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China's Financial Statecraft and the internationalization of the Renminbi: what looms over Brazil's foreign exchange reserves?

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ABSTRACT

In the XXI century, the foreign affairs community has observed the resurgence of geoeconomics – the use of economic means to geopolitical purposes. This time around, however, emerging powers are at the centre stage and the instruments of choice are based upon monetary and financial capabilities, such as currency swap agreements, trade policies, credit lines, and foreign investment. This process has been defined as Financial Statecraft. The reasons for this phenomenon, albeit manifold, relate to the fact that traditional geopolitical tools (*e.g.* armed forces) are not as effective in today's geopolitics as they used to be – *e.g.* during the Cold War. In this context, due to its economic growth, massive foreign exchange reserves and high level of savings, China has acquired enough financial power to employ it globally, making it a top international creditor, a major foreign investment source, and issuer of an international reserve currency. These developments have been reflected in Brazil. China not only is the largest trading partner, but also one of the major sources of foreign capital to the Brazilian economy. Brazil lacks capital to meet its needs of investment, especially in infrastructure, whereas China needs steady flows of commodities and has abundant financial resources. Against this backdrop, these countries have developed a deep economic and financial partnership, which is illustrated by their prolific cooperation in the last decades, such as common stances regarding the reform of the international financial institutions and the establishment of the BRICS initiative. In this context, this article analyzes the Chinese Financial Statecraft in relation to Brazil and assesses a scenario in which China deploys financial statecraft instruments to coax the Brazilian state into including the yuan in its currency reserves. We find that, owing to Brazil's moderate-to-high level of stateness and low threats to its strategic interests in case of compliance, the Chinese attempt would likely be successful.

Keywords: China; Brazil; Economic Statecraft; Financial Statecraft; Geoeconomics

RESUMO

No século XXI, a comunidade das relações exteriores observou o ressurgimento da geoeconomia – o uso de meios econômicos para fins geopolíticos. Desta vez, no entanto, potências emergentes estão no centro dos acontecimentos e os instrumentos escolhidos são baseados em capacidades monetárias e financeiras, como *swaps* cambiais, políticas comerciais, linhas de crédito e investimento estrangeiro. Esse processo foi definido como *Financial Statecraft*. As razões para esse fenômeno, embora múltiplas, estão relacionadas ao fato de que as ferramentas tradicionais de geopolítica (e.g. forças armadas) não são tão eficazes na geopolítica atual quanto costumavam ser – por exemplo, durante a Guerra Fria. Nesse contexto, devido ao seu crescimento econômico, maciças reservas de divisas internacionais e alto nível de poupança, a China adquiriu poder financeiro suficiente para empregá-lo globalmente, tornando-a um dos principais credores internacionais, importante fonte de investimento estrangeiro e emissor de uma moeda de reserva internacional. Esses acontecimentos refletiram-se no Brasil. A China não é apenas o maior parceiro comercial, mas também uma das principais fontes de capital estrangeiro para a economia brasileira. O Brasil carece de capital para atender às suas necessidades de investimento, especialmente em infraestrutura, enquanto a China precisa de fluxos estáveis de commodities e possui abundantes recursos financeiros. Nesse cenário, esses países desenvolveram intensa parceria econômico-financeira, demonstrada por sua prolífica cooperação nas últimas décadas, como posicionamentos comuns em relação à reforma das instituições financeiras internacionais e o estabelecimento da iniciativa BRICS. Nesse contexto, este artigo analisa o *financial statecraft* chinês em relação ao Brasil e avalia um cenário em que a China utiliza instrumentos de *financial statecraft* para convencer o Estado brasileiro a incluir o Yuan em suas reservas internacionais. Concluímos que, devido ao nível moderado-a-alto de *stateness* do Brasil e às baixas ameaças aos seus interesses estratégicos em caso de conformidade, a tentativa chinesa provavelmente seria bem-sucedida.

Palavras-Chave: China; Internacionalização do Renminbi; Financial Statecraft; Reservas cambiais; Brasil.

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INTRODUCTION

The international political economy has been undergoing structural changes in the past several years. The globalization of finance has engendered a world where the "poor" finance the "rich", not the other way around as history would suggest (Alfaro et al., 2014; Brender & Pisani, 2009), and, despite the discourse of the free markets' triumph over the state in the wake of the Cold War (Fukuyama, 1992), the financial disruption has been essentially led by state entities armed with unparalleled stockpiles of foreign exchange reserves. According to Daniel W. Drezner (2009), when states accumulate capital they acquire two capabilities: "first, by enhancing their ability to resist pressure from other actors and, second, by increasing their ability to pressure others" (Drezner, 2009, p. 9). In this setting, emerging powers began using their economic and financial means to both protect and pursue their national interest. "In the golden age of economic statecraft" (Drezner, 2015), it is, in fact, *financial statecraft* (Steil & Litan, 2006) that has been standing out. In this context, states are increasingly engaging in geopolitics with "sovereign check books and other economic tools" (Blackwill & Harris, 2016b).

Meanwhile, established economic centres – i.e. the European Union (EU), Japan, and the United States – have been in relative decline, especially after the 2008 Global Financial Crisis (GFC). As a result, in terms of finance and GDP, the world has become more multipolar to the benefit of the Global South (Gelb, 2010; Kirshner, 2014). This rebalancing of power has, in turn, fuelled an "interdependent competition" (Wright, 2017), mainly between traditional great powers – e.g. the U.S. and Japan – and rising powers – notably Russia and China. Contrary to the liberal interdependence paradigm, the context in which those transformations have taken place has been marked by "the return and intensification of geopolitical competition" despite unprecedented levels of interdependence (Wright, 2017, Chapter 5).

The reliance of virtually all states on international flows of capital, goods, service, data, and people (Leonard, 2016; Wigell et al., 2018) has fostered the development of asymmetric vulnerabilities and dependencies – i.e. *asymmetric interdependence* (Keohane & Nye, 2012). Under these circumstances, economic and financial capabilities have become a preferred and potent means of pursuing strategic objectives. As Keohane and Nye put it, "It is asymmetries in dependence that are most likely to provide sources of influence for actors in their dealings with one another. Less dependent actors can often use the interdependent relationship as a source of power in bargaining over an issue and perhaps to affect other issues" (Keohane & Nye, 2012, p. 9). The Sino-American trade war, triggered in 2017 by the Trump administration, is an eloquent example of this state of affairs.[1]

The potential costs of disruptions caused by armed conflicts have soared due to the development of global production chains (GPCs), a corollary of the deepening interdependence of the global economy. The manufacturing of computers, for example, entails the use of technology developed in one country, raw materials extracted in another, components made in several others, and final assembling in yet another. In this setting, as noted by C. O. Fjäder, "these flows [capital, goods, information, and people] become critical to the economy of each country, and severing these connections would incur significant damage" (Wigell et al., 2018, p. 29). Therefore, market considerations are increasingly factored in the nations' geopolitical calculus.

The reasons for these phenomena relate to a series of changes in world politics. As argued by Luttwak (1990), the traditional geopolitical instruments – e.g. armed forces – are not as effective as they used to be – e.g. during the Cold War – to accomplish most of foreign policy challenges. Baldwin (2016) goes further and argues that in the field of international relations "the importance of military force has been exaggerated" and "the role of non-military forms of power has been underestimated" (2016, p. 178):

> When a state's interests conflict with those of another state, most states most of the time do not use force; instead, they do what most other people do most of the time—*they try to create a situation in which it is in an adversary's interest to do what is wanted* (italics added for emphasis) (David A. Baldwin, 2016, p. 184)

Another factor comes from the fact that for most emerging powers military deterrence or conflict are not viable options to challenge the international *status quo* up against US's war machine. Although rising powers have exponentially increased their investments in armed forces – most notably Russia and China –, the American state has concentrated so much military power that it will remain unmet by any other

[1] Kucik, J. (2017, October 10). Trump's Trade War Begins. *Foreign Affairs*. Retrieved May 13, 2019, from https://www.foreignaffairs.com/articles/united-states/2017-10-10/trumps-trade-war-begins

country for the foreseeable future (Allison, 2017). An arms race with the US, thus, would be a fool's errand.

The resurgence of geoeconomics[2] is also associated with the re-emergence of the state capitalism (Leonard, 2016). "Bureaucratically engineered capitalisms" (Vihma, 2018) tend to establish state-owned enterprises (SOEs) and, more recently, sovereign wealth funds – SWF (Blackwill & Harris, 2016b; Vihma, 2018). Moreover, today´s state capitalism combines high degree of government control – either directly, through ownership, or indirectly, through tax incentives or finance by state-owned banks – with high levels of integration to the global economy (Kurlantzick, 2016). To illustrate this development, Blackwill and Harris (2016b) provide some measures:

> One-third of the emerging world's foreign direct investment (FDI) from 2003 through 2010 came from state-owned firms. In the early 2000s, the world held around $2 trillion in reserves; as of mid-2015, that total now exceeds $11 trillion, with sovereign wealth funds—a term only coined in 2005—holding another estimated $3 trillion to $5.9 trillion in assets. (Blackwill & Harris, 2016b, p. 37)

Against this backdrop, transnational financial mobility has soared and translated into bloating international balance sheets of fast growing emerging economies, where return rates were substantially more appealing (Brender & Pisani, 2009; B. J. Eichengreen et al., 2008; Kawai & Prasad, 2011). As highlighted by Brender and Pisani (2009), most of this recycling of external surpluses – which happened in the form of stockpiling high levels of foreign exchange reserves – enabled China to obtain increasing economic and financial importance in the international system. To illustrate, the People's Bank of China (PBoC) foreign exchange reserves grew by ten fold, from around $150 billion in 1997 to almost $1.5 trillion in 2007, the world´s highest holdings thereafter[3]. Ben Bernanke, the FED´s chairman from 2006-2013, also noted it in 2009: "As would be expected given the increasing size and sophistication of their economies, the nations of the [Asian] region have also begun to exert a substantial influence on global economic

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[2] For a comprehensive analysis of the resurgence of state capitalism, see, for example, Kurlantzick, J. (2016). *State capitalism: How the return of statism is transforming the world*. Oxford University Press.
[3] IMF DATA (http://data.imf.org/).

developments and on international governance in the economic and financial spheres" (Bernanke, 2009, p. 11). As a matter of fact, the ancient Middle Kingdom current account surpluses represented almost half of the developing regions between the AFC and the GFC, turning China into an unavoidable player in the financial and monetary globalization (Brender & Pisani, 2009).

Consequently, between the AFC and the GFC, Chinese export-led growth kept accelerated pace – at around 10% annually – while coupled with massive and rising capital and current account surpluses, dubbed "twin surpluses". From 1999 to 2007, its trade surplus jumped from roughly US$30 billion to over US$300 billion, well over, for example, Germany´s US$230 billion.[4] In relation to the growing capital account surpluses, scholars usually list two main sources. First, there is the excess savings. Although the PRC´s investment rate is very high, over 40%, its savings rate is even higher, above 45%[5] of GDP.[6] Second, as argued by Yu (2010), given the very strict capital controls – aimed to stave off risks of Balance of Payment (BoP) crises – Chinese authorities required that large FDIs were export-oriented. Under these conditions, in 2002 inbound FDI achieved US$52.7 billion, making China the world's largest recipient of these financial flows (Y. Yu, 2010). Therefore, Chinese current-account surplus between crises (1999-2007) was on average above 4% of GDP.[7]

The GFC was a pivot moment for China's ascent as it consolidated the Asian giant as a geoeconomics great power, especially in the realm of financial statecraft (FS). For the first time since the establishment of the Bretton Woods System in 1944, the epicentre of the worldwide financial maelstrom was in the advanced economies, more precisely in the United States. As a result, the American capitalist model and the Western international financial institutions – e.g. the IMF – were demoralised

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[4] *Source*: World Bank national accounts data, and OECD National Accounts data files. Data are in current U.S. dollar.

[5] To provide some perspective, in the same period, the world presented an average savings rate of 25%; upper middle income countries, 33%; OECD members, 22%; Latin America and the Caribbean, 19%; the United States, 18.5%; and Brazil, 16%. *Source*: World Development Indicators, International Monetary Fund, Balance of Payments Statistics Yearbook and data files, and World Bank and OECD GDP estimates. Accessed on 04/24/2019.

[6] For a discussion on the reasons why the Chinese have such a high savings rate, see chapter 14, 'Why Does China Save So Much', in Eichengreen, B. J., Pak, Y., & Wyplosz, C. (Eds.). (2008). *China, Asia, and the new world economy*. Oxford University Press.

[7] In 2007, when the GFC erupted, the PRC had a current-account surplus of almost 10% of GDP. *Source*: World Development Indicators, International Monetary Fund, Balance of Payments Statistics Yearbook and data files, and World Bank and OECD GDP estimates. Accessed on 04/24/2019.

(Grabel, 2011; Kirshner, 2014). As China and other large emerging economies agreed to assist the faltering advanced economies during the crisis, the United States, the EU, and Japan vowed to accelerate reforms in global governance. The Western powers replaced their G-8[8] with the G-20,[9] in which developing countries took central stage. There was indeed some progress: the G-20 summit was created; the dissatisfaction with the USD as the central international reserve currency regained moment and the "unloved dollar standard" (McKinnon, 2013) was subjected to widespread opprobrium;[10] and there were attempts to improve the surveillance of international finance, such as the new Financial Stability Board (FSB) (Cao, 2018). However, from the perspective of the EMEs, other more meaningful reforms of the IFS were found wanting (Helleiner, 2014).

The GFC – "born and bred" (B. Eichengreen, 2011) in the United States –, the lax monetary policies[11] of the advanced economies, in general, and by the US, in particular, have brought to fore China's external financial vulnerability[12] – the "dollar trap"[13] – and the substantial gap between its financial and economic power and its influence on the IMFS. First, its investment-led and export-dependent growth model left the Chinese economy dependent on global demand, but especially American and

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[8] The G-8 was an inter-governmental political forum from 1997 until 2014, consisting of France, Germany, Italy, Japan, the United Kingdom, the United States, Canada, and Russia plus a representative of the European Union. In 2014, Russia was suspended indefinitely following its annexation of Crimea.

[9] The G-20 was initially established as a forum of finance ministers in 1999. When it substituted the G-8, it became a summit venue. The membership consists of Australia, Canada, Saudi Arabia, the United States, India, Russia, South Africa, Turkey, Argentina, Brazil, Mexico, France, Germany, Italy, Great Britain, China, Indonesia, Japan, and South Korea as well as the European Union.

[10] In 2009, the Governor of the People's Bank of China Zhou Xiaochuan called for the replacement of the dollar as the main reserve currency with a "super-sovereign reserve currency" as proposed by J. M. Keynes at the Bretton Woods Conference in 1944 (Zhou Xiaochuan, 2009).

[11] Zhang (2015) refers as well to the quantitative easing programs adopted by the European Central Bank and the Bank of Japan.

[12] Gao and Yu of the Chinese Academy of Social Sciences (CASS) stated this fact in 2011: "The current crisis has exposed the vulnerability of China's financial position under the existing international monetary system, which is characterised by the domination of the US dollar as the international reserve currency. Because a national currency is used as the international reserve currency, US policy aimed at crisis management has created strong externality to the rest of the world. Because China holds some USD 1 trillion in US dollar assets in its foreign exchange reserves, it has become an easy prey of American domestic policies. The value of China's foreign exchange reserves is in danger of being significantly eroded as a result of the debasing of the US dollar, which is, in turn, a result of the US government's crisis management" (BIS & BoK, 2011, p. 105).

[13] As pointed out by Paul Krugman in the wake of the GFC: "China had driven itself into a dollar trap. China acquired its $2 trillion stash – turning the People's Republic into the T-bills Republic – the same way Britain acquired its empire: in a fit of absence of mind. And just the other day, it seems, China's leaders woke up and realised that they had a problem [ ] they are, apparently, worried about the fact that around 70 percent (sic) of those assets are dollar-denominated, so any future fall in the dollar would mean a big capital loss for China" (Krugman, 2009).

European demand. Furthermore, continuous foreign exchange accumulation exposed China to financial losses on its reserves in case of USD devaluations and inflation. This financial vulnerability was sharply compounded by the FED's QE programs. In terms of foreign exchange reserves, China's holding increased even faster than the pre-crisis period. As mentioned above, in 2007 the PRC had around US$1,5 trillion; in 2014, when it peaked, it reached almost US$4 trillion. At the end of 2017, it was at US$3.2 trillion,[14] which is higher than the sum of the next four largest holdings[15]. As noted by Wang (2016):

> Following the global financial crisis in 2008, this discontent turned into widespread anxiety that China's holdings of US dollar assets would lose their value as a result of American economic problems and macroeconomic policies. A consensus emerged that China would be better off investing in other types of assets overseas (Wang, 2016, p. 2)

In order to gain more autonomy and political influence, thusly raising the RMB's international profile, China has decided to double down on its global geoeconomics strategy (Cohen, 2017; Kirshner, 2014). To this end, the Chinese state has been acting to shore up its economic growth momentum to further amass economic power and, thus, expand its role in the international financial system to the benefit of the Yuan. Domestically, the Chinese authorities have implemented massive fiscal stimulus packages and have pressed on structural reforms to shift an investment and export-dependent economic growth model to a domestic consumption one in order to mitigate its external economic and financial vulnerabilities (Vermeiren, 2014; Wang, 2015). As illustration, from 2010 to 2016, the Chinese economy grew at an average rate of over 9% annually. By 2015, its growth did indeed slow down by around one-third, but that meant it still kept growing by an average of 6.5% (Allison, 2017). As a result, China has turned into the world´s second largest economy, whereas, albeit massive stimulus packages, the US economy averaged 2.1% annual growth, the EU economies 1.3%, and Japan, 1.2% (Allison, 2017).

