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External and internal factors of international reserve management in China

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Abstract. This study focuses on the management of international reserves in China, one of the global leaders in reserve volumes. China actively employs its reserves not only to mitigate the adverse effects of external shocks on its balance of payments, exchange rate, and overall economy, as is customary in global practices, but also to stimulate socio-economic development, expand access to external markets and advanced technologies, and enhance the position of the Chinese economy within the global economic system. The study aims to analyze the mechanism of international reserve utilization in China and identify key factors shaping this mechanism over the past 15 years. The results indicate that China's international reserves are intrinsically linked to its export-oriented economy. Key influencing factors include fluctuations in export growth, shifts in external demand, the implementation of the "dual circulation" strategy since the early 2010s, and the recently introduced "socialist modernization" strategy. The implementation of this strategy encountered a number of challenges discussed in the study, therefore export still plays a decisive role in building international reserves and ensuring the growth of the Chinese economy. Faced with declining external demand and slower export growth, China introduced the "dual circulation" concept to partially rely on domestic demand. However, challenges in its implementation have kept exports central to the accumulation of reserves and economic growth. Amid escalating global challenges and sanctions pressure, China has intensified efforts to improve economic efficiency, culminating in the introduction of the "socialist modernization" strategy in 2023. Based on an analysis of these factors and the decisions of the Third Plenary Session of the 20th Central Committee of the Communist Party of China, this study evaluates China's medium-term strategies for managing international reserves.

Keywords: economic growth, economic development strategy, export, dual circulation, world economic crisis, domestic and foreign demand

Authors' contribution. Andronova I.V. — research concept and design; Jiang W. — data collection, data analysis, text writing. All authors have read and agreed to the published version of the manuscript.

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Внешние и внутренние факторы управления международными резервами в Китае

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Аннотация. Рассмотрены вопросы управления международными резервами в Китае (КНР). Китай относится к числу мировых лидеров по объему резервов и активно использует их не только для нейтрализации негативного влияния внешних шоков на платежный баланс, валютный курс и экономику в целом, как это принято в мировой практике. Китай применяет международные резервы в механизме стимулирования собственного социально-экономического развития, а также в качестве инструмента расширения доступа к внешним рынкам и технологиям, укрепления позиций китайской экономики в мировой экономической системе. Цель исследования — общее описание механизма использования международных резервов в Китае и выявление основных факторов, оказывающих на этот механизм влияние в последние полтора десятилетия. Показано, что формирование и использование международных резервов Китая непосредственно связано с экспортной ориентацией экономики КНР. Поэтому к основным факторам, влиявшим на управление международными резервами Китая, относятся динамика экспорта, изменение внешнего спроса, степень успешности реализации Китаем стратегии «двойной циркуляции» с начала 2010-х гг., а также стратегия «социалистической модернизации», выдвинутая в последнее время. Китай до 2010-х гг. имел экспортную ориентацию экономики, однако в связи с сокращением внешнего спроса и замедлением динамики экспорта, с начала 2010-х попытался изменить стратегию экономического развития, выдвинув концепцию «двойной циркуляции», частичной опоры в своем развитии на внутренний, а не только внешний спрос. Реализация этой стратегии шла с рядом сложностей, рассматриваемых в исследовании, поэтому экспорт по-прежнему играет определяющее значение в формировании международных резервов и обеспечении роста китайской экономики. При этом нарастающие проблемы в мировой экономике, санкционное давление заставляют Китай искать пути повышения эффективности собственной экономики для чего с 2023 г. выдвинута новая стратеги «социалистической модернизации». С учетом анализа влияния этих факторов и логики решений XX Пленума ЦК КПК дана оценка подходов Китая к управлению международными резервами в среднесрочной перспективе.

Ключевые слова: экономический рост, стратегия экономического развития, экспорт, двойная циркуляция, кризисные явления в мировой экономике, внутренний и внешний спрос

Вклад авторов. Андронова И.В. — концепция и дизайн исследования; Цзянь В. — концепция и дизайн исследования, сбор и анализ данных, написание статьи. Все авторы одобрили окончательную версию статьи.

