Imports in Yuan*. The European Conservative. Retrieved June 25, 2023, from <https://europeanconservative.com/articles/news/de-dollarization-argentina-to-pay-for-chinese-imports-in-yuan/>

Since the early 2000s, China has begun establishing itself as a foreign creditor and lender of last resort, through the offering of yuan-based swap lines and funds from state-owned banks. Argentina is just one of the 40+ nations that have been offered a swap line. Since the 2000s, China has lent nearly \$250 billion in sovereign debt, much of which were emergency funds.<sup>30</sup>



Source: Cited in Bloomberg

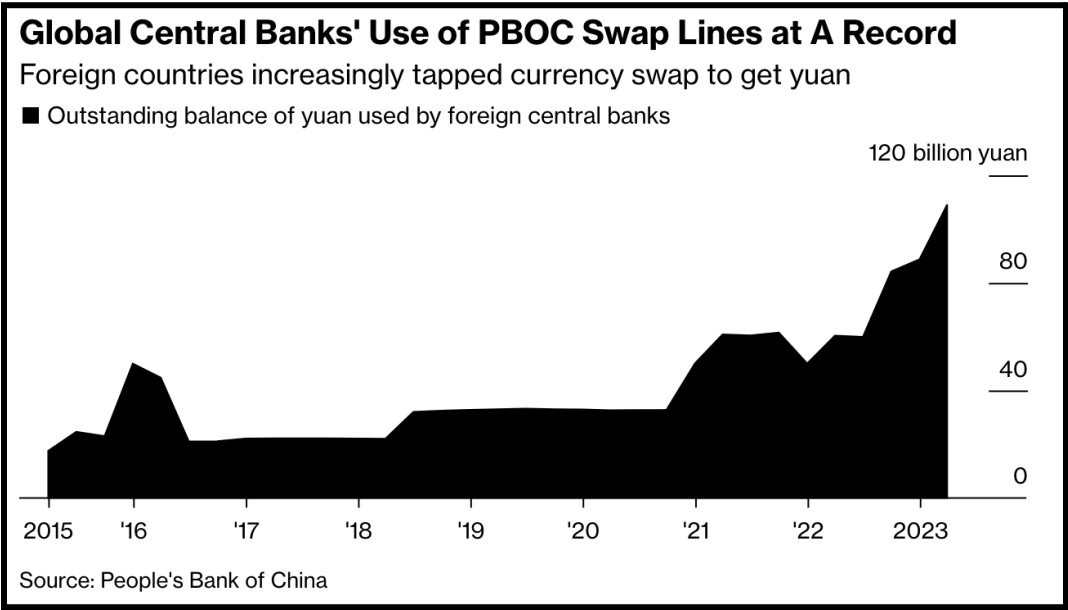
These increases in funds provided through yuan-based swap lines have shed light on the yuan's escalating importance in our global economy. However, China's role as such a large sovereign creditor has not come without controversy. Many of these nations receiving the funds face situations of extreme financial instability. Some of them, such as Sri Lanka, have already defaulted on the loans, forcing them to figure out a plan of payment while neglecting other basic needs.<sup>31</sup> While the loans are often intended to support the growth of infrastructure, these heavily indebted nations often struggle to pay back these Chinese loans and unable to see tangible growth in the intended areas. China has also established a reputation as an unforgiving lender, often jumping to the front of repayment lines and remaining unwilling to accept any

<sup>30</sup> Donnan, S., & Hancock, T. (2023, March 27). *China Lent Heavily to Developing Nations. Now it's Helping Them Manage Their Debt*. Bloomberg. Retrieved June 25, 2023, from <https://www.bloomberg.com/news/articles/2023-03-27/china-s-relation-to-developing-countries-turns-debt-manager>

<sup>31</sup> Condon, B. (2023, May 18). *China's Loans Pushing World's Poorest Countries to Brink of Collapse*. Associated Press. Retrieved June 25, 2023, from <https://apnews.com/article/china-debt-banking-loans-financial-developing-countries-collapse-8df6f9fac3e1e758d0e6d8d5dfbd3ed6>

losses on defaulted loans. Because of this, many deem China’s lending to be predatory, which is what led to the term “debt-trap diplomacy” being coined. Many of these loans have been related to China’s Belt and Road initiative, which included Argentina.<sup>32</sup> However, whether or not this lending can really be considered predatory is under debate. Given Argentina’s usage of the currency swap line is recent, we likely won’t see its true effects soon.