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[14] Source: IMF Data (http://data.imf.org)

[15] Japan had US$1.3 trillion; Switzerland, US$ 811 billion; Saudi Arabia, US$510 billion; and Russia, US$432 billion. Source: World Development Indicators – IMF, IFS and data files

Furthermore, the Chinese state has been expanding its financial presence in the IFS and has become a major source of investments and financing, especially for the EMEs.[16] With its massive amounts of savings and of foreign exchange reserves, China has turned into one of the world´s leading international investors and will most likely remain so (Jin et al., 2016). In 2015 and 2016, China also overtook Japan as the second-largest source of outbound investment (UNCTAD, 2017, 2018; Zhai, 2018)[17]. Therefore, this process represents the pivot transition of the Chinese economy from "global manufacturers to global investors" (Du & Zhang, 2018). As best captured by Miko Huotari (2018):

> . . . while the necessary institutional adaptation of the international financial institutions (IFI) is stagnating, global financial and monetary order is becoming increasingly fragmented and polycentric. New patterns of capital flows and currency usage, as well as regional and other decentralised patterns of financial and monetary cooperation, are driving this evolving polycentricism. (Wigell et al., 2018, p. 128)

In terms of the *RMB Internationalization Initiative* (RMBII), scholars have highlighted the anomalous conditions under which this process has begun and the unusual path Chinese policy-makers have undertaken to internationalise the Yuan (Cao, 2018; Cohen, 2017; B. Eichengreen, 2014; Park, 2016). Based on previous cases, the internationalisation of sovereign currencies generally warrants some pre-existing conditions in order to succeed, which have not yet been met by the Chinese economy since the RMBI official launch almost a decade ago. Moreover, whereas most of the past instances of currency internationalization, such as the yen and the German mark, were based mainly on market forces, the *RMB-nization* (Lo, 2013) has been led chiefly by state initiatives deliberately developed to promote the international use of the Yuan (Chey et al., 2019). According to Cohen, China is "using a combination of policy innovations, cautious financial liberalization and diplomacy – 'currency statecraft', in other words" (Cohen, 2017).

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[16] And increasingly so for advanced economies, such as exemplified by the 16+1 Initiative. For more on this initiative, see, for example, Gisela, G. (2017). China, the 16+1 format and the EU. *At a Glance*, 8.

[17] In 2016, China was once again net exporter of capital.

In terms of the conditions under which the RMBII has taken place, historical precedents suggest that some criteria should be met to attain successful currency internationalization. First, a liberalized capital account, a market-based exchange rate regime, and an unregulated interest rate have in general preceded the international use of a domestic currency (Cao, 2018; Chey et al., 2019; B. Eichengreen, 2011). However, in China's case, albeit substantial policy measures and reforms to this end, these prerequisites are still found wanting and might remain so in the foreseeable, given that these reforms would "go to the heart of the Communist Party´s distinctive model of political and economic management" (Cohen, 2017, p. 15). As remarked by Cohen, should Beijing follow through with financial liberalization, it would erode the party´s hold on power:

> . . . more financial liberalization would weaken a critical tool of leadership control – the government's long-standing ability to manage monetary and financial conditions. Domestically, monetary control has meant direct authority over interest rates and the availability of credit, enabling the state to allocate resources to favoured borrowers and to minimize its own funding costs. Internationally, control means a closed capital account and a managed exchange rate. 'Financial repression', as economists call it, is a vital cog in Beijing's machinery of political autocracy. It is not at all clear how much political authority the ruling class is prepared to sacrifice for the sake of renminbi internationalization. (Cohen, 2017, p. 15)

Under these conditions, the Chinese government has decided to put infrastructure in place to support the international use of the Yuan and entice other central banks to hold the redback as reserves without ceding too much control over capital flows and the domestic financial sector (Cao, 2018; B. J. Eichengreen & Kawai, 2015; Kirshner, 2014). In terms of the supply side – i.e. financial infrastructure – the PRC has made substantial progress. For example, as of June 2016, the PRC has designated sixteen RMB offshore clearing banks worldwide. It has also catered quotas for RMB qualified foreign institutional investors (QFII) to countries such as Australia, Canada, Chile and Singapore (Park, 2016).

As far as the Yuan as a vehicle currency is concerned, despite the fact that the PRC is the world's largest trading nation, the results have been mixed. Although trade settlement in redbacks soared from meagre levels in 2009 to close to 25 per cent in 2014 and 2015, it has since stalled and trended lower. Consequently, most of Chinese international commerce have still been settled in USDs (Liao & McDowell, 2015; McDowell, 2019).

In relation to the use of RMB by other central banks as foreign exchange reserves, the outcomes have been similar to those regarding trade settlements. Foreign holdings of Chinese currency and deposits increased steeply from 2009 to 2014, when they peaked. However, although the levels have since bounced back, they have not yet recuperated the 2014 levels. As of April 2019, the RMB's share of international payments was at 1.88% (SWIFT, 2019). Notwithstanding, it must be reminded that, despite these drawbacks and some sceptical voices, the IMF recognized in October 2016 Chinese authorities' commitment to internationalising the RMB, by including it in the SDR basket.[18] As Cohen states:

> Success in a conflict of statecrafts can be measured in two ways: in terms of policies effectively implemented on the supply side of the market, or in terms of substantive impacts on behaviour on the demand side. On the first measure, China's record of accomplishment to date is quite impressive. *On the second, however, it is not doing so well* [italics added for emphasis] (Cohen, 2017, p. 11).

In this context, one of the main reasons pointed out by analysts for the low international demand for Yuan stems from the perceived unpredictability of cross-border flows of RMB, which is, in turn, a consequence of the still managed capital account (Cao, 2018; B. J. Eichengreen & Kawai, 2015; Park, 2016). In order to provide international liquidity in its currency, given Chinese authorities aversion to fully liberalizing capital flows, once gain the PRC has resorted to its economic and financial capabilities to export Yuan in a controlled manner, as well as to coax other countries into holding them in the meantime (Wigell et al., 2018). Therefore, instead of trade deficits, China's statesmen have been moving in the direction of capital account deficits (The Economist, 2019). Under these circumstances, as some pundits had predicted, China has pushed for broader use of the RMB by first transforming itself into the developing world financier and then gradually bringing its

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[18] IMF News. (2016, September 30). IMF Adds Chinese Renminbi to Special Drawing Rights Basket. Retrieved from https://www.imf.org/en/News/Articles/2016/09/29/AM16-NA093016IMF-Adds-Chinese-Renminbi-to-Special-Drawing-Rights-Basket

currency into the fold (Park, 2016). In the case of Latin America, China has been denominating a part of its loan in Yuan[19], as we further discuss later on when analysing Chinas's FS towards Brazil.

Under these circumstances, China has been increasing its economic and financial presence in Latin America, in general, and in Brazil,[20] in particular. Both the region and the country have a substantial demand for long-term finance for infrastructure projects, whereas the PRC has a huge supply of capital and, as pointed above, a need to export it as part of the RMBI.[21]As far as Brazil is concerned, in stark contrast to the Chinese case, Brazil´s rise stalled in 2013 – or its downfall began – hitting its trough with the election of Jair Bolsonaro for President in 2018, "the Trump of the Tropics". In 2014, Brazil´s economy entered into its worst recession in recent history, and from 2015 to 2016 its economy contracted 8.2 per cent in real GDP. Following this grave recession, real GDP grew by 1 per cent in 2017. Public debt, in turn, has been mounting and is expected to surpass 90 per cent of GDP in 2023 (IMF - W. H. Dept., 2018). Meanwhile, the anticorruption probe Lava Jato (Car Wash)[22] left the main heavy construction companies in tatters.

In such scenario, the already limited capacity of investment of the Brazilian economy was further reduced, whereas the need for infrastructure investments lingered on. The investment needed over this period is approximately R$ 205 billion annually – approx. US$57 bi[23] (IDB & WEF, 2019). According to a report authored by the World Economic Forum (WEF) and the Inter-American Development Bank (IDB), Brazil´s infrastructure requires investments estimated at around 3.2% of GDP over 2019-2024; however, from 1993 to 2015, it invested around 2.3% of GDP. To illustrate, Brazilian infrastructure investment as a proportion of GDP is estimated to be close to 2%, whereas it is 7% in China and 5.5% in India.

Moreover, another issue has to do with Brazil's foreign exchange (FX) reserves. Albeit the present dismal situation, the Brazilian central bank (BACEN) still

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[19] In the section on China's Financial Statecraft towards Brazil, we discuss this process further.

[20] Biller, D. (2018, April 28). China Expands Brazil Frontier as Investment Grows During Crisis. *Bloomberg News.* Retrieved February 21, 2019, from https://www.bloomberg.com/news/articles/2018-04-25/china-expands-brazil-frontier-as-investment-grows-during-crisis

[21] Renminbi (RMB), "the peoples currency", Yuan and "redback" are here used interchangeably to refer to China's national currency.

[22] For more on this subject, see, for example, Rotberg, R. I. (Ed.). (2019). *Corruption in Latin America: How politicians and corporations steal from citizens* (1st ed.). Springer International Publishing.

[23] Based on the 2018 average Exchange rate of 3.59 BRL/USD. Source: https://www.bloomberg.com/quote/USDBRL:CUR

holds close to US$380 billion, among the world's ten largest and well above some measurements of adequacy (*e.g.* the Guidotti-Greenspan-IMF). Following the general trend verified among EMEs, Brazilian authorities profited from the commodity prices boom of the 2000s to amass these record levels of international reserves. In this setting, as Brazil-China economic and financial interdependence has become asymmetric to the Chinese benefit and the pressing need for external capital raises the question of whether the Chinese authorities will make use of its financial leverage to coax Brazil into including the "people´s currency" in its portfolio arises.

As a matter of fact, such use of economic leverage has already been happening as some recent events corroborate. Following Jair Bolsonaro's election as Brazil's new president, in an article published by the *South China Morning Post,* it was recalled that in February 2018, despite Brazil's recognition of the "One China" policy, Bolsonaro decided to visit Taiwan – the first time a Brazilian presidential candidate did so since the 1970s –, triggering China's ire. At the time, the Chinese embassy in Brazil described it as an "affront to the sovereignty and territorial integrity of China".[24] Moreover, Joana Alves, an assistant manager at CW CPA, an advisory company based in Hong Kong, noted in an article in the *South China Morning Post* about the visit, "Many people have called Bolsonaro the Brazilian Trump and some statements concerning China are very similar. However, Bolsonaro also promised in his campaign to increase and speed up Brazil's economic development. *He cannot do that without China. It's impossible*" (italics added for emphasis). The same article also points out to the following remarks made by *China Daily*, a state-controlled Chinese publication: "Dumping China, whom Bolsonaro once described as an exceptional partner, may serve some specific political purpose. *But the economic cost can be back-breaking for the Brazilian economy, which has just emerged from its worst recession in history* (added for emphasis)." Then, action followed the words and, in march 2019, *Valor Economico*, Brazil's main business newspapers, reported that Bolsonaro's anti-China rhetoric had led Chinese authorities to postpone the first disbursement of the Brazil-China Cooperation Fund.[25] As Reilly (2013) notes, "The temptation to deploy China's economic might for strategic benefit has proven

[24] Carvalho, R. (2018, November 4). Brazil nut: will 'Tropical Trump' Bolsonaro's anti-China front crack? *South China Morning Post*. Retrieved January 14, 2019, from https://tinyurl.com/ybjqt2oc
[25] Rittner, Daniel; Krüger, Ana (2019, march 7th). Bolsonaro's rhetoric puts Brazil-China fund on hold. *Valor International*. Retrieved May 10, 2019, from https://tinyurl.com/yyynvkys

irresistible. China today is using *economic statecraft* more frequently, more assertively, and in more diverse fashion than ever before" (Reilly, 2013, p. 2). Thus, the Sino-Brazilian economic and financial interdependence has reached such levels of asymmetry that Brazil has turned into a target of China's use of economic and financial levers to attain its foreign policy goals.

In such setting, the study of the potential impacts of China's rise as a great power in financial statecraft coupled with its geopolitical goals – i.e. RMBI – on the Brazilian state has gained great importance. The Sino-Brazilian financial cooperation, bilaterally and internationally, China's consolidation as a deep-pocket creditor for developing countries, and Brazil's stakes in the international monetary order (at around US$ 380 billion) inspired this dissertation to contribute to the studies of how the deployment of financial statecraft could potentially impact the Brazilian foreign policy calculus in the foreseeable future.

In sum, RMB internationalisation is advancing, especially after the renewed impetus brought upon, first, by the GFC, more recently, by the BRI; the PRC has become a great power in geoeconomics in general and in financial statecraft in particular;[26] Chinese official banks and multilateral financial institutions have become central sources of long-term capital for developing economies; whereas Brazil has one the largest FX reserves worldwide and lacks capital for project finance. Under these circumstances, this study intends to answer whether China would be successful, despite any potential political costs, should it attempt to influence Brazil's government through financial statecraft instruments to include substantial sums of Yuan in its foreign exchange reserves.

In order to respond this question, after laying out our hypothesis, main assumptions, and methodology, we review critically the theoretical framework, discuss and define our central analytical framework, i.e. the concept of *Financial Statecraft*. In the following section, we analyse China's FS characteristics, main instruments and institutions that enable use of this strategy. We, then, examine the Sino-Brazilian financial interdependence and China's initiatives in relation to Brazil. Finally, we present our concluding remarks.

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[26] In the words of O'Reilly, "Never in world history has one government had so much control over so much wealth" (Reilly, 2013).

Hypothesis

This dissertation's main hypothesis is based upon the following assumptions. In the realm of the RMBI foreign policy goal, in view of historical precedents such as the IMF's inclusion of the "people's currency" in the Special Drawing Rights (SDRs) basket in 2016, China will employ the *fait accompli* strategy, which means it will take an active role to artificially stimulate the demand side of the aforementioned process through financial statecraft instruments. Thusly, RMB will become *de facto* one of the top international currency, despite lacking a fully liberalized capital account and financial sector. Moreover, Brazil and China economic interdependence will continue to deepen due to the complementary trade, inflow of Chinese capitals (e.g. FDI and loans), the Brazilian state's fiscal crisis and its economy's chronic lack of long-term capital.

Another underlying premise is that alternative sources of external financing – i.e. the United States, its Asian ally, Japan, and Europe – would likely not be able to lend to and/or invest in Brazil on a comparable size and at the same terms as the Chinese state, given their political regimes and their current economic prospects, as explained throughout this dissertation. Conversely, notwithstanding slowing economic growth, China will still pursuit the employment of its economic and financial power to either avoid detrimental strategic developments or to promote beneficial initiatives in world affairs, as it has been the case historically.

The hypothesis that undergirds this study is the following:

Hypothesis 1 (H1): In case China deploys its financial statecraft instruments towards Brazil to expand the Renminbi's international use, Brazilian statesmen will comply.

Methodology

Brazil has large systemic importance, regionally and internationally, as well as a wide variety of relationships with the PRC. The Brazilian economy is Latin America's largest one; Brazil's foreign exchange reserves are among the world's highest; and the Brazilian state has participated, frequently in partnership with China, in various relevant multilateral negotiations (e.g. G20, BRICS). Moreover, in choosing Brazil, we also select a case not yet studied as a target of FS, avoiding covering cases already over-analysed in the economic and financial statecraft literature, although dealing with a high profile case.

We decided for the theoretical model developed by Blanchard and Ripsman (2008, 2013), whose main objective is to identify "the conditions under which states using economic coercion or incentives ("senders") can achieve their political objectives" (Blanchard & Ripsman, 2013). Our choice refers to its relevant advantages in itself and over existing approaches. First, it provides a unified approach to all expressions of economic statecraft, including financial statecraft, and, thus, it has generality, i.e. it can explain the causes of failure and success across multiples countries and cases. Second, despite its generality, it also presents some parsimonious, since it uses one composite for each of its two independent variables, one international (*Threat to Strategic Interests* – TSI) and other domestic (*stateness*).