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Introduction

In global practice, the accumulation of international reserves, as guided by the standards of the International Monetary Fund (IMF), primarily serves to mitigate the effects of external shocks on national economies. This is achieved through exchange rate adjustments and addressing disparities in the balance of payments. Specifically, international reserves are predominantly utilized for currency interventions and the servicing of external debt liabilities.

In China, the scope of reserve functions is conceptualized more broadly. International reserves are actively utilized as an instrument to promote socio-economic development, including funding domestic economic initiatives, sterilizing monetary expansion associated with reserve accumulation, and providing financial resources for overseas projects.

Moreover, the dynamics of China's international reserves are closely linked to export performance, as the trade surplus serves as the primary driver of reserve accumulation. Consequently, the volume and growth rate of reserves are directly influenced by export trends, which, in turn, function as a key determinant of China's overall economic growth trajectory.

The global economic challenges that emerged after the 2008–2009 financial crisis, coupled with the decline in external demand, compelled China to pivot away from its heavily export-dependent development strategy in the early 2010s.

This shift was marked by the introduction of the "dual circulation" strategy, which emphasizes a partial reliance on domestic demand. The successful execution of this strategy would inevitably reshape the role of international reserves in China's socio-economic development mechanisms due to reduced reliance on export growth.

Nevertheless, this transition has been fraught with numerous challenges. Although export growth has decelerated under the pressures of evolving global economic conditions, it continues to serve as a critical driver of China's economic expansion. As such, international reserves remain vital to China's economic development in the medium term, even as their utilization priorities are expected to shift in accordance with the decisions of the Third Plenary Session of the 20th Central Committee of the Communist Party of China (CPC), which focused on advancing economic modernization reforms.

In light of this, the topics discussed in this article — including the role of international reserves in China's economic development, the factors behind the official shift in China's economic strategy, the barriers to transitioning toward a domestic demand-driven economy, and the challenges propelling China toward "socialist modernization" in the medium term — are of significant relevance.

Materials and methods

China is recognized as one of the global leaders in international reserves. Over the past 25 years, the volume of China's reserves has experienced consistent growth, increasing from USD 30 million in early 1990 to USD 3.3 trillion by October 2024[1]. According to standard international practices and the IMF's reserve adequacy framework (International Monetary Fund, 2014; Alekasir et al., 2019), China's international reserves are currently deemed excessive. However, these standard adequacy assessments are premised on the assumption that the primary function of international reserves is to mitigate adverse impacts of external economic shocks, particularly those reflected in exchange rate instability and balance of payments discrepancies.

China conceptualizes the functions of international reserves within a significantly broader framework, actively leveraging them to stimulate domestic economic growth, finance external initiatives such as the "Belt and Road Initiative" (BRI) and a "Community with a Shared Future for Mankind" and enhance access to foreign markets and critical technologies (Misztal, 2021; Yu, 2022; Zhang, 2021). Therefore, unlike many other countries, for China, the accumulation of international reserves does not equate to withdrawing a portion of export revenues from economic circulation and locking it in financial assets, predominantly within the financial systems of advanced economies. On the contrary, it functions as a catalyst for driving China's own socio-economic development.

The dynamics of China's international reserves, alongside their application potential in stimulating domestic economic development and financing external projects, are intricately linked to China's economic development strategy. Until the 2010s, China's growth was predominantly driven by external demand. However, in response to long-term challenges in the global economy, China sought to adopt a growth strategy with an increased emphasis on domestic demand.

The successful implementation of this strategy would have diminished the role of exports and international reserves in driving China's development. However, due to several factors, the full implementation of this approach was not achieved (Arapova, Duggan, 2020; Ostrovskii, 2022; Xu, 2023).

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[1] Data and Statistics. State Administration of Foreign Exchange. Retrieved October 10, 2024 from: http://www.safe.gov.cn/en/DataandStatistics/index.html?COLLCC=2262376994& 4

These factors, along with the key influences on the management of China's international reserves, are subsequently examined in this article. The analysis culminates in an evaluation of the current state and medium-term prospects for China's reserve management, with consideration of recent CPC Central Committee decisions on reforms and socialist modernization.