With a number of nations tapping into their convenient yuan-based swap lines, we are seeing record numbers of central banks globally accessing these loans offered by the People’s Bank of China.

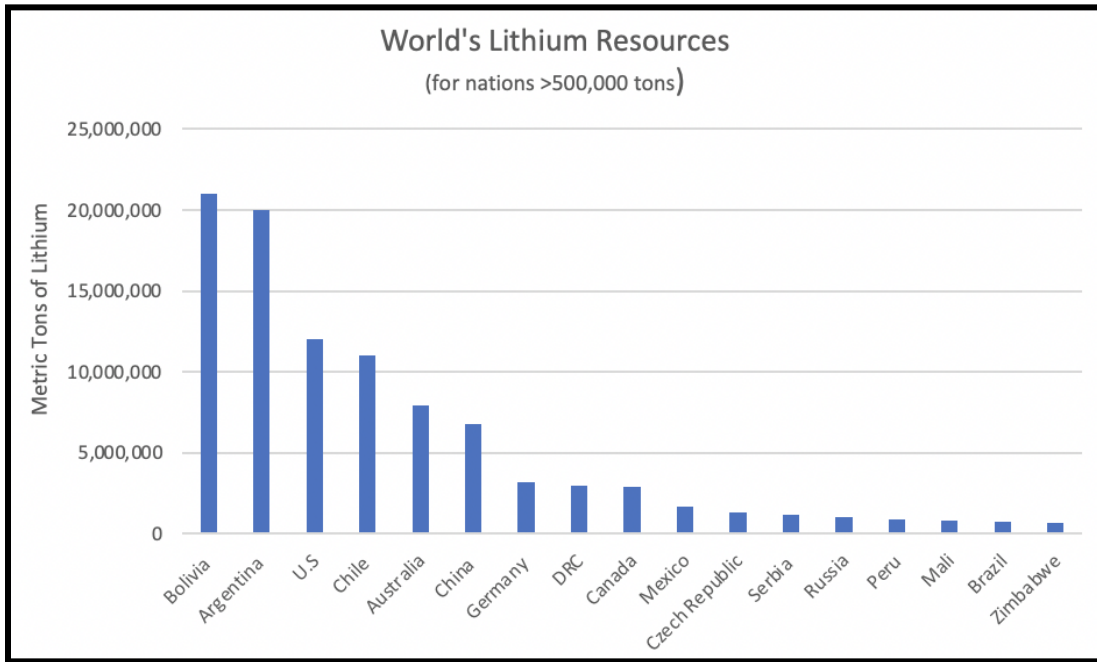


Source: Cited in Bloomberg

While China does not typically disclose which nations have actually utilized their swap lines, it does disclose the nations which have been offered access to them. Interestingly, most of these countries are in situations of financial stability, with Argentina and its low credit ratings remaining an outlier. This further brings up the question of China’s interest in lending to a country with such a low creditworthiness, especially given that it doesn’t typically offer the lines to nations with such low credit ratings.

<sup>32</sup> Donnan, S., & Hancock, T. (2023, March 27). *China Lent Heavily to Developing Nations. Now it's Helping Them Manage Their Debt*. Bloomberg. Retrieved June 25, 2023, from <https://www.bloomberg.com/news/articles/2023-03-27/china-s-relation-to-developing-countries-turns-debt-manager>

One answer to this question might lie within Argentina’s natural resource reserves and China’s interest in obtaining them. Argentina may not possess an impressive credit rating or project confidence that it will pay back its debt, but it is one of the largest exporters of lithium.



Source: Time Magazine

As the world’s second largest lithium exporter, Argentina plays an important role in the production of this highly-demanded metal. The Lithium Triangle - comprised of Argentina, Chile and Bolivia- is where over 60% of the world’s known lithium is situated.<sup>33</sup> This makes the region incredibly valuable to nations looking to increase their access to lithium.

