

DIARY

Book 20-A

China

Report (White) giving

4/9/36

Book 20-A

- a) Political background**
 - b) Economic background**
 - c) Foreign trade**
 - d) Possible future developments
in United States-China trade**
- Et cetera**

Treasury Department
Division of Research and Statistics

Date April 9 1936

To: Secretary Morgenthau

From: Mr. Haas *MA*

Confidential

Attached is the report on China which has been brought up-to-date by Mr. White and his assistants.

The table of contents should facilitate your referring to those parts of the report which are of particular interest to you.

China

Division of Research and Statistics

April 9, 1936

THE NEW MONETARY POLICY OF CHINA



CURRENCY RESERVE BOARD

SHANGHAI

JANUARY 15, 1936

NOTE

This booklet contains the English translations of important documents relating to the monetary reform adopted on November 3, 1935, namely, the statement issued by His Excellency Dr. H. H. Kung, Minister of Finance, on November 3, 1935; the decree of November 3, 1935; and regulations issued in pursuance thereof. Every effort has been made to give in English the correct sense of the Chinese texts, but only the latter are authoritative.

Currency Reserve Board
Shanghai, January 15, 1936.

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MINISTER KUNG'S STATEMENT*

With the abandonment of the gold standard in recent years by many leading nations, and the rapid rise in the world price of silver, China's currency has become seriously overvalued. There has been severe internal deflation, with growing unemployment, widespread bankruptcies, flight of capital abroad, fall in government revenues and an adverse balance of payments. For the three and a half months commencing July 1934, exports of silver amounted to more than 200 million dollars and it was evident that unless immediate measures were taken, the country would be drained of its silver stock. Accordingly, on October 15, 1934, the Government imposed a duty and an equalization charge on the export of silver, which by checking the rise in the exchange rate and the exodus of silver through legitimate channels, averted an immediate calamity.

It was, however, clear at the outset that the measure adopted could only be temporarily effective; as long as the value of the currency remained high, deflation would continue and with increased severity; should the value fall and create a wide disparity between the domestic and foreign price of silver—as in fact has happened—extensive smuggling of silver would result.

In order to conserve the currency reserves of the country and to effect lasting measures of currency and banking reform, the Government, following the precedents of many countries in recent years, has decreed, with effect from November 4, 1935, as follows:—

1. The banknotes issued by the three Government banks, i.e., The Central Bank of China, The Bank of China, and The Bank of Communications, shall be full legal tender, and the banknote

* Issued on November 3, 1935

reserves of the three banks shall be placed under a unified control. The notes of all other issuing banks will continue in circulation, but will gradually be withdrawn and replaced by notes of the Central Bank. No new notes are to be issued by these banks and all their unissued notes as well as their bank note reserves are to be deposited with the Central Bank.

2. All debts expressed in terms of silver shall be discharged by the payment in legal tender notes of the nominal amount due.

3. All holders of silver are required to exchange their silver for legal tender notes.

4. The exchange value of the Chinese dollar will be kept stable at its present level, and for this purpose the Government banks will buy and sell foreign exchange in unlimited quantities.

The Government-owned Central Bank is to be reorganized as the Central Reserve Bank of China and will be owned principally by banks and the general public, thus becoming an independent institution, devoting itself chiefly to maintaining the stability of the nation's currency. The Central Reserve Bank of China will hold the reserves of the banking system and act as depository of all public funds and will provide centralised re-discount facilities for the other banks. The Central Reserve Bank of China will not undertake general commercial business, and after a period of two years will enjoy the sole right of note issue.

Measures have also been prepared for strengthening the commercial banking system and giving increased liquidity under sound conditions to the commercial banks so that they may have resources available to finance the legitimate requirements of trade and industry. These measures will include the creation of a special institution to deal exclusively with mortgage business, and steps will be taken to amend the present legal code so as to

improve the security of mortgage deeds.

Plans have been completed by which the National Budget will be balanced within a period of eighteen months. The Government is determined to avoid inflation and will take energetic measures to deal with speculation and attempts to bring about unwarranted increases in prices.

This constructive programme for the rehabilitation of the financial and economic condition of the country will be inaugurated immediately and carried through as rapidly as possible. The Government is confident that the nation will wholeheartedly support it in these measures to relieve depression and promote national prosperity.

DECREE OF NOVEMBER 3, 1935, REGARDING
THE NATIONAL CURRENCY.

With the abandonment of the gold standard in recent years by many leading nations, and the rapid rise in the world price of silver, our currency has become seriously affected, resulting in severe internal deflation, with growing unemployment, widespread bankruptcies, flight of capital abroad, fall in government revenues, and an adverse balance of payments. For the three and a half months commencing July, 1934, exports of silver amounted to more than 200 million dollars, and it was evident that unless immediate measures were taken, the country would be drained of its silver stock. Accordingly, on October 15, 1934, the Government imposed a duty and an equalization charge on the export of silver, which by checking the rise in the exchange rate and the exodus of silver through legitimate channels, averted an immediate calamity.

It was, however, clear at the outset that while the measure adopted could only be temporarily effective, it was not a fundamental solution. During the past year numerous petitions were received urging the Government to devise appropriate remedies. Recently, internal deflation became even more severe, and the business depression more acute. If continued, conditions would become intolerable.

In order to conserve the currency reserves of the country and effect a stable monetary and banking reform, and to prevent a financial catastrophe, the Government, following the precedents of many countries in recent years, has decreed, as follows:

1. As from November 4, 1935, the banknotes issued by The Central Bank of China, The Bank of China, and The Bank of Communications shall be full legal tender. Payment of taxes and

discharge of all public and private obligations shall be effected by legal tender notes. No use of silver dollars or bullion for currency purposes shall be permitted; and, in order to prevent smuggling of silver, any contravention of this provision shall be punishable by confiscation of the whole amount of silver seized. Any individual found in illegal possession of silver with intention to smuggle it shall be punishable in accordance with the law governing acts of treason against the State.

2. Banknotes of issuing banks, other than The Central Bank of China, The Bank of China and The Bank of Communications, whose issue had been previously authorized by the Ministry of Finance, shall remain in circulation, but the total outstanding banknotes of each bank shall not exceed the amount in circulation on November 3, 1935. The outstanding banknotes of these banks shall be gradually retired and exchanged for Central Bank of China banknotes within a period to be determined by the Ministry of Finance. All reserves held against the outstanding banknotes, together with unissued or retired notes of these banks, shall be handed over at once to the Currency Reserve Board. Notes previously authorized and in process of printing shall also be handed over to the said Board upon taking delivery by the banks.

3. A Currency Reserve Board shall be formed to control the issue and retirement of legal tender banknotes, and to keep custody of reserves against outstanding banknotes. Regulations governing the said Board shall be separately enacted and promulgated.

4. As from November 4, 1935, banks, firms, and all private and public institutions and individuals holding standard silver dollars, other silver dollars, or silver bullion, shall hand over the same to the Currency Reserve Board or banks designated by the

Board in exchange for legal tender notes, at face value in the case of standard silver dollars and other silver dollars which conform to the terms of previous monetary legislation of the Government, and in accordance with the net silver content in the case of silver bullion or other forms of silver.

5. All contractual obligations expressed in terms of silver shall be discharged by the payment of legal tender notes in the nominal amount due.

6. For the purpose of keeping the exchange value of the Chinese dollar stable at its present level, The Central Bank of China, The Bank of China and The Bank of Communications shall buy and sell foreign exchange in unlimited quantities.

The measures set forth above are designed for economic rehabilitation. The Central Bank of China will be reorganized to function as a bankers' bank. The general banking system will be strengthened, giving increased liquidity to the commercial banks under sound conditions, so that they may have resources available to finance the legitimate requirements of trade and industry. Measures have been prepared to create a special institution to deal with mortgage business; and steps will be taken to amend the present legal code affecting real estate mortgages so as to make real estate more acceptable as security for loans.

Plans of financial readjustment have been made whereby the National Budget will be balanced. Also with the centralization of note issue, the provision of adequate reserves against the legal tender currency, and a system of rigorous supervision, confidence in the currency will be strengthened. It is hoped that the nation will whole-heartedly support the Government in measures to promote the national prosperity. The Government will take drastic measures to deal with speculation and attempts to bring

about unwarranted increase in prices, and with any action intended to hamper the execution of the measures set forth in this decree.

**REGULATIONS GOVERNING THE CURRENCY
RESERVE BOARD. ***

Art. 1. The Currency Reserve Board is specially created by the Ministry of Finance for the purpose of centralizing the issue and consolidating the credit of legal tender notes. Branches shall be established in the various commercial centres at the discretion of the Board.

Art. 2. In accordance with the order of the Government, the Board shall have custody of the reserves against legal tender notes, and shall control the issue and retirement of such notes.

Art. 3. The Board shall be composed of the following members:

1. Five representatives appointed by the Ministry of Finance.
2. Two representatives each appointed by the Central Bank of China, the Bank of China and the Bank of Communications.
3. Two representatives appointed by the Bankers' Association.
4. Two representatives appointed by the Native Bankers' Guild.
5. Two representatives appointed by the Chamber of Commerce.
6. Five representatives of other banks of issue, specially designated by the Minister of Finance.

Art. 4. The Governor of the Central Bank of China shall be *ex officio* Chairman of the Board and the Board shall elect a Standing Committee of five to seven of its members for the execution of routine work.

Art. 5. The Board may invite leading financiers, both Chinese and foreign, to serve as advisers.

* *Promulgated on November 3, 1935*

Art. 6. The Board shall designate the Central Bank, the Bank of China and the Bank of Communications as depositories for the custody of the reserve funds. The apportionment of the funds to be deposited in each shall be determined by the Board and reported to the Ministry of Finance for record.

Art. 7. The Board shall inspect the reserve depositories once a month and announce to the public the amounts of note-issue, as well as the kinds and amounts of the reserves, and shall report to the Ministry of Finance for record.

Art. 8. The Board is authorized to employ a staff in order to carry on its work.

Art. 9. The Board may draw up its rules and regulations, subject to the approval by the Ministry of Finance.

Art. 10. These regulations shall become effective from the date of promulgation thereof.

**REGULATIONS GOVERNING THE BRANCHES OF
THE CURRENCY RESERVE BOARD ***

Art. 1. In accordance with Article 1 of the regulations governing the Currency Reserve Board, branches shall be established in various commercial centres upon the recommendation of the Board and subject to the approval by the Ministry of Finance.

Art. 2. The Board shall entrust the branches with the custody of reserves against legal tender notes in their respective localities.

Art. 3. The members of each branch shall be appointed by the Ministry of Finance on the recommendation of the Board. The Ministry of Finance shall designate one member as the chairman of each branch.

Art. 4. The members of each branch shall elect a standing committee of three to seven of their members for the execution of routine work, the names of such members to be reported to the Ministry of Finance for approval and for the records of the Currency Reserve Board.

Art. 5. Each branch of the Board is authorized to employ a staff in order to carry on its work.

Art. 6. The branches of the Board may draft rules and regulations governing the execution of their duties, subject, however, to the Currency Reserve Board recommending them to the Ministry of Finance for approval and record.

Art. 7. These regulations shall become effective from the date of promulgation thereof.

* *Promulgated on November 28, 1935.*

**REGULATIONS GOVERNING THE EXCHANGE OF
SILVER FOR LEGAL TENDER NOTES ***

Article 1. All banks (both modern and native), shops, business houses, public organizations, and individuals throughout the country, having in their possession silver coins, mint bars, raw silver, silver ingots, silver bullion, and all other forms of silver and/or silver articles, shall turn them over to the nearest local exchange office in exchange for legal tender notes (fa—pi) within three months, beginning from November 4 of the 24th Year of the Republic (1935), with the exemptions enumerated below:

(1) Silver absolutely indispensable as raw material for industrial, artistic or other lawful purposes, the use of which has been authorized by the Government in accordance with the Regulations governing the use of silver in the manufacture of silver articles.

(2) Ancient coins, rare coins, or ancient silver relics having cultural value.

(3) Silver utensils and ornaments manufactured and in possession of owners, prior to the promulgation of these Regulations.

Article 2. The offices for the exchange of legal tender notes consist of the following:

(1) The Central Bank of China, The Bank of China, and The Bank of Communications, their branches and authorized agents.

(2) Banks, (modern and native), pawnshops, post offices, railway offices, steamship offices, telegraph offices, and other public organs or organizations authorized by the above-mentioned three Banks i. e., The Central Bank of China, The Bank of

* *Promulgated on November 15, 1935*

China and The Bank of Communications.

(3) Offices for the collection of national and local revenue throughout the Country.

(4) The District (Hsien) Governments.

Article 3. When exchanged for legal tender notes, all silver articles, other than silver coins or mint bars in current circulation, shall be evaluated on the basis of the degree of their fineness (percentage of silver content).

Article 4. In districts where no legal tender notes are in circulation, persons in possession of silver dollars, silver bars, raw silver, silver ingots, silver bullion or other forms of silver and/or other silver articles shall have them exchanged for legal tender notes in the offices stipulated in Sections 2, 3 and 4 of Article 2.

Article 5. The offices enumerated in Sections 2, 3 and 4 of Article 2, after receiving silver dollars, silver bars, raw silver, silver ingots, silver bullion, or other forms of silver and/or other silver articles (in exchange for legal tender notes), shall immediately turn them over to the nearest branch or authorized agent of any one of the three banks i. e. The Central Bank of China, The Bank of China, and The Bank of Communications, in exchange for legal tender notes. Hoarding, concealing or using the above-mentioned silver for other purposes shall be construed as criminal acts.

Article 6. Acts of extortion by threat, committed during the period of exchange (of legal tender notes for silver), against persons in possession of silver dollars, silver bars, raw silver, silver ingots, silver bullion or other forms of silver and/or other silver articles, shall be construed as acts of obtaining goods of value under false pretences.

Article 7. In the exchange of silver dollars in current circulation for legal tender notes, no difference whatsoever shall be permissible, i. e., the exchange shall be dollar for dollar. In case of violation of this provision, in accordance with the degree of the offence committed, the legal tender notes or the silver dollars involved, or both the legal tender notes and the silver dollars involved, shall be confiscated. Persons receiving, purchasing or exchanging silver coins or silver articles at a premium with or without intent to smuggle the same shall be dealt with in accordance with Articles 2 and 5 of the Provisional Regulations governing Punishment for Interference with the National Currency.

Article 8. These regulations, having been referred by this Ministry to the Executive Yuan and circulated, shall be observed, by all persons and organizations, and shall be in effect from the date of promulgation.

**REGULATIONS GOVERNING USE OF SILVER IN THE
MANUFACTURE OF SILVER ARTICLES. ***

Article 1. The use of silver in the manufacture of silver articles shall be governed by these Regulations.

Article 2. Beginning from the date of promulgation of these Regulations, only silver alloy shall be used as the raw material for the manufacture of silver utensils and ornaments. Where the use of silver is necessary the content of pure silver shall not exceed 30 per cent.

Article 3. Silver utensils and ornaments manufactured before the promulgation of these Regulations may continue to be sold for the time being, until disposition of existing stocks has been effected. Silver bullion not yet manufactured into articles shall not be sold without consent of the proper authorities.

Article 4. Manufacturers of silver articles shall, within one month from the date of promulgation of these Regulations, report the kind and number of such silver utensils and ornaments together with the amount of silver contained therein and also the amount of unused bullion on hand, through the local Silversmiths' Guild or the Chamber of Commerce, to the nearest branch of The Central Bank of China or the nearest authorized agent of that bank, for examination and subsequent transmission to the Ministry of Finance. Where the Central Bank of China has no Branch, the reports shall be submitted through the Bank of China or the Bank of Communications or other agencies, for examination and subsequent transmittal to the Ministry of Finance.

Article 5. Raw silver or silver bullion required by manufacturers of silver articles shall be purchased through The Central Bank of China, The Bank of China, The Bank of Communications or specially designated agencies. However, the purchase shall be

* Promulgated on November 15, 1935.

conditional upon a written guarantee being furnished by the local Silversmiths' Guild or the Chamber of Commerce to the effect that the Guild or the Chamber of Commerce will be jointly and severally responsible for any violation of these regulations.

Article 6. The maximum amount of silver to be purchased by manufacturers of silver articles shall not exceed 30 per cent of the average amount of silver contained in the silver utensils and ornaments sold by them over a period of three years before the promulgation of these Regulations. In the case of silver shops which have been established for less than three years, the maximum shall not exceed 30 per cent of the average amount of silver contained in the silver utensils and ornaments sold by them during the year before the promulgation of these Regulations.