Under the scholars' theoretical model, the effectiveness of financial statecraft should vary as a function of the level of threat to the target-states' strategic interests (TSI), which requires a comparison between the "expected strategic consequences" of both compliance and non-compliance. As best explained by Blanchard and Ripsman:

> To the extent that compliance with the sender's demands threatens to undermine the target state's strategic situation by surrendering key resources that are essential for security, to weaken deterrence by undercutting perceptions of resolve and projecting weakness, or to alienate key allies, economic statecraft should be less likely to achieve its purpose. (Blanchard & Ripsman, 2013, pp. 24–25)

Furthermore, as they assess their model, Blanchard and Ripsman (2013) compare it to three ideal-type theoretical contenders: i) *a realist model*; ii) *an economic liberal model*; and iii) *a domestic conditionalist model*. The first one is based on the premise that economic statecraft does not, in general, influence states, as national authorities are more preoccupied with political and strategic goals. In other words, political and strategic desiderata matter more than the economic ones and, thusly, economic statecraft should *ceteris paribus* be ineffective**.** The second one assumes that the greater the economic benefits to the target state, the greater the probability of adherence. The last one, in turn, contends that democracies, for example, are more prone to abide by economic statecraft than others (Blanchard & Ripsman, 2013)[27].

Concerning the model of our research, the assessment of this international variable entails weighing expected strategic consequences of two scenarios – compliance and non-compliance – with the foreign power's demands. It follows that the authors propose ranking recipient-state' TSIs from non-compliance (TSI-N) and compliance (TSI-C) as *low, moderate, high,* or *very high*. In principle, states under greater TSI-N are more likely to comply with the originator's demand, provided that TSI-C does not present greater risks and costs. Thus, TSI stems from the differential between TSI-N and TSI-C.

In order to aggregate the two components of TSI into a single measure, we follow the steps proposed by Blanchard and Ripsman (2013, pp. 151–153). First, we translate our qualitative assessments into ordinal rankings of 1, 2, and 3 – *low, moderate,* and *high,* respectively*.* Then we subtract the ranking of TSI-C from TSI-N to obtain the composite measure. Consequently, TSI can be positive, neutral, or negative, ranging from +2 to -2. These categories are defined as *positive-high* (+2)*, positive-low* (+1), *neutral* (0), *negative-low* (-1), *negative-high* (-2). A positive TSI expresses greater strategic costs from non-compliance. A negative number, in turn, denotes greater threats to the strategic interests of the target country, should it comply with the foreign power's demand.

In the domestic realm, given that economic statecraft usually works by rallying the domestic support of powerful interest groups, its success also depends on domestic political factors. Therefore, according to Blanchard and Ripsman (2013), the political impact of the external economic incentives is a function of the target state's level of *stateness*. When this variable is high, for example, it means that the government can shield itself from resentful groups. This key domestic political

[27] For more information on these ideal-type theoretical contenders, see Blanchard, J.-M. F., & Ripsman, N. M. (2013). *Economic Statecraft and Foreign Policy: Sanctions, Incentives, and Target State Calculations* (1st ed.). Routledge. https://doi.org/10.4324/9780203098172

variable is comprised of the recipient's government's *autonomy*, *capacity*, and *legitimacy*. *Autonomy* (i) refers to the target state's capacity to take decisions in the face of domestic political opposition; *capacity* (ii) refers to the target state's ability either to compensate – *economic capacity* – or coerce – *coercive capacity* – potential losers in case of rebuffing the originator state; and *legitimacy* (iii), which refers to the ability of the state to rally disgruntled domestic groups (Blanchard & Ripsman, 2008, 2013)[28]. It follows that each of these components impacts the level of protection a target state has against outside interference or, conversely, the intensity of the effects from economic statecraft; in our case, financial statecraft.

As far as those components of *stateness* are concerned, to aggregate them into a single ranking, first, we assign numerical points to our qualitative assessments. *Low* designation receives 0 points, moderate 1 point, and high 2 points. In the case of between-rankings, *low-to-moderate* gets 0.5 and *moderate-to-high* 1.5. Then we sum Brazil's total scores and convert to a categorical rank of *stateness* aggregate level. An aggregate score below 2 expresses low level of *stateness*, meaning that the state should have *a priori* little wherewithal available to overcome political costs arising from its policy decisions. An aggregate score between 2 and 3.5 denotes *moderate stateness*, which, in turn, suggests that the government has some instruments available to assuage political opposition, but not to dominate state-society relations (Blanchard & Ripsman, 2013, pp. 161–164). In regard to *overall state capacity*, we follow Blanchard & Ripsman logic and use a weighted average to emphasize the higher ranked capacity so as to avoid underestimating the state's ability to "lean upon its greater power resources to co-opt or supress opponents". Based on a score-scale from 0 to 2 (*low* = 0; *moderate* = 1; *high* = 2), we multiply the higher score by 2, add it to the lower score and divide by 3 (Blanchard & Ripsman, 2008, pp. 158–159).

It must be noted that the approach to estimating the explaining variables relies on "qualitative judgements based on a uniformly applied set of guiding questions", which we include in the final section where we apply the chosen methodology. The method is consistent with the fact that these evaluations entail "a range of complex

[28] For a thorough review of these concepts, see Blanchard & Ripsman (2013). A political theory of economic statecraft. In Blanchard, J.-M. F., & Ripsman, N. M. (2013). *Economic Statecraft and Foreign Policy: Sanctions, Incentives, and Target State Calculations* (1st ed.). Routledge. https://doi.org/10.4324/9780203098172

contextual considerations", as each polity's decision-making environment is unique. Hence, we explain the rationale underlying our judgments to the benefit of consistence (Blanchard & Ripsman, 2013, Appendix I). Based upon the responses – how many negative or positive, how many disadvantages or advantages – we rank the state's levels of *TSI* and *stateness* and, then, apply the scores and aggregate them to elaborate a composite measure of these two intervening variables.

In terms of data and sources, we consulted available secondary sources, such as the China Global Investment Tracker[29] – which is published by The American Enterprise Institute and the Heritage Foundation and has a comprehensive data set spanning from 2005 to 2019 –, as well as the China-Latin America Finance Database – which is elaborated by the Inter-American Dialogue[30]. We had to rely more on secondary sources, as the Chinese authorities either do not provide the data in English or not at all claiming national security reasons. Additionally, the Chinese government tend to channel the flow of outbound capital through offshore financial centres, such as Hong Kong, China, and tax havens, such as Luxembourg, Virgin Islands, and Cayman Islands (De Jong et al., 2017).

[29] For more on the dataset, access http://www.aei.org/about/
[30] For more information on the dataset, access https://www.thedialogue.org/about/

THEORETICAL FRAMEWORK

In order to shed light on the potential impacts of China´s rise as a financial power on Brazil´s foreign exchange reserve´s management, we review the literature concerning our analytical framework, Financial Statecraft (FS). Given that FS is, in fact, a subset of Economic Statecraft (ES), it is necessary to briefly discuss the latter in order to better apprehend the former, i.e. this dissertation's analytical framework.

Economic Statecraft

First and foremost, although some authors use it interchangeably (e.g. Blackwill & Harris, 2016b), one must clarify the difference between *geoeconomics* and *economic statecraft* to prevent any misconceptions. In the words of Braz Baracuhy, "although economic diplomacy and economic statecraft are essential for successful geoeconomics, they are not identical" (Wigell et al., 2018, p. 16). The latter implies a geographical dimension, whereas the former does not necessarily. Scholvin and Wigell (2018) aptly explain the geo-dimension:

> … The geo-dimension in geo-economics means that the economic bases of national power must have *decisive* geographical features: resources being located at specific places, or sea-lines of communication taking specific routes, for example. Alternatively, the objective of geo-economic strategies must be geographically delimited, as in the case of a sphere of influence that a hegemon controls by keeping its neighbouring countries economically dependent on itself. (Wigell et al., 2018, p. 6)

To illustrate, when Russia cut off natural gas supplies to Ukraine and Europe in 2006 and again in 2009, it was exercising geoeconomics, given the importance of the geographic dimension of the Russian pipeline networks. China's Belt & Road project is also a good example of geoeconomics, although also of economic statecraft, due to its underlying foreign policy objectives, such as the RMBI, a project not geographically delimited.

In contrast to geoeconomics, the definition of economic statecraft has been relatively consensual, with its origin in the seminal work of David A. Baldwin (1985), *Economic Statecraft*[31]. In general terms, it refers to the employment of economic means by a government to affect the conduct of another state in accordance to foreign policy goals. To the effect of this study, however, we use Blanchard and Ripsman's definition, since it stands out from the literature for being specific, comprehensive and clear:

> *Economic statecraft* refers to an attempt by a *sender* state to influence a *target* state either to do something it would not ordinarily do or to forgo an action that it would otherwise engage in, by the manipulation of the market in a manner that provides economic benefits to states that comply and/or imposes economic penalties on those who fail to comply. It may involve the direct manipulation of normal bilateral or multilateral economic relations or it may be used indirectly, through threats and promises to intervene in the economic relationship. The two dominant strategies of economic statecraft are economic sanctions (a coercive strategy) and economic incentives (a persuasive strategy). [italics added for emphasis] (Blanchard & Ripsman, 2013, p. 5)

Regarding the two predominant strategies of ES – i.e. coercive and persuasive – economic sanctions (*sticks*) are measures taken by one state (sender, originator, practitioner) to disrupt another state's (target, recipient, subject) economy so as to coerce its compliance with the foreigner's desires. However, as noted by Armijo and Katada (2014), the literature on ES has been dominated by studies on punitive measures, due to the focus on the American case, whose policy-makers have traditionally preferred coercive method[32]. Conversely, economic inducements (carrots) are rewards proffered by the sender to the recipient to obtain acquiescence or change in behaviour.

Before continuing, in order to best apprehend the concept, one must distinguish economic statecraft from foreign economic policy, and economic warfare. As Chan and Drury point out, economic measures meant to militarily defeat a belligerent opponent or to oust an unfriendly regime do not constitute economic statecraft, rather economic warfare (Chan & Drury, 2000). Additionally, Steil and Litan (2006) bring attention to the distinction between economic statecraft and foreign

[31] As a matter of fact, some scholars use both terms interchangeably, as discussed later on.
[32] For example, Dobson (2003), Chan & Drury (2000), Drezner (1999), and Hufbauer et al. (2009).

economic policy. The former employs economic means to ends that may or not be economic, whereas the latter may or not use economic means in pursuit of economic objectives (Steil & Litan, 2006). In a similar vein, Klaus Knorr (1973) excludes from the exercise of economic power – which only concerns statecraft and geopolitics – two types of economic policies: i) those intended to "exploit international market power for economic gains as a matter of course", such as to improve terms of trade; ii) and those adopted exclusively to fulfil domestic demands. As a general rule, the author argues that in the absence of "benevolence or malevolence" from the conduct of the public actors, there is no use of economic power. To illustrate instances in which no economic power is employed, Knorr cites the purchases of territories from other sovereign states by the United States in the early 1800s[33] (Knorr, 1973).

Regarding traditional forms of economic statecraft, there are some discrepancies among scholars, and Dobson (2003) is a case in point[34]. Due to a different conception, the author departs from the definitions laid out above and includes under forms of economic statecraft economic warfare and non-economic instruments deployed against economic targets in wartime[35]. The scholar justifies his choice arguing: "sharp theoretical distinctions drawn between sanctions, strategic embargoes, cold economic warfare and economic warfare cannot be sustained when trying to explain practice" (Dobson, 2003, p. 7). Notwithstanding, we think that David Baldwin draws a rather clear distinction between economic warfare and economic statecraft when he states that "bombing a library is not called cultural warfare; bombing homes is not called residential warfare; bombing nuclear reactors is not called nuclear warfare; and bombing factories should not be labelled economic warfare" (David Allen Baldwin, 1985, p. 40).

Moreover, in order to differentiate ES from FS, Steil and Litan (2006) list the following tools of ES: i) trade privileges, tariffs, and quotas; ii) trade sanctions; iii) foreign aid in drought or disaster; and iv) regional trade agreements. In contrast,

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[33] The United States bought the Louisiana territory from France in 1803, for $12 million, and Florida from Spain in 1819 for $5 million (Knorr, 1973).

[34] Not only Dobson, but also M. Leonard et al., in *Connectivity War*, approach geoeconomics, economic statecraft, economic warfare etc. the same way see (Leonard, 2016).

[35] Dobson, in fact, distinguishes economic warfare from cold warfare. "The former can involve military action, such as blockades and strategic bombing, and is thus only possible in wartime, whereas cold warfare, which shares similar objectives, in conducted in conditions of formal Peace" (Dobson, 2003, p. 6). For a full discussion on this topic, see chap. 11, *Economic Statecraft: theoretical considerations in* Dobson, A. P. (2003). US Economic Statecraft for Survival, 1933-1991: Of Sanctions, Embargoes and Economic Warfare (1st ed.). Routledge.

Reilly (2013) does not distinguish the two types of statecraft and, thus, includes financial instruments in its three main strategies of ES, i.e.: “providing capital through foreign aid or direct investment; expanding trade via preferential trade agreements or state procurements; and altering monetary policies such as purchasing foreign bonds or intervening in currency markets” (Reilly, 2013, p. 2).

Blackwill and Harris, in turn, consider geoeconomics and ES as synonyms[36], referring to the former as a substitute for the latter. Hence, given that their approach falls into the ES realm, we include here their “today’s leading geoeconomics instruments” (Blackwill & Harris, 2016a)[37]. According to the authors, there are seven economic tools apt to geopolitical uses: “trade policy, investment policy, economic and financial sanctions, cyber, aid, financial and monetary policy, and energy and commodities” (Blackwill & Harris, 2016b, p. 24).

Financial Statecraft

With regard to Financial Statecraft (FS), it is a relatively new concept, first coined by Steil and Litan (2006). The authors define it as “those aspects of economic statecraft that are directed at influencing capital flows” – i.e. FS is a subset of tools under ES. As forms of FS, they list the following: *i) capital flow guarantees and restrictions; ii) financial sanctions on non-state actors; iii) underwriting foreign debt in a currency crisis; and iv) currency unions or dollarization* (Steil & Litan, 2006, p. 4).

The scholars also identify a qualitative difference between the two measures of FS “involve a manifestly greater degree of political sensitivity or ‘sovereign intrusion’”. To illustrate this, they note how capital flows can have much more grave and immediate repercussions than trade flows, such as foreign exchange market shocks and financial defaults under cross-border liquidity freezes. In sum, “the stakes are higher and the foreign policy challenges are greater and more complex for

[36] In their definition of geoeconomics, they include “the effects of other nations’ economic actions on a country’s geopolitical goals” and neglect the geo-dimensions. In fact, Blackwill and Harris deem geoeconomics a matter of economic factors rather than geographical ones: “Geoeconomics, in our view, is about providing a parallel account of how a state builds and exercises power by reference to economic factors rather than geographic ones” (Blackwill & Harris, 2016b, p. 24). Mark Leonard et al. (2016), in *Connectivity War*, use geoeconomics, economic statecraft, and economic warfare without much conceptual rigor. For more on the “terminological muddle” regarding geoeconomics, see Wigell et al. (Eds.) (2018). Introduction. In Wigell, M., Scholvin, S., & Aaltola, M. (Eds.). (2018). *Geo-Economics and Power Politics in the 21st Century: The Revival of Economic Statecraft* (1st ed.). Routledge.

[37] Just as Reilly, Blackwill and Harris do not apply the concept of FS in their works on ES.

financial statecraft than for traditional economic statecraft" (Steil & Litan, 2006, p. 5)[38].

Armijo and Katada (2014) have in recent years further developed the concept, but with a focus on its employment by emerging powers so as to overcome the traditional understanding – e.g. Steil and Litan (2006) – that associates FS with sanctions applied by the powerful against the weak states. To this end, the authors have expanded the definition to include those strategies that do not have a particular target, i.e. those "aimed at altering systemic conditions, the institutions and governance of global finance" (L. Armijo & Katada, 2014, p. 2). More recently, Armijo et al. (2019), honing in on the financial capabilities that enable states to engage in FS, have refined their definition[39], which guides this dissertation's research:

> When state leaders employ their direct, regulatory, or implicit influence over currency, credit, capital markets, and financial institutions in the service of their larger foreign policy goals – such as expansion of their territorial influence or to forge political partnerships abroad – they engage in 'financial statecraft' (FS). (L. E. Armijo et al., 2019, p. 2)

Additionally, building on works by Andrews et al. (2006), Armijo and Katada sorted the FS strategies into three dichotomies, based on aims, targets, and instruments (L. Armijo & Katada, 2014, p. 8). Regarding the first dichotomy, the aims of FS may be *defensive* (or *shield*) and *offensive* (or *sword*). Defensive aims are *internally-oriented* (in the terminology of Andrews, 2006, apud L. Armijo & Katada, 2014) and are intended to protect the national economy from external financial shocks and, consequently, enhance a country´s international autonomy – i.e. broaden its policy space. As measures of *defensive shield*, there are, among others, *capital account controls, accumulation of foreign exchange reserves,* and the *establishment of regional* or *multilateral stabilization funds*. Offensive aims, in turn, are *externally-oriented* (Andrews, 2006) and have the purpose of changing the conduct of other state(s) or influencing the evolution international conditions by means of active

[38] McNamara makes a similar comment in the context regional financial cooperation: "[…] monetary and financial integration, for all its potential functional benefits, […] confronts a deeply political and politicized realm where political authorities jealously guard their policy prerogatives" (McNamara, 2016, p. 352).