The metal, also frequently referred to as “white gold” has seen demand rapidly escalate due to its role as an integral component of electric vehicle batteries.<sup>34</sup> The mineral is most commonly found in brine pools or any salt-rich deposits, which Argentina is abundant in.<sup>35</sup> With electric vehicle sales increasing

<sup>33</sup> Kawase, K. (2021, October 13). *Chinese Investors Jostle Over Argentine Lithium Mines*. Nikkei Asia. Retrieved July 8, 2023, from <https://asia.nikkei.com/Business/Materials/Chinese-investors-jostle-over-Argentine-lithium-mines>

<sup>34</sup> Ibid

<sup>35</sup> Ford, C. (2022, April 21). *Why is Lithium Important and How is it Extracted?* AMLI Residential. Retrieved July 8, 2023, from <https://www.amlri.com/blog/why-is-lithium-important-how-is-it-extracted>

exponentially, companies across the world are keen on securing a steady supply of lithium to power the production of their lithium-ion batteries.

Argentina is situated in a unique position within South American lithium production. With Chile's lithium mines already quite developed and Bolivia facing political instability, Argentina provides an attractive alternative.<sup>36</sup> With many mine expansion plans already in the pipeline and the nation housing a comparatively stable political scene, foreign companies and nations have turned to Argentina. China, with EV sales currently running at three times last year's levels, needs to secure its access to lithium.<sup>37</sup> In late May 2023, a Chinese lithium miner by the name of Tibet Summit Resources announced a \$1.7 billion plan to build two new lithium mines in Argentina.<sup>38</sup> In addition, in February of 2022, the Chinese miner Zijin Mining, announced a \$380 million plan to build a lithium carbonate production plant in the Catamarca province of Argentina.<sup>39</sup> These plans are just two of the many instances of Chinese lithium miners investing millions and even billions to construct lithium mines and production plants within Argentina.

The significance of this goes beyond the construction of lithium plants. For a number of years, the Chinese government has made investments into various Argentine infrastructure projects. In May of 2022, the Bank of China and China Development Bank announced a \$4.7 billion investment into constructing a hydroelectric dam in the Santa Cruz province of Argentina.<sup>40</sup> In mid 2022, another plan was announced for a \$1.25 billion investment into building a fertilizer plant. Countless other examples exist in terms of

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<sup>36</sup> Kawase, K. (2021, October 13). *Chinese Investors Jostle Over Argentine Lithium Mines*. Nikkei Asia. Retrieved July 8, 2023, from <https://asia.nikkei.com/Business/Materials/Chinese-investors-jostle-over-Argentine-lithium-mines>

<sup>37</sup> Ibid

<sup>38</sup> *Argentina Says Chinese Miner to Invest \$3.7 Bln in Lithium Projects*. (2023, May 31). Investing News. Retrieved June 25, 2023, from <https://investingnews.com/argentina-says-chinese-miner-invest-lithium-projects/>

<sup>39</sup> *China's Zijin Mining to Invest \$380 mln in Argentina Lithium Plant*. (2022, February 4). Reuters. Retrieved June 25, 2023, from <https://www.reuters.com/article/argentina-lithium-zijin-mining/chinas-zijin-mining-to-invest-380-mln-in-argentina-lithium-plant-idUSL6N2UF06P>

<sup>40</sup> Espina, M. (2022, August 23). *China Increases Investment into Argentina, Eyes Lithium*. Bloomberg Linea. Retrieved July 8, 2023, from <https://www.bloomberglinea.com/english/chinas-increases-investment-in-argentina-eyes-lithium/#:~:text=According%20to%20a%20report%20from,total%20cost%20of%20%244.71%20billion>

Chinese investments in Argentine infrastructure. The nations also signed an agreement in February of 2022, for Argentina to join China's Belt and Road Initiative.<sup>41</sup>

Another interesting angle arises when considering lithium industry ownership within the Lithium Triangle and Latin America. Argentina stands out as an outlier, given it is one of the few nations in the region that have not attempted to nationalize its lithium industry. Bolivia has had a nationalized lithium industry for many years. Mexico nationalized its industry in early 2023, and Chile has recently proposed plans to semi-nationalize its lithium industry.<sup>42</sup> In Chile, all future mining contracts will have to be made in a private-public partnership that the state will retain control of.<sup>43</sup> Argentina takes a different approach as noted by its privatization policies and no intentions of nationalizing its lithium industry. This difference makes Argentina a more attractive location for companies to commence their mining operations, given the absence of having to form private-public partnerships under state control.