Results and Discussion

China, through the People's Bank of China, purchases foreign currencies and channels them either via sovereign wealth funds into domestic investments — such as funding the capital of state-owned development banks, which focus on driving growth in China's real economy sectors — or, as aligned with international norms (Brandt et al., 2020), into foreign assets. However, these investments are less focused on traditional financial instruments, such as government bonds of developed countries, and instead prioritize targeted sectoral and equity investments. These investments are directed toward countries and industries that support the expansion of Chinese exports or facilitate access to advanced technologies critical for China's innovation-driven growth.

Thus, in the asset structure of China's largest sovereign wealth fund, the China Investment Corporation (CIC), which managed approximately one-third of China's international reserves in 2023, domestic investments in the capital of Chinese financial institutions constituted 37 to 49% between 2018 and 2022. Most of these institutions are state-owned development banks.

Around 40 to 50% of CIC's foreign assets were classified as "alternative instruments," including sector-specific overseas investments made through direct equity participation, hedge funds, or related credit arrangements. These investments were strategically aimed at either consolidating China's positions in key export markets or broadening access to critical technologies essential for its development. The remaining 29 to 39% of foreign financial assets comprised equity investments in companies, which were not primarily intended for income generation but pursued the same strategic objectives as the "alternative instruments"[2].

In addition, renminbi (RMB) issuance associated with foreign currency purchases by the People's Bank of China has been directed toward strengthening banks' resource bases. Through bank lending and other financial channels, these funds have predominantly financed investments in domestic economic development. Given that this development had been largely export-driven until recently, such issuance was ultimately channeled into expanding export-oriented production rather than speculative trading or domestic consumption. This approach enabled China to avoid the typical negative effects associated with monetary expansion of this kind.

China adhered to an export-led economic development strategy from the 1990s until the early 2010s. However, during this period, the growth dynamics of exports, economic growth rates, and the pace of international reserve accumulation began to decelerate (fig. 1).

[2] China Investment Corporation Annual Reports. China Investment Corporation. Retrieved October 10, 2024, from http://www.china-inv.cn/chinainven/Media/Annual_Report.shtml

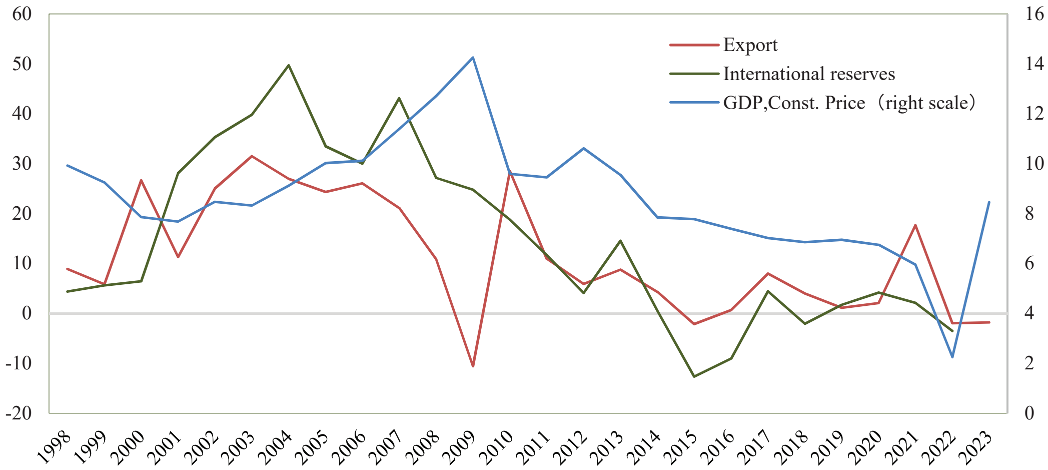

Figure 1. Growth of China's GDP at constant prices, export volume and international reserves, year-on-year, percentage

Source: composed by W. Jiang, I.V. Andronova based on World Bank. World Development Indicators. Retrieved October 10, 2024, from https://databank.worldbank.org/source/world-development-indicators#

Overall, this export-oriented development strategy allowed China to sustain rapid economic growth for many years and resolve domestic socio-economic issues, particularly by raising the standard of living of the population.

The accumulation of international reserves was instrumental in the implementation of this strategy, as it drove China's economic development and supported the advancement of its innovation ecosystem through the mechanisms discussed earlier in this article. However, after the global financial crisis of 2008–2009, the global economy entered a period of slowdown, accompanied by declining consumer demand. This led to a deceleration in China's export growth and the pace of its international reserve accumulation (fig. 2).