Article 7. At the end of every six months, manufacturers of silver articles shall submit reports on the total amount of pure silver contained in the silver utensils and ornaments manufactured by them within the period covered by the reports, through the local Silversmiths' Guild or the Chamber of Commerce, to The Central Bank of China, or The Bank of China, The Bank of Communications, or their authorized agencies for examination and subsequent transmittal to the Ministry of Finance.

Article 8. In case of suspension of their business, manufacturers of silver articles shall exchange their silver utensils, silver ornaments, and silver bullion in stock, for legal tender notes, through The Central Bank of China, The Bank of China or The Bank of Communications, their value being assessed on the basis of their silver content.

Article 9. Any manufacturer of silver articles found guilty of violating these Regulations shall be ordered to suspend business. Any manufacturer of silver articles, found guilty of smuggling or of attempting to smuggle silver shall be dealt with in accordance

with Articles 2 and 5 of the Provisional Regulations governing Punishment for Interference with the National Currency.

Article 10. With regard to the provisions of Articles 2 to 8 inclusive, the banks selling silver shall despatch representatives from time to time to conduct inspections. Any case of violation of Article 9 shall be reported to the local civil or judicial authorities for action.

Article 11. The use of silver for artistic, pharmaceutical, or other industrial purposes shall also be governed by these Regulations. However, in cases specially approved by the Ministry of Finance, the 30 per cent restrictions stipulated in Articles 2 and 6 shall not be applicable.

Article 12. These Regulations shall come into force from the date of promulgation thereof.

REGULATIONS GOVERNING THE INSPECTION OF NOTE ISSUES AND RESERVES BY THE CURRENCY RESERVE BOARD *

Article 1. These regulations are formulated in accordance with Article 7 of the Regulations governing the Currency Reserve Board.

Article 2. The Board shall inspect once a month the total amount of note issue as well as the kinds and amounts of reserves therefor.

Article 3. The Board shall inspect both the cash and security reserves.

Article 4. Note issues shall be fully secured by 60% cash and 40% securities. Cash reserves shall consist of gold, silver and/or foreign exchange, and security reserves shall consist of securities (bonds, notes, etc.,) issued or guaranteed by the Government, and/or other assets acceptable to the Ministry of Finance, and/or acceptable short-term commercial papers.

Article 5. Cash reserves in the form of silver dollars and/or silver and/or gold held in vaults shall be examined and checked, and those held in branches or banks abroad shall be proved by documents.

Article 6. Security reserves in the form of securities and other assets held in vaults shall be examined and checked, and those held in branches or banks abroad shall be proved by documents.

Article 7. In the case of districts in which the Board is represented by branches, inspection of note issue as well as the kinds and amounts of reserves shall be made by such branches and reported to the Board. In districts having no branches, such inspection shall be made by the local office of the Central Bank of

* Promulgated on December 23, 1935.

China, or of the Bank of China or of the Bank of Communications, and the result shall be reported to the Board through their respective head offices.

Article 8. The Board shall announce to the public the result of each inspection, giving the total amount of note issue, as well as the kinds and amounts of reserves, and shall report to the Ministry of Finance for record.

Article 9. These regulations shall become effective from the date of promulgation thereof.

REGULATIONS GOVERNING SUBSIDIARY COINS* (FU-PI-TIAO-LI)

Article 1. Subsidiary coins (Fu-pi) are to be minted exclusively at the Central Mint, and circulated by the Central Bank of China.

Article 2. Subsidiary coins shall be classified as follows:

Nickel Coins:	Value	Weight	Fineness.
	20 cents	6 grams	100% nickel
	10 cents	4.5 grams	100% nickel
	5 cents	3 grams	100% nickel
Copper Coins:	1 cent	6.5 grams	95% copper and 5% tin-zinc alloy.
	½ cent	3.5 grams	95% copper and 5% tin-zinc alloy.

Article 3. Subsidiary coins shall be calculated on a decimal basis. A \$1.00 legal tender note (Fa-Pi) shall be equivalent to: five 20-cent nickel coins, ten 10-cent nickel coins, twenty 5-cent nickel coins, one hundred 1-cent copper coins or two hundred ½-cent copper coins.

Article 4. The designs of the subsidiary coins shall be determined by the Ministry of Finance, and submitted, through the Executive Yuan, to the National Government for promulgation.

Article 5. The nickel coins shall be legal tender for payments up to the amount of \$20, and the copper coins up to the amount of \$5 National Currency. This provision however shall not apply in the payment and collection of taxes or in currency exchange at the Central Bank of China.

*Promulgated on January 11, 1936.

Article 6. Existing subsidiary coins shall be withdrawn from circulation by the Ministry of Finance, and shall be destroyed by melting and recast. However, during a specific period, they shall still be permitted to circulate at their respective market value. The detailed measures for the enforcement of this provision as well as the aforesaid time-limit shall be determined by order of the Ministry of Finance.

Article 7. Subsidiary coins, which through wear and tear over a long period have lost 5 per cent of their legal weight, may be exchanged for new coins at the Central Bank of China.

However, if the coins are intentionally damaged or debased through heavy stamping of seals or otherwise, resulting in the loss of weight or the alteration of their original form, they shall become null and void, be prohibited from circulation, and shall not be exchangeable for new coins.

Article 8. Any person who counterfeits subsidiary coins or impairs the credit thereof, shall be punished in accordance with law.

Article 9. These regulations shall come into force from the date of promulgation thereof.

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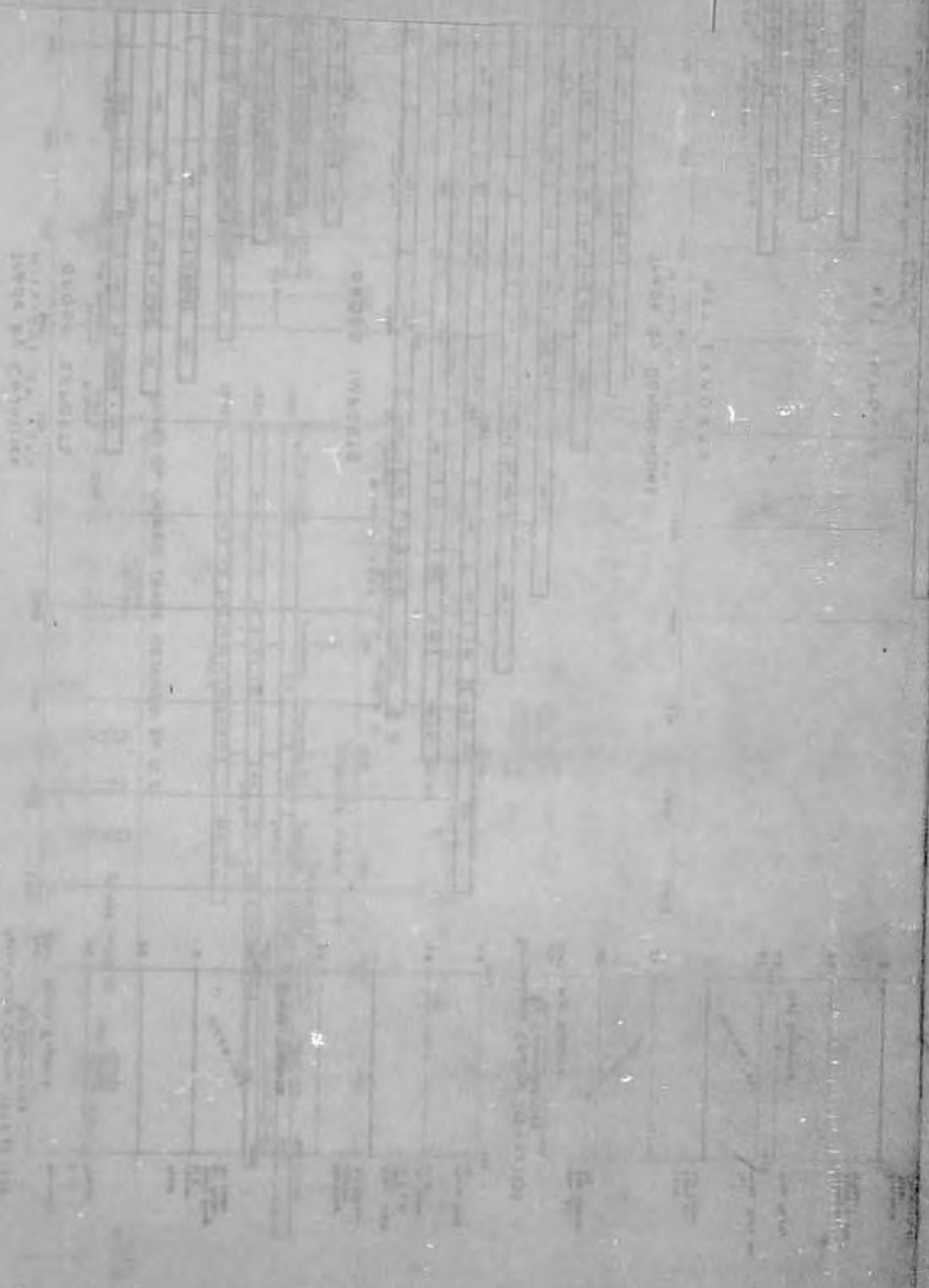
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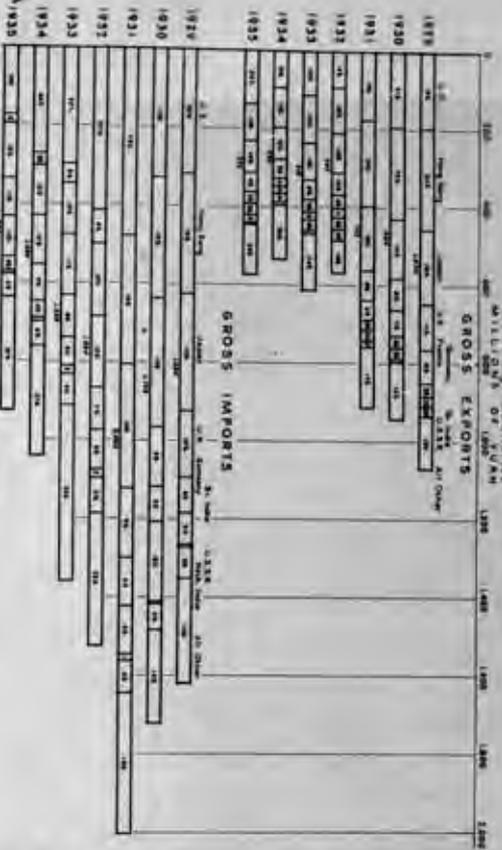
CHINA - FOREIGN TRADE



CHINA - FOREIGN TRADE

1929 to 1935

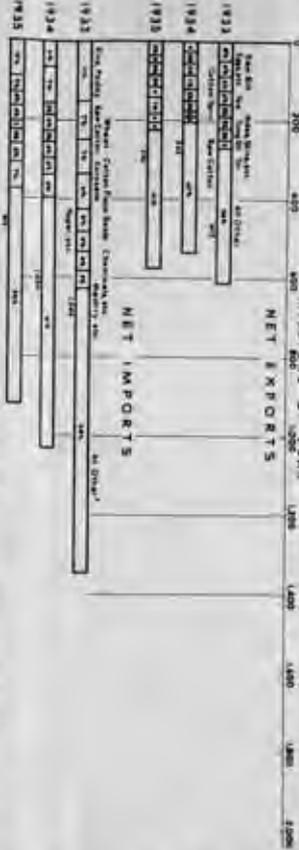
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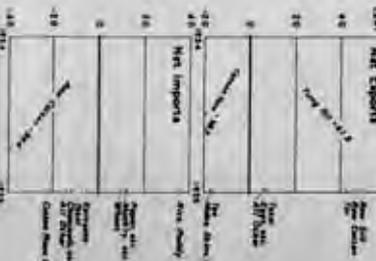
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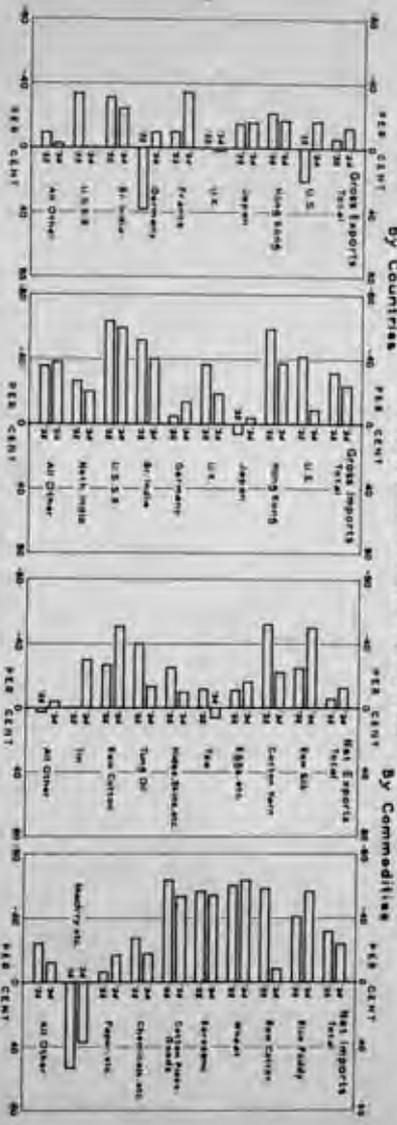
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Percentage Change 1924 to 1935
By Commodities



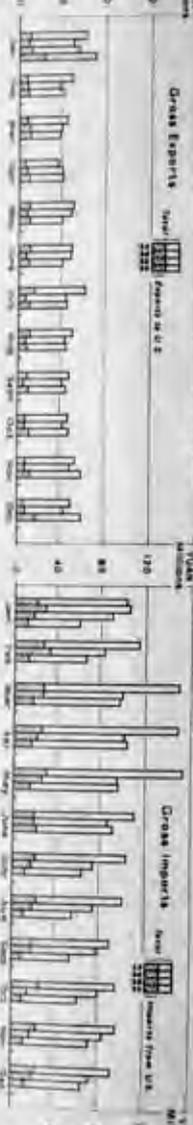
PERCENTAGE CHANGE FROM 1933



CHINA'S TRADE WITH U.S.



SHARE OF CHINA'S TRADE OBTAINED BY U.S.



TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE April 9, 1936

TO Secretary Morgenthau
FROM Mr. Haas *JH*
Subject: China

SUMMARY

A. POLITICAL BACKGROUND

Area. China, once twice the size of the United States, is now smaller than our own country. The huge outer ring of provinces has been irretrievably lost to England, France, Russia, Japan. The Great inner ring is as good as lost, the provinces being under foreign domination. It is only the core of the Chinese Empire that remains, and within this core there is neither peace nor unity.

Political set-up. The Central Government, with its headquarters at Nanking, (near Shanghai) is under the leadership of the military dictator Chiang Kai-shek. The general, however, has effective control over only a part of China. A left wing faction of the Government is in control of a section around Canton (in the southeast) and cooperates with the Central Government merely on a voluntary basis. A portion of China, varying in size from day to day with the fortunes of war, is in the hands of the Communists, against whom Chiang Kai-shek wages incessant warfare.

The people. Population uncertain; probably about 425-450 million. Very high birth rate but death rate almost as high due to widespread poverty, ignorance, infanticide, famine, flood, and civil war. The family system which is largely responsible for the static character of the people is yielding only very slowly to Western ideas and political radicalism.

The family still plays the dominant role in Chinese life. This factor together with a combination of religions and the ethical teachings of Confucius has made the Chinese a people of peculiar stoicism. They accept for the most part with a bewildering fatalism the indescribable misery of their lives. Their religious and ethical beliefs foster superstition, help keep the birth rate high, farms small, tradition strong, and the peasant in debt for expenditures on ceremonials.

B. ECONOMIC BACKGROUND

Natural resources. China has less land fit for cultivation than has the United States. She is poor also in minerals, having little copper, lead, zinc, and silver. Her iron is of a low grade and widely scattered, her large coal resources are not readily accessible. She is, however, the leading world producer of antimony and tungsten. How much oil China has is a matter of dispute, some estimates being low, others extravagantly high.

