

A SINO-US FRICTION - RISKS AND PRECAUTIONS OF USD SETTLEMENT BY CHINESE ENTERPRISES IN INTERNATIONAL TRADE¹

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A Sino-US Friction - Risks and Precautions of USD Settlement by Chinese Enterprises in International Trade¹



I. Introduction

Since the United States (“the US”) unilaterally initiated the “301” investigation against China in August 2017, the Sino-US bilateral economic and trade relations have undergone a major historical downturn. In recent years, the US’ tendency to “close the door” on China in the fields of economy, trade, science and technology has become increasingly evident². On 15 January 2020, the signing of the Economic and Trade Agreement between the Government of the United States of America and the Government of the People’s Republic of China temporarily put an end to the continued escalation of trade conflicts, but on the deep structural issues, the two parties have not yet reached a consensus, the competing interests between China and the US is long-term and complicated³, so it remains unclear whether the US will follow up with further restrictive measures, such as financial sanctions, against China.

II. Financial Sanctions

Financial sanctions are generally high-intensity economic sanctions⁴ through the obstruction of

¹This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, legal or other professional advice. Please refer to your advisors for specific advice.

² Pan Yingli and Zhou Xiaoping: 《美国的全球化陷阱、贸易争端诉求与中国的战略应对》, 《国际经济评论》2018, Volume 6, p.85. Yu Shigao: 《美国挑起贸易争端的深层原因及其应对研究》, 《大庆师范学院学报》May 2020, Volume 40, Issue 3.

³ Qin Weibo and Wang qinglong: 《中美贸易摩擦背景下我国外汇储备变化对“一带一路”地区 OFDI 的影响》, 《吉林大学社会科学学报》May 2020, Volume 60, Issue 3.

⁴ Xu Yisheng and Ma Xin: 《美国金融制裁的法律、执行、手段与特征》, 《国际经济评论》2015, Volume 1, p. 131-153.

financial flows and the freezing of assets of the sanctioned party⁵. Throughout the US sanctions against Iran and Russia, the US has long been the principal initiator of financial sanctions, taking advantage of the strong position of the US dollar, its important role in international trade and its political and military position. The US through freezing and confiscation of government officials of sanctioned country's assets, restricting access to the US bond market by sanctioned country's enterprises to finance, cutting off the ability of the sanctioned country to obtain US dollars, closing the US dollar trade settlement channel and other major measures, implements economic and financial measures against the sanctioned country, and causes significant direct economic losses to the sanctioned country. In the case of sanctions against Iran, the imposition of sanctions has resulted in a significant financial decline in Iran's oil exports, a decline in its gross national product, and severe damage to its credit system, international trade, payments and settlements etc.⁶ Financial sanctions are primarily imposed by restricting the free movement of the sanctioned party's currency, ultimately forcing it to make concessions or compromises in line with the interests of the sanctions initiator⁷. The settlement currency agreed upon by Chinese enterprises in their international trade has become a constraint for their future development, in particular the LNG international long-term resource procurement projects is likely to bear the brunt.

III. Risks of using USD as settlement currency

When Chinese enterprises conduct trade on a global scale, agreements entered into by the trading parties usually stipulate that the US dollar is the currency of settlement. This is also determined by the international monetary system centered on the US dollar⁸. The US financial sanctions against Iran are effective because of the financial status of the US dollar in the global financial system, nearly half of all cross-border settlements are conducted in US dollars, and docking with the US banking system for clearing and other business is an indispensable part of every bank with international business⁹. Due to the above, on the one hand, in the negotiation and formulation of future international trade agreements, especially for long-term LNG procurement agreements, since those agreements usually involve as long as 20 years of trade and involve large amount of trading finance, once the settlement currency is hard hit, it is likely to affect the effect and performance of the entire agreement, and affect China's procurement of offshore energy resources. Chinese enterprises should therefore consider the issue of

⁵ Gary Clyde Hufbauer, Jeffrey J. Schott and Kimberly Ann Elliott: 《反思经济制裁》, Du taoyi, Shanghai People's Press, 2011.

⁶ Niu Xinchun: 《伊朗的“经济圣战”: 一场政权保卫战》, 《国际问题研究》2013, Volume 1, p. 95-107.