Since the 1980s–1990s, the global economy has operated under conditions of economic integration, transitioning to financial globalization around the early 2000s. On the one hand, this signifies that value-added is created through global value chains (GVCs) involving dozens of countries, each specializing in distinct stages of production. On the other hand, restrictions on the international flow of goods, services, and key factors of production — such as capital, labor, and technology — have been largely eliminated.

In these value chains, the generation of value-added primarily depends on final, rather than intermediate, consumption, with household final consumption playing a critical role. However, as demonstrated in Fig. 2, based on official data from the World Bank, household final consumption has been experiencing a sustained decrease.

As the author of this article suggests, this has been the central challenge facing the global economic system over the past 15 years. Without an increase in demand, there is little justification for expanding value creation, and demand contraction leads to declining returns on investments in the real economy sectors and a slowdown in economic growth rates.

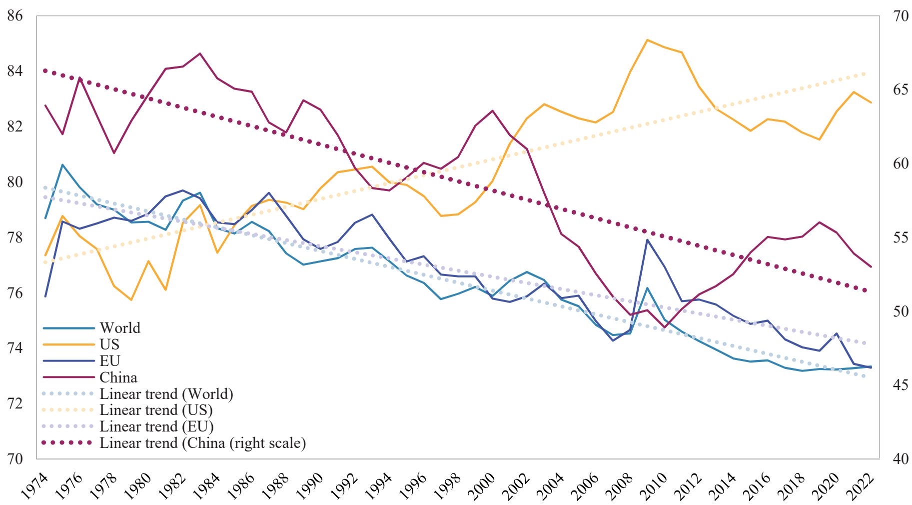

Figure 2. Final consumption of households in percentage of GDP

Source: composed by W. Jiang, I.V. Andronova based on World Bank. World Development Indicators. Retrieved October 10, 2024 from https://databank.worldbank.org/source/world-development-indicators#

This trend became particularly evident following the 2008–2009 global financial crisis. It is evidenced by the persistent slowdown in GDP growth across the global economy, including major economies such as the United States, China, and regional groups like the Group of Seven (G7) and the European Union (EU)[3]. However, the situation is more clearly demonstrated by data on the output gap, as shown in Fig. 3, rather than by growth rates alone.