[39] For comparison, their previous definition – more vague – is the following: "We define 'financial statecraft' as the intentional use, by national governments, of domestic or international monetary or financial capabilities for the purpose of achieving ongoing foreign policy goals, whether political, economic or financial" (Armijo & Katada, 2014, p. 2).

involvement. To illustrate, when one state offers sovereign loans to another, but, in exchange, requires political support, such as at multilateral negotiations, the creditor is employing its *financial sword* (L. E. Armijo et al., 2019; L. E. Armijo & Katada, 2014; L. Armijo & Katada, 2014).

Concerning the second dichotomy, the targets of a nation's FS fall into the *bilateral* and *systemic* categories. Bilateral actions are directed toward a rival, partner, or client state, whereas systemic policies are meant to influence the global financial order, such as international governance institutions, monetary regimes, or practices to undergird foreign policy desiderata. As remarked by Armijo and Katada (2014), traditional scholarship has, nevertheless, identified FS as essentially direct and bilateral, in which a traditional power – e.g. the US and the EU – coerces or induces a developing country to change its behaviour. However, as suggested by the Bretton Woods System (BWS) and its legacy organizations (e.g. the World Bank and the IMF), countries with structural or indirect power[40] are able to exert substantial systemic influence by shaping, *inter alia*, market conditions, procedural rules of a given international regime, the range of options available, or by setting the agenda of international organizations (L. E. Armijo & Katada, 2014; Strange, 2004). Vermeiren notes, for example, that, since the USD remains the central currency in the global monetary system, the United States enjoys unparalleled structural monetary power (Vermeiren, 2014). In such a scenario, the range of options international currencies and the conditions under which the IFS operates are controlled by the U.S..

The third and last dichotomy refers to the distinction between *strictly financial* – such as credit, FDI, and other cross-border financial flows – and *monetary instruments* – such as exchange rate regimes and international currency usage – of FS (L. Armijo & Katada, 2014, p. 8). In terms of financial instruments, sanctions may take the form of withholding funds or restricting access to certain capital markets, whereas inducements may take the form of additional loans or debt pardons. Monetary power, in turn, is not always obvious, although consequential, and hence warrants a more detailed review.

To begin with, Andrews (2006) defines international monetary power (IMP) as "a relational property that exists whenever one state's behavior changes because of

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[40] According to Strange, structural power "is the power to shape and determine the structures of the global political economy within which other states, their political institutions, their economic enterprises and (not least) their scientists and other professional people have to operate" (Strange, 2004, p. 24).

its monetary relationship with another state" (Andrews, 2006, p. 8). Concerning how IMP operates, according to Cohen (2015), it manifests itself as *power to delay* – the ability of postponing the *continuing costs* of adjustment – or *power to deflect* – the capability of passing some or all the *transitional adjustment costs* onto others. To best understand these two concepts of monetary power, we must first briefly clarify the aforementioned costs. *Continuing costs* of adjustment are those stemming from "the new payments equilibrium prevailing after all change has occurred", whereas *transitional costs* are those arising from "the change itself" (Cohen, 2015, pp. 56–57). Concerning the former, Andrews remarks that they have to be afforded by the deficit state, they cannot be distributed outwards, "because by definition deficit states absorb resources in excess of their income, and a return to balance means that this state of affairs has ceased" (Andrews, 2006, p. 13); in other words, at the new equilibrium, deficit economies will have a smaller share of combined global output (Cohen, 2015). Therefore, the power to delay is particularly valuable for deficit states, as deferring the continuing costs of adjustment for as long as possible serves their interests.

As far as transitional adjustment costs are concerned, Vermeiden points out the associated distributional implications, as balance-of-payments adjustments warrant "either a market-driven fall of exchange rates, prices and incomes in deficit countries, reinforced by restrictive monetary and fiscal policies, or a market-driven rise of exchange rates, prices and incomes in surplus countries, reinforced by more expansionary monetary and fiscal policies" (Vermeiren, 2014, p. 23). Therefore, given that the larger the exchange rate oscillation, the larger the costs of transition, a state's power to deflect corresponds to its capability to transfer costs arising from the realignment of relative prices, incomes, or exchange rates to its economic partners (Andrews, 2006). Given that adjustment measures have an adverse impact on the purchasing power or personal balance sheets of key domestic constituencies, statesmen have a strong incentive to avoid the "burden of adjustment", i.e. to pass on as much as possible the associated costs (Cohen, 2015).

Another relevant difference between those two expressions of monetary power concerns what Cohen calls "dual nature of monetary power" (2015, p. 64), i.e. its internal and external dimensions, which, in turn, refer to a nation's "autonomy" and "influence". On the one hand, power to delay falls within the internal dimension of monetary power and, thus, must also be understood as "power-as-autonomy"

(Vermeiren, 2014, p. 23), in that it enables national authorities to maintain domestic macroeconomic policies regardless of external imbalances (Cohen, 2015). On the other hand, power to deflect falls within the external dimension of monetary power and, hence, it also falls under "power-as-influence", which Vermeiren aptly describes as the expression of "an ability to shape the outcome of a balance-of-payments conflict" (2014, p. 24). Under Armijo et al.'s FS dichotomies, in turn, *power to delay* and *power to deflect* correspond, respectively, to a state's employment of *shields* and *swords*.

It is now necessary to understand what are the underlying factors from which IMP derives, as well as its sources, or in the words of Cohen "the macrofoundations of monetary power" (Andrews, 2006, Chapter 2). *Power to delay*, as hinted above, rests on the state's international liquidity position, which, in turn, consists of foreign exchange reserves and access to external credit. Therefore, the larger the liquidity available to a country – relative to others – the longer it can defer balance-of-payment adjustment costs. *Power to deflect*, in contrast, is founded on the nation's "fundamental structural variables", i.e. its distinctive economic characteristics. Among these, in terms of IMP, it matters the most the degrees of *openness* and *adaptability* of a given national economy developed by Cohen (Andrews, 2006, Chapter 2; Cohen, 2015, Chapter 3), which are derived from the concepts of *sensitivity* and *vulnerability*. According to Keohane and Nye:

> In terms of the cost of dependence, sensitivity means liability to costly effects imposed from outside before policies are altered to try to change the situation. Vulnerability can be defined as an actor's liability to suffer costs imposed by external events even after policies have been altered. Since it is usually difficult to change policies quickly, immediate effects of external changes generally reflect sensitivity dependence. Vulnerability dependence can be measured only by the costliness of making effective adjustments to a changed environment over a period of time. (Keohane & Nye, 2012, p. 11)

For Cohen, the distinction made by Keohane and Nye is important, since it highlights that any adjustment process has two separate elements: *stimulus* and *response*. The former relates to the initial effects a foreign imbalance has on a national economy, whereas the latter refers to the difficulty with which these effects can be reversed. The power to deflect is a function of both these two features.

Therefore, concerning the two key fundamental structural variables undergirding a nation's *power to deflect*, *openness* determines an economy's sensitivity – always in relative terms – to disequilibria in its balance of payments (stimulus). *Adaptability*, in turn, defines a nation's relative economic vulnerability to external imbalances (response). Empirically, *openness* is gauged by the ratio of foreign trade to GDP, since: " [t]he more open an economy, the greater is the range of sectors whose earnings and balance sheets will be directly impacted by adjustment, once the process begins … [O]penness makes it difficult for an economy to avert at least some significant impact on prices and income at home" (Cohen, 2015, p. 66). Adaptability, in contrast, even though more arduous to gauge, as "it encompasses a myriad of qualities at the microeconomic level, such as factor mobility, informational availabilities, and managerial resilience" (Cohen, 2015, p. 66), it is essential for IMP. In general terms, *adaptability* is defined by the ease with which productive resources can be reallocated within the national economy – "allocative flexibility" – in order to reverse or accommodate foreign adverse pressures, thusly curbing or avoiding more dramatic economic and political repercussions (Andrews, 2006; Cohen, 2015; Vermeiren, 2014). It follows that states with relatively closed economies and/or relatively adaptive economies have the power to deflect some or all transitional adjustment costs onto other national economies.

To empirically illustrate the IMP, the QE program implemented by the FED to stabilize and then stimulate the American economy epitomizes the practical implications of the powers to delay and to deflect. As American authorities flooded the domestic and global financial markets with USDs, many countries whose national currencies do not enjoy reserve asset status had no choice but to sterilize capital inflows by further increasing their dollar holdings; otherwise, their national economies could suffer inflation pressures and/or their exchange rates could excessively appreciate. As a result of this state of affairs, the United States was able not only to maintain large fiscal deficits – thusly delaying macroeconomic adjustments –, but also to export inflation pressures – thusly deflecting "the burden of adjustments" (Cohen, 2015). As Eichengreen noted:

> Emerging markets complain that as their economies expanded and their central banks felt compelled to augment their dollar reserves, they were obliged to provide cheap finance for the U.S. external deficit, like it or not. With cheap foreign finance keeping U.S. interest rates low and enabling

> American households to live beyond their means, poor households in the developing world ended up subsidizing rich ones in the United States. The cheap finance that other countries provided the U.S. in order to obtain the dollars needed to back an expanding volume of international transactions underwrote the practices that culminated in the crisis. The United States lit the fire, but foreigners were forced by the perverse structure of the system to provide the fuel. (B. Eichengreen, 2011, p. 5)

However, monetary power is one facet of the national capabilities necessary to practice FS effectively.

According to Armijo et al., there are four categories of financial and monetary resources that a state may deploy "for the *conscious* purpose of obtaining foreign policy advantages" (2019, p. 3) – credit, network, currency, and governance capabilities; and "[p]ossession of large shares of any of financial capability pillar enhances a state´s options to exercise FS" (L. E. Armijo et al., 2019, p. 2). Therefore, *ceteris paribus*, the creditor capability stems from recurring current account surpluses. Necessarily, this process entails an equivalent capital account deficit, whether in the form of net capital exports or accumulation of international reserves. Hence, current account surpluses enable state authorities to voluntarily export capital, as, for example, outward foreign investments (OFI), loans, and purchases of foreign portfolio assets, such as stock and bonds. Nevertheless, there is one exception to this rule, i.e. the issuer of an international currency, since it can create and proffer credit to foreigners by simply printing its money as long as demand for it persists. Under these circumstances, those states dependent on foreign capital – i.e. with recurring current account deficits – are vulnerable to political influence from its creditors (L. E. Armijo et al., 2019).

The second element of a nation's global financial stance refers to its *market centrality* and *network power* (L. E. Armijo et al., 2019). As noted by Oatley et al. (2013), the IFS is a very complex network of persistent creditor-debtor relationships, in which actors frequently take multiple roles simultaneously, as creditor, debtor, or broker. Under these conditions, a state's *network power* is a function of the centrality of its nodes, which reflects the number and strength (i.e. persistence over time) of the links that must pass through that node. As Cohen summarizes it, "[t]he more links there are through the node and the greater is *the asymmetry* of those ties, the more central is the actor" (Cohen, 2015, p. 36). From this asymmetry, it follows that the IFS has a hierarchical structure, based on the degree of centrality of each national financial market within the network (Oatley et al., 2013). The degree of financial market centrality, in turn, derives from one or more of three factors – i.e. *credibility*, *stability*, and *economic size* (L. E. Armijo et al., 2019). *Credibility* stems from the perception that a given financial market provides a business-friendly environment. Long-lasting political and economic *stability*, in turn, means to investors that it is a safe haven to foreign savings. Finally, the bigger the size of an economy, the more funds others will hold there for the sake of convenience.

Therefore, according to *the Global Financial Centres Index 25* (Yeandle & Wardle, 2019), in the hierarchy of the contemporary global financial system, the United States is at the centre of the network, strongly connected to most other countries, followed by the United Kingdom, Hong Kong, China, Singapore and Shanghai. The American financial system dominance reflects, for instance, the fact that it has become the main provider of safe assets for the global economy, which are, however, increasingly concentrated in public and publicly guaranteed assets, due to, inter alia, USD's international role, large recurrent budgetary deficits, and lax monetary policies (Bordo & Taylor, 2017). As Beckworth and Crowe aptly put it, "The world depends on the US financial system to provide an adequate amount of safe assets and needs the Federal Reserve to maintain stable global monetary conditions. Some, although by no means all, of the strains in the global economy in recent decades can be attributed to failures on this score" (Bordo & Taylor, 2017, Chapter 2). Under these conditions, the US government is capable of imposing financial sanctions by publishing blacklists, denying other countries, foreign banks and citizens access to the American financial networks (L. E. Armijo et al., 2019; Steil & Litan, 2006) This state of affairs, in fact, is one of the reason why an increasing number of emerging powers are looking for alternative routes in the IFS, as the Chinese RMBII and China International Payment System (CIPS)[41] corroborates.

The third category of global financial and monetary capabilities refers to the international status of a national currency (L. E. Armijo et al., 2019). First and foremost, according to the literature (e.g. Ito & Chinn, 2013; Lee, 2014; Liao & McDowell, 2015; Triffin, 1983), an international currency has to fulfil three primary criteria. It needs to be (i) an unit of account; (ii) a medium of exchange; and (iii) store

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[41] The CIPS initiative is discussed later on.

of value. In official terms, an international currency may be applied as the reference currency for exchange rates (*i.e.* unit of account), the vehicle currency for foreign exchange interventions (*i.e.* a medium of exchange), and the reserve currency (*i.e.* store of value). Private institutions may use it for invoicing and settlement of trade and financial transactions (*i.e.* unit of account and medium of exchange), as well as for holding international assets (*i.e.* store of value).

Under these conditions, the issuer of a leading international currency (e.g. the USD and the EURO) acquires "exorbitant privileges", in the words of de Gaulle's finance minister, Valéry Giscard d'Estaing (apud B. Eichengreen, 2011). In addition to the aforementioned power to delay and power to deflect, the global central role of a domestic currency also provides structural and network powers, as reviewed above in this section (B. Eichengreen, 2011; B. J. Eichengreen & Kawai, 2015; Kirshner, 2014). A corollary of this state of affairs is that a run on the US dollar triggered by concerns over the American growing current account is unlikely, since many countries hold large dollar-denominated reserves, have dollar-denominated debt, or peg their currencies to the greenback. In terms of structural power, actors and agents – private and public – tend to acquire vested interests in the USD stability, as well as support their nations' maintenance of close ties with the United States (Bordo & Taylor, 2017).

Lastly, the fourth core component of FS is the global financial governance capability (GFGC), i.e. how much political clout a country has over the creation, development, and reform of transnational economic and monetary regimes and institutions. The ability of states powerful enough to mould, influence, or alter multilateral financial organizations – e.g. the IMF and the World Bank – in accordance to their own interests is a particularly consequential form of financial power. Since these countries are able to enshrine in the institutional design of the governance structure rules, procedures, and ideologies suited to their interests, they continue to benefit from them, "even long after their initial power advantages have waned" (L. E. Armijo et al., 2019, p. 5). In the case of the IMF, for instance, the advantages of wielding GFGC can be verified in the organization's chart and voting power distribution. According to its *Articles of Agreement*[42], any substantive change in the fund's governance requires an eighty-five per cent majority, a requirement that

[42] IMF (1944), Articles of Agreement of the International Monetary Fund, available at https://www.imf.org/external/pubs/ft/aa/index.htm

in effect gives its main founding member, the United States, veto power, as it still controls more than fifteen per cent of the total voting power. Here, again, this state affairs has stimulated emerging powers, mainly China, to deploy their FS capabilities to create alternative global financial governances, such as the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB).

CHINA'S FINANCIAL STATECRAFT

The Chinese version of FS is based upon the selective employment of economic incentive (*carrots*) and penalties (*sticks*). Chinese influence may be exerted through reciprocity, "*in which desired behavior is rewarded while undesired behavior is punished*". Beijing may also provide benefits unconditionally, in view of eventually producing desirable political and economic changes in the target state (Reilly, 2013; Wigell et al., 2018, Chapter 12). Albeit not shying away from deploying coercive measures, Chinese statesmen have, in general, preferred carrots to sticks. According to Abdelal and Kirschner (1999), this policy aims at producing "Hirschmanesque effects: the transformation of domestic politics brought about by the pattern of international economic relations" (1999, p. 132). The underlying reason is to prevent any threat perception in the target country and, hence, counter-balancing measures that could thwart Chinese economic and political objectives (Blackwill & Harris, 2016b; Wigell et al., 2018; Wright, 2017).