Transportation and communication. Except for trails, there are altogether only 25,000 miles of roads in China. Railroads -- 7,000 miles, most of them in poor repair -- are a less important carrier than water transport, but man and animal power are the means principally relied on. Communication is desperately bad, so that it is possible for hundreds of thousands to die of famine in one region while only a few hundred miles away there is plenty.

Agriculture. Predominantly an agricultural country with tiny farms, intensively cultivated with painstaking but unscientific hand labor. Though China grows very large crops of rice, wheat, corn, beans, sweet potatoes and other foodstuffs, she is not a net food exporting country. Her imports of foods are usually greater than her exports.

The peasants are exploited on every hand, and barely manage to exist from one harvest season to the next. Inadequate fertilizer and unscientific farming reduce the crop yield, while high marketing costs, hopeless transportation facilities, and burdensome land taxes keep return from the small crop pitifully small.

Industry. Mostly confined to small shops, and households. Less than one per cent of population connected with large-scale factories. Only a few industries -- textile, cigarette, match, oil crushing, paper making and flour milling -- chiefly under the management of foreigners, have reached the large factory stage. Rate of industrialization very slow.

Labor. There are always great masses of unemployed and partially employed, especially in the large coastal cities to which thousands of refugees flee after every flood and famine. The wages are extremely low -- 15 to 50 cents a day, and the hours are long. The costs of production are high notwithstanding; capital is scarce and interest rates high, workers are illiterate and untrained to machine production, transportation costs are high, business organization is poor, standardization is unknown, and large-scale methods of production are confined to few industries.

Public finance. Budget deficits each year of 100 to 150 million yuan are met with loans from Government and private banks at very high

interest -- 8 to 12 per cent. Government bonds sell at yields of 10 to 15 per cent. Outstanding debt is about $4\frac{1}{2}$ billion yuan (including old loans) almost half being in default. Almost half the total revenue of 800 million yuan is for military expenditure, and about a fourth for loan service.

Balance of payments. China has always had an "unfavorable" balance of trade which she paid for by remittances from Chinese abroad, imports of capital, and expenditures by foreigners in China, and had enough left to obtain large silver and gold imports. In the last few years her excess of imports remained large, but her means of payment have dwindled, with the result that for the first time in 20 years there occurred a heavy outflow of gold and silver.

C. CHINA'S FOREIGN TRADE

China's balance of trade is normally unfavorable. China's annual imports almost double her exports. The United States is China's most important customer, taking about one-fourth of China's exports (excluding Hong Kong trade which is really domestic trade). Japan is a close second and Great Britain a poor third. The United States is also in the lead as a source of supply to China. We supplied 19 per cent of China's imports. Japan, Germany, and Great Britain next on the list furnish 15, 11, and 10 per cent of China's imports.

Since China was accorded by foreign governments the right to impose duties (1931) she has raised rates far above the 5 per cent formerly allowed. This has had the double effect of giving rise to the smuggling of much goods, and establishing protection to numerous agricultural crops (e.g., rice and wheat) and to many industries.

China's chief items of export are cotton yarn, metals and minerals, chiefly tin, tungsten and antimony; eggs and egg products, raw silk, silk piece goods, and raw cotton. Her chief imports are metals and minerals, raw cotton, rice, machinery and tools, chemicals, tobacco and kerosene oil.

Why does China with such extremely low wage rates have as her most important source of supply a country with wage rates 5 to 20 times as high? We sell her cotton, tobacco, kerosene, wheat, coal tar, iron and steel manufactures, tin plate, machinery, automobiles, etc. China has the raw material, soil and climate necessary to produce these and almost every other item we export to her. But she lacks capital, power, technical equipment, mechanical skill, transportation facilities, business organization. Therefore, though her wage rates are very low, her costs of production would be higher because her output per hour per man would be very much lower than ours.

What happened to our trade with China between 1929 and 1934? In absolute amounts, our exports to China decreased from 479 to 413 million yuan, but in per cent of China's imports we gained materially on the others. We increased our share (exclusive of Manchuria) from 19 to 27 per cent, while Japan dropped from 18 to 11 per cent. We continued, however, to take the same proportion of China's exports.

Has the situation altered in 1935? Yes. Very considerably. Instead of the customary large excess of exports we have an import balance. In 1935 our exports to China dropped almost half as compared with last year, while our imports from China increased almost half. These changes also represent a decrease in our share of China's total imports and an increase in our share of purchases of China's total exports.

How explain the drastic reversal in United States-China trade? Partly because of our agricultural policy; partly because of the general economic conditions in China, and partly because of the special nature of the specific commodities that bulk large in our trade with China. Fluctuations in the price of silver have been only one of several factors contributing to the trade reversal.

China's January trade figures. They show continual marked increase in total exports as compared with January 1935, and greater decrease in total imports. For the second consecutive month and the first time in many decades -- China has an excess of exports.

D. POSSIBLE FUTURE DEVELOPMENTS IN OUR TRADE WITH CHINA

Is China's cotton production responsible for our decline in raw cotton sales? No. Though her output has increased considerably in the six years before 1935, she buys -- or did buy before 1935, more from us than she did in any of the three years 1928, 1929, or 1930. Her cotton exports remained unimportant. In the past year, however, our cotton exports to China have dropped sharply, not because she produced more cotton herself -- in fact her crop last year, owing to bad weather dropped sharply -- but because she consumed much less. In the next decade her cotton output is likely to increase, and she may even begin exporting significant amounts.

What will happen to our exports to China if or when Japan adds her capital and brains to China's low wages? It will take many decades before Japan can supply China with enough capital to make much difference in China's output per man hour. Besides, while progress was in the making in China, our own technique and capacity to produce would be improving. China's gain must be a relative one if she is to produce more cheaply than we do. In certain industries the effect will be quickly felt -- but those industries will be just the ones which now constitute Japan's exporting industries.

If Japan attempts to industrialize China, her own nationals will feel the competition more keenly than we will. Therefore, Japan is more likely to confine her efforts to developing China's natural resources and improving her transportation.

The more capital that is poured into China, the more goods will China import, though numerous articles she imports now will be replaced by others as time goes on. Our Southern States (for example) purchase much more per capita from the industrialized New England than they did when the South was less developed.

China may import more -- but if Japan controls China, will China import more from us? Japan, if she can, will doubtless give her own products preferential treatment and some of our industries would suffer accordingly. However, for a long time to come, China will compete more with Japan than with the United States. Until she becomes supplementary -- through the development of her soil, transportation and natural resources -- our total trade to China would probably increase.

E. MONETARY AND BANKING SYSTEM PRIOR TO 1935

The monetary system. Until a few years ago China's monetary system was chaotic. Copper coins (40 to 50 billion copper "cash"); subsidiary silver (400 million yuan of mostly .20 yuan pieces), circulated at a discount varying from time to time and from place to place. Bank notes issued by all sorts of institutions, without any reserve requirements, circulated at par or at discounts varying according to the reputation of the issuing bank. About 1.6 billion old silver dollars of various designs and slightly different weights, and scores of varying sized bars of silver "sycee taels" transacted the bulk of the wholesale financial transactions.

Two important improvements were introduced in 1931 and 1933.

(1) In 1931, the right to issue bank notes was restricted to banks, and to only those banks fulfilling necessary requirements. A reserve of 60 per cent silver and 40 per cent in securities against note issues was also imposed.

In 1933, a new standard unit of Chinese currency was established -- the yuan or Chinese dollar. The troublesome sycee taels were all withdrawn, but only a few of the new dollars were minted.

The banking system. Before 1931 there were virtually no national laws controlling banking. Each province had its own bank which never published statements and which frequently over-issued its own notes. Almost any institution or person could receive deposits, issue notes, or lend money without having to comply with any regulations as to specie or cash reserves, maximum loans, etc. Banks seldom lasted more than 10 years; even the larger ones undergoing frequent reorganization.

A new bank law passed in 1931 was designed to bring all banks under the regulation of the Central Government and to introduce reserve requirements against note issue, and numerous modern devices against customary banking abuses. Owing to the weakness of the Central Government, the reforms could not be enforced in many areas in China.

The banks of China now consist of (a) the Government owned and controlled Central Bank of China and two semi-Government banks which are virtually controlled by the Government; (b) Provincial banks, several of which act independently of Nanking; (c) "Native or old-style" banks which do most of their lending business to the Chinese small merchant; (d) the modern-style commercial banks which operate for the most part in Shanghai and which make loans on collateral rather than personal security and (e) finally the foreign banks which deal largely in foreign trade financing and international capital movements.

Interest rates are very high in China and there are no facilities for the flotation of bonds and stocks to investors. The banks supply long-term credits for capital expenditures. Rediscounting and a bill market are quite undeveloped in China. The Central Bank and semi-Government banks with their several hundred branches scattered throughout China issue a large share of the total notes and also absorb a large portion of the Government bonds.

F. THE PRICE OF SILVER AND CHINA'S ECONOMIC CONDITION

Did China's foreign trade hold up while that of all other countries declined? Yes and no. Her exports dropped almost 15 per cent in 1930, and by 1934 they had dropped to one-half. But her imports continued to rise through 1930 and 1931. The reason is simple. Her exports reflected conditions abroad which were growing worse; her imports reflected her domestic conditions which were not.

When did the depression become marked in China? In 1932. Almost two years after it appeared elsewhere, but a year and a half before the Silver Purchase Act of 1934 was passed. England abandoned the gold standard in September 1931 and numerous other countries followed. The price of silver (and what is almost the same thing - Chinese exchange) in terms of those currencies consequently rose. China's balance of payments became unfavorable in 1932, exports dropped more than one-third, imports one-fourth, prices fell, industrial activity declined, unemployment increased, and large sums of silver flowed from the interior to Shanghai. The depression was in full swing. The Sino-Japanese conflict also broke out about that time, the effects of which were further destructive to business in China.

What did the price of silver have to do with the state of business in China? The increase in the world price of silver caused the yuan exchange

rise. Appreciation of China's exchange with its repercussions on international capital movements and prices turned her balance of payments -- normally favorable -- unfavorable. An unfavorable balance of payments was accompanied by an outward movement of specie from China which helped the depression by deflating prices, stimulating hoarding, and accentuating the contraction of credit.

Why did not China take steps to prevent the rise in the price of silver from affecting her domestic situation? She did, but owing to the peculiar nature of China's monetary and banking system, her attempt could at most be only partly successful.

What was there especially peculiar about China's monetary system?

(1) China was virtually the only country on a silver standard (Persia and Ethiopia who also had been on a silver standard were unimportant factors in the situation). The consequence was that the price level in China was influenced more by the world price of silver than was the world price of silver by the purchasing power of silver in China, i.e., price level in China.

(2) China was a hard money country. Her circulation includes about 115 billion silver Chinese dollars, 400 million subsidiary silver coins and 40 to 50 billion copper cash. The subsidiary coins and copper cash circulated at their metallic value compared to the silver dollar and not at their nominal value.

(3) The Central Government in China could not effectively administer her money and banking legislation throughout China. She feared she would be unable to enforce a regulation calling in all coins to be replaced by token coins of the same nominal value.

What have these peculiarities in China's monetary and banking system to do with China's difficulties? A good deal. With the price of silver rising abroad, China could not cut her price level off completely from its effects. She tried to prevent the outflow of silver by placing an export duty and equalization fee on its exportation, but this obstacle could be effective only if the price of silver did not rise beyond 60 cents or so. Above that level the profit from smuggling became so great that the export prohibition lost much of its effectiveness.

She could not suspend convertibility without sending the silver coins to a premium -- or notes to a discount, and give rise to three measures of price -- one in notes ($\frac{1}{2}$ and $\frac{2}{3}$ yuan notes also circulate) and one in silver, and one in copper cash. Moreover, the suspension of convertibility would cause losses to the note holders but not to the coin holders. The effect of suspension of convertibility she felt would be hoarding, smuggling of silver, and for a time at least monetary chaos.

She felt she could not call in silver coins and replace them with either notes or debased coins because of the strong preference the

Chinese have for coins, and the lack of effective control of the Central Government over the monetary habits of the people.

Did our silver policy bring the depression to China. No. It could not have done so since the Silver Purchase Act was passed in June 1934, and the depression in China was in full swing during 1932. It was England's departure from the gold standard in September 1931 that started the rise in the price of silver in terms of an important currency.

G. ECONOMIC EVENTS IN CHINA SINCE ABANDONMENT OF THE SILVER STANDARD

New monetary and banking measures. On November 3rd China completely abandoned the silver standard. Convertibility of notes was suspended. All holders of silver were required to exchange their silver for legal tender notes at face value. Future note issues were restricted to the three Government banks. Central Bank functions were modified to resemble more closely those of Central Banks in other countries. (A Chinese group are supposed to be in the United States now studying our Federal Reserve System as a likely model.)

Monetary changes since November. Official sterling rate was kept pegged at $14\frac{1}{2}$ d. but dollar rate was moved a few per cent twice. The premium on silver in China disappeared after silver prices dropped. New coins of nickel and of copper ($\frac{1}{2}$, 1, 5, 10, and 20 cent pieces) are beginning to be put into circulation to replace the silver coins, and there is talk of minting 50 cent and dollar coins with some silver content.

Has the outstanding silver been turned in? Only a little of it. It is estimated that there is still outstanding about $1\frac{1}{2}$ billion out of the 2 billion or so of yuan silver coins out on November 1st.

How has business been in China since November? Conditions have improved slightly; wholesale, stock and bond prices have turned upward. Exports are higher than last year and imports are lower, so that for the first time in many decades China is experiencing a favorable trade balance.

Has the United States lost much by the trend of business in China? We have doubtless lost some trade, both direct and indirect, but the extent of the loss is easily exaggerated. The total loss sustained by the United States cannot be all, or even mostly, allocated against our silver policy. World-wide depression, currency depreciation, political disruption, Japanese aggression, and civil strife were important contributory factors to China's depression.

H. MONETARY PROBLEMS THAT CONFRONT CHINA NOW

Will a fall in the price of silver force China back on the silver

standard? It is a possibility, but only a slim one. It would occur if the pressure on the yuan would be so great as to engender a sharp depreciation. In that case, it is possible that a return to the silver standard might be necessary to check the decline, though it is not certain that the check would be effective.

Will she be able to keep the sterling-yuan rate at the present level? Her chances are only fair. It depends partly on the political situation in the Far East and upon our decision with regard to China's silver. Underlying economic conditions are not unfavorable to the maintenance of the present rate, but her reserves which can be used to support the yuan are not large enough to stand a great deal of pressure.

Would China be better able to keep the sterling-yuan rate at the present level if the United States purchases more silver from China? Yes, it would help somewhat. Her foreign reserves would be somewhat greater, confidence in the future of the yuan would be strengthened a little, some more silver would be turned in to Government banks, some of the capital which has left China in the past year might return, and, finally, foreigners might look with less disfavor on investments in China.

I. MONETARY PROGRAMS CHINA MUST CHOOSE FROM

There are three course open to China.

(a) She can peg her exchange to some leading currency or pursue an independent course, altering her exchange rate as she deems such action necessary.

(b) She can return to the silver standard either in the form used before November 1935 or in some modified form.

(c) She can adopt a gold or gold exchange standard, or a gold and silver standard - i.e., bimetallic.

If China is determined to continue a managed currency, she is likely to continue to peg her exchange to sterling, though it probably would be more advantageous to her -- barring special concessions -- to peg her exchange to the dollar.

China is unlikely to return to a silver standard as she feels that the arguments against such a course are more weighty than those in favor. The situation might be different, however, if China were to receive satisfactory assurances that the price of silver would be kept stable.

China would probably prefer to adopt a bimetallic standard than a silver standard. But again, she would doubtless want some assurance that the price of silver would not drop below selected mint price.

What course would we prefer China to take? On political grounds, from our point of view it would be preferable for China to decide to return to the silver standard, but on economic grounds a better case could be made for her return to the bimetallic standard. The next best alternative is that China should either peg her yuan to the dollar or unpeg it from sterling and keep it somewhere between sterling and the dollar.

What difference does it make whether the yuan is linked to the dollar or to sterling? It would enhance the prestige of the currency selected, increase slightly brokers' earnings, and possibly trade. It would also increase the international monetary influence of the currency selected. The advantages would be approximately the same for the dollar as for sterling except that more Chinese trade, more prestige, and more international financial business in New York means less to the United States than to England.

Linking of the yuan with the dollar at our request would involve us a little more in Far Eastern politics.