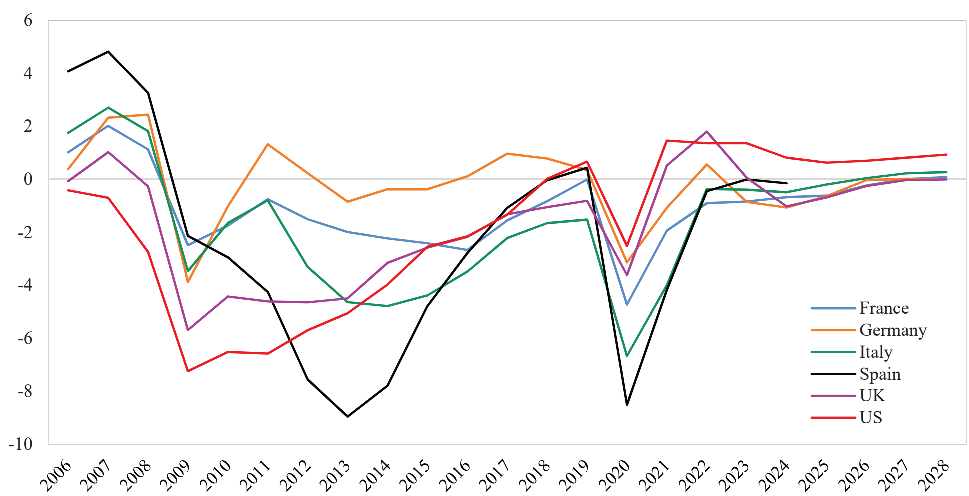

Figure 3. Output gap (the difference between actual and potential GDP), in percentage of potential GDP, IMF estimate, actual for 2006–2023, IMF forecast until 2028

Source: composed by W. Jiang, I.V. Andronova based on data from the IMF. World Economic Outlook Database, April 2024. Retrieved October 12, 2024, from https://www.imf.org/en/Publications/WEO/weo-database/2024/April

[3] Databank. World Development Indicators. The World Bank. Retrieved October 10, 2024, from https://databank.worldbank.org/source/world-development-indicators#

The negative output gap, which became prominent after 2007, reflects prolonged economic stagnation, as understood within the framework of the GDP gap concept (Barkema, Gudmundsson, Mrkaic, 2020).

It is worth noting that in mainstream economic discourse, this issue has neither been thoroughly addressed nor recognized as a symptom of the global crisis stemming from the economic-financial globalization model that has shaped capitalism over recent decades. In the past few years, global economic challenges were initially attributed to the subdued recovery of the world economy following the 2008–2009 global financial crisis.

Subsequently, significant attention was directed toward the adverse economic effects of the COVID-19-induced economic crisis during 2020–2021. More recently, the ongoing disintegration of global markets and other negative trends in the global economy have been linked to the impact of economic sanctions and countersanctions following the initiation of the Special Military Operation (SMO) in 2022 (Aiyar et al., 2023).

In other words, the negative phenomena observed in the global economy after 2007 fragmented into several distinct economic crises, which align with the logic of medium-term economic development cycles.

This approach reflects the prevailing mainstream economic thought, which is largely rooted in the principles of the new neoclassical synthesis. Within this framework, analyses primarily focus on short- and medium-term business cycles and the crises arising from them. Long-wave economic dynamics, as well as structural crises, are almost entirely neglected (Mayevsky, Kirdina-Chandler, 2022).

At the same time, some Russian scholars, notably S.Yu. Glazyev (Glazyev, 2022) and M.L. Khazin (Khazin, 2019), propose that the global economic challenges of the past 15 years represent manifestations of a global structural economic crisis. This crisis, they argue, stems from the limits to growth inherent in the economic and financial globalization model. Crises of this nature, as illustrated by the economic downturn of the early 1930s and the subsequent Great Depression, can persist for years.

One way or another, China, confronted with unfavorable external dynamics during and after the 2008–2009 crisis, recognized these changes as structurally significant and long-term. Consequently, starting in the early 2010s, it revised its economic development strategy, emphasizing a shift toward greater reliance not only on external demand but also on domestic demand. Officially, this strategic adjustment was termed the "dual circulation strategy" (Arapova, Duggan, 2020; Kulintsev, 2021; Ostrovskii, 2022; Xu, 2023).

If successfully implemented, this strategy would inevitably redefine the role of international reserves in supporting China's socio-economic development. A decline in exports — both the primary source of reserve accumulation and a mechanism for sterilizing the unintended monetary consequences of such accumulation — would result in a reduction in the volume of China's international reserves. This, in turn, would restrict the use of these reserves for the purposes outlined earlier in this article.

In practice, the implementation of this strategy faced significant challenges, primarily stemming from domestic rather than international factors. Initially, the idea of reorienting toward domestic demand received widespread support, as China boasts a vast domestic market. Moreover, over the years of reform, the living standards of a substantial portion of its population had improved considerably. Against the backdrop of shrinking external demand, this growth was perceived as a way to offset potential losses in economic growth rates.