The Chinese state also designs FS policies that simultaneously promote different interests – such as geopolitical, economic, and political. To illustrate, when China invests in the infrastructure of cash-strapped oil-rich countries, it secures energy resources – a geopolitical dimension –, it opens their markets to Chinese exports – an economic dimension –, and it gains these governments' political goodwill to support Chinese demand in multilateral fora (Blackwill & Harris, 2016b; Wigell et al., 2018).

Another relevant characteristic of China's FS is its decision-making process, i.e. the "ability to control outbound investment" (Blackwill & Harris, 2016, p. 87). In contrast to democratic market economies, foreign investment decisions of Chinese firms and banks may be directly – e.g. SOEs, state-owned banks (SOBs), and SWFs – or indirectly – e.g. private sector – by the Chinese government (Wigell et al., 2018, pp. 61–74). Consequently, most of China's long-term capital outflows sent through public channels arrive via government banks and firms (Blackwill & Harris, 2016b, p. 54; Shaw, 2018, p. 36).

China’s Instruments of Financial Statecraft

The Economic Apparatus of the Chinese State

China’s socialist legacy and state-driven economic model have been enshrined in the Chinese government institutions, among which central agencies of the state’s economic governance. As shown further in this section, all major Chinese FS instruments are under direct or indirect control of these bureaucracy branches, which warrants from this dissertation a quick review of them.

- The Ministry of Commerce (MOFCOM): it not only watches over enterprises and policies relating to foreign trade and investment, but also runs directly foreign aid.
- The National Development and Reform Commission (NDRC): it establishes industrial policies and approves main development projects.
- The State-owned Assets Supervision and Administration Commission (SASAC): it controls PRC’s major state-owned enterprises (SOEs) and has a mandate to increase the value of those state assets.
- The Ministry of Finance (MOF): it oversees the financial sector, manages the national budgets, decides fiscal policy, and defines macroeconomic policies.
- The People’s Bank of China (PBoC): as China’s central bank, it controls currency flows, establishes banking policies and, beside the China Banking Regulatory Commission (CBRC), oversees the banking system.

Policy Banks

China Development Bank (CDB) and China EXIM Bank (CHEXIM) are the leading agencies in PRC’s FS. As a result of 1994 reforms of the financial sector, the Chinese government created the CDB and CHEXIM as policy banks, i.e. as support to the state’s policy objectives. These banks have initial paid-in capital from the PBoC and MoF and raise additional funding on both domestic and global capital markets. Its shareholders are the MoF (36.54 per cent); Central Huijin Investment

Ltd[43] (34.68 per cent); Buttonwood Investment Holding Company Ltd[44] (27.19 per cent); and the National Council for Social Security (1.59 per cent) (CDB, 2018). In terms of mandates, the CDB mainly backs Chinese macroeconomic policies set by the MoF and laid out in the Five Year Plans, concentrating its resource in power generation, fossil fuels, agriculture and infrastructure in general. Besides, the CDB has ministerial rank within China's government and is directly overseen by the State Council (CDB, 2018). Finally, as of end-2018, CDB's total assets amounted to RMB16.2 trillion (or roughly US$2.3 trillion[45]).

The CHEXIM's, in turn, according to its 2017 annual report, financially supports 'foreign trade, cross-border investment, the Belt and Road Initiative, international industrial capacity and equipment manufacturing cooperation, science and technology, cultural industry, "going global" endeavours of small and medium enterprises, and the building of an open economy' (CHEXIM Bank, 2017). The CHEXIM, for example, has funded most of China's overseas investments in the energy sector, most notably dams, such as the cases of Ecuador, Mozambique, and Sudan, where it has financed the construction of dams. Moreover, in 2017, the bank provided financing to more than half of BRI's flagship projects and its total assets amounted to RMB3.6 trillion (or roughly US$520 billion[46]) (CHEXIM Bank, 2017). In comparison to its foreign peers, the bank sets itself apart by being under direct control of China's State Council and subject to direct supervision of the MOF, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), and the PBoC.

With their sheer size and under direct control of the State Council, these banks – although not the only ones at the service of the Chinese state – are two central supports to FS policies. The CHEXIM Bank, for instance, is able to provide concessional loans to the developing world with lower interest rates than other major Chinese commercial banks, such as the People's Bank of China, since the government would subsidise the difference. Additionally, this bank's financial services reach most of Asian, Africa, Latin America and the South Pacific regions (CHEXIM Bank, 2017). As aptly noted by Wu & De Wei, "[s]ince such loans and

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[43] A subsidiary of the China Investment Corporation, the Chinese sovereign wealth fund.

[44] Which is owned by the State Administration of Foreign Exchange of the central bank, the PBoC.

[45] Based on 2018 CNY/USD average Exchange rate of 6.98 published by the World Bank (https://data.worldbank.org/)

[46] idem.

investments are highly sought after by developing nations, they could be used as a bargaining chip in any bilateral negotiation process" (2014, p. 784).

Chinese Foreign Investments

According to Jin, Li and Wu (2016), there are three types of Chinese foreign investment (CFI). The first is investment led by Chinese government agencies, i.e. the CDB and the Eximbank. The second type is outward direct investments (ODIs), which are meant to acquire control right of foreign assets and corporations. In this case, since the Chinese government has either control or strong influence over State-Owned Enterprises (SOEs), it holds sway on their investment choices. The third form refers to portfolio investments, i.e. the purchase of foreign financial assets, such as sovereign and corporate debt markets and publicly traded stocks.

Concerning Chinese ODI (CODI), MOFCOM is responsible for reporting the data by recipient country; however, according to their reports, more than half of the outflow goes to Hong Kong. Although unlikely, it is not feasible to identify the final destinations of those flows. Regarding Chinese portfolio investment, data is also hard to come by, as the policy banks do not report detailed information on loans to individual countries. Nevertheless, the CDB and the Eximbank do publish their overall portfolio of cross-border lending, which, as of end-2016, was at US$675 billion, more than double the size of World Bank's. In recent years, total lending to developing states is estimated to be about US$40 billion annually. In terms of sectors, loans to developing nations flow chiefly to infrastructure (Dollar, 2018).

Under FS, the ODIs stand out due to its impact in binding strategies, whereby recipient economies become increasingly dependent on the rising power, which, in turn, gains political leverage. Such FS strategy is not only more subtle than traditional geopolitics, but also it has de capacity to engender local interest groups willing to lobby for it, as their interests become more intertwined. Consequently these flows may alter the policy calculus for many states, broadening the available options of some and narrowing those of others (Blackwill & Harris, 2016b; Hirschman, 1980; Wigell et al., 2018). From the Chinese foreign policy perspective, beside the geopolitical benefits – access to energy and raw materials –, ODIs are useful in three important ways: they epitomize its "win-win" principle of international economic cooperation, serve as alternative investment to its massive foreign exchange reserves, and advance the RMBII. In this regard, Kirshner (2013) states, "[a]s a result, China's status and influence have been enhanced. States that trade with China will consider how their foreign policy decisions might affect their relations with Beijing" (Kirshner, 2013, p. 30).

Chinese cross-border investments have been expanding, especially since the GFC, and, meanwhile, CODIs have accomplished watershed moments. In 2015, the PRC became the world's second largest global investor in terms of FDI stocks, trailing the United States but surpassing Japan. In 2016, the volume of CODI attained US$183 billion, well over FDI into mainland of US$126 billion (Jaguaribe, 2018). In 2017, albeit falling for the first time since 2003, Chinese overseas investments still represented the second highest in history and 10 per cent of the global total, according to MOFCOM[47]. By the end of 2017, CODI stock reached US$1.8 trillion, representing 5.9 per cent of the world's ODI stock. However, albeit the second, it is still far behind US's, whose global share is almost four times the PRC's. In contrast to American and Japanese investors, who concentrate on manufacturing sectors, most of Chinese investments are in energy, raw materials and infrastructure. However, as corroborated by the 2017 data, CODI has started to shift towards manufacturing, services, and technology. In terms of industrial distribution, the six largest industries with a stock scale higher than US$100 billion included leasing and business service industry, wholesale and retail industry, information transmission/software and information technology service industry, financial industry, mining industry and manufacturing industry, taking up 86.3% of the total stock of China's outward foreign direct investment[48].

Two other aspects present in their press releases are relevant to our purposes. Chinese authorities emphasize what they call the "win-win effect" of CODI by citing the contributions of overseas enterprises to the tax revenue and employment of host countries.[49] Moreover, they have also highlighted the participation of the Yuan in the process. In 2017, 20% of CODI flows were settled in RMB, generally in the form of equity rights and debt instruments for enterprises'

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[47] MOFCOM. (September 29, 2018). Ministry of Commerce Holds the Press Conference on the Statistical Communiqué of Chinese OFDI in 2017. Retrieved from http://english.mofcom.gov.cn/article/newsrelease/press/201809/20180902791965.shtml
[48] Idem.
[49] Ib.

overseas investments.[50] Here, therefore, we find another instance of China applying FS to promote the international use of its currency.

Sovereign Wealth Fund – SWF[51]

Although named sovereign wealth funds (SWFs) since 2005, funds owned by sovereign states for long-term investment purposes are over a century old[52]. However, they returned to the limelight due to their size and growth rate in recent years. Another factor that has attracted attention to these funds is their ownerships, as many of today's largest funds are owned by non-democratic states – e.g. United Arab Emirates, Qatar, Saudi Arabia, and China. Concerning their sheer size and growth of recent years, in 2005, the aggregated total assets under management (AUM) of sovereign funds was estimated at about US$895 billion. Currently, according to data compiled by the SWFI, the top 81 largest SWFs have total AUM of almost US$8 trillion[53], 2/3 of which, as some have estimated, belong to authoritarian regimes (Shaw, 2018). In this scenario, some actors have been concerned with SWF investment decisions being captured by governments for political purposes and the potential risks for national security[54] and SWFs have become "the current incarnation of the tension between competing forms of capitalism – state capitalism as opposed to market capitalism . . ." (Shaw, 2018, p. 431).

Basically, SWFs function as monetary buffers for high levels of capital inflow in commodity-rich economies to prevent potentially detrimental consequences to the home economy, such as the *Dutch Disease*[55]. In terms of funding, the main sources

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[50] Ib.

[51] We use the definition of SWF employed by the Sovereign Investment Lab at Bocconi University: "*Special-purpose investment funds or arrangements that are owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies that include investing in foreign financial assets*" (IFSWF, 2018).

[52] The world's oldest SWF is considered to be the Kuwait Investment Authority (KIA), established in 1953 (Gelpern, 2011).

[53] Source: SWFI. *Top 81 Largest Sovereign Wealth Fund Rankings by Total Assets.* Retrieveid from (https://www.swfinstitute.org/fund-rankings/sovereign-wealth-fund).

[54] For an overview of SWFs, see, for example, Bernstein, S., Lerner, J., & Schoar, A. (2013). The Investment Strategies of Sovereign Wealth Funds. *Journal of Economic Perspectives*, *27*(2), 219–238.

[55] Coined by *The Economist* in 1977 to describe the woes of the Dutch economy during a gas exports boom, the term Dutch Disease refers to a scenario in which a surge in commodity exports leads to a steep rise in foreign-exchange inflows, which, *ceteris paribus*, generates inflationary pressures and excessive exchange rate appreciation, damaging the national economy competitiveness (see The

are, in general, natural resources revenues, fiscal surpluses, and government-owned companies. In this regard, the Norwegian SWF is a case in point. Norway Government Pension Fund Global is the world´s largest of its kind, with total AUM at over US$1 trillion[56] and its funding comes from petroleum revenues from its numerous rigs in the North Sea (Bernstein et al., 2013).

However, as is the case of the PRC, many of these funds have been established as alternative investments to excess foreign exchange reserves (Brender & Pisani, 2009, pp. 41–57). China´s Sovereign Wealth Funds (SWFs) – the China Investment Corporation (CIC) and China's State Administration of Foreign Exchange (SAFE) – are trade surplus funded and have control over vast amounts of the state´s official foreign exchange reserves. As of 2019, for example, the CIC – established in 2007 with more then US$200 billion of assets – has AUM of close to US$950 billion[57].

In terms of FS, there are different ways SWFs could be – and have been – employed. Nevertheless, as examined by Lenihan (2014), although this instrument could potentially be used for "predatory investments", such as the acquisition of strategic companies to control sensitive networks, resources, or technologies, it is unlikely that states would use SWFs to coercive ends, in view of reputational concerns and regulatory mechanisms against such actions[58]. Conversely, from a hirschmanesque perspective (Hirschman, 1980), SWFs may be used to take advantage of asymmetric interdependence (e.g. Keohane & Nye, 2012). As Lenihan aptly put it, "[s]tates will, therefore, seek to increase their economic power, which benefits not only that state's domestic economy, but also provides absolute gains to its trading partners, and hopefully increases the state's ability to influence others by enhancing either its position of dominance, or the dependence of other states on its economic policies" (2014, p. 238) and, moreover, "[…] even if a SWF makes all of their investment decisions on the basis of purely economic logic, and with the

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Economist. (2014, November 5). What Dutch disease is, and why it's bad. Available at *https://www.economist.com/the-economist-explains/2014/11/05/what-dutch-disease-is-and-why-its-bad*.

[56] Source: The Sovereign Wealth Fund Institute – SWFI. Retrieved May 3rd, 2019, from https://www.swfinstitute.org/fund-rankings/sovereign-wealth-fund.

[57] Idem.

[58] The United States, for example, has the Committee on Foreign Investment in the United States (CFIUS), whose task is to review FDIs in order to assess potential effects on national security (webpage: https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius).

seemingly benign intent of any other passive institutional investor, their very existence may be to fulfil a politically motivated purpose as part of a state's larger grand strategy to enhance their economic power relative to another state or set of states" (2014, p. 246).

China`s *Patient Capital*[59]

In relation to the creditor capabilities of FS (L. E. Armijo et al., 2019), China has been consolidating itself as a *system-influencing state* (Keohane, 1969)[60] in global finance, most notably as a source of long-term capital to the developing world, surpassing, by far, the World Bank and its regional spin-offs, e.g. the Inter-American Development Bank (IDB) and the Asian Development Bank (ADB). Among the reasons for the attractiveness of the Chinese finance is its particular model.

There is also an evolving debate about the preferences or indifferences in China's model of development finance.[61]. In terms of loans, studies have shown that Chinese development finance in the 21st Century has no geographic pattern, no correlation to political stability[62] and rule of law indices. Neither did they produce any evidence linking its lending to debt unsustainability in recipient-countries. Finally, infrastructure and industry seem to be the preferred sectors.

Chinese institutional investors (*e.g.* China Development Bank, Chinese Exim Bank) usually make credit decisions based on long-term horizons and relationships, geopolitical considerations (*e.g.* raw materials and energy supplies) and, as a result, they are more willing to forgo stringent conditionalities and cope with economic cycles. Some authors refer to the Chinese credit policy as a form of *patient capital* (Kaplan, 2016), whereas others see it as yet another instrument of *currency statecraft* (Cohen, 2017). Moreover, Chin and Gallagher (2019) call attention to the Chinese *coordinated credit spaces* approach to international finance. In this regard,

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[59] (Kaplan, 2016).

[60] According to Keohane, system-influencing states are those "which cannot expect individually to dominate a system but may nevertheless be able significantly to influence its nature through unilateral as well as multilateral actions" (1969, p. 295).

[61] For example, see: Kolstad and Wiig (2012); Zhang and Daly (2011); Dollar (2017, 2018); Kaplan (2016); Brautigam (2009).

[62] According to Luo et al. (2017), however, this aspect changes depending on the type of investment: resource investors prefer political stability, whereas non-resource-investors have no strong preference to it.

China's development finance institutions (DFIs) tend to operate in a coordinated fashion – "with a number of different (Chinese) banks and non-back corporate actors" working in tandem (Chin & Gallagher, 2019, p. 248).

Another relevant aspect of Chinese financial institutions is the willingness to lend money to countries in political and economic turmoil (*e.g.* Venezuela), or shutout from international markets (*e.g.* Argentina). They lower their country-risk by means of commodity-backed repayments (*e.g.* loan-for-oil) and Chinese equipment-purchase requirements (Dollar, 2017, 2018; K. Gallagher, 2016; K. P. Gallagher & Irwin, 2015). In this setting, according to Chin and Gallagher (2019), the establishment of the Asian Infrastructure Investment Bank (AIIB) epitomizes China's consolidation on the global stage as a development finance great power. All in all, these findings further demonstrate Chinese Financial Statecraft in practice, as foreign policy objectives trump credit risks assessments.

Infrastructure Alliances – The Belt & Road Initiative

Arguably, infrastructure alliances pertain to those financial instruments more clearly related to geopolitics in view of its clear "focus on the topographical chessboard" (Wigell et al., 2018, p. 43). This sector becomes even more relevant in the context of hyper-connectivity and interdependence of current globalization, along with massive infrastructure deficits and lack of long-term capital available to the developing world. In scenario, infrastructure great powers may manipulate other states' political calculus either by the threat of "mutually assured disruption" (MAD) of multiple kinds of flows – such as goods, capital, and data – or by the expansion of hard infrastructure making one country's economic node central to that of others in a lasting way (Leonard, 2016, p. 15). A case in point is Brazil and Paraguay joint construction of the Itaipú mega-dam, whose electricity generation accounts to 90% of the Paraguayan total supply, but only 15% of the Brazilian side. Under these conditions, it still produces consequential political impacts in both countries[63].