What would China like to obtain from us now? Probably more purchases of her silver, possibly some assurance of support of the yuan at current rates, or even at a more moderately altered one. She may also be hoping to obtain a loan like the 1933 wheat loan, and perhaps is also seeking additional political or economic advantages by maneuvering the United States into the position of increasing our interest in Chinese affairs.

Why should we buy silver from China? For the following reasons: (a) It will help improve business conditions in China; (b) it will help keep the yuan from depreciation; (c) it will decrease our gold holdings and increase gold holdings elsewhere; (d) for every ounce of silver purchased at a low price, the United States Government makes a handsome seigniorage profit; (e) silver at current (foreign) price is not a bad investment; (f) we should get some concession in return for our purchases.

What could China offer in return? In order of attractiveness to the United States, China might adopt the following courses: (a) Return to a silver or bimetallic standard; (b) link the yuan to the dollar; (c) unpeg the yuan from sterling.

Together with any of the above three, China could increase the minting of coins containing silver, as well as the silver content of those coins, and finally could give the United States additional assurances that no measures which in effect discriminated against American economic interests in China will be taken by the Chinese Government.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE April 9, 1936

TO Secretary Morgenthau
FROM Mr. Haas *JJA*
Subject: China

A. POLITICAL BACKGROUND

1. China is melting away.

Formerly twice the size of the United States, China is rapidly losing great slices of her domains. Burma was cut off by the British piece by piece from 1826 to 1886; Hong Kong was taken in 1842; Indo-China was added to the French Empire from 1861 to 1882; territory North of the Amur went to Russia in 1858; Formosa, Pescadores, Korea and a whole chain of islands were absorbed by Japan by 1910, and Manchuria came under Japan's control in 1932. In the past few years, the Japanese army has acquired virtual control over Jehol, Hopei, Chahar provinces, and the Peiping-Tientsin area in the North. The Soviet Union dominates Outer Mongolia which regards itself as an autonomous state. British trained Tibetan troops are occupying large sections of "Inner" Tibet, while Yunnan on the southern border is under the thumb of France, and the adjoining Kwangtung and Kwangsi are virtually independent.

In the accompanying map the area in blue, though usually included among China's thirty provinces, is either completely cut off from the National Government or, for the time being at least, virtually independent. In many spots the actual boundaries marking regions where Central Government authority ceases are uncertain and shifting.

2. Who controls what is left?

The National Government at Nanking, though nominally the Government of China, actually exercises effective control only over a part of China. The control of the remainder is divided between the left wing of the Kuomintang Party with headquarters in Canton, and the Communists who had recently been driven from South-Central China to their western stronghold in the fertile and populous province of Szechuen, but are now reported spreading North into Shensi and southeast into Hunan and Kweichow. Only in the dozen or so provinces around Kaingsu (the province in which the two important cities, Nanking and Shanghai, are located) can the Central Government be said to exercise effective control, and

even in some of those provinces the degree of that control is not to be compared with that exercised by central governments in most other countries.

3. The Republic of China retains little of the democratic principles she started with.

The democratic ideals of Sun Yat Sen, who in 1911 brought about the revolution which overthrew the Manchu dynasty, and who became the provisional president of the newly created Republic, are no longer in ascendancy. Chiang Kai-shek is virtual dictator, though his actual power is more limited than that of either Hitler or Mussolini.

The Governors of the Provinces exercise a good deal of local autonomy, the degree of autonomy varying from province to province and depending upon the extent of loyalty to the Central Government and the strength of military forces. Provincial independence, which has always been considerable in China, and which flourished unrestrained for ten years after the death in 1916 of President Yuan Shih-kai, is the stumbling block to the establishment of a strong and united administration. This modern feudalism cramps the revenue of the National Government, divides responsibility, and makes difficult a unified foreign policy.

4. China is torn by internal strife.

From 1928 to the present, the Nanking Government has waged an incessant struggle, both political and military, to hold together its shaky realm. The Communists have been a constant source of difficulty. Communist influence was dominant in the Government until 1927, when a split occurred between Michael Borodin, the Russian adviser and leader, and Chiang Kai-shek, generalissimo of the Kuomintang forces. The split resulted in victory for the General, whose first act was a ruthless purge of the Communist elements in the Government.

But this act did not dispose of the problem. Though driven underground in most parts of the country, a few able leaders in the Communist faction by the latter part of 1927 had gathered together in South-Central China a considerable army, and established dominion over an area that varied with the success of their arms and their propaganda. Their appeal has been mainly to the peasants, based upon a reapportionment of the lands, elimination of the crushing land taxes, cancellation of debts, and abolition of absentee landlordism. But Communist rule in this area came to an abrupt end in the winter of 1934, when, in his sixth major offensive against the Communist forces, Chiang Kai-shek forced them to evacuate the Kiangsi area. Then began a dramatic forced march

to the West, across two thousand miles of intervening provinces to Szechuen, where the Eastern Communist army joined a group already entrenched in the northern part of this province. In recent months, the Communists have again extended their area of control, and as bitter opponents to Japanese expansion in China are gaining a little in prestige and influence.

The National Government is further confronted by a split in its own ranks. An independent and well-armed wing of the Kuomintang Party has been in control in the South for several years. Though cooperating loosely with the Central Government, it has done so on an entirely voluntary basis, more or less subject to change without notice.

5. What is China's foreign policy?

China's foreign policy consists now, as it has in the past, chiefly in keeping foreign nations from taking still further slices of China. The Washington Conference of 1921-22 gave China, in the Nine Power Treaty, partial realization of this simple policy of political independence. Control over her tariffs was returned to her in 1931, as well as many other foreign concessions, through treaty revisions. These developments were furthered by the sympathetic attitude of Great Britain and the United States. Since 1931, however, a reversal of the trend toward China's independence has set in, inaugurated by the aggressive action of Japan in Manchuria.

6. What is Japan doing to China?

The cartoon which portrays Japan swallowing piecemeal the Chinese dragon paints the picture accurately. First Formosa, Korea, Pescadores, then Manchuria, Jehol, now Chahar, Hopei and the Peiping-Tientsin area. Japan is at present flourishing on the diet, but indigestion is likely to ensue in the event of war with Russia. China today appears to be facing a program of what the Japanese call "cooperation", which may eventually involve the end of the "open-door" policy in China, and would place supervision of foreign economic agreements (loans, construction, concessions, etc.) virtually in the hands of the Japanese Government, as it has been in Manchuria. Nor is Japan likely to content herself with economic domination of what is left of China. Within the past year Japan has imposed a degree of censorship on the Shanghai press that augers ill for China's political as well as economic sovereignty.

Japan has informally pressed upon the Central Government of China three demands which provide an ever open channel for an extension of Japanese control over China. These demands are: (a) the suppression in China of anti-Japanese agitation, (b) the prevention - with Japanese

assistance if necessary - of the spread of Communist influence in North China, and (c) the acceptance of Japanese co-operation in the promotion of economic welfare of China. Whenever Japan wishes she can employ any or all of the three demands as an excuse to either send armed forces further into China, or by the threat of such action force the Nanking Government to accede to Japan's program.

Regardful also of the threat to her ambitions presented by the close proximity of Soviet Russia, Japan is moving to protect her position in the Northwest. The predominantly Mongol Northwest portion of Manchuria has been organized into a separate province, with a considerable degree of local autonomy. This move has created a rallying point for the supporters of traditional Mongol ways and thus a bulwark against Soviet propaganda.

In the Southeast seacoast province of Fukien, Japan is employing, with some success, surreptitious and devious means to place the Chinese peasant under Japanese control. In the South, Japan works hand in hand with French imperialism. France effectively dominates one of the Southern Chinese provinces, extends her sphere of influence over two of the neighboring provinces, and has a close understanding with Japan (treaty of 1907) pledging mutual support to sustain each other's territorial rights in Asia.

Thus, in the North, Northwest, East and Southeast Japan is busy whittling away at China's independence.

7. Religion in China has helped to keep the masses docile under extreme poverty.

Several religions in China have undergone a partial synthesis in which the lines of demarcation have been blurred. Buddhism, the most important of Chinese religions in number of adherents, has for its central doctrine salvation through righteousness, and this ideal, although somewhat obscured by later growths, still remains a very potent source of influence in Chinese life. Taoism, the most important of the indigenous religions, is today in large part a system of magical rites. Confucianism is not a religion but a body of ethical precepts, having to do with the individual in family and governmental relationships. Christianity in various doctrinal forms has been known in China for centuries, but because of its exclusive and non-compromising character has met the hostility of the State as subversive of the State religion, and has been under suspicion as an entering wedge for imperialism. Mohammedanism, Judaism, and Lamaism (Tibetian and Mongolian forms of Buddhism) have also considerable bodies of adherents.

The dominant religions in China are superimposed upon a basis of superstition and geomancy -- a cross between astrology and sorcery, with

a dash of black magic. The spirits of earth, water and air are carefully consulted in all undertakings, and a very elaborate system of divination is practiced. This applies to the bulk of people, not, of course, to the educated.

These various elements in Chinese religion have resulted in the evolution of a people with a peculiar combination of mystical stoicism, ethical precepts, ignorant superstition, religious tolerance, ancestral veneration, and ceremonial behavior. They help keep the birth rate high, the farms small, tradition strong, women in a low legal status, and expenditures on funerals, births, weddings and religious practices extremely great, while adversity, poverty, death and exploitation are accepted with a fatalism bewildering to the Western mind.

8. The family unit is all-important in China.

The fundamental unity of Chinese life is based upon the sanctity of the family group. Chinese society is a social democracy of myriad family corporations, whose relations are determined by an elaborate social code. The local government is thus a patriarchal association of elders, heads of families, and this fact secures the perpetuation of a remarkably stable local government even in troubled times.

The family system, promoted by Confucian teaching, emphasizes respect and obedience of children for the parents, and the obligation of parents to have as many male offspring as possible. It also calls for a division of the inherited holdings among the males. These precepts have helped maintain a high birth rate and have been responsible for ever-increasing subdivision of land.

9. Shanghai is not China!

In discussion conditions in China, it is well to remember that Shanghai is not the whole of China. Too frequently what is happening in Shanghai -- by far the wealthiest and most important city financially, industrially, and commercially -- is erroneously assumed to be true of China. The error is made easy by the fact that so much of what appears in English and in the foreign press is written in Shanghai or Nanking. There are very large areas in the interior of China with teeming population which are largely primitive and isolated economic units. Transportation and communication are so poor that economic changes occurring in one part of China may not have any repercussions on other parts for a very long time, or never. Enormous distances (not to be measured in miles, but in transportation facilities) exist between the coast and the interior. It takes a long time for the repercussions of economic changes to percolate through the interior and rural areas, and there are doubtless numerous communities in China whose primitive economic life has remained unaffected by fluctuations in the price of silver in 1934 and 1935.

A glance at the chart on the next page, for example, shows how dangerous it is to speak of "China" as though it were as homogeneous economically as the United States, Japan, or any European country. On the chart are the prices in terms of per cent of the farm price of a staple like rice prevailing in each province in October 1933 as compared with January 1931. The variations are in some cases enormous; from a drop of 51 per cent in the Western province of Chinghai to a rise of 19 per cent in the adjoining province of Sinkiang. Variations almost as great could be shown for wheat prices. If these variations existed for such highly standardized, staple and transportable commodities, it is clear that one must speak with caution of price movements, wage rates, business conditions in "China".

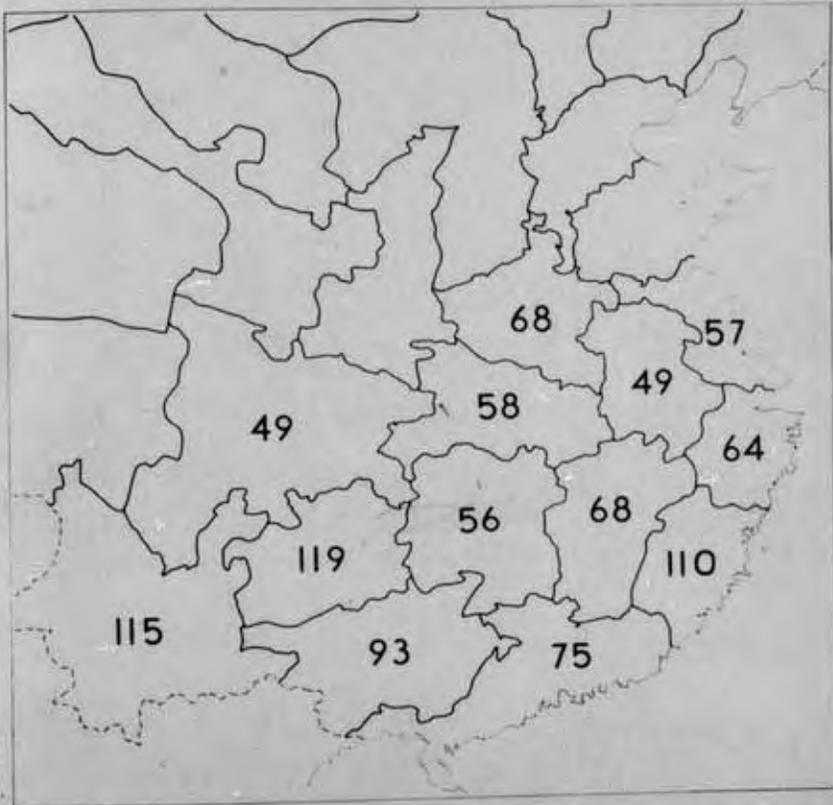
On the other hand, it would be incorrect to assume that the bulk of Chinese people remains unaffected by trends in foreign trade, or expansion or contraction of credit, or changes in the price of exported and imported commodities. The farmer has to sell his surplus crop -- no matter how small that may be -- to merchants who in turn sell to larger merchants. The price of those crops is inevitably influenced by conditions prevailing in the larger centers, and in the world. The interest rate paid by the small merchant, and the amount of credit he may obtain is likewise affected by conditions prevailing in the commercial centers. So a drain of silver from the interior to Shanghai, or out of Shanghai to foreign countries, or alterations in yuan exchange rates, sooner or later affect with varying degrees of intensity large numbers of communities in China.

B. ECONOMIC BACKGROUND

10. China is not rich in natural resources.

The extent of China's mineral resources is a matter of much dispute and widely different estimates. Complete surveys with modern technique have never been made. It is possible, therefore, that there is more rather than less mineral wealth than is now known to exist. Mineral wealth is chiefly concentrated in the rough, high, and sparsely populated parts of the country. Coal, it is agreed, is the most important resource, but since the transportation is poor the fields are not readily accessible and China imports more coal than she exports. The iron resources made up of low-grade ore are small and widely scattered and, therefore, do not lend themselves to modern large-scale methods of extraction. In the other common metals, such as copper, lead, zinc, and particularly silver, China is very poor. She is, however, the leading world producer of both antimony and tungsten, producing today about 70 per cent of the world production of the former, and about 50 per cent of the latter. She also produces considerable quantities of tin and manganese ore.

FARM PRICE OF RICE IN CHINA OCTOBER, 1933 IN PERCENT OF JANUARY, 1931



The divergence of opinion as to the petroleum resources is puzzling. According to several authors there is little oil in China; others claim there is a moderately good supply of oil (located in the provinces of Sinkiang and Kansu); and a recent report by an American expert states that the supply of oil in China is enough to supply the whole world for 300 years! The author who quotes this estimate admits that existing wells have failed, but he attributes this to the inadequacy of the survey work.

Much of China consists of steppes, desert and mountainous territory. Even were the outlying provinces of Mongolia, Tibet, and Sinkiang to be included, there would be less land fit for cultivation than there is in the United States.

11. Is China's population growing?

Nobody knows! The authorities disagree but the concensus of opinion among those who have studied the question is that China's population is increasing. Even the approximate population is unknown. Despite frequent government censuses, the authorities differ widely in their estimates. Some claim the population to be as low as 300 million, and others as high as 480 million. The majority of scholars place the figure near 425 to 450 million.

The birth rate is very high, but so is the death rate. The birth rate is estimated around 45 per thousand. Even in Japan it is only 32, while in the United States it is almost half that of Japan -- 18. Only in Russia does the birth rate probably equal China's. But the population in China is kept down by a very high death rate -- much higher than in any country we know of. Famines, floods, civil wars, pestilence, mal-nourishment, infanticide, unbelievable ignorance, scanty medical facilities, ruthless exploitation and extreme poverty make the infant death rate enormous and the average span of life short. A Chinese writer recently reported that last year -- and past years -- 24,000 dead infants were picked up in the streets of Shanghai alone.