However, some scholars argue that by maintaining high economic growth rates over an extended period and boosting factor productivity, China has approached structural growth limits. This phenomenon, often referred to in academic literature as the "middle-income trap" or "middle-growth trap", is characterized by a deceleration in economic growth rates as per capita income rises, a trend that has been observed in China since 2009[4]. This issue typically stems from three primary factors:

- The rise in incomes and living standards increases costs in export-oriented sectors, thereby reducing the price competitiveness of national exports in global markets and triggering an outflow of foreign direct investment (FDI) from export-driven industries;
- As incomes grow, the marginal propensity to consume declines, while savings propensity rises, which adversely affects domestic final demand in the economy;
- Productivity growth eventually reaches an upper threshold within the prevailing technological and industrial paradigm. Using the terminology of S. Yu. Glazyev (Glazyev, 2022), this results in a slowdown in both productivity growth and total factor productivity (TFP) across the economy as a whole (Orekhovsky, 2020).

All three groups of challenges have also manifested themselves in China. Furthermore, the effects of these issues on domestic demand have been exacerbated by structural demographic challenges resulting from the long-standing family planning policies of China (Wang, 2016).

The presence of these issues in China can be observed through both statistical data and scholarly research. On the one hand, statistical data highlight key indicators, including slowing economic growth alongside rising GDP per capita after the 2008–2009 crisis, increasing gross savings amid declining household final consumption, decelerating total factor productivity growth, an uptick in the outflow of foreign direct investment (FDI) from China's economy since the early 2010s, and a reduction in the labor force starting in 2015[5, 6].

On the other hand, these challenges are further confirmed by academic studies. Research by Al-Haschimi A. and Spital T. (Al-Haschimi, Spital, 2024), as well as Brandt et al. (Brandt et al., 2020), has provided substantial evidence of these constraints, particularly highlighting structural factors such as demographic shifts

[4] Databank. World Development Indicators. The World Bank. Retrieved October 10, 2024, from https://databank.worldbank.org/source/world-development-indicators#

[5] Databank. World Development Indicators. The World Bank. Retrieved October 10, 2024, from https://databank.worldbank.org/source/world-development-indicators#

[6] National Date. National Bureau of Statistics of China (NBS). Retrieved October 12, 2024, from https://data.stats.gov.cn/english/easyquery.htm?cn=C01

and reduced export competitiveness that have significantly shaped China's economic development in recent years. Additionally, the World Development Report 2024 by the World Bank offers a comprehensive analysis of the middle-income trap, shedding light on how these structural barriers can hinder sustained economic growth in countries like China (World Bank, 2024).

Given the challenges outlined above, the "dual circulation strategy" has been implemented with significant prudence, despite its status as a cornerstone of China's long-term development strategy in official documents. Exports, however, remain a critical pillar of China's economic growth. This is partly because exports and external projects serve as mechanisms for sterilizing the monetary stimulus injected into the economy, including through the accumulation of international reserves.

Nonetheless, internal difficulties and unfavorable external dynamics have necessitated adjustments to China's medium- and long-term development plans. These changes were articulated in the documents of the 20th Central Committee Plenary Session of the CPC, held in July 2024. The session emphasized that, amid a challenging and multifaceted domestic and international landscape, combined with a new wave of scientific and technological revolution and industrial transformation, China is committed to further deepening reform comprehensively to advance Chinese modernization (Xi, 2024a).

In economic terms, this modernization aims to enhance the efficiency of China's economy through technological and organizational innovations, alongside the digital transformation of governance. This vision is closely aligned with Xi Jinping's ideas, first publicly articulated in 2023. During a speech in September 2023 in Heilongjiang Province, a key hub for China's heavy machinery manufacturing sector, Xi Jinping stressed the importance of accelerating the development of "new economy" sectors — such as green and digital industries — and called for the active consolidation of the country's scientific and technological potential.

This push for acceleration was linked to the intensifying sanctions pressure imposed by Western countries and the pressing need to overcome technological dependence on the United States and Western Europe, particularly given the restricted access to advanced foreign technologies. According to Xi Jinping, the new productive forces should be defined by their foundation in high technologies and innovation, the quality of their output, and their efficiency — achieved through the optimal integration of labor, capital, and materials, tailored to regional circumstances (Borokh, Lomanov, 2024; Xi, 2024b).

Building on this vision, in 2024, Xi Jinping further elaborated on his thesis regarding the development of productive forces by emphasizing the need for not only advancing "new economy" sectors but also promoting the technological and organizational modernization of China's traditional industries (Xi, 2024b).