In this setting, infrastructure alliances have become an essential component of China's FS strategy and for three main reasons. The first one is the Chinese

[63] Schipani, Andres (2019, June 10th). Itaipú dam talks with Brazil set to vent Paraguay's pent-up energy. *Financial Times.* Available at: https://www.ft.com/content/48b3f930-56cf-11e9-8b71-f5b0066105fe

abundance not only of labour force, but also of capital, due to its high savings rate – over 40% - and its lasting current account surpluses of recent decades[64]. Second, China's slower economic growth has been reflected in excess capacity in its construction sector. Third, the Chinese economy guarantees long-term access to strategic natural resources, consumer markets, and political clout. In the words of Parag Khanna, "[t]rade is how China builds ties overseas; investments is how it builds leverage" (Leonard, 2016, pp. 103–108).

The Belt and Road Initiative (BRI) is one of the most eloquent examples of China's financial statecraft through infrastructure alliances. Although much has been debated about PRC's underlying motives in launching the initiative (Aoyama, 2016; Blanchard, 2018; Cheng, 2016; Huang, 2016; Summers, 2016; Z. Wu, 2009; H. Yu, 2017); officially, the BRI aims to "maintain closer economic ties, and deepen political trust; enhance cultural exchanges; encourage different civilizations to learn from each other and flourish together; and promote mutual understanding, peace and friendship among people of all countries." Cheng (2016) summarizes the debate about the underlying reasons:

> (1) To conquer world markets by opening up the markets of emerging and developing economies to deal with (i) China's excess production capacity, (ii) inadequate Chinese domestic demand, and (iii) bottleneck in further expanding the saturated export markets in developed economies;
> (2) To make direct investment in these countries, thereby securing supply of resources, especially in the natural resource sector; it is a new phase of China's "going global" policy officially proclaimed in 2002 after China's outward investment initiative was frequently dampened by Western countries which created various barriers to takeovers, mergers and acquisitions, and greenfield investment;
> (3) To extend the country's global strategy of promoting Renminbi's (RMB) internationalization by using RMB as well as part of an excessive foreign reserves;
> (4) To strengthen the diplomatic relationship with, and increase the popularity of China among, the partner countries; it is friendship building strategy motivated by geopolitical objectives;
> (5) To counter the economic aspects of the U.S. strategic "Pivot to Asia" policy, which includes the Trans-Pacific Partnership (TPP) free-trade

[64] "China's overall trade surplus has enabled it to run up the world's largest current-account surplus ($219 billion) and amass foreign-exchange reserves of $3.9 trillion" (Leonard, 2016, p. 191).

> agreement that appears to explicitly and intentionally exclude China's participation (Cheng, 2016, p. 310)

The third objective falls within the Chinese efforts to strengthen its currency capabilities (L. E. Armijo et al., 2019). A corollary of the first two intertwined objectives, recent reports on the progress of the RMB internationalization[65] have already identified some increased interest in the Yuan stemming from the BRI. The initiative provides an important platform for internationalizing the redback, promoting its use both as a trade and financing currency. BRI countries and firms will have incentives to expand their usage of RMB for "debt issuances, swaps, settlement, credit insurance, currency speculation, trade pricing, investment, and trade financing as a way to hedge and reduce transaction costs" (Blanchard, 2018, p. 7). Chinese enterprises, in turn, will be able to allocate their RMB balance sheets to fund projects under the BRI, increasing RMB liquidity in the concerned countries therefrom shoring up further RMB business. Although the BRI's scope is on Asian, European, and African continents, opportunities for Chinese investment extend to other parts of the world, including the Americas, offering additional paths for RMB use. Incidentally, since its launch, the Initiative has evolved from a regional strategy to a global strategy, and is open to the participation any nation[66](Aoyama, 2016; Blanchard, 2018; Cheng, 2016; Huang, 2016; H. Yu, 2017).

The BRI and RMB internationalization initiatives combined have the potential to transform the international system. Although the BRI's scope is on Asian, European, and African continents, opportunities for Chinese investment extend to other parts of the world, including the Americas, offering additional paths for RMB use. Incidentally, since its launch, the Initiative has evolved from a regional strategy to a global strategy, and is open to the participation any nation[67] (Aoyama, 2016; Blanchard, 2018; Cheng, 2016; Huang, 2016; H. Yu, 2017).

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[65] "It's important to note that businesses surveyed believe that the Belt and Road Initiative (BRI) – an ambitious and multifaceted strategy first announced by Chinese President Xi Jinping in 2013 – will have a positive impact on the growing use of RMB." 2017 Renminni Internationalisation Report. *HSBC Bank plc.* Available at: https://www.business.hsbc.com.cn/-/media/library/markets-selective/china/pdfs/2017-renminbi-internationalisation-survey-report-en.pdf.

[66] National Development and Reform Commission. (March 28, 2015). People´s Republic of China, Vision and Actions on Jointly Building Silk Road Economic Belt and 21st Century Maritime Silk Road. Retrieved July 18, 2018, from http://en.ndrc.gov.cn/newsrelease/201503/t20150330_669367.html.

[67] Idem.

Multilateral governance capability

According to Katada et al. (2017), collective forms of financial statecraft can be divided into four basic categories: i) *inside reforms of existing institutions*; ii) *inside options for influencing markets*; iii) *outside options to create new institutions or instruments*; and iv) *outside options to influence the shape of international markets*. In this realm, states exert their *governance capabilities* (L. E. Armijo et al., 2019; L. Armijo & Katada, 2014) of FS, as explained in our theoretical framework section, in order to improve its *structural power*, i.e. transform its material power and current account surpluses into international political influence and ideational power (Strange, 2004, pp. 25–32). In this setting, we focus on the *outside options to create new institutions or instruments*, at which the Chinese FS has excelled.

At first, Chinese efforts were concentrated in Asia, mainly as a reaction to the IMF-led management of the AFC. In May 2000, the ASEAN+3 announced the creation the Chiang Mai Initiative (CMI) as means to provide emergency liquidity to member states under currency crises. The original CMI consisted in fact of a network of bilateral swap agreements (BSAs) with US$ 40 billion of nominal capital. The CMI mechanism worked actually as an umbrella institution under which BSAs would be negotiated between borrower and creditor states. In reaction to the GFC this time around, ASEAN+3 decided in 2009 to multilateralize and provide more autonomy to the CMI by establishing the Chiang Mai Initiative Multilateralization (CMIM), a multilateral arrangement initially comprising of US$ 120 billions of paid-in fund. China, Japan, and South Korea would contribute with 80% of the total (32%, 32%, and 16%, respectively) while ASEAN countries, the remaining 20%. This agreement came into effect in 2010. Since then, the CMIM was further reinforced by i) doubling its size to US$ 240 billion, ii) raising IMF de-linked share to 30%, iii) extending maturity and supporting period and iv) creating a crisis prevention facility.

China's flagship initiative in terms of *global financial governance* is arguably the creation of the Asian Infrastructure Investment Bank (AIIB). When in October 2014, 21 Asian nations signed the agreement establishing AIIB, observers asked themselves the reasons for this initiative, given that the region already had a multilateral lender, the Asian Development Bank (ADB). The Chinese official answer was that Asia had enormous deficit of funding for infrastructure. However, if that were the case, it would have been a matter of increasing ADB's capital. As *The Economist* reported at the time[68], regardless of the real motives, the creation of a new regional bank meant expanded Chinese influence at the expense of Asia's incumbent powers, i.e. the United States and Japan. The AIIB has 87 members from all over the world and of all levels of income, even traditional American allies – such as Germany, France, and the UK – except for Japan and the United States. Notwithstanding, as Blackwill and Harris state: "Beyond attempting to weaken the U.S. alliance fabric of the region, the AIIB could allow China to pull its neighbors closer into its orbit, into relationships that promise increased geoeconomic benefits including decreased tension over territorial claims" (Blackwill & Harris, 2016b, p. 115).

The AIIB, however, is but one of a series of new institutions launched or backed by the Chinese state since the GFC. The PRC has also proposed the BRICS' New Development Bank (NDB – US$100 billion in capital) and Contingent Reserves Agreement (CRA – US$100 billion in capital), the latter based on China's experience with the CMI. Additionally, Chinese money has funded regional investment funds in Africa, Asia, Eastern Europe, and Latin America & Caribbean (LAC), such as the Silk Road Fund (SRF), with US$40 billion, whose investors include the Chinese SWF China Investment Bank (Kapur, 2017).

Furthermore, an often overlooked but very relevant initiative is the PRC's development of its own international payment system the China International Payment System (CIPS)[69]. Its first phase of operation began in 2015 and the second in May 2018, further expanding the reach and capacity of this initiative towards full operation in the near future. The new clearing system is expected to lower transaction fees for those doing business outside China and trying to wire RMB funds into the country[70]. Nevertheless, the geopolitical importance of this project was made obvious during the Crimea crisis, when the Russian government, after intervening in Ukraine's political upheaval, annexed that region. In reaction to the Russian aggression, Western powers put in place a multitude of sanctions and publicly considered barring Russia from SWIFT (Society for Worldwide Interbank Financial Telecommunications), the dominant global financial messaging system. However,

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[68] The Economist. (2014, November 11). Why China is creating a new "World Bank" for Asia. Retrieved February 17, 2019, from https://www.economist.com/the-economist-explains/2014/11/11/why-china-is-creating-a-new-world-bank-for-asia

[69] The CIPS provides clearing and payment services for financial institutions in the cross-border RMB and offshore RMB business.

[70] See Phase 2 of RMB Cross-border Interbank Payment System Fully Launched. (May 5, 2018). *PBoC News*. Retrieved May 20, 2018, from http://www.pbc.gov.cn/english/130721/3533376/index.html

amid Russian threats of escalation and retaliations, the Western powers did not follow through with the plan. The consideration of using the SWIFT as punishment alarmed Chinese authorities, who increased efforts to create its own international payment system (Blackwill & Harris, 2016b; Katada et al., 2017; Wigell et al., 2018).

One of PRC's most notable initiatives – but also disappointing as explained later on – is its network of bilateral currency swaps agreements (BCSAs), in accordance to its "more targeted and incremental approach" to the internationalisation of the Yuan, despite the lack of full convertibility (Blackwill & Harris, 2016b; Katada et al., 2017; Wigell et al., 2018). Based upon the original Chiang Mai Initiative (CMI), worldwide, BCSAs took off in the aftermath of the 2008 Financial Crisis to countervail liquidity shortages in Chinese trade and investment partners. As best explained by A. Yelery (2016):

> A BCS [i.e. BCSA] is a mechanism through which economies trade in local currencies. It means that the exports are invoiced in local currencies avoiding the dependency on international currencies used as common currencies for international trading, such as the US dollar or the euro. Under a BCS, two economies, by entering into an agreement, mutually decide the nature of settlement including the exchange and interest rates without reference to any third party currency. Hence, the BCS is an effective tool to hedge the exchange rate risks. (Yelery, 2016, p. 141)

As of December 2016, the Chinese government had signed BCSAs with 35 different central banks, amounting to 3.6 trillion Yuan or US$ 450 billion[71] (F. Zhang et al., 2017). Liao and McDowell (2015), in turn, explain how economic interdependence and BSA converge: "[f]irst, trade and direct investment interdependence between China and potential partner countries connects to BSA cooperation via two mechanisms: (i) financing insulation from international liquidity shocks and (ii) reduced transaction costs of cross-border exchange for local firms" (Liao & McDowell, 2015, p. 402). Among those partners was Brazil's Central Bank (BCB), which signed a RMB 190 billion – or approximately US$24 billion[72] – BCSA in June 2012. However, it expired 3 years latter and seems to not have been renewed, and

[71] Based on a 8 RMB/USD exchange rate used by the authors to estimate the values in RMB.
[72] Idem.

no reasons for it were published[73]. Nevertheless, recent studies have concluded that PRC's BCSA strategy has been ineffective as far as RMBI policy goal is concerned (McDowell, 2019) and inconclusive as far as impacts on bilateral trade with BRI partners are concerned (F. Zhang et al., 2017).

[73] According to McDowell (2019), BCB did not provide any information on the line's status.

CHINA`S FINANCIAL STATECRAFT AND BRAZIL

On august 15th, 2019, is the Sino-Brazilian diplomatic relations 45th anniversary. Although China has become a major Brazilian partner in trade, investments, and in international negotiations, this state of affairs started to take shape only in the turn of this century; until then, bilateral relations were lacklustre for decades. However, in the 2000s, the complementarities between both economies translated into intense economic relations, which not only led to closer cooperation in a multitude of domains, but also to an asymmetric interdependence to the benefit of China.

Given national similarities, overlapping objectives and common initiatives, to analyse Chinese FS towards Brazil, we compare it with Latin America and the Caribbean (LAC) as a form of benchmark. Just as in the regional case, by intensifying economic interdependence and integration between itself and Brazil, the Chinese state expects not only access to consumer markets, natural resources, and investment opportunities to its humongous international reserves, but also some *quid pro quo*, i.e. political support in multilateral negotiations and in its foreign policy goals, such as the "One China" (L. Yu, 2015). At any rate, the Sino-Brazilian cooperation in the IMFS stands out against the rest of the countries, as we demonstrate throughout this section.

In terms of *de facto* economic and financial interdependence (Liao & McDowell, 2015), China and LAC relations have been busy in the last decades. The Asian giant has always wanted to secure raw materials, energy supplies, and export markets, whereas Latin American nations have always wanted access to long-term capital to finance secular untapped demand for infrastructure, especially if they can pay with their wealth of natural resources. Investments in the LA6 (Brazil, Chile, Colombia, Mexico, Peru and Paraguay) are low as a result of low saving rate. As noted in a paper published by the IMF, theoretically investment should not depend on domestic savings in open economies but, in the real world, they do (IMF, 2018), and countries with lower saving rates have lower investments levels. In comparison to other EMEs, in LA6 countries half of the difference in savings is explained by low public savings (IMF, 2018). It follows that an increase in public savings would result in an increase in total savings and stimulate higher investments. However, in the Brazilian case, this scenario is unlikely in the foreseeable future due to its sluggish economic recovery and the dismal situation of its heavy construction sector, in the wake of *Car Wash* probe (Rotberg, 2019).

Against this backdrop, some scholars have identified the development of a Latin American "Yuan Diplomacy" in reference to William Taft's "Dollar Diplomacy" (K. Gallagher, 2016), i.e. Financial Statecraft under our theoretical framework. As Gallagher observes (2016):

> …. By 2014 Chinese development banks were providing more finance to Latin American governments than the World Bank or the Inter-American Development Bank (IDB). In 2010 and in 2014 China provided Latin American governments more funds than the World Bank, the Inter-American Development Bank, and the US Export-Import Bank (US Ex-Im) combined. (K. Gallagher, 2016, p. 65)

According to the China Global Investment Tracker[74], in the period between 2005 and 2018, Brazil was the fifth largest recipient of Chinese investments, with US$56.6 billion in total volume, trailing the United States (US$174.9 billion), Australia (US$95.4 billion), Britain (US$73 billion) and Switzerland (US$60.9 billion). Furthermore, according to estimates from the Inter-American Dialogue and the Global China Initiative at Boston University's Global Development Policy Center, CDB and Eximbank have provided US$140 billion in finance to Latin America and Caribbean (LAC) from 2005 and 2018 (Myers & Gallagher, 2019). In the region, the PRC has been a crucial source of finance for Venezuela, Ecuador, Brazil, and Argentine, countries with insufficient financial resources to tap their investment needs, coupled with constrained access to global capital markets in recent years (IMF, 2018).

Against this backdrop, in 2014, the Chinese government and LAC leaders decided to provide more institutional density to their economic cooperation and launched the China-CELAC Forum (Community of Latin American and Caribbean States), whose first event was hosted by the PRC in January 2015. Concurrently, Chinese authorities also proposed the "1+3+6" cooperation framework: one plan, the China-CELAC Cooperation Plan 2015-2019 (CCCP15-19); three engines – trade, investment, and finance; six fields – energy and resources, infrastructure

[74] Source: China Global Investment Tracker, available at http://www.aei.org/china-global-investment-tracker/.

construction, agriculture, manufacturing, scientific and technological innovation, and information technologies. Under the CCCP 2019-2023, the PRC has pledged US$250 billion in direct investments to the region by 2023 (Dussel Peters & Armony, 2015, pp. 73-74,90-92; L. Yu, 2015, p. 1058).