12. Transportation and communication are terribly inadequate.

Transportation facilities away from the coast and rivers are so primitive, so inadequate that it is not unusual for a famine to exist in one region with literally hundreds of thousands starving to death, while only a few hundred miles away the crops are adequate. There are only some 7,000 miles of railroad (compared with 250,000 in the United States), most of it built 20 to 30 years ago. The roadbeds, equipment, rolling stock, and management are for the most part in very bad shape. Good highways are likewise scarce. Except for trails, there are in that huge rugged country only about 25,000 miles of roads altogether. (The United States has 100 times more than that in paved roads alone.) Water transport -- coastal vessel, river boat, canal barge -- carries a considerable portion of China's commerce, but over most of China's area,

goods are carried by man or animal power. It has been stated that 20 per cent of China's population are engaged in transport in one form or another! Even allowing for much exaggeration, it is evident that poor transportation is a serious obstacle to a higher national income.

The present Government is making strenuous efforts to improve the railroads and highways, but two-thirds of the heavy railway debt (about 1 billion yuan) is in default, and, therefore, it is very difficult to attract the capital so sorely needed for repairs and new construction. The railway construction that is going on is financed almost wholly with domestic capital. It is reported that a German concern is supplying 10 million yuan of railroad material on credit, taking 7-year bonds for security, but such sums are insignificant compared to what is needed.

13. China is predominantly an agricultural country, yet is a net importer of food!

Over 80 per cent of the people are engaged in agriculture. The farms are tiny -- in the denser areas about 1 acre per holding -- and are cultivated very intensively by primitive yet most painstaking methods. Despite irrigation and fertilization, much of the soil has become impoverished and yields are comparatively poor.

Nevertheless, there are so many old and young, women and children engaged in farming that the total agricultural output of China is high. The output has to be high to keep 400 million people alive, since China produces only a relatively trifling amount of surplus raw materials and manufactured goods with which to purchase imports. China ranks high in the production of rice, corn, wheat, millet, wood oil, beans, sweet potatoes, peanuts, and walnuts. It is third in the production of cotton (producing one-fourth of the United States' output), and grows large quantities of tobacco, sugar cane, bamboo, ginger, mushrooms, licerice, sesame, rapeseed, etc.

China does not produce a surplus of foods. Notwithstanding the large areas of cultivatable land in China, and the large number of people engaged in farming, China is not a food exporting country. She exports some and imports others, but on balance she is a net importer of a small amount. Though producing more than one-third of the world's huge rice crop, and 600 million bushels of wheat, China imports each year large quantities of rice (90 million yuan in 1935), and of wheat and wheat flour (40 million yuan in 1935).

14. Bulk of the population keeps only two jumps ahead of starvation.

Despite the fact that China cultivates a large area with an intensive application of hand labor, there is rarely an abundance of food for

the entire population. The peasant farmer is unmercifully exploited on every hand. Each year great numbers of them have to pawn some of their meagre property in order to obtain funds to carry them through till harvest, or for a funeral or wedding, and the interest charges may be as high as 10 per cent a month. The average farm family consumes almost half its output and the other half of the small crop passes through the hands of so many middlemen, and is subject to such high transportation costs that the farmer receives very little for his produce. Even that little is reduced by burdensome taxes.

The crying need in China is not for more land, but for greater yields on the land already cultivated, and a larger share of the returns to the peasant for his product. Better seeds, more fertilizer, protection against plant diseases, extension of irrigation and dykes, are sorely needed to raise the output per acre, while better transportation facilities, removal of some of the very burdensome taxes, improvement of rural credits, and better marketing facilities, will give the peasant a chance to improve his inconceivably low standard of living.

15. Industrialization of China is in its infancy.

Only some 20 years ago virtually all industry was confined to the cottage variety. Most of it still is. Even in cotton weaving, the most advanced of the modern manufacturing industries in China, it is estimated that four-fifths of the cotton cloth consumed in China is made on hand looms. Less than 1 per cent of the population of China is connected with large-scale industry, and there are only some half dozen mines equipped with modern machinery. The only industries that have reached the large factory stage are the textile, cigarette, match, oil crushing, paper making, and flour milling -- with cotton spinning and weaving far in the lead.

Foreign companies have taken the initiative in the industrialization and either manage or control most of the large factories. More than half the cotton textile mills, for example, are owned by the Japanese, who operate their mills much more efficiently than do their Chinese competitors. In the past few years, a much heightened tariff against imports has counteracted the keener competition of foreign producers of certain items, and has been responsible for the establishment of several hundred factories. Yet it will take many decades at the rate China is progressing now before industrialization of China will reach even adolescence.

16. Labor is cheap, inefficient, unorganized, and badly exploited.

The wages of labor in industry are extremely low, ranging from .40 yuan (or 15 cents in United States money) per working day in the mines and cotton spinning, to double that for carpenters and masons,

and triple that for shipbuilding. A recent investigation showed the average wage of industrial workers in Shanghai in 1934 to be .55 yuan a day (i.e., 17 U. S. cents) for a 10½ hour day. The hours of labor are long, 10 to 12 being common, and though there are laws regulating working conditions, minimum wages, etc., no employer seems to obey them. Wages have been falling in the past three years and unemployment increasing.

Unemployment and under-employment are the gravest of China's many social problems. In rural districts the farmer is partially employed for most of the year, while large numbers obtain only occasional work. In the large cities conditions are even worse. Every disaster, flood, drought, civil disturbance, sends hordes of people to the large coastal cities seeking some sort of work, at any wages whatsoever. In Shanghai alone it is estimated that several hundred thousand of such people live in mud huts hastily thrown up by themselves.

When the Communists dominated the Kuomintang, 1924 to 1927, unionism was encouraged, but since then the number of unionists has fallen considerably. The present Government though recognizing the legality and desirability of unions encourages organization of employers and has subjected labor unions to definite political control. Much more widespread than labor unions are local guilds, of ancient origin, which regulate apprenticeships, prices and master workman relationships in the handicraft industries, such as they did in England and France before the Industrial Revolution. But, as to be expected, it is the modern labor union that is active in the growing struggle for better working conditions. Several hundred strikes took place last year, many of them successful. Yet the number of unionized workers is so small a proportion of the population that the effect on the total situation is negligible.

17. With such extremely low wages and long hours, why doesn't China capture a greater share of foreign markets?

Low wages do not make low costs of production. The important measure is the productivity of that labor, i.e., the cost of production per unit of output. Chinese labor has extremely low productivity because:

- (1) Capital is scarce and interest rates are very high. The Chinese are, therefore, at a disadvantage whenever much capital is needed in production.
- (2) Workers are ignorant, illiterate, and haven't even an elementary scientific knowledge or appreciation of mechanical methods of production.
- (3) Transportation facilities are very bad, and the expense of securing any raw material from the interior is high.

- (4) Efficient business organization, scientific research, standardization of equipment, are almost unknown. There is no general use of weights and measures, and local customs vary greatly.
- (5) Notwithstanding a domestic market of 350-450 million people, large scale production is not promoted, because of the low income, poor transportation, inter-port duties, monetary confusion, civil wars, and lack of communication.

The consequence of all these handicaps is that China imports, for example, automobiles and machinery from the United States despite the fact that China has iron and coal and the American worker gets 20 to 50 times more wages!

18. China's Government finance is in a bad way.

The problems of public finance have always constituted a source of major difficulty for the Central Government. Constantly recurring civil warfare has necessitated heavy expenditures, while the strength of local governments has seriously limited Nanking's revenues. The source of the Central Government's revenues is almost entirely indirect taxes. The beginnings of an income tax has been recently instituted. Some revenues are shared with the provincial governments, in proportions which vary with the power of the Central Government to compel their remission. Customs, by far the most important source of revenue, yields between 55 per cent and 65 per cent of total revenue receipts of the Central Government, but most of it is already pledged for specific debt service. Difficulties of collection are great. Not only do costs run as high as 10 per cent of receipts, but smuggling is very common, especially into areas controlled by the Japanese. Revenue from salt taxes are also important, constituting a third of the national revenue.

Less than 10 per cent of the total revenues go toward what we consider ordinary governmental functions. Almost a half the total revenues -- a proportion equalled in few countries -- is for military expenditures. Loan service accounts for another 25 per cent and subsidies take an additional large slice. Expenditures rose from 435 million yuan in 1929 to 898 million in 1934.

Inevitable deficits, amounting in recent years to about 100-150 million yuan have to be met by borrowing at the very high rates of 8 to 12 per cent. The total indebtedness of the Central Government is roughly estimated to be between $4\frac{1}{2}$ and 5 billion yuan, if old loans are included, but service is not being met on almost half of it. Several of the important foreign debts amounting to some 700 million yuan have a lien on specific sources of revenue, so interest is being paid, but on most other foreign loans payment is in arrears. The Government bonds sell at yields ranging from 10 to 15 per cent.

The national debt is extremely small when reduced to per capita amounts, but the national income is so low, and the source of national revenue so restricted, and the portion allocated to payment abroad so large, that the total debt constitutes a heavy burden on the National Government. The Government is unable to finance its loans by direct sales of its bonds to the people, so it borrows from the Central and semi-Government banks and also from the modern-style banks, leaving as security its bonds which are accepted at only 50 per cent face value. The banks sell securities from time to time and credit the Government with the proceeds.

In February 1936 the Central Government announced the consolidation of 35 internal loans (totaling about 1.5 billion yuan) into one loan. By lengthening the maturity dates, the annual redemption charge has been reduced and somewhat relieved the pressure on the Government finances -- a pressure that was aggravated by the sharp decline in customs receipts during the last four months.

19. The British and the Japanese have large sums invested in China.

Of the 3½ billion yuan roughly estimated to be invested in China by foreigners, England supplied more than a third, and Japan a little less. Part of the Englishman's annoyance at our silver program originated in his belief that rising price of silver was bad for his holdings of Chinese investments. Japan's interest in China also is enhanced by the fact that more than three-fourths of her foreign investments are in China. Americans have about 200,000,000 yuan (i.e., about 60 million U. S. dollars) invested in China.

No foreign capital has been flowing into China during the last few years (except the United States cotton-wheat loan). On the contrary, there has been a movement of capital out of China, due chiefly to the disturbed political situation. China needs capital very badly, but prospects of borrowing large sums abroad are not good unless some government gives her a loan in exchange for some concession, or a Consortium again begins to operate in return for further restriction of China's sovereignty.

20. China has always had an "unfavorable" balance of trade, but a "favorable" balance of payments.

China has for the last 20 years imported much more than she exported and met the payments for her import excess with remittance from Chinese abroad, by expenditures in China of foreigners and foreign institutions, and by imports of foreign capital. She even received enough to pay for a constant excess of imports of silver and usually some of gold.

In the last few years the situation has radically altered. Her import excess remains large (344,000,000 yuan in 1935), but her capacity to pay for that excess has declined seriously. (a) Immigrant remittances which used to be a very important source of foreign revenue (some 380 million yuan in 1930) have fallen owing to the world depression; (b) capital is flowing out instead of in because of the political disturbance, monetary uncertainty and depression in China; and (c) foreigners are spending less in China. The consequence has been a heavy outflow of silver and gold for the first time in 20 years, accentuated by rising price of silver abroad. In the years 1932-33-34-35, 800 million yuan of silver and gold left the country legally while Chinese writers estimate that at least half as much was smuggled out.

C. CHINA'S FOREIGN TRADE

21. China imports much more than she exports.

China has had an excess of imports for 20 years. The loss of Manchuria, which in the late twenties had developed a large export balance, reduced the exports greatly. It was only because of the heightened restrictions on imports, and because of the drop of incomes in China after 1931 that the import excess was prevented from skyrocketing. As it was, China's total foreign purchases in each of the past five years were almost double her sales.

(China's foreign trade for the past six years is shown in some detail in one of the accompanying large colored charts, "China - Foreign Trade. China's trade balance since 1926 is plotted among other data on the other large colored chart, "China - Economic Situation".)

22. The United States is China's most important customer, and most important source of supply.

A sixth of China's exports is recorded as going to Hong Kong. Inasmuch as British controlled Hong Kong is little more than an important port which taps the Southeastern portion of China, trade with Hong Kong is in a sense domestic rather than foreign. Of the purely foreign countries, the United States is China's chief customer, with Japan second, and Great Britain third. We purchase about one-fourth of China's exports, and Japan (including Korea) purchased in 1935 one-sixth. British India, Germany, France, and the Netherlands purchased 3 to 5 per cent each.

In sources of supply the United States ranks first, though the extent of her lead dropped sharply in 1935. We supplied 19 per cent of China's imports, and the nearest competitors for the leading position were Japan with 15 per cent, Germany with 11 per cent, and Great Britain

with 10 per cent. Netherland India and British India followed with about 5 per cent each.

23. From 1929 to 1934 our share of sales to China increased considerably.

In the six years, 1929 to 1934, we supplied a constantly growing share of China's imports, but purchased only the same proportion of her exports.

We increased our share of China's business (exclusive of Manchuria) from 19 per cent to 27 per cent of her imports, while Japan's dropped from 18 to 11; Great Britain's share increased from 9 to 12 per cent, Germany's rose from 5 to 9 per cent, and British India held her own.

In purchases from China we continued to take about the same proportion - 18 per cent of her exports. Great Britain's share increased slightly (7 per cent to 9 per cent) if Hong Kong is not included; if Hong Kong exports were included in China's export trade, Great Britain's share would have shown a very large drop. Japan's share declined from 17 to 15 per cent, and France dropped from 8 to 4 per cent. British India doubled her share, as did the Netherlands, while Germany's increased slightly.

24. Complete reversal in our Chinese trade in 1935.

The United States has for many years sold to China 50 per cent more than she purchased from China. But in 1935 a complete reversal took place. Instead of selling China 50 per cent more than we bought, we bought almost double the amount we sold to China. In 1934, for example, our sales to China were \$69 millions and our purchases \$44 millions; whereas in 1935 our sales were \$38 millions and our purchases \$64 millions. For the first time in at least ten years we had a large import excess instead of a large export excess in our trade with China.

This marked shift in trade was due not to any general situation, but chiefly to conditions peculiar to the trade between the United States and China. This is evidenced by the fact that while our total exports in 1935 were 7 per cent greater than in 1934, our exports to China were 44 per cent less. On the other hand, whereas China's total exports in 1935 were only 8 per cent more in 1935 than in 1934, she sold the United States 46 per cent more in 1935 than she did in 1934.

Our share of China's imports dropped from 27 per cent in 1934 to 19 per cent in 1935, while Japan's share increased from 12 per cent to 15 per cent, and Germany's from 9 to 11 per cent. Great Britain's share suffered along with that of the United States, but not nearly so much, dropping only from 12 to 10 per cent.

In contrast to the drop in the share of China's business obtained by American producers, we increased the proportion we took of China's total exports from 17 to 23 per cent, while Japan did not increase her share, and Great Britain decreased hers from about 10 to 9 per cent.

In short, from the point of view of our trading relations, China has every reason to be thankful for the role played by the United States in China's foreign trade of 1935.

25. Why did this sudden reversal in United States-China trade occur?

Partly because of our agricultural policy; partly because of Chinese conditions, and partly because of the nature of commodities that bulk large in our trade with China.

China purchased 11 per cent less imports in 1935 than in 1934, but her imports from us dropped 36 per cent (in terms of yuan). The bulk of our decreased sales to China in 1935 were in raw cotton, leaf tobacco, and wheat. But it was only in wheat that we lost to some other country (Australia). Whereas China bought 3 million yuan more of wheat in 1935 than in 1934, she bought 20 million less - or almost none - from the United States!

In the case of cotton, however, we sold them 28 million yuan less, but that was no greater proportionate loss than suffered by other cotton exporting countries to China. We still sold her almost half her cotton imports. This does not mean, however, that our cotton program may not be partly responsible for China's total decrease in cotton imports.

Leaf tobacco presents a somewhat different picture. We furnish China practically all her imports, and therefore the decrease in her total imports of leaf tobacco of 22 million yuan all came out of our exports.

Our increased purchases from China in 1935 can be explained chiefly on grounds of the particular commodities dealt with. The bulk of our increased purchases was in tung oil, raw silk and wool, sesame seed, peanut oil, and egg albumen. On three of these items - raw silk and wool, peanut oil, and tung oil - our total imports from all countries increased much more than our imports of those items from China, and was due to causes independent of movements in exchange rates or prices in China. Though our imports of sesame seed came chiefly from China, the increase in its importation also had little to do with changes in yuan exchange or prices.

