China long kept a tight hold on its currency as a way to control its economy and to help its factories sell their products overseas. But China has grown in economic power and ambition, and the old restrictions are not helping a country that hopes to call more of the world’s financial shots.

In his new book, “Gaining Currency: The Rise of the Renminbi,” Eswar S. Prasad describes how China’s view of its currency has evolved, starting from the Han dynasty — China invented paper money, of course — to today’s globally ambitious leadership. Mr. Prasad, a professor at the Dyson School of Applied Economics and Management at Cornell University and senior fellow at the Brookings Institution, was formerly head of the International Monetary Fund’s China division. In an interview, he explained China’s motivations, how money can be a back door to overhauling the country’s financial system and why some people fear a financially powerful China.

**Why is China reconsidering the role of its currency?**

China is increasing its dominance in the world economy. But there was a sense that China wasn’t getting the respect that it felt it deserved. One of the
manifestations of that was that its currency was not quite seen as an elite currency.

Chinese policy makers, especially the more reformist-minded officials, recognized that China needs to do a lot of work to get its financial markets ready before the renminbi could become a prominent international currency. Of course, there is a lot of opposition to such reforms because the system worked well for a lot of politically and economically powerful people.

About three or four years ago, these reformist-minded officials had a very important insight: If they could get the Chinese people and leadership to sign on to making the renminbi a great global currency, that could provide a very useful mechanism for getting around the opposition and putting in place a lot of reforms. Ultimately it would be good for China, no matter what happened to the currency.

I view this as a sort of Trojan horse strategy.

Making the currency international requires meeting requirements from foreign institutions like the I.M.F. At the same time, China is increasingly wary of what it calls “Western influences.” Can those external pressures still help China overhaul its financial system?

These serve a very positive role, but they must come from the right sources in the right fashion. When the U.S. Treasury or the I.M.F. tells China to allow its currency to appreciate, that is seen as something that is not necessarily in China’s best interest.

When it comes to matters where the West has some sort of prize to offer, that changes the dynamic. We’ve seen some examples of that over the last year and a half. When China decided it wanted to get the renminbi into the I.M.F.’s elite basket of currencies, it felt that this would be a great way of getting more prestige for its currency in one fell swoop. The I.M.F. and China came together and decided on a checklist of things that China needed to accomplish over the next year. That checklist turned out to be very useful particularly for the People’s Bank of China [China’s central bank] in pushing out its reforms.

After the 2008 financial crisis, the United States pumped money into
its financial system, which in effect lowered the value of China’s vast holdings of American debt. How has that affected China’s ambitions for its currency?

It is a matter of enormous frustration for China that the U.S. has such a dominant role in global finance. Because of its old policies, China has become even more vulnerable to U.S. policy, especially monetary policy.

Chinese are net creditors to the rest of the world. That is, the world owes China a lot more than China owes to the world. But the net income that China’s earning — the amount paid by foreign investors minus the amount it pays out to foreign investors — is in fact negative. Foreign investors get pretty good returns in China. But China, because most of its foreign assets are in the form of U.S. Treasuries and the government securities of other advanced economies, is earning piddling rates of return.

The fact that the U.S. dollar is so dominant in global finance, and also that the architecture of global finance is controlled by the U.S. and the Western economies, frustrates the Chinese. I think the Chinese feel that the system is stacked against them.

Many foreign economists say China should loosen its grip on its financial system — opening the capital account, as policy wonks call it. But you quote one respected Chinese voice, Justin Lin Yifu, criticizing that view. How prevalent is that opposition?

It is surprisingly prevalent even among Chinese economists who are pro-reform. There is a good reason for that: If one takes economic theory and the practical experience of emerging market countries into consideration, China is doing it exactly the wrong way.

The right way to do it is to make domestic financial markets more sound, improve regulatory frameworks and make the exchange rate more flexible so that it can act as a shock absorber. Then you can open up the capital account.

But I think there’s a logic to China’s strategy. Opening up the capital account
isn’t just about money, because China doesn’t need money from abroad. But what comes with the money is very important.

One example is where the Chinese government brought in foreign strategic investors into its banks. In 2007, in particular, there was concern that there was no improvement being undertaken in the corporate and financial structure of the big state-owned banks. The idea was that those foreign investors in the banks will have an incentive to bring with them better corporate governance practices and better risk-management practices. So all these sort of collateral benefits that come with the capital are what China wants.

The Chinese government prizes stability. Will it give up control?

China represents a grand and fascinating experiment in managing these two fundamentally contradictory impulses: trying to let the markets work freely versus trying to maintain stability and control in the market. We see that in a variety of contexts, and the currency is no exception. The Chinese government would like the currency’s value to be more market-determined because they see that as important in terms of increasing the renminbi’s prominence.

They view the stability of the currency as an important marker of their ability to manage the economy well. This is going to create a number of stumbles and missteps in the future, and indeed it already has.

Should the world be concerned about China’s growing financial ambitions?

There is a positive view about this — that having China become more engaged with the international community is a good thing. Rather than saying that it is a developing country and should be handled by different standards, China might recognize that ultimately having good rules governing international trade and finance would be to its own benefit.

But I think there was also a fear that China could end up parlaying its economic heft into a more strategic influence that then feeds into its somewhat expansionist tendencies. In the past, and in fact until fairly recently, China took a fairly
brute-force approach, using its economic clout to gain economic and political influence.

Now China has adopted what I think is a much more savvy and disciplined approach to its international engagement. First, it’s increasing its influence in existing international institutions, which allow it to influence the rules of the game from the inside. Second, it is setting up its own institutions like the A.I.I.B. [Asian Infrastructure Investment Bank] that allow it to redefine the rules of the game from the outside. Third, it is bringing lifelines to countries, and bringing them [other countries] into its embrace by setting up institutions with them.

China is very effectively gaining what I like to think of as a multilateral sheen for its effort to build closer economic relationships with other countries.

At a time when the political rhetoric in the U.S. is about disengaging and questioning traditional lines both economic and political, I think China stands ready to fill in the void. That is not intrinsically a bad thing. But we have to remember many of the values the U.S. in particular has fought for, or tried to expand, like supporting democratic forms of government, by-and-large free markets, freedom of expression and so on. All those are anathema to China.

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