Furthermore, in the specific case of the CODI, the PRC became Latin America's third-largest investor, reaching, as of end of 2013, a total FDI stock of about US$86 billion, while worldwide it surpassed US$660 billion – nonfinancial direct more than US$540 billion. Hence, at the time, Latin America became China's second investment destination (13%), far behind Asia (67.7%) (Dussel Peters & Armony, 2015). Concerning Brazil,[75] substantial changes have been verified only in recent years. In 2010 alone, annual CODI amounted to around US$9.6 billion, whereas from 1990 to 2009 it totalled a meagre US$255 million (Blanchard, 2016). According to a report published by the Brazilian government on inward Chinese investments[76], between 2003 and august 2018, China's FDI stock in Brazil reached US$54 billion, but with the bulk of its investments taking place in the wake of the GFC. In 2017, for instance, Chinese firms spent a record high US$17.7 billion on LAC mergers and acquisitions, but mostly in the Brazilian energy sector, where two major SOEs – State Grid Corp. of China and the State Power Investment Corp. – made deals amounting to US$14.5 billion. SGC bought 95 per cent of CPFL Energia SA, Brazil's largest private electricity distributor, for US$12.2 billion, while SPI bought Sao Simao hydroelectric power plant for US$2.3.

However, while these sectors are still the most important, the Brazilian case is also a good example of diversification in Chinese outward investments, as other sectors – such as transport, finance, and agriculture – are growing in importance (Jaguaribe, 2018). For example, Brazil's third largest air-conditioner manufacturer is Gree, a Chinese company, and Brazil's biggest network equipment provider is Huawei, a Chinese telecom company. It has also been reported that cranes of Chinese brands have 85 per cent share of the Brazilian market, among which Sany alone holds 37 per cent.

[75] For more on the Venezuelan case, see: Blanchard, Jean-Marc F. 'Political Aspects of Chinese Investment in Latin America', 2016.

[76] SEAIN/MPDG, *Boletim Sobre Investimentos Chineses No Brasil - n. 7*, 21 December 2018 <http://www.planejamento.gov.br/assuntos/internacionais/arquivos/boletim-investimentos-chineses-no-brasil-no7.pdf> [accessed 16 May 2019].

In terms of regional FS, as remarked by Myers and Gallagher (2019), Chinese authorities complemented China's financial strategy in LAC with regional and bilateral funds managed by the CDB and China Eximbank. In 2015, the China Three Gorges Corporation (CTGC) drew upon the US$30 billion of available capital in the China-LAC Industrial Cooperation Investment Fund (CLAI) as financial support to its bid for the concessions of two hydropower plants in Brazil[77]. Then, in 2016, the CTGC bought US$1.2 billion of hydropower assets from Duke Energy-Brazil[78], this time drawing capital from the US$ 10 billion China-LAC Cooperation Fund (CLAC). In 2017, in turn, the CLAC Fund provided financial backing to the acquisition of Duke Holdings and investment in Electrosul (Myers & Gallagher, 2019). In 2017 as well, Brasilia and Beijing established the US$20 billion China-Brazil Fund for the Expansion of Production Capacity in 2017[79], with US$15 billion from the CLAI and US$5 billion from Brazilian coffers. That same year, Petrobras signed the only oil deal in the region with China: US$5 billion guaranteed by 10,000 barrels of oil per day over a 10-year period. In summary, "[s]ince 2010, China has also emerged as a key source of new investments in Latin America, while US and European financial flows have continued to decline" (Wigell et al., 2018, p. 166).

Another relevant area in the Sino-Brazilian financial interplay is their the *de jure* (Liao & McDowell, 2015) integration and cooperation, rekindled at the beginning of the XXI century. As a result, the PRC has become one of Brazil's main partners in international fora. Furthermore, they established a strategic partnership in 1993, but later (2012) elevated it to global strategic partnership, signalling the long-term perspective both countries have of their political and economic ties. International financial cooperation between the two nations, in turn, expands over a wide range of domains, from the BRICS group to the G-20, as a reflection of a variety of converging interests. In the realm of financial global governance, based on the G-20 platform,

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[77] CTG Brasil. (2016, October). CTG Brasil takes over the operation of the Ilha Solteira and Jupiá hydropower plants". Retrieved April 10, 2019, from http://ctgbr.com.br/en/ctg-brasil-takes-over-the-operation-of-the-ilha-solteira-and-jupia-hydropower-plants/.

[78] Poindexter, Gregory. (2016, October 12). CTGC purchases US$1.2 billion of hydropower assets from Duke Energy-Brazil. *Hydro Review.* Retrieved April 10, 2019, from https://www.hydroworld.com/articles/2016/10/ctgc-purchases-us-1-2-billion-of-hydropower-assets-from-duke-energy-brazil.html.

[79] Branco, M. (2017, June 27). Brazil-China fund now operational with $20 billion. *Agência Brasil.* Retrieved April 10, 2019, from http://agenciabrasil.ebc.com.br/en/economia/noticia/2017-06/brazil-china-fund-now-operational-20-billion/.

both countries have defended reforms in the international financial architecture, whose main institutions – IMF and BIRD – are not anymore representative of the economic weight of its members. They also criticise the veto power some countries still have in major organizations, namely US´s in the IMF, and the US dollar role as the central reserve currency.

As the main leaders of the G-20, they contributed to advancing the reform of the Bretton Woods Institutions (i.e. IMF and World Bank), whose results, for instance, made the Asian giant the third largest shareholder of the IMF and placed Brazil among the top ten. By the same token, their cooperation within the BRICS (Brazil, Russia, India, China and, since 2011 South Africa) resulted in the creation of the New Development Bank (NDB) – with US$100 billion in capital – and the Contingent Reserve Agreement (CRA) – also with US$100 billion in capital – at the BRICS Summit of Fortaleza, Brazil, in 2014. Additionally, PRC invited Brazil to be one of the founding members of the Asian Infrastructure Investment Bank (AIIB) (Moschella & Weaver, 2014).

Concerning the Chinese FS and the RMBI, has to do with the world's foreign exchange (FX) reserves. For instance, as Brazil's economic and financial relations with China deepen, the question of whether or not to include the “people´s money” in the Brazilian portfolio arises; especially since the *RMB-nisation* is a state policy and Brazil´s international reserves are among the top ten worldwide. According to IMF`s proposed measure – the ratio of reserves to short-term debt (ST debt), also known as the “Greenspan-Guidotti” rule –, the Brazilian State has FX reserves in excess from a precautionary point of view, covering more than 370 per cent of its ST debt, when 100 per cent is the prescribed ratio.

Against this backdrop, in cases like Brazil's, whose central bank holds amounts of international reserves well above its ST Debt, a scenario of diversification is not far-fetched. In fact, in 2009, the Brazilian Central Bank (BCB) began a policy of currency diversification. Between 2012 and 2017, it re-established the outsourcing of the management of part of the international reserves with the stated goal of diversifying investments[80], and in 2015 the BCB decreased or liquidated holdings of other currencies, such as the Swedish krona and the Danish krone. In terms of portfolio, as of December 2017, the currency allocation of the reserves was: 82.3% in

80 At the end of 2015, the total sum managed by third parties was US$ 5.86 billion or 1.6% of the international reserves (DERIS-BCB, 2016).

USD dollars, 5.0% in euros, 4.5% in Canadian dollar, 2.9% in Australian dollar, 2.8% in sterling pound, 1.8% in Japanese yen and 0.8% in gold (DERIS-BCB, 2018). Under these conditions, Brazil's international reserves represent an enticing target to the Chinese FS in the context of the RMBI efforts.

Furthermore, under the current political circumstances in Brazil, it is relevant to test whether political factors at the international and domestic levels impact significantly the transformation of external economic stimuli into diplomatic dividend (Blanchard & Ripsman, 2013, p. 3). President Jair Bolsonaro, elected in 2018, has a history of anti-China rhetoric[81], as well as his alignment with the Trump administration, which, incidentally, is in the midst of a large trade war against the PRC. On the one hand, granted, there is an authoritarian communist state, but with capital in excess and ambitious foreign policy goals. On the other, indeed, there is a far-right populist Brazilian government, but in dire need of capital, struggling to get out of an economic morass and economically enmeshed with its ideological archenemy. This setting to the scenario described by Drezner (2009): "[i]f the target state is in such desperate straits that no other actor is willing to bear the risk of extending credit, then financial statecraft can be a powerful form of leverage" (Drezner, 2009, p. 18)[82].

Brazil's Threat to Strategic Interests (TSI)

Drawing on the scenario laid out in the preceding section, we analyse the international political dimension, in accordance to Blanchard and Ripsman's argument that "economic statecraft should vary depending on the degree of threat to target state strategic interests (TSI) associated with the economic influence attempt" (Blanchard & Ripsman, 2013, p. 25). At each component, we first apply the scholars *political theory of economic statecraft* to Bolsonaro's case. Then, given Lula's contrasting ideology, improving domestic economy, and propitious international environment, we also test the model to his first mandate (Lula-1).

[81] Lapper, R. (2019, April 23). Bolsonaro Took Aim at China. Then Reality Struck. *Americas Quartely.* Retrieved May 5, 2019, from https://www.americasquarterly.org/content/china-brazil-trade

[82] By no means Brazil is or would be "in such desperate straits that…", given its large currency reserves. However, it needs to boost investments to fully recover from one of its most grave economy crisis, chiefly in infrastructure, while the government is undergoing a severe fiscal imbalance.

Guiding questions for TSI-C
1 Would compliance with the sender's demands affect the target state's sovereignty, independence, or territorial integrity? If so, to what extent?
2 Would compliance with the sender's demands undermine the target state's ability to secure itself from a geostrategic threat or create new threats? If so, to what extent?
3 Would compliance with the sender's demands damage the target state's reputation with allies or its standing internationally? If so, to what extent?
If the answer to any of these questions is affirmative, then three subsequent questions are addressed to determine the seriousness of the threat.
4 Does the target state face any existential security threats?
5 Is it embroiled in an enduring rivalry?
6 Does the state have a reputation that needs repair or vigorous defense?

Concerning the first set of *guiding questions* for TSI-C, in case the Brazilian government acquiesces to our hypothetical demand by China of including the RMB in the foreign exchange reserves, we do not see any meaningful impact on Brazil's sovereignty, independence, let alone territorial integrity. In terms of the state's ability to protect itself against geostrategic threat or the creation of new ones, given the size of Brazil's currency reserves, the inclusion of RMB would not hinder Brazil's ability to counter, for instance, capital flights, neither it would create any new threat, *ceteris paribus*. However, due to Bolsonaro's proximity to Trump and the US trade war against the originator state (i.e. the PRC), we do identify potential damage to Brazil's reputation in relation to the American government. As the answer to one of the questions was affirmative (the latter), we address the remaining three questions.

One of Brazil's main advantages in international politics is that it does not face existential security threats. LAC countries, for example, are barred from development nuclear weapons due to the Treaty of Tlatelolco, which came into full force in 2002, when Cuba ratified it[83]. Additionally, the Brazilian state does not have any more meaningful territorial disputes (Alsina Jr., 2014). In terms of enduring rivalries, the

[83] Treaty for the Prohibition of Nuclear Weapons in Latin America and the Caribbean (LANWFZ) (Tlatelolco Treaty). Retrieved from https://www.nti.org/learn/treaties-and-regimes/treaty-prohibition-nuclear-weapons-latin-america-and-caribbean-lanwfz-tlatelolco-treaty/.

answer would be affirmative during the first half of the 20th century, when Argentine and Brazil did, indeed, engage in a long-lasting rivalry. However, since then both countries have been closely cooperating with each other, especially after the establishment of the Mercosur. The response to the last question, relating to the target's need to repair or vigorous defend its reputation, is more ambiguous. Anyhow, an affirmative answer is appropriate, provided that the current Brazilian administration might not see any need to repair its reputation, but it does see the necessity to vigorous defend it, given the role played by nationalism in Bolsonaro's political platform.

Guiding questions for TSI-N

1 Would non-compliance with the sender's demands lead to compound political or military sanctions from the sender and its allies that would threaten the target state's sovereignty, independence, territorial integrity, or national security?

2 Would non-compliance with the sender's demands serve to alienate other states or international institutions and, therefore, lead to diplomatic isolation?

3 Would non-compliance with sender preferences damage the prestige or reputation of the target?

4 Does non-compliance interfere with the target's ability to achieve other important military or political goals?

If the answer to any of these questions is affirmative, then three sub- sequent questions are addressed to determine the seriousness of the threat.

5 Does the target state face any existential security threats?

6 Is it embroiled in an enduring rivalry?

7 Does the state have a reputation that needs repair or vigorous defense?

In relation to the second set of *guiding questions*, for TSI-N, there are no evidences that Brazilian government's rebuff to Chinese demands would lead to threats against sovereignty, independence, etc., even more so in view of Trump's animosity towards China and his proximity to Bolsonaro's regime. Regarding the second question, given the Sino-Brazilian *de jure* integration, there is, indeed, a risk of diplomatic isolation in some of the various multilateral initiatives both states have in common, as examined in the first part of this section. The PRC could alienate Brazil from the China-CELAC Forum, suspend – as it has already done – or divert economic efforts to other countries or regional cooperation initiatives, such as the

Pacific Alliance, comprised of Chile, Colombia, Mexico and Peru, whose explicit goal is forging close relations with the Asia-Pacific region. Therefore, an affirmative response to this question is warranted.

The answer to the third question is more straight forward and negative. As it happens in many other nations, China's public image as an authoritarian communist state would help – at least not worsen – the Brazilian international stance in case of non-compliance. Our affirmative response to the fourth question resides on the fact that, given the Sino-Brazilian *de jure* integration of the last decades, rejecting China's offers could make some of Brazil's foreign policy objectives more challenging. For example, one could argue that without the Chinese support, the selection of the Brazilian diplomat Roberto Azevêdo to the helm of the WTO would have been more difficult. Since there are affirmative answers, in accordance to Blanchard and Ripsman model, we should respond to the subsequent questions, but as they are equal to the last three of the preceding questionnaire, answers remain the same.

In summary, given that under TSI-N there are more affirmative responses than under TSI-C, TSI-N is *high,* whereas TSI-C is moderate. Consequently, the differential (TSI-N – TSI-C) is +1, which means that the perceived costs of non-compliance to Chinese demands in a context of FS are higher than those of compliance.

Moving on to Lula-1, as remarked above, the international panorama at the time was much more benign than the one inherited by President Bolsonaro. Therefore, in relation to the first set of *guiding questions* for assessing TSI-C, should the Brazil include the RMB in its currency reserves, as expected, we do not see any meaningful impact on Brazil's sovereignty, independence, nor territorial integrity. Moreover, the state's ability to protect itself against geostrategic threat or the creation of new ones, given the rapidly improving situation of the Balance of Payments – 12.9% average export growth rate and current account surpluses – and the payment of the IMF debt, the inclusion of RMB would not have impaired Brazil's capacity to deal, for instance, with capital flights, neither it would have created any ensuing threat, *ceteris paribus*. Furthermore, as a consequence of Lula growing popularity and international goodwill from his social policies, there was hardly any potential harm to Brazil's reputation (Love & Baer, 2009, pp. 116–133). As the answer to none of the questions was affirmative, we do not address the remaining three questions.

Regarding the second set of *guiding questions* (TSI-N), there are also no evidences that Brazilian government's refusal of Chinese demands would engender threats against sovereignty, independence, and territorial integrity. Nevertheless, concerning the second question, at the time of Lula's first mandate, the Sino-Brazilian cooperation was gaining momentum, although not comparable to the current situation. It follows that there was no meaningful risk of diplomatic isolation or otherwise. Consequently, a negative response to this question is appropriated.

Furthermore, regarding the third question, the response is plainly negative for reasons similar to those provided for Bolsonaro's government. China, in fact, was far less known globally during President Lula's first term than presently. Jim O'Neill's famous paper heralding the BRICs acronym had been published not long ago – on the 30th November 2001[84]. It is thus reasonable to assume that Brazil's international stance would not be blemished should it rebuke China's *quid pro quo*. The answer to the fourth question is also negative for the same reason as the previous question: in short, the PRC had not yet accomplished its economic encirclement of the Brazilian market. Since there are no affirmative answers in this set of questions, the remaining ones are ignored. Hence, TSI-C and TSI-N are low (1) in the case of Lula-1. It follows that there is no differential (TSI-N – TSI-C = 0) between both scenarios, i.e. the perceived costs of non-compliance and compliance to Chinese demands in a context of FS are roughly equivalent.

Table 1 Braziliian TSI - Lula-1 *versus* Bolsonaro

Presidency	*TSI-N*	*TSI-C*	*(TSI-N) - (TSI-C)*	*TSI*
Bolsonaro	High (3)	Moderate (2)	+ 1	Positive low
Lula-1	Low (1)	Low (1)	0	Neutral

Brazil's *stateness*

To approach the domestic dimension, we evaluate Brazil's national institutions, the interplay between government branches, economic situation, among other aspects, that would buttress a state in instances of power politics. Should Bolsonaro's government comply with Chinese demands, in addition to economic

[84] Available at https://www.goldmansachs.com/insights/archive/archive-pdfs/build-better-brics.pdf

incentives or costs, there would be political repercussions, internally and externally. In this setting, we apply Blanchard and Ripsman *guiding questionnaire* to assess how likely a successful outcome would be, should Chinese authorities deploy FS measures to compel Brazilian statesmen to change its foreign exchange reserve policy to accommodate RMB in its holdings.