26. Latest data show China's imports continuing to decline and her exports to increase.

In January 1936 her exports were 23 per cent greater than in

January 1935 (but no greater than in December 1935), and her imports 33 per cent less than in January 1935 (but 7 per cent less than in December 1935). We lost our proportionate share of her imports (i.e., her imports from the United States decreased 33 per cent), but our purchases from China increased 90 per cent, though China's total exports to all countries increased only 28 per cent.

For the second consecutive month -- and the first time in many decades -- China had an excess of exports. If the trend continues, she will end the year with an excess of exports -- for the first time in at least 20 years. This would greatly help remove the pressure against her balance of payments and yuan exchange.

27. What are China's chief exports and imports?

There is no single item, or classification, which dominates China's imports or exports. The two items we customarily associate with China -- tea and raw silk -- constitute together only about 10 per cent of her exports. Both have declined in importance because China's chief tea and silk competitors in India, Ceylon, and Japan, have steadily improved the quality and fostered standardization of grades, a program China has failed to adopt.

Other important items of exports are cotton yarn; metals and minerals, chiefly tin, tungsten, antimony; eggs and egg products; furs and skins, wood oil, raw silk; silk piece goods; raw cotton. Each of these classifications constitutes about 5-6 per cent of China's exports. One-fourth of China's exports consist of food, drink, and tobacco, and one-half of raw materials and semi-manufactured goods, and only about one-sixth of manufactured goods.

China's imports, as to be expected of an agricultural country, consist chiefly of manufactured and semi-manufactured goods, though her imports of food, drink, and tobacco bulk large. They constitute about one-fifth of her imports. Chief items of import were metals and minerals, principally iron and steel; raw cotton; rice; machinery and tools; chemicals and kerosene oil. Together these few categories make up almost 40 per cent of China's imports.

28. What do we buy from and sell to China?

We buy almost exclusively raw materials -- furs, tung oil, carpet wool, bristles, tin, goat and kid skins, tea and raw silk. Our purchases of tea and raw silk from China, however, amounted to a small proportion of our total consumption. Last year imports of both items

together from China were less than \$6 millions, while our total imports of raw silk amounted to \$96 millions, and of tea \$17 millions.

We sell China raw material and manufactured goods. Raw cotton is our most important export, tobacco next; kerosene, wheat, coal-ter products, iron and steel manufactures, automobiles, and electric machinery are poor thirds. Over a fifth of our total exports of airplanes went to China in 1933 and 1934, about a sixth of our kerosene exports, and a tenth of our tobacco exports, but in 1935 the proportion of the latter two was much less.

Though we are China's chief customer and source of supply, she is quite unimportant in our foreign trade except in a few agricultural items. She ranked in 1935 seventeenth in our list of customers, and eleventh in the list of countries we buy from. China took only 1.7 per cent of our exports, while our imports from China constituted less than 3 per cent of our total imports.

D. POSSIBLE FUTURE DEVELOPMENTS IN OUR TRADE WITH CHINA

29. Is China cutting into our raw cotton market?

Only potentially, by growing more for her own consumption -- not by selling more to other countries. In fact her purchases from the United States in 1933 and 1934 were greater than they were in 1928, 1929, or 1930, though much lower than in 1931 and 1932, notwithstanding a very substantial increase in her cotton crop. In 1928-1929 cotton exports to China averaged 100 million pounds; in 1933-34 they averaged 156 million pounds, but in 1935 they dropped to 46 million pounds. Part of the imports in 1933-34 were a consequence of the 10 million dollar cotton and wheat loan extended by the United States to China in 1933.

China's 1934-1935 cotton crop was about 3.1 million bales, or 30 per cent of our crop for that year, but her 1935-36 crop will be about 25 per cent of ours. She has been increasing her crop fairly steadily. From 1930-31 to 1935-36 China's output would have increased about 400,000 bales (while over the same period our output

decreased eight times that amount) were it not for very unfavorable weather -- flood and drouth -- in cotton raising areas. As it is, though the cotton acreage planted in China was slightly greater than it was last year, her cotton crop dropped from 3.1 million bales to 2.6 million. Ours, on the contrary, increased 1 million bales.

China's exports of raw cotton are not a factor in the decline of our cotton exports. Though her exports were 50 per cent greater last year than in 1934 (but 25 per cent less than in 1933) their total was only 70 million pounds, or only 2 per cent of our raw cotton exports! Her exports go chiefly to Japan. Last year China increased her exports to both Japan and Germany, but the totals involved are as yet too small to warrant fears that China will soon become a serious competitor of ours.

There is the frequently expressed opinion in China that with moderate improvement in the methods of raising cotton and in seed selection -- such as has been already made in two of the provinces -- China will easily become self-sufficient in cotton and even have a surplus for export. If crop conditions had been the same in 1935 as in 1934, her output would have been some half million bales greater, an amount much larger than her total imports during 1934 and 1935.

She has been importing from two to five times the amount she exports, but her imports - which come chiefly from the United States and India - constitute a steadily decreasing proportion of her consumption. Though it is true that China herself can consume a great deal more cotton if the standard of living there rises, it is likely that unless cotton prices remain much lower than they have China will increase her output in the near future more rapidly than her consumption.

30. Will the United States be cut out of other foreign markets if China becomes further industrialized?

Not for many decades, if ever, will the Chinese cut into American

foreign markets for anything other than cotton textiles and some minor items. The rate of industrialization in China will be so slow, and the progress to be made before mass production methods can be developed is so much, that even if Japan were to subjugate China and turn all her efforts toward developing China, many decades would elapse before China could produce for export most of the manufactured items we now export.

When Chinese labor becomes more effective -- because of additional capital, or better technique, or lower transportation costs -- China will not necessarily undersell American exporters. To undersell them in foreign markets, China must progress almost as rapidly as the United States, else her improvement will prove no advantage in competitive markets. She must accumulate much more capital than she now has, her transportation facilities must improve considerably, etc., etc. Japan, for example, is much further advanced in industry than is China, and has wages that are very low compared with the United States, yet we sell Japan a host of manufactured items.

Those who are gravely concerned lest the Japanese or Chinese overtake us in technical and business efficiency apparently overlook the fact that progress is continually being made here. There is surely no indication that the rate of technological advance has slowed down in the United States, nor can it be reasonably claimed that no further progress is to be expected from our engineers and business men in the technique of production and marketing.

31. What will happen if Japanese brains, organization, and capital combines with low-paid Chinese labor?

There will be an increase of China's exports of those manufactured goods which require the least technical skill on the part of operators, the greatest proportion of labor to capital, and which are made of raw materials with the least transportation costs.

Textiles of the cheaper grade will doubtless show the greatest increase among the industrial goods. But much of the foreign capital and ability, in the event of Japanese penetration, will go into transportation facilities and mining, with the result that grains and raw materials will be cheaper and the worker will have more to spend on manufactured goods. With increased capital and improved management, in China, her national income will increase, and she will be a better market for foreign goods.

32. An industrialized China will mean more not less foreign trade for China.

It cannot be too frequently stated that increased productivity on the part of a people results in more trade, not less -- providing markets

are kept open. Illinois and Massachusetts exchange much more goods per capita with each other now than they did when Illinois was far less industrialized. Nor is it necessary that markets be wholly free in order for trade to increase; it is merely essential that the barriers be not absurdly heightened. A more prosperous China will consume more automobiles, more machine tools, more copper, sewing machines, cotton, oil, etc., just as a more prosperous United States will consume more tea, ginger, tin, furs, and raw silk.

If ever the stage be reached in which the advantage possessed by the United States will rest only in natural resources, it will be because other countries have as much capital, as good organizing ability, as high mechanical skill in all lines, etc., as Americans have. When that millennium arrives -- world productivity will be so great, and standards of living so high it will hardly matter if trade is confined to raw materials. In the meantime, Americans can rest assured their foreign trade will increase -- unless nations pursue an extreme program of economic nationalism, and sacrifice standards of living in order to become more nearly self-sufficient.

Our own trade with China will, in the long run, likewise increase, though whether much or little depends largely on the commercial and exploitation policy Japan will pursue if, or when, China comes to be completely under her thumb.

33. Will we sell a Japanese dominated China as much as we would a free China?

Probably not. China under the "open door" policy will provide a much better market for American products than China with a door opened wide only to Japanese producers. It is not certain whether other countries will stand for less favorable treatment in China than Japan would "receive", yet probably sooner or later Japan would find ways to give her own producers preferential treatment, notwithstanding the fact that such action would be in violation of existing treaties. Preferential treatment would secure for her producers a larger share of China's business.

Nonetheless, until China increases her agricultural and mineral output, she will continue to need cotton, kerosene, oil, and tobacco, and these she will be likely to purchase from the United States whether Japan controls China or not. On the other hand, Japan exports to China numerous items -- cotton manufactures, iron and steel, machinery, chemicals, dyes -- in which the United States, Great Britain and Germany all compete more or less closely. Japan will doubtless secure a greater share of business in those categories as time goes on, but if Japan is going to obtain a larger portion of China's business, she must buy much more from China. If she doesn't buy more from China, Japan must buy more from other countries, while making it possible for China to sell more to other countries.

To the extent that the two countries are complementary rather than competitive, Japan can successfully increase trade with China at the expense of other countries -- but neither as a source of food, nor mineral, nor metal wealth can China supply much of Japan's needs in addition to her own -- at least, not until the long and expensive task of substantially improving transportation and agriculture in China has been carried out. Japan cannot simply increase her own exports to China at the expense of other countries and expect those countries to continue to purchase as much from China as formerly.

34. China at present is more competitive than complementary with Japan.

China with her undeveloped natural resources is competitive with Japan and not complementary. The one thing China has to offer Japanese capital and brains, aside from the opportunity of developing transportation, public utilities and mines, is a cheaper and much less intelligent labor supply than Japan has at home. If the Japanese should attempt to utilize this cheaper labor in industry, they will find that China will cut into Japan's own domestic and foreign markets more than into those of any other nations. Japanese capital and organization ability would flow (as it already has, e.g., in the cheap cotton textiles) into just those industries which the Japanese have been most successful at home with low-grade labor.

(England's cotton-goods industry is now suffering from the development in India of cotton manufacturing by British capital seeking to take advantage of low wages in India.)

The safeguard of our trade lies in the fact that if China expands industrially, Japan's industries will benefit least, or suffer most; whereas if public utilities, transportation, etc., are developed, China's foreign trade with other countries will be greater.

One point must not be overlooked. If Japan is going to invest large sums of capital in China, then Japan's exports to China will increase, but the additional exports to China will not be at the expense of other countries' exports to China. To the contrary, if Japan puts much capital into China to build power stations, railroads, bridges, etc., a portion of that capital will be expended in countries other than Japan. (We are speaking of main currents and trends. Clearly, there will be a large number of exceptions.)

Altogether Japanese domination of China is not likely to reduce our total exports to China much, though it may well prevent it in the long run from being nearly so large as it would be with an independent China. This is true only under the assumption that an independent China will be as peaceful and as economically progressive as a China dominated by Japan. Otherwise our trade might be greater with a Japanese policed China than with a war torn China.

E. MONETARY AND BANKING SYSTEM PRIOR TO 1935

35. What connection, if any, is there between business conditions in China now and the world price of silver?

Was the U. S. silver policy responsible for the appearance of the depression in China?

The answers to these questions will be more easily understood if the peculiar nature of China's monetary and banking system before November 1935 is briefly examined first. Because the alterations made in the past few months have not yet been effective throughout China, it is necessary to understand what the situation was before, as well as since, November 1935.

36. What was peculiar about China's monetary system?

Until a few years ago it was a Westerner's nightmare.

(a) Copper coins, the chief hand-to-hand circulating medium of the bulk of the people were not only depreciated (in terms of silver), but fluctuated in value from day to day and from place to place in terms of silver.

(b) Subsidiary silver coins likewise circulated at depreciated rates, in terms of the silver bars and silver dollars.

(c) Silver "dollars" consisted of a collection of foreign dollars, and some half dozen varieties of domestic dollars varying in weight, fineness, and value as much as 5 per cent.

(d) Bank notes issued by banks, exchange dealers, pawnshops, factories, public utilities, and individuals, circulated some at par, and some at discounts varying according to the reputation and record of the issuing bank or person.

(e) "Sycee tael". Finally, most confusing of all, the silver "tael" consisting of bars of silver that varied in weight, fineness, and exchange value from town to town. These "sycee taels" constituted the unit of account and means of settling business and larger transactions. There were Shanghai taels, and Canton taels, and Peking taels, and Hankow taels, etc., etc., but no matter what tael a man possessed he had to exchange it in the "cash shops" or at the money changers for the local currency -- at a fee -- if he wished to spend it. It has been said that a traveller could start out on a journey in China with a large sum of money and in a short time expend the bulk of his funds in exchange fees.

37. What improvements were made in the circulating media?

Two changes were instituted which made Chinese currency much less

chaotic than it had been previously.

(a) In March 1933 the yuan (or Shanghai "dollar"), containing .768 ounces of pure silver, was made the standard unit of Chinese currency, to be coined exclusively by the Shanghai mint. All accounts are required to be kept in yuan. The confusing and most inconvenient "sycee taels" were to be completely withdrawn from circulation.

(b) Since 1931 the right to issue bank notes was restricted to banks only, and to only those banks fulfilling necessary requirements. A reserve of 60 per cent silver and 40 per cent in securities against notes was required.

The changes which have taken place in the past few months will be taken up later.

38. What change did these improvements actually make in the circulating media by November 1935?

Not a great deal. The note issue was somewhat improved, and the "taels" were eliminated, but the coins in circulation remained about the same.

(a) The copper coins remained. Copper coins were minted by local communities, as well as by the Central Government. There being no requirement that a fixed ratio be maintained between token and subsidiary coins and a given weight of silver, the provinces had been quick to seize the opportunity of a seigniorage profit and vast quantities were minted. Some 40 to 50 billion of "copper cash" have been minted in the past 40 years, and as a consequence they depreciated to about one-third their value. Nominally 10 cash = 1 cent; and 100 cents = 1 yuan, but actually the exchange value was about 340 cash = 1 yuan. Many wages and retail prices in rural areas and even in urban districts were set in terms of copper "cash" and not in silver.

(b) Silver subsidiary coins likewise remained unaltered. They were also minted in various provinces without any requirement that their value be kept at a fixed ratio with a given weight of silver. Not being legally redeemable in any fixed unit of silver, they too were minted in such large quantities as to cause their depreciation. About 400,000,000 yuan of subsidiary coins (almost all of 20-cent denomination) were outstanding. They circulated at the value of their metallic content -- about 20 per cent discount of their nominal value -- and (with silver dollars) were used in payment of taxes, rent, loans and wholesale transactions, all stated in terms of yuans.

(c) Silver dollars in circulation were virtually unchanged. Few new dollars were minted and the old silver dollars -- about 1¹/₂ billion of them -- continued to constitute a very important element in the

circulating media. The troublesome "sycee taels", however, were mostly withdrawn from circulation and placed in the vaults of the Shanghai banks.

(d) Bank note circulation improved. Issues by numerous small agencies ceased and those legally issued obtained wider circulation and inspired more confidence. Notes were issued by the Central Bank, semi-Government banks, and several of the large "modern-style" banks. Some of the foreign banks also issued notes but their total was very small. The Central Bank of China (the Government bank) and the Bank of China (a semi-Government bank) had the largest amount of notes outstanding. Together they issued 225 million yuan or more than half of notes of all Shanghai banks. A survey made of sample areas indicated that the amount of bank notes circulating in China rapidly increased in the last five years so that by November 1935 they more than equalled the number of silver dollars in circulation. (The banking system of China is briefly described in Sections 39 and 40 below.)

Not all note issues were under the jurisdiction of the Nanking Government. Certain provinces are only under nominal control of the Central Government; in many others the small banks, virtually "pawnshops", ignored the Government regulations, while because of the extra-territorial rights the foreign banks are not subject to control by the Nanking Government at all. Nevertheless, on the whole, bank notes of the leading banks in China became a stable and safe circulating medium which before the change in November 1935 were kept (except for isolated cases) redeemable in silver on demand.

In the few months previous to suspension of specie payments in November there developed less certainty with regard to the continued redemption of the outstanding notes at their face value in current weight dollars, but the maintenance of high reserve ratio and the assumption recently of Central Bank control over many of the note issuing banks helped to keep its own notes and the notes of the larger banks circulating at par.