Despite these nations' differences in national lithium policies, they are currently in talks to form a regional lithium alliance. Argentina, Chile, Bolivia and Brazil are considering the creation of what many are referring to as a "lithium OPEC".<sup>44</sup> While the alliance's inception is not yet confirmed, it would allow these nations to plan their mining operations, price setting and production of lithium. As OPEC allows its nations to collude on the price setting and production of oil, the lithium OPEC would allow these nations to achieve more desirable prices for their lithium exports. Additionally, it may also help

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<sup>41</sup> Espina, M. (2022, August 23). *China Increases Investment into Argentina, Eyes Lithium*. Bloomberg Linea. Retrieved July 8, 2023, from <https://www.bloomberglinea.com/english/chinas-increases-investment-in-argentina-eyes-lithium/>

#:~:text=According%20to%20a%20report%20from,total%20cost%20of%20%244.71%20billion

<sup>42</sup> Nugent, C. (2023, April 28). *What Would Happen if South America Formed an OPEC for Lithium?* Time. Retrieved July 8, 2023, from <https://time.com/6275197/south-america-lithium-opec/>

#:~:text=The%20semi%2Dnationalization%20is%20the,the%20world%27s%20identified%20lithium%20deposits

<sup>43</sup> Villegas, A. (2023, April 21). *Chile Plans to Nationalize its Vast Lithium Industry*. Reuters. Retrieved July 8, 2023, from <https://www.reuters.com/markets/commodities/chiles-boric-announces-plan-nationalize-lithium-industry-2023-04-21/>

<sup>44</sup> Jamasmie, C. (2023, March 6). *South America Looks at Creating Lithium OPEC*. Mining.Com. Retrieved July 9, 2023, from <https://www.mining.com/south-america-looks-at-creating-lithium-opec/>

attract some of the more profitable steps in lithium production, like battery manufacturing and lithium processing, to move to the region which mostly exports lithium in its raw form.<sup>45</sup>

While this strategic alliance may be good news for the nations involved, it likely won't be good for nations like China who are keen on securing a steady supply of lithium, but may have to face higher prices in the future. With China's notable presence in Argentina through lending and foreign direct investment, Argentina does have considerations to keep in mind. China has invested billions into Argentina infrastructure, has lent billions through the offering of its swap lines and Chinese corporations have spent billions developing lithium mines in Argentina. If China put pressure on Argentina to back out of a lithium OPEC, it could seem reasonable to assume that Argentina would do so. Given China's integral role in Argentina's economy, Argentina is in the business of keeping China content in order to continue securing future access to currency swap lines and investments. While China's true interest in Argentina is impossible to determine, there is logical reasoning present to believe that it could have to do with an interest in lithium. Argentina presents China with a great opportunity to not only boost the yuan's presence on the global stage, but also solidify its presence in a rapidly growing lithium market.

## **Future Implications for The Yuan and Dollar**

With China conspicuously engaging in efforts to increase the yuan's international presence, it is relevant to note what China's involvement in Argentina can indicate about this very topic. Through taking this example, it becomes clear that one route China is taking to try and bring the yuan to hegemony is by serving as a last resort lender to financially insecure nations. With nations like Argentina distressed and in need of securing new funds, a perfect opportunity is created for China to come in and provide emergency funds through their yuan swap lines. Furthermore, the provision of these funds makes these nations more

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<sup>45</sup> Nugent, C. (2023, April 28). *What Would Happen if South America Formed an OPEC for Lithium?* Time. Retrieved July 8, 2023, from <https://time.com/6275197/south-america-lithium-opec/>



likely to commit to further future usage of the yuan, often through agreeing to settle future trade in the yuan.

The question then arises of what this instance of de-dollarization can indicate about the future landscape for both the yuan and dollar. With nations like Argentina beginning to de-dollarize, could the yuan one day supplant the dollar as the world's dominant currency? If so, what would it take for this to happen?

The dollar's rise to dominance was a long process with many obstacles that had to be overcome and challenges that needed to be faced. The path would be no easier for the Chinese yuan. Despite recent rises in central banks tapping yuan-based currency swap lines, China still faces several significant barriers in truly expanding the yuan's international presence. While the dollar and yuan may provide similar prospects in terms of credit risk and currency risk for asset allocation, the situation is different for liquidity risk. The US Treasuries market is frequently denoted as the world's most liquid government securities market.<sup>46</sup> The situation is different for China whose economy is subject to strong capital controls. There are very specific regulations on the amount of money that citizens are allowed to move in and out of China. Because of this, foreigners can have difficulty moving their funds out of China. It is also quite difficult for foreigners to open offshore accounts at Chinese banks. Some banks require monthly deposits of a specified amount in order to open an account.<sup>47</sup> If a citizen is able to open an account, they can only wire in money up to a certain point, called the foreign exchange quota.<sup>48</sup> These capital controls deter many investors from Chinese markets. The liberalization of these stark capital controls would be absolutely necessary if China truly wants the yuan to one day see hegemony. The likelihood and timeline of such is debated, but would not occur in the short-term even if it were to happen.