Guiding questions for legitimacy	***Guiding questions for autonomy***
1 Is there systematic or large scale violent dissent, such as violent protests or assassination attempts?	1 Is there separation or concentration of power? (i.e., Does the executive/ leader dominate or does the legislature, the military, or some other actor act as a veto player over foreign policy?)
2 Is there unusually large emigration?	2 Is the executive a unitary actor, or is it a coalition of parties, societal forces, or interest groups?
3 Does the state rely on systematic repression?	3 Do different parties/factions control different institutions of government?
4 Are there public opinion indicators (from public opinion polls or the press) that a significant segment of the population views the regime as illegitimate?	4 In democratic systems, does the government command the support of a strong majority in the legislature?
5 Are there public opinion indicators (from public opinion polls or the press) that a significant segment of the population views the government/leader as illegitimate?	5 Do existing political procedures facilitate autonomous action by the executive/leader? (i.e., Is there party discipline? Do key actors routinely defer to the executive/leader in foreign affairs?)
6 Does a region or a segment of the population express the desire to declare independence from the regime?	6 What are prevailing norms on the conduct of foreign policy? Do they encourage executive/leader independence in foreign affairs, or executive/leader restraint?

In relation to the Brazilian state's *autonomy*, as declared on article 2 of the Brazilian Constitution[85], the Legislative, the Executive, and the Judiciary are independent powers of the Brazilian Union. Therefore, there is separation of powers and available checks and balances mechanisms between the three government branches. Owing to Brazil's political system, which requires large party coalitions to

[85] Constitution of the Federative Republic of Brazil: Constitutional text of October 5, 1988. Available at: https://wipolex.wipo.int/fr/text/218270.

form majorities, different parties control different institutions of government but ny and large public employees are hired through public exams. Concerning the governments command over a strong majority in the legislature, although we give an affirmative response to the 4th question, this aspect is not straight forward, as Bolsonaro's administration did suffer some defeats in Congress. However, it has been able to pass important reforms, such as the Pension Fund reform, which warrant *supermajorities* – 2/3 of all the votes in both Houses of Parliament. Moreover, the responses to both questions 5 and 6 are "yes" and for the following reasons: party regiments and legislation tend to punish party indiscipline; the existence of the *Instituto Rio Branco,* a public think tank and school for diplomats controlled by the Ministry of Foreign; and the constitutional powers assigned to President of the Republic in foreign affairs, among which are, according to article 84 of the Constitution, "maintain relations with foreign States", "conclude international treaties, conventions and acts, ad referendum of the National Congress". All in all, in terms of *autonomy*, we gauge Brazilian government's autonomy as *high*.

As far as the *economic capacity* is concerned, in 2010, Brazil had the second highest tax revenues as percentage of GDP in the LAC region and higher than many OECD countries[86]. Additionally, the Brazilian state has sizeable non-tax revenues, such as from its shares in public companies, e.g. *Petrobras, Banco do Brasil* and *Caixa Econômica Federal* – a oil giant and two large public commercial banks. As described by Cheibub, "They [presidential democracies] range from cases such as the United States, where presidents are institutionally weak, to those of Brazil and Chile, where the president can issue decree-laws, has exclusive power to propose the budget, and may set the pace with which bills go through the legislature" (Love & Baer, 2009). Nevertheless, it has also relevant budget rigidities, such as high mandatory expenditure, which means that more than 80 per cent of federal spending cannot be modified without new legislation. Moreover, in terms of financial assets, under which the authors include currency and gold reserves as well as natural resource endowments, Brazil still has one the ten highest FX reserves, it is one of the

[86] For more information on *Revenue Statistics in Latin America* and the LAC Fiscal Initiative, access www.latameconomy.org/en/fiscal-policy/revenue-statistics and www.oecd.org/tax/lacfiscal.

ten largest oil producers[87], and the world's second largest exporter of iron ore, manganese, and bauxite[88].

In sum, the Brazilian state has a large fiscal base, but low surplus tax capacity coupled with mounting budget deficits. Regarding its external financial sources, although an international net creditor due to rising FX reserves, it has lost its investment grade, its gross public debt is high, at over 75% per cent, in a context of fragile economy. Under such conditions, it is reasonable to conclude that currently the Brazilian government has limited borrowing capacity, internally and externally. Notwithstanding Brazil's weak fiscal position, its large FX reserves lead us to evaluate the Brazilian economic capacity as *low-to-moderate*, instead of *low.* In relation to the remaining two questions, due to the President's powers in tax issues, we consider that the Brazilian government has some policy instruments and networks to employ as coercion, co-optation, and countermeasures. Recently, Jair Bolsonaro signed a decree that lifted the mandatory publication of public traded companies' financial statements in newspapers, taking an important revenue source from them, which was considered as a countermeasure against the media's coverage of the government[89]. All in all, we judge Brazil's current *economic capacity* as *low-to-moderate*.

[87] U.S. Energy Information Administration. (2019, April 18). *Country Analysis Executive Summary: Brazil*. Retrieved May 10, 2019, from https://www.eia.gov/beta/international/analysis.php?iso=BRA.

[88] Austmine Limited. (2015, July 2015). *Articles & Editorials*. Retrieved May 10, 2019, from http://www.austmine.com.au/News/brazil-iron-ore-industry-overview.

[89] Valor. (2019, August 07). Bolsonaro issues measure that affects print. *Valor International.* Retrieved August 07, 2019, from https://www.valor.com.br/international/news/6380523/bolsonaro-issues-measure-affects-print-media.

Guiding questions for economic capacity	Guiding questions for coercive capacity
1 How much money does the government have at its disposal? (What is its national budget? Its tax haul?)	1 What is the size of the police relative to the population/territory of the state?
2 What is its surplus tax capacity?	2 How large is the utilizable military capacity (not necessary for other purposes) relative to the population/territory of the state?
3 What other domestic non-tax resources does it have access to?	3 To what degree does the intelligence apparatus penetrate society?
4 Can the government tap international capital markets or lending institutions? What is its debt rating? Does it have access to foreign aid?	
5 Does the government have access to policy instruments and networks that can facilitate coercion, co-optation, and countermeasures?	
6 How concentrated is economic policymaking within the bureaucracy?	

As far as *coercive capacity* is concerned, Brazil has over 335 thousand active military personnel, which makes it the 16th largest army worldwide[90], despite having the 6th largest population. However, we argue that the Brazilian state has moderate levels of this component mainly because of the frequent employment of the Army in the national territory for public safety operations[91] and the existence of the *Força Nacional de Segurança Público* (FNSP), comprised of highly trained and equipped personnel readily available to deal with 'threats to public order"[92]. Albeit its deployment requires formal request by the respective governor and authorization by

[90] *International Institute for Strategic Studies (14 February 2018). The Military Balance 2018. London: Routledge. ISBN 9781857439557.*

[91] Londoño, E., & Darlington, S. (2018, February 16). Brazil's Military Is Put in Charge of Security in Rio de Janeiro. *The New York Times.* Retrieved from https://www.nytimes.com/2018/02/16/world/americas/brazil-rio-military-security.html

[92] For strategic and safety reasons, the Brazilian government does not disclose the quantity of troops readily available to the FNSP.

the Minister of Justice[93], the latter's decision is discretionary, which suggests the potential for political calculus. Furthermore, regarding police force, in Brazil only the Federal Police serves under the Union and disposes of 15 thousand members, whereas the Military Police, which is not related to the Army, have over 400 thousand active members and the Civil Police over 120 thousand, but are under the states control[94]. Under these circumstances, despite the strict constitutional limits on the state's power to spy on its citizens and to arrest without court-approved warrants, the Brazilian government does have *moderate-to-high coercive capacity*[95], mostly due to the frequent use of the Army domestically and the existence of the FNSP. Consequently, Brazil's *overall state capacity* is *moderate* (1)[96].

In terms of *legitimacy*, "the degree to which society, as a whole, respects the authority of the regime and its right to govern" (Blanchard & Ripsman, 2013, p. 159), political legitimacy in Brazil resides on the democratic procedure that selects its leaders. It follows that, although President Bolsonaro's approving rate is at 35 per cent at the time of this writing, his legitimacy remains significant, especially while his government is capable of passing important reforms in Congress. Indeed, there have been mass protests against Bolsonaro's rule, but they have not been "systematic violent dissent" (Blanchard & Ripsman, 2013, pp. 159–160). Under these circumstances, none of the responses to the first three questions relating to legitimacy were affirmative. Incidentally, there is also no unusually large emigration flow. Nevertheless, the 4th and 5th answers are positive, as recent polls pointed out that 6 in 10 people are unsatisfied with Brazil's democracy[97] and around 1 in 3 Brazilians judge the current government as "bad or awful"[98]. Finally, given that there

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[93] MJSP. (n.d.). Saiba mais sobre a atuação da Força Nacional de Segurança Pública. Retrieved May 10, 2019, from https://www.justica.gov.br/news/collective-nitf-content-1546630482.88.

[94] ISSAT. (2015, February 2). Executive Summary. *Brazil Country Profile.* Retrieved May 10, 2019, from https://issat.dcaf.ch/Learn/Resource-Library2/Country-Profiles/Brazil-Country-Profile

[95] "*Moderate* coercive capacity refers to states which possess surplus coercive capacity, but are limited to some extent by manpower shortages, competing demands on these forces, or restrictions on their use of internal security forces" https://issat.dcaf.ch/Learn/Resource-Library2/Country-Profiles/Brazil-Country-Profile (Blanchard & Ripsman, 2013, p. 158).

[96] **Economic capacity** = 0.5 (low-to-moderate) / Coercive capacity = 1.5 (high-to-moderate). **Overall state capacity** = [0.5+(2*1.5)]/3 = 1.25.

[97] Faria, Flávia. (2019, June 4). 6 in 10 People Unsatisfied with State Democracy in Brazil. *Folha de S. Paulo.* Retrieved June 5, 2019, from https://www1.folha.uol.com.br/internacional/en/brazil/2019/06/6-in-10-people-unsatisfied-with-state-of-democracy-in-brazil.shtml.

[98] Leme, Luisa. (2019, April 10). *Approval Tracker: Brazil's President Jair Bolsonaro.* Retrieved April 20, 2019, from https://www.as-coa.org/articles/approval-tracker-brazils-president-jair-bolsonaro.

is no credible and relevant separatist movement, the 6th response is negative. All in all, therefore, the current Brazilian government has *moderate legitimacy.*

Turning to Lula-1, as far as the *legitimacy* component is concerned, unlike Bolsonaro's, Lula's initial popularity did not last owing to political scandals, but as soon as the economy picked up pace, his personal rejection (*untrustworthiness*) was in decline and his approval ratings an upward trend[99]. Moreover, there were also no credible region or segment of the population manifesting separatist demands. Therefore, these conditions lead us to evaluate Lula-1 *legitimacy* as *moderate-to-high* (1.5).

In terms of *autonomy*, given that most of the relevant factors are institutional and bound by the Constitution, the only contrast in the responses to the guiding questionnaire refers to the fourth question. The Lula government did not "command the support of a strong majority in the legislature", although it was able to constitute *ad doc majorities* with *pork barrel politics*, as it had ample fiscal leeway to do so. Based upon these reasons, we consider *autonomy* during Lula-1 as *moderate-to-high* (2).

During Lula's first presidential mandate (Lula-1), the economy was picking up steam and the commodity boom was brewing; consequently, tax revenues were on the rise. In this context, *economic capacity* accounts for the main difference between both cases. Although FDI were in decline in the wake of the privatization program of FHC´s (1994-2002), the high interest rates and large trade surplus – mainly due to the international commodities boom – kept large inflows of foreign exchange. As a result, currency reserves rose steadily from US$37.8 billion in 2002 to US$85.8 billion in 2006. This enabled the Lula government to pay off its entire debt to the IMF. Moreover, Lula-1 kept high surplus tax capacity, since it managed to maintain increasingly larger primary budget surpluses throughout its first term. The administration was also able to increase tax burden and, thusly, revenues (Love & Baer, 2009, pp. 49–65). In view of these considerations, it is adequate to evaluate Lula-1 *economic* capacity as *high* (2).

[99] Lula's approval ratings were on average 34 percent in the first-half, but 48 per cent in the second-half of his first mandate. Disapproval ratings, conversely, were on average 40 percent in the first two years, but fell to 31 per cent in the last two years.

Furthermore, regarding *coercive capacity*, it was during Lula's first term that the National Public Security Force (FNSP) was created (2004). As a matter of fact, as remarked by Bertazzo (2012):

> … security and defence policies introduced by President Lula da Silva confirmed the trend of increasingly turning to the armed forces when police capacity was overwhelmed or largely absent (as was repeatedly the case when state police forces went on strike). Six months before the end of his term, President Lula da Silva extended the power of arrest to members of all armed forces acting in a police capacity. (Bertazzo, 2012, p. 814)

It follows that we judge Brazil's *coercive capacity* in the period was *moderate-to-high* (1.5). As a result, aggregating both capacities, Brazilian government's *overall state capacity* under Lula-1 was *high* (2)[100].

Table 2 Braziliian overall state capacity

Presidency	*Economic*	*Coercive*	*Total*
Bolsonaro	Low-to-moderate (0.5)	Moderate-to-high (1.5)	Moderate (1)
Lula-1	High (2)	Moderate-to-high (1.5)	High (2)

Table 3 Braziliian Stateness

Presidency	*Autonomy*	*Capacity*	*Legitimacy*	*Overall stateness*
Bolsonaro	High (2)	Moderate (1)	Moderate (1)	High (4)
Lula-1	Moderate-to-high (1.5)	High (2)	Moderate-to-high (1.5)	Very high

[100] Economic capacity = 2 (high) / Coercive capacity = 1.5 (moderate-to-high) / Overall state capacity = [1.5+(2*2)]/3 = 1.83 (~2).

CONCLUSION

In this research, we strived to show that states increasingly exert power politics by economic means, notably financial ones. In a context in which virtually all states rely on international flows of capital, goods, services, and people, instead of armies, rising powers – above all China – are stockpiling economic and financial power to protect and advance their strategic interests; instead of dropping bombs, they are offering contracts and capital. Consequently, the Chinese state has excelled at the 21st century geopolitical game without deploying soldiers.

Moreover, after experimenting to global financial crises in a relative short period – the AFC and the GFC –, emerging powers began realizing that the Western-led international financial architecture was not representative of the distribution of power and, in fact, it was designed in such a way that translated in the “dollar trap”. However, as the Chinese currency reserves reached almost US$4 trillion in 2014, PRC’s modern mandarins realized that it would have to act unilaterally to change the status quo. To this end, they launched the Renminbi Internationalization Initiative to gradually scape the “dollar trap”.

Against this backdrop, the Brazilian case stands out in Latin America due to the multidimensional character of its financial relations with the Asian behemoth. Since the GFC, China’s global political and economic influence has intensified and in a wide variety of domains, which is reflected in its relationship with Brazil. Except for Venezuela, Brazil is Latin America’s main destination of Chinese FDI, financial cooperation and loans. Both countries have cooperated to the rise of the G-20 in the context of global financial and monetary governance. Additionally, the BRICS group has spawned two relevant financial initiatives in recent years, the CRA and the NDB.

Under these circumstances, by applying Blanchard and Ripsman’s political theory of economic statecraft we provided and discussed evidences that the Sino-Brazilian relations represent an eloquent example of asymmetric interdependence and, thusly, that Brazil is an enticing target for China’s Financial Statecraft. In doing so, we demonstrated that the Chinese FS towards Brazil is likely to be effective.

Brazil has scarcity of investment capital; China has abundance of capital. China is Brazil’s main trading partner and main source of trade income; Brazil is not even among China’s 15 major trading partners. The Brazilian construction sector is in tatters due to corruption scandals and economic recession; the Chinese construction sector has excess capacity and expertise. China wants to internationalize its currency, but the demand side is still weak; and Brazil has US$375 billion FX reserves, well above its needs.

Based on Blanchard and Ripsman's model, we suggested that the Brazil has *low* degree of perceived strategic threats regardless of whether it complies or not. The same is true on terms of *stateness*. Therefore, despite potential negative political fallout domestically, the Brazilian state could comply to China's FS initiatives, take advantage from the Chinese struggle for more political influence and obtain the long-term capital it needs to invest in infrastructure and fully recover from one of its worst economic and political crises. All in all, Brazilian authorities should be aware of Chinese bargaining power and contrast it with Brazil's needs and, instead of antagonizing, it ought to be pragmatic and toil to maximise potential benefits that might come from future Chinese FS policies towards it.

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