(e) The Haikwan tael ceased to be used. It had been the unit of account in which customs figures were computed, but did not exist in either coin or ingot form. In February 1930, it was replaced by the Customs Gold Unit, equal to 40 cents of the old U. S. gold dollar. All customs duties were payable in these customs gold units. Therefore, when silver rose in terms of gold it was equivalent to a reduction in import duties and vice versa.

39. Some important changes effected in the banking system in 1931.

China's banking system was modernized five years ago. Before that year there were virtually no national laws controlling banking. Each

province had its own bank, which never published statements and which frequently specialized in over-issue of its own notes. Almost any institution or person could receive deposits, issue notes, float securities, or lend money without having to comply with any regulations as to specie or cash reserves, maximum loans, etc. Banks seldom lasted more than 10 years; even the large ones undergoing frequent reorganization.

In 1931 a banking law was passed designed to bring all banks under the regulation of the Central Government and to introduce reserve requirements against note issues and some modern devices against customary banking abuses. Beside the reserve requirement for note issue already referred to, numerous provisions respecting periodic examinations, reports, limitations on inter-bank loans and so on were included in the new law.

It must be remembered that the laws of the Nanking Government can be effectively enforced only in the provinces around the lower Yangtze Valley. Several of the more distant provinces are more or less independent from the Nanking Government control, especially with regard to monetary and banking regulations, while in many more the new bank laws of the Central Government are winked at. The Provincial Banks, particularly, do much as they please. Nevertheless, Shanghai being by far the most important financial market in China, the new provisions have done much to bring about order out of the previous chaotic conditions.

40. Banks of China are made up of six separate types.

The banks of China consist of (a) the Government owned and controlled Central Bank of China; (b) two semi-Government banks -- the Bank of China and the Bank of Communications; (c) Provincial banks; (d) "modern-style" commercial banks; (e) "native" or old-style banks; and (f) the foreign banks.

(a) The Central Bank of China, created in 1928, corresponds in organization and powers to the usual Central Bank. It issues notes, accepts deposits both from banks and individuals, and acts as the Government fiscal agency. It is owned and controlled by the Government, has many branches, and operates in the interests of the business community of China. The volume of note issue by the Central Bank constituted about one-fourth of the note issue of all Shanghai banks. The major portion of the Government funds are deposited with the Central Bank and these constitute the bulk of the bank's deposits. The loans made by the Central Bank are mostly loans to the Government (chiefly in the form of over-drafts) and are secured by deposits of Government

bonds, or pledges of certain fiscal revenues. There are no legal restrictions on the amount the bank may lend to the Government.

(b) The semi-Government banks, the Bank of China and the Bank of Communications, with their 250 branches scattered throughout China, function not only as semi-Government institutions, but as the leading modern-style Chinese commercial banks. These two banks are also important lenders to the Government; almost half of their loans being for the account of the National Government. Part ownership and power of appointment of the Chairman, and some of the board members, gives the Central Government a considerable measure of control over the policies and operations of these two banks. An indication of their importance in the banking community may be judged from the fact that both banks together have about a billion in yuan deposits, which is over two-thirds of the total deposits of the 25 largest modern-style Chinese banks combined and the Bank of China issues more notes than the Central Bank. In April of last year the National Government extended its investment and its control over these two banks.

(c) Provincial banks. Almost every province had its government bank, a notable one being the Kwantung Provincial Bank at Canton. These issued notes, coined silver and copper money, and in several instances conducted usual banking functions. Some of them operated with complete, and many with considerable, independence of Peking control.

(d) Chinese native banks. Though the old-style, so-called native banks are steadily losing ground to the modern-style Chinese commercial banks, they still play a very important role in providing credit for the Chinese business men. It has been stated that they do 90 per cent of the total lending business done in China. There are probably about 1,500 banks of the larger type. Almost all their loans are extended on the basis of personal credit and not on collateral. This is one of the chief reasons why rediscounting has not developed as yet in China. Their rates of interest (figured per cents, per day, per thousand) vary considerably from borrower to borrower and from region to region. None of them have the right to issue notes, but this prohibition is not effective throughout China. They can, however, obtain notes from the note-issuing banks by depositing with these institutions a minimum of 80 per cent cash and the remainder in marketable securities, chiefly National Government bonds.

The record of native banks has been a bad one, marked with very frequent failures. Rarely do the individual banks endure for more than a decade. The large part of their deposits payable on demand belong to the modern-style commercial banks who are eager to deposit surplus funds with them, inasmuch as the native banks guarantee a minimum rate of 2 per cent or more. The native banks, in turn, use the funds at a profit in granting small unsecured loans at high interest rates. Individuals, except for some comparatively well-to-do persons, usually do not make deposits in native banks. This reloading of modern-style bank funds

makes the volume of loans to business by native banks very vulnerable to any outward drain of funds from the Shanghai banks.

(e) The "modern-style" Chinese banks. These differ from the native banks in that they are joint stock corporations instead of unlimited liability partnerships and many more of their loans are made on collateral rather than on personal security alone and that in general their banking business resembles more closely the modern bank to be found in any country. There are some 80 of these modern-style Chinese banks with head offices, for the most part, located in Shanghai.

They, too, go in heavily for National Government loans, one-fourth of their portfolios consisting of such assets.

(f) The foreign banks. Some 20 foreign banks obtain their charter and are under the control of their respective governments. Because of the existence of extraterritorial rights, the Nanking Government is presumed to have no control over their operations. Their business is largely confined to dealings in foreign trade and international capital movements. They are practically the only banks that deal to any extent in commercial paper.

41. There are no underwriting or investment banks in China.

A peculiar feature of banking is the extension of long-term credits by banks for capital expenditures. In European countries, or in Japan, these expenditures would be financed by flotations of bonds or stocks to investors, but in China there are practically no Chinese institutions and a very few foreign ones that are equipped to handle issues of bonds or stocks. The large loans are frequently to provinces and municipalities and are usually secured either by a deposit of provincial government bonds or by pledges of specific provincial receipts such as salt taxes, or farm taxes. Many of the loans made for these capital expenditures are shared by the leading banks who form frequent consortiums. On loans to farmers they frequently accept commodities -- wheat, rice, etc. -- for collateral. They keep these stores in numerous warehouses they have built in scattered regions for the purpose, and sell the stocks when the market is favorable.

42. Interest rates are very high in China.

Capital is scarce in China, and because of the disturbed political conditions and weak Central Government, the risks involved in lending are high. As a consequence, interest rates are much higher than in other leading countries. Government domestic bonds sell at yields of 10 to 15 per cent, while the rates on six-month Government loans range from 8 to 12 per cent! Rates on short-term commercial loans may run as high as

12 per cent. Banks pay interest on demand as well as time deposits. Rates of 3 or 4 per cent on demand deposits, and 6 or 8 per cent on time deposits are not uncommon in native banks outside of Shanghai.

F. THE PRICE OF SILVER AND CHINA'S ECONOMIC CONDITION

43. Why was China's monetary situation especially different from that of any other currency?

For two reasons: China was on a silver standard, and China was a "hard" money country.

(a) China had for her standard unit a silver coin. Therefore, the value of her exchange in terms of the currency of any country varied with the price of foreign silver in that country. This, however, is also true of the French franc or the Dutch guilder or any other coin that is fixed in terms of gold. But whereas several countries have a gold unit as their standard, only China (and two minor countries, Persia and Ethiopia) had a silver unit as the monetary standard. The consequence of this fact was that the price level in China has less effect on the price of silver in foreign countries than had the price of silver in foreign countries on the price level in China. Another way of stating the situation is that China's exchange (which was approximately the same as the foreign price of silver) had a strong influence on prices in China, but price movements in China had only a slight effect on the world price of silver.

The above was true so long as China did not interfere with the export or import of silver. When silver was not permitted to move freely, China no longer was on the silver standard, and her price level was severed (not wholly cut) from the influence of changes in the world price of silver. China, in October 1934, placed restrictions on the export of silver, which action was made necessary -- and at the same time made difficult to enforce -- by the second important difference between China's monetary situation and all others.

Before turning to the second difference it is worth noting that smaller transactions, and even many wages were set in terms of copper "cash" which have a value that was not fixed to silver. A rise in the value of silver (i.e., drop in silver prices in China) was accompanied by a relative fall in value of copper "cash" (i.e., rise in prices set in copper "cash"). The inverse relationship was not exact but it was close enough to be significant. It reduced somewhat the adverse repercussions that a rise in the value of silver had on Chinese labor whose wages were in terms of copper "cash".

(b) The second important difference was that China was a "hard money" country.

What is meant by a "hard money" country? Simply that the full weight standard unit coins constituted an important element in the

circulating medium, and that all other coins were valued in terms of that standard unit at their metallic content. In China there were about 1 1/2 billion silver dollars (almost all of former coinage, but their silver metallic content was almost the same as the new standard yuan), about 400 million yuan of subsidiary silver coins, and about 40 to 50 billion copper "cash".

44. What had these two characteristics of China's monetary system to do with China's economic situation from 1933 to 1935?

A good deal: both business activity and prices in China were involved.

The price of silver in foreign countries determined the price of Chinese exchange in those countries (within a range of 5 per cent caused by expenses incidental to shipping silver between the East to the West). Variations in the rate of exchange affect the trade balance; and the prices of imported and exported commodities in China. Variations in the balance of trade affected the flow of silver.

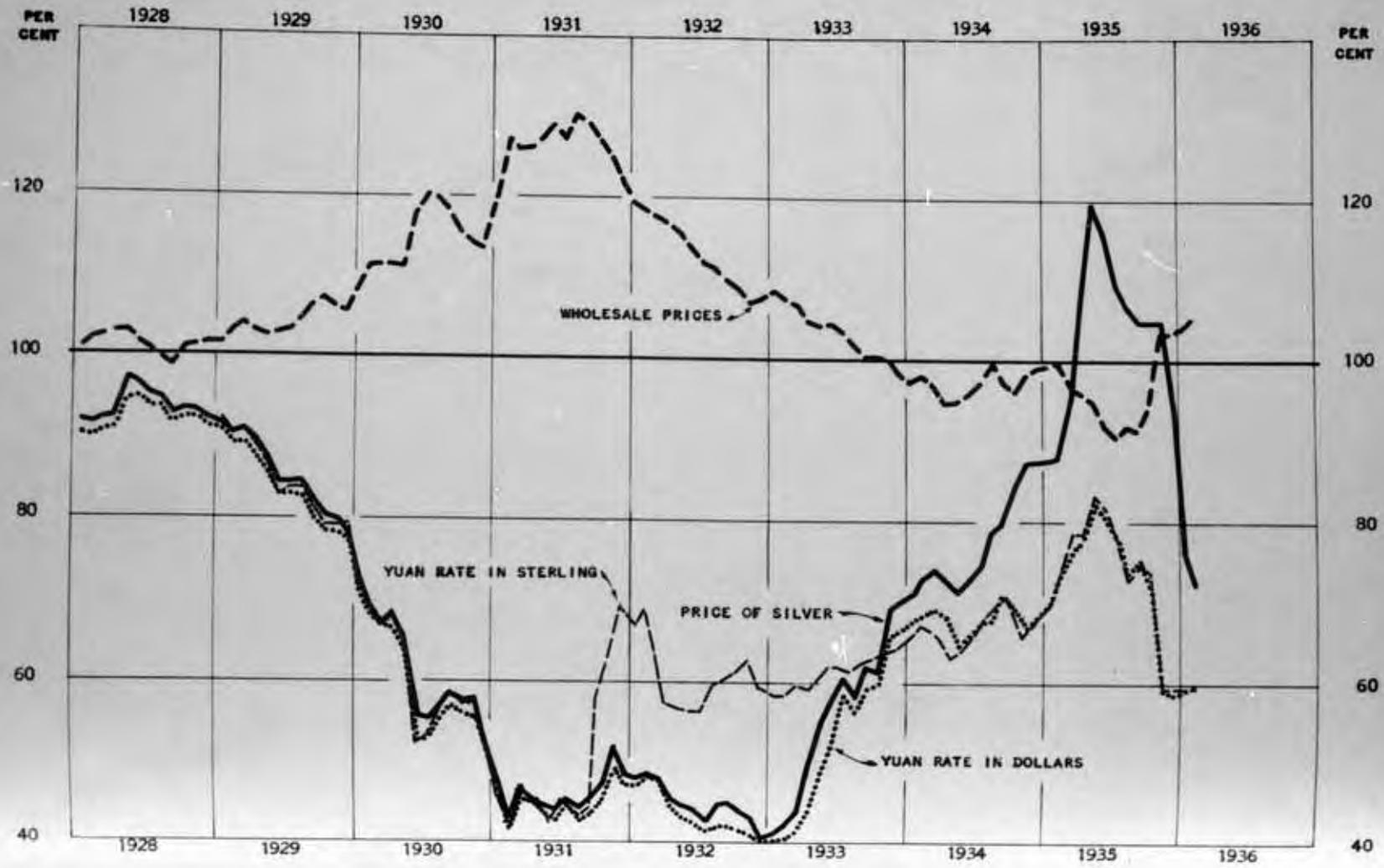
In China an outward drain of silver was apt to be particularly serious, because there is no such elasticity of deposit credit on a given amount of cash as prevails in check using countries. An expansion of credit calls for much more circulating medium than it would in England or the United States. Bank notes were used to some extent, but not enough to compensate for the lack of check using habits. Furthermore, as was pointed out earlier, much of the credit extended to business men -- particularly the smaller ones -- throughout the larger communities of China is by "native" banks who frequently use funds left with them for that purpose by "modern-style" banks located chiefly in Shanghai. If silver was withdrawn from Shanghai banks either for hoarding or export, there appeared pressure on loans in many parts of China. The banks reduced their balances with the native banks, and these in turn would be forced to call in as many loans as possible.

Along with, as well as a consequence of the influence of the price of silver on China's credit structure, her price level was much influenced by the price of silver. Though the closeness of that relation -- i.e., prices in China and silver prices - is frequently exaggerated, it is true that there was a tendency for prices to rise in China when the price of silver was falling, and vice versa. The chart of Shanghai prices on the following page shows that clearly.

The price of silver rose from 17 pence an ounce in January 1933, to 24 pence - an increase of about 40 per cent, while in terms of U. S. dollars the price rose over 100 per cent during that period (from 25 cents to 53 cents). Wholesale prices in China over that period decreased 12 to 16 per cent, depending upon the area referred to. In Canton,

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WHOLESALE PRICES IN SHANGHAI, PRICE OF SILVER AND CHINESE EXCHANGE RATE IN N. Y. 1926 = 100



and in North China, the decrease was 16 per cent, and in Shanghai district the decline was only 11 per cent. Though the decrease in prices was by no means large, it reflected an intensification of the depression, and at the same time contributed to that intensification.

The extent of the adverse effect on business, to judge from the various indices published, appears however to have been exaggerated by the press in China and by critics of American silver policy. Prices declined, banks were failing, and unemployment increasing, but the extent of the change is not to be compared, for example, with our own experience of 1931 and 1932. In fact, a crude production index compiled by the Central Bank of China actually shows an increase in production from January 1933 to October 1934. Yet banking data, stock and bond prices, and other data do, on the whole, support the claim of commentators in China that the depression was growing worse.

The expectation of further silver price increases was, moreover, accentuating hoarding, credit contraction, and reduced business activity. To avoid further price declines and to stem the growing depression, the Chinese Government wished to cut her monetary system free of the world price of silver just as gold countries did with the world price of gold when confronted with a similar situation.

But China could not easily cut herself off completely -- as did the United States, England, and others from gold -- because of the second difference, namely, because China was a "hard money" country. Whereas the United States could suspend inconvertibility or change the gold content of the dollar merely by passing a law to that effect, inasmuch as most of the gold in circulation was in the form of gold certificates, China would find that course of action difficult. Having a very large circulation of silver, China felt she could not suspend convertibility without causing a contraction of her circulating medium through: (a) hoarding of her silver dollars and subsidiary coinage, (b) an outflow of silver when the foreign price of silver in the Chinese dollar exceeded the exchange rate (plus transportation and melting charges). Or, to put it in other and less precise terms, when the Chinese silver coins had an "external" value greater than its "internal" value, silver coins were exported.

45. Why did not the Chinese Government call in the silver coins and replace them with notes dollar for dollar just as the United States called in the outstanding gold?