⁷ Tao Shigui and Nie Lei: 《美国对伊朗经济金融制裁的动因、影响及启示》, 《南京邮电大学学报(社会科学版)》 December 2017, Volume 19, Issue 4.

⁸ Li Xiaogeng: 《权力之巅: 国际货币体系的政治起源》, Social Sciences Academic Press (China), 2017, p.111.

⁹ Tao Shigui and Nie Lei: 《美国对伊朗经济金融制裁的动因、影响及启示》, 《南京邮电大学学报(社会科学版)》 December 2017, Volume 19, Issue 4.

settlement currency in their future international trade projects, agreements and contracts etc. with trading parties.

IV. Solutions

1. The choice of Hong Kong Dollar or Renminbi (“RMB”)

Since the Hong Kong Special Administrative Region of the People’s Republic of China (“Hong Kong”) is a relatively mature international financial center, its legal currency, Hong Kong dollar, can be one of the options for Chinese enterprises. Since 17 October 1983, Hong Kong has implemented a Linked Exchange Rate System to stabilize the exchange rate of Hong Kong dollar in the range of 7.75 to 7.85 Hong Kong dollars to one US dollar through a rigorous, robust and transparent currency board system¹⁰. The Hong Kong Monetary Authority has established a one-to-one relationship between its currency base and foreign exchange reserves through direct and indirect means¹¹, resulting in a relatively stable exchange rate between the Hong Kong dollar and the US dollar, and is directly pegged to the US dollar, allowing Hong Kong dollar to be used as an alternative option for the trading parties in the negotiation of future international trade agreements.

As the legal currency of China, in recent years, there has been significant progress in direct RMB transactions. In 2010, the China Foreign Exchange Trade System launched direct RMB transactions against Ringgit and Ruble; subsequently in 2014, the RMB realized direct transactions against Pound, Euro and four other non-US dollar currencies; in 2012, the governments of China and Japan launched direct RMB transactions against Yen; on 1 October 2016, RMB formally joined the Special Drawing Rights (SDR), and the recognition of RMB continues to grow globally. Up till now, the realization of RMB being directly traded against non-US dollar currencies covers almost all major currencies in the world¹².

2. The choice of other currencies

In addition, Chinese enterprises can also negotiate with the trading party to choose the currency of a country where both parties of the international trade are located for their trade settlement, thus simplifying the exchange process, reducing transactional costs and

¹⁰ Hong Kong Monetary Authority, Linked Exchange Rate System https://www.hkma.gov.hk/gb_chi/key-functions/money/linked-exchange-rate-system/.

¹¹ Zhang Qidi: 《香港联系汇率制度运行原理探析》，《债券》2018, Volume 5.

¹² Pan Dayang: 《人民币对非美元货币直接交易的意义、问题及应对》，《中国物价》，August 2016.

enhancing the efficiency of international trade. In addition, it can also negotiate with the trading party to choose the currency of other countries or regions for settlement according to the actual situation.

3. The choice of other currencies

In addition, Chinese enterprises can also negotiate with the trading party to choose the currency of a country where both parties of the international trade are located for their trade settlement, thus simplifying the exchange process, reducing transactional costs and enhancing the efficiency of international trade. In addition, it can also negotiate with the trading party to choose the currency of other countries or regions for settlement according to the actual situation.

4. Amending existing agreements denominated in US dollars

For international trade agreements in which the Chinese enterprise has used the US dollar as the settlement currency, the trading party may amend the signed agreement, for example, by adding a triggering clause, so that in the event of restrictive measures such as financial sanctions by the US against China or other countries where the trading party is located, the international trade agreement will be settled in other currencies.

V. Conclusion

In the process of negotiating and signing international trade agreements, it is sometimes difficult to predict the potential risks of the agreement and future developments in the international community. Parties should pay particular attention to the provisions relating to the settlement currency in international trade agreements, as well as to the development of policy, finance and public opinion in the international community, in order to systematically reduce the adverse consequences that the trading parties may suffer, while the drafting, design and negotiation of such trade agreements are usually very complex. Therefore, in dealing with such legal issues, it is always crucial for Chinese enterprises, especially large energy enterprises, to consult legal experts in international trade regarding specific situations.

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