Additionally, the approach to the BRI has been recalibrated. While it was previously focused primarily on establishing logistical infrastructure between China and Europe — or more broadly, between Asia and Europe — it is now framed under the Chinese vision of a Community of Shared Future for Mankind. The BRI has evolved into a long-term global initiative to foster shared development, reflecting China's intent to construct its own macro-region. This approach has become increasingly relevant in the context of the "fragmentation" of the global economy — a term recently emphasized by the IMF.

This represents a new type of integration, distinct from traditional models, with the European Union being a prime example. Traditional integration emphasizes the convergence of economic development indicators, unification of regulatory standards, establishment of supranational institutions, and ultimately, the adoption of a supranational currency. By contrast, the new type of integration advocated by China under the framework of "a Community with a Shared Future for Mankind" focuses on constructing new value chains and fostering cooperation in areas of shared interest among participants, including emerging technologies and "new economy" sectors[7].

Notably, the economic reforms outlined in the decisions of the 20th Central Committee Plenary Session of the CPC do not explicitly address export development or the expansion of China's international market presence. Instead, the reforms prioritize the establishment of a unified national market, the strengthening of core market economy institutions, the development of productive forces aligned with Xi Jinping's vision, the integration of the real and digital economies, and the enhancement of infrastructure policies encompassing transportation, digital systems, and other critical networks.

At the same time, the acceleration of technological modernization — especially given China's reliance on the Asian model of innovation, which depends heavily on adopting core foundational technologies — necessitates access to such technologies and, by extension, a sustained presence in Western markets. This presence is largely supported by sectoral investments and equity participation in companies, financed through international reserves. While China may achieve technological independence in the long term, such reliance is likely to persist in the foreseeable future.

Furthermore, the institutional framework established to advance a Community with a Shared Future for Mankind will also require significant financial support. This framework includes over 20 multilateral cooperation platforms between China and the Association of Southeast Asian Nations (ASEAN), Africa, Arab nations, Latin America, and Central and Eastern Europe, as well as an extensive network of financial institutions such as the Silk Road Fund, the Asian Infrastructure Investment Bank (AIIB), and the China-Central and Eastern Europe Investment Cooperation Fund, among others[8]. These institutions, along with other initiatives related to the project, have relied — and will continue to rely — on financing from China's international reserves, which are themselves primarily accumulated through export revenues.

[7] Xinhua. *The Belt and Road Initiative: A Key Pillar of the Global Community of Shared Future*. The State Council Information Office of the People's Republic of China. October 10, 2023. Retrieved October 12, 2024 from http://english.scio.gov.cn/whitepapers/2023-10/10/content_116735061_6.htm

[8] Xinhua. *The Belt and Road Initiative: A Key Pillar of the Global Community of Shared Future*. The State Council Information Office of the People's Republic of China. October 10, 2023. Retrieved October 12, 2024 from http://english.scio.gov.cn/whitepapers/2023-10/10/content_116735061_6.htm

Conclusion

International reserves serve as a key instrument in the global economic toolkit for mitigating the effects of external shocks on national economies. In the case of China, these reserves play an additional role by acting as a driver of economic development through their allocation to the equity capital of development banks and external economic projects.

The effective use of China's reserves in this capacity is inextricably linked to the dynamics of its exports. However, recent global economic crises have significantly reduced external demand for China's manufactured goods, thereby slowing the accumulation of its international reserves.

China's attempt to transition from an export-oriented growth strategy to one centered on domestic demand has not achieved the desired outcomes due to various challenges discussed in this article. As a result, while "dual circulation" remains the official medium- and long-term economic development strategy of the People's Republic of China (PRC), external demand continues to play a pivotal role in driving China's economic performance.

In this context, considering the imperative to finance "a community with a shared future for mankind" initiative and to secure access to external technologies — particularly in light of the decisions made during the Third Plenary Session of the 20th Central Committee of the Communist Party of China regarding the country's modernization — exports are expected to remain the primary driver of China's development in the medium term. This reliance will likely persist despite the declining external demand, which has slowed the growth rate of Chinese exports. At the same time, international reserves will continue to play a central role in China's economic development framework, with policies supporting their accumulation expected to remain in place.

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