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<sup>46</sup> McDowell, D. (2022, February 11). *What is Holding the Yuan Back? Xi is*. Georgetown Journal of International Affairs. Retrieved July 8, 2023, from <https://gjia.georgetown.edu/2022/02/11/what-is-holding-the-yuan-back-xi-is/>

<sup>47</sup> *The Tactics People Are Using to Get Their Money out of China*. (2021, March 10). Bloomberg. Retrieved June 25, 2023, from <https://www.bloomberg.com/news/articles/2021-03-11/>

<sup>48</sup> *Ibid* from-crypto-to-offshore-accounts-tactics-used-to-get-cash-out-of-china

This example of Argentina's de-dollarization provides some insight on what some of the dollar's biggest future challenges may be. With Argentina de-dollarizing for the yuan, there is reason to believe that one of the dollar's biggest challenges moving forward is the de-dollarization of financially unstable countries. It is important to note that Argentina's reasoning for de-dollarization was not because it saw the yuan as a more attractive currency, rather, it was an initiative undertaken in response to record-low dollar reserves. These low dollar reserves were a result of a severe drought which destroyed the market for their largest export. That being said, were it not for an unprecedented drought that caused an unfortunate depletion of grain exports, Argentina likely would not be in the situation of de-dollarization that it has found itself in. This is important to note given that this de-dollarization occurred because of a rare weather event and in a situation of economic downturn, not in a situation of promising economic growth. For context, another example of a country undertaking recent efforts to de-dollarize is Russia. Once again, Russia hasn't begun de-dollarization because it saw the yuan as necessarily more attractive, given its lack of convertibility, but rather in response to US sanctions related to the Russia-Ukraine War.<sup>49</sup> Once again, this is an instance of de-dollarization related to a rare and undesirable circumstance. While Russia has been attempting to de-dollarize for many years, its motivations have always been a response to political conditions. Because of this, there is no significant reason to believe that economically thriving nations will be motivated to turn to the yuan, rather nations in severe economic recessions or rare circumstances. Until we see economically thriving and financially sound nations start de-dollarizing for the yuan, there isn't any reason to believe that these current instances of de-dollarization indicate the yuan posing a significant threat to the dollar's dominance. While it may be possible that countries in certain circumstances or recessions will de-dollarize, these instances are rare. Together, they may weaken the dollar, but likely would not be enough to genuinely challenge the dollar's dominance.

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<sup>49</sup> Sor, J. (2023, March 5). *Here's Why Experts Say Russia and China's Attempts to 'de-dollarize' Global Markets are Going Nowhere*. Business Insider. Retrieved June 25, 2023, from <https://markets.businessinsider.com/news/currencies/dollar-dominance-russia-china-us-currency-wars-ruble-yuan-trade-2023-2>

## Conclusion

Amid an economic recession and diminishing dollar reserves, Argentina has made the decision to de-dollarize their economy through barring companies from accessing official dollars to finance imports, agreeing to settle future trade with China in the yuan and through tapping yuan-based currency swap lines offered by China. A layer of complexity is added when considering the financial soundness of Argentina. With a reputation as a serial defaulter, Argentina and its CC credit rating doesn't provide its creditors with the confidence it will service debt on time. With three debt defaults in the 2000s and a narrow avoidance in 2023, Argentina desperately lacks any degree of creditworthiness. However, this has not stopped China from coming in and readily providing Argentina with billions worth of loans through its yuan-based swap lines. China's interest in emerging as a lender here might be rooted in its interest in Argentina's lithium industry.

The test of time may provide a clearer conclusion about the importance of lithium in China's interest in Argentina. Further research within this topic could include in-depth analyses of other de-dollarization case studies. An analysis of other instances of de-dollarization might help paint a clearer overall picture in regards to China's motivations for recent lending and investment initiatives. Investigating examples like Russia could also shed light on other possible challenges for the dollar, such as its weaponization which has been fueled by US sanctions. The future implications of de-dollarization for the dollar's dominance is a complex question and topic. Investigating one case study can only reveal part of the picture.

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