She was afraid to try it. Chinese authorities felt that most of the people having silver would not respond to the call. The Central Government believed itself too weak to enforce a demand of that kind. The result of such an order, they feared, would be an increase in hoarding and in smuggling of silver out of the country.

46. Couldn't China check all exports of silver by placing a tax on silver, or making it illegal to export silver?

No! She could check the legal exports of silver, but not the smuggling. China tried to do both, but succeeded in checking only legal exports. To stop the legal export, and cut her monetary system at least partly free from the effects of rising world price of silver, she imposed (October 1934) an equalization fee and export tax on silver exports. This step in effect was equivalent to a departure from the silver standard and enabled her to peg yuan exchange (at rates altered from time to time) and prevent a profit from the legal export of silver by altering the equalization fee. The fee was adjusted to equal the discrepancy between the internal and foreign value of silver.

The effectiveness of the check was diminished as silver rose in price. The more silver rose in price abroad and the higher the equalization fee necessary, the greater became the profit to be obtained through smuggling silver out of the country.

For China particularly, because of the vast amounts of silver outstanding, and because of her weak Central Government, and the great attraction to many poor Chinese of a chance to earn a few dollars as risky go-between, the ease of smuggling is such that the Chinese Government felt it was futile to permit the gross profit to rise higher than 20 per cent or so. They even found it necessary to announce a death penalty (or imprisonment) on those caught smuggling silver out of the country, even though the profit was less than 20 per cent.

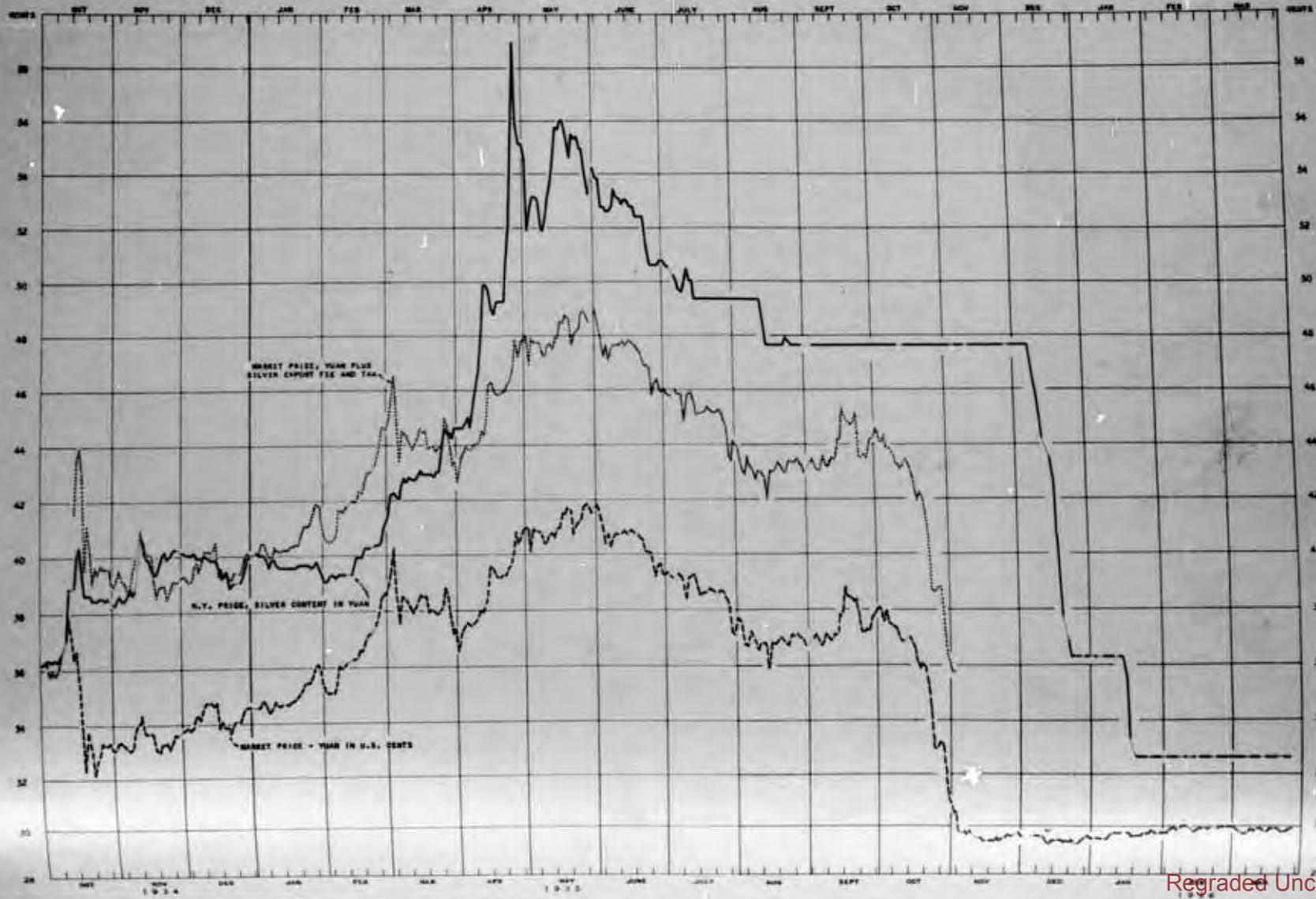
47. What then did China do when the price of silver kept rising in March, April, and May of 1935?

China did not increase the equalization fee further because she felt it would be rendered ineffective by an increase in smuggling. Nor was she ready or apparently willing to attempt at that time any important change in her monetary system. On the contrary, in order to allay uncertainty and hoarding and stimulate confidence in the convertibility of the bank notes in standard weight yuans, the Government reiterated her intentions of not devaluing or debasing the yuan. She, therefore, adopted the only other course open, namely, permitted her exchange to appreciate. It went from 34 in January to 41 in May.

Even then the rise in exchange did not wipe out the profit possible from shipping silver legally. Examination of the chart on the following page shows that from the middle of April on a profit of 10 per cent or so could have been made on silver shipments (the distance between the middle curve and the top curve). Their published trade statistics record virtually no silver exports at that time. If no legal exports took place it was either because the banks were keeping their promise to cooperate

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EFFECT OF DEMONIALIZATION FEE ON CHINESE EXCHANGE



with the National Government by not shipping silver even when a profit was possible -- or the "moral persuasion" employed by the Government against the banks was being effective.

The Government assumed control over exchange transactions in the fall of 1934. The foreign banks, by virtue of their extraterritorial rights and the location of some of them in cities not under Nanking control could do much as they liked with regard to their exchange transactions. Since they are important dealers in exchange, their freedom from control of the Government made its control over exchange rates more difficult than would otherwise be the case. Yet even were there absolute control over exchange transactions, the Government could only have permitted the rate to rise unless it were willing to have smuggling increased.

48. Why didn't China employ her stabilization fund to keep the yuan exchange rate stable?

When China imposed the tax on silver to keep the exchange rate down and preserve her silver holdings, she also created a stabilization fund of 100,000,000 yuan and placed it under the control of a committee made up of representatives of the three banks (one of them the Central Government Bank and the other two semi-Government banks) which supplied the funds and who were also given power to alter the equalization fee. The object of the fund was stated to be the usual one of preventing undue fluctuations in exchange rates. (Any loss sustained by this fund was to be made good by the National Government.)

Why then did she not keep the equalization fee at 6.751, and use her fund to keep the rate stable at (say) 35?

For the obvious reason that the stabilization fund could lower the price of silver only by parting with her silver in exchange for gold, and her 100 million yuans pledged to the stabilization fund were equal only to a month or two supply of American purchases. After she had sold that amount she would have been powerless to exert further restraint on the upward rise unless she were willing to put up more funds or abandon the silver standard completely. As she could not check the price of silver from rising except at the sacrifice of her silver holdings, she could not let the exchange rate remain at the low level because to have done so would have resulted in an increased flow of silver.

49. Was the United States silver policy responsible for the appearance of the depression in China?

No, it could not be. The Silver Purchase Act was passed in June 1934, but the depression in China was in full swing during 1932. From

1931 to 1932 exports (excluding Manchurian figures) fell more than one-third; wholesale prices fell about 11 per cent and export prices about 15 per cent; over one hundred million yuan of gold flowed out of the country legally, and almost as much illegally (only the Central Bank had the authority to permit gold exports); while the customary inflow of 40 to 100 million yuan of silver ceased and a net outflow appeared for the first time in 15 years; industrial activity in Shanghai dropped markedly; bank note issues of Shanghai banks declined 20 per cent (without allowance, furthermore, for the upward secular trend in note issues); bank clearings dropped one-third; large sums of silver flowed into Shanghai banks, chiefly because opportunities for sound loans were dwindling. Everything pointed to declining business activity during 1932.

From January 1932 to January 1933, the price of silver in the United States fell from 30 cents an ounce to 25.7 cents (monthly averages) -- a decline of 15 per cent! Insofar as the United States price of silver exercised any influence at all in China during that period, it was in the direction of reducing rather than intensifying the depression in that country.

50. It was England's departure from the gold standard in September 1931 that started the rise in the world price of silver.

While the price of silver in the United States was falling, it was rising in England. The price of silver in dollars, in sterling, in yen, and other currencies moves together so long as those currencies maintain a fixed ratio with each other. But when, as has happened after 1930, the currencies of various countries change in relation to each other, the price of silver moves differently in various countries. Under those circumstances, we no longer can speak of a world price of silver. We must speak of a sterling price of silver, or of dollar price, or yen price, etc. The chart on the following page shows how the dollar price of silver and the sterling price of silver diverged in 1932.

For China, the most important prices of silver are the dollar, yen, sterling prices, because it is with those countries that China conducts most of her foreign trade and other international transactions (with the exception of Hong Kong and Manchuria). The gold price of silver is also important, but not nearly so much as the others mentioned (except when the dollar, sterling or yen are tied to gold). More than three-fourths of Chinese foreign trade is conducted with countries whose exchange rate either closely follows Chinese rates or moves with dollar, sterling, or yen. In the light of these facts, it would be very misleading to judge the effects of changes in the price of silver on China by changes in the gold price during the years 1930-34.

The price of silver in terms of virtually all currencies (and,

therefore, in terms of gold since the exchanges of most countries were then tied to gold) dropped sharply from the middle of 1928 to the spring of 1931. From then on, we must speak in terms of leading currencies.

In the fall of 1931, an important number of countries, including Japan and sterling countries, depreciated their currencies, and consequently the price of silver in those countries -- or what is almost the same thing, the price of yuan exchange in those countries -- rose. Numerous other currencies depreciated during 1932, raising the price of silver in more currencies. The United States joined the procession in 1933 and the dollar price of silver mounted rapidly.

51. Why did so much silver flow into Shanghai before the passage of the Silver Purchase Act, and out of Shanghai after that date?

From December 1931 to May 1934, the stocks of silver in the Bank in Shanghai mounted from 275 million yuan to 570 million. This silver came from the interior and was a consequence of declining internal trade and growing insecurity, and large numbers of native bank failures in outlying districts. The drain of silver from the outlying districts into Shanghai, and the growing depression which accompanied it and helped it along, was in no way due to our silver policy, which did not materialize until 1934.

After July 1934 -- or two years after the depression in China was in progress -- silver began to flow out of Shanghai to foreign countries because of the growing adverse balance of trade, the flight of capital, and rising price of silver. In the 3 months preceding the inauguration of the equalization fee and duty on silver exports, more than 150 million yuan left Shanghai banks. During this period, it will be remembered, the legal exports of silver amounted to almost 200 million yuan. The legal exports dropped sharply during November and December, then virtually disappeared. How much silver was smuggled out since October 1934 is unknown, but as stated earlier, there is evidence that considerable smuggling went on.

52. Did the imposition of the silver equalization fee help matters?

It appeared to do so at first, yet the change was certainly not marked. Wholesale prices in Shanghai and other areas rose a few per cent. In the Canton area, however, prices continued to fall. Exports showed no marked change, but imports - though subject to erratic monthly movements - continued on a lower level than during the comparable months of the previous year. Stock prices fell and smuggling of silver and some legal silver exports continued. The crude index of industrial activity published by the Bank of China remained at approximately the same level.

In the late spring of 1935 China's situation grew somewhat worse. The price of silver rose sharply, and with it the yuan exchange. Prices began to decline, and by September had dropped about 5 to 10 per cent, though the price of silver -- and with it the yuan exchange -- had receded from its high level. On the other hand, stock and bond prices remained about the same and exports showed some improvement, while imports dropped sharply. There were more bank failures, but not enough to give cause for concern.

Sentiment in favor of devaluation appeared to be gaining. The Central Government, weakened in its control by the Japanese program in North China and by internal disagreement on the policy to be pursued toward Japanese aggression, despaired of effectively controlling smuggling. Nor was there much hope of a cessation of our silver purchase policy. Judging from the sharp break of yuan exchange in October, numerous insiders must have known a monetary change was imminent. In fact, later some important personages in Government circles were accused of having profited by the advance knowledge.

On November 3rd, 1935, China completely abandoned the silver standard. Silver was ordered nationalized and convertibility of note

G. ECONOMIC EVENTS IN CHINA SINCE ABANDONMENT OF THE SILVER STANDARD.

53. What new monetary and banking measures were introduced since November 1, 1935?

(a) Only banknotes issued by the three Government banks (i.e., The Central Bank of China, The Bank of China, and The Bank of Communications) shall be full legal tender. The reserves against these notes is to be placed under a unified control.

Notes of all other banks will be withdrawn gradually from circulation to be replaced by notes of Central Banks. No new notes are to be issued by them.

(A cable of February 14 from our Commercial Attaché reports that a decree of November 4 gave the "China Farmers' Bank" /a bank not listed and about which we can find no information except a cabled report dated December 26, 1935, which stated that the Government contemplated the establishment of an agricultural bank/ permission to issue up to 100 million yuans. The cable reports the bank had on February 14 50,000,000 yuan notes outstanding.)

(b) All contractual obligations expressed in terms of silver are to be discharged by payment of legal tender notes, yuan for yuan.

(c) All holders of silver are required to exchange their silver for legal tender notes at face value.

(d) The Government is to stabilize the exchange value of the yuan (in what unit is not specified) by buying and selling foreign exchange.

(e) Central Bank is to be reorganized into the Central Reserve Bank of China; its ownership by public increased; and its functions altered to resemble those of Central Banks elsewhere.

54. What monetary changes have occurred since China abandoned the silver standard?

(a) The official sterling-yuan rate (i.e., the Shanghai official rate quoted by the Central Bank of China) has been kept at $14\frac{1}{2}$ d., but the official U. S. dollar-yuan rate has been altered twice (from $29\frac{1}{2}$ cents to 30, and from 30 to $29\text{-}3/4$).

The market rates of both sterling-yuan, and dollar-yuan, varied slightly from day to day, with sterling rate moving within a narrower range than the dollar rate. Notwithstanding the fact that the market rates in Shanghai of both dollars and sterling move, it is commonly stated and is so regarded that the yuan is pegged to sterling and not to the dollar. It is the fixing of the "official" rate which determines the currency pegged to. Small changes in the buying and selling price on the market are always permitted - just as fluctuations occur within the gold points in exchange rates between two gold currencies.

(b) The premium on silver in China -- which, despite the legal prohibition on premiums, had been as high as 20 per cent in the months following the nationalization order -- disappeared with the drop in the price of silver. At present exchange rates, the silver in the silver yuan is worth about 32 cents. Or, to put it another way, when silver is priced on the world market at 40 cents an ounce, the bullion value of the yuan coins approximates its normal value in the exchange market. Sometimes this fact is referred to by the phrase that at present pegged rates 40 cents is the parity of the silver yuan.

(c) The new coins (5, 10, and 20 cent nickel pieces and 1 cent and $\frac{1}{2}$ cent copper coins) that were to replace the subsidiary silver and copper cash in circulation have already made their appearance, but their number is not yet large.

(d) The note issue of the Government banks has increased by about 425 million yuan, and the cash reserves against these note issues are reported to have increased 300 million yuan (February 8, 1936 - latest date about which we have received information).

(e) It is estimated that 100 to 200 million yuans of silver were smuggled out, and 100 million (excluding recent U. S. purchases) exported, while large sums of silver coins were hidden away.

55. Will the new Chinese coins contain silver?

It is not yet certain. The subsidiary silver, 10 and 20 cent pieces, are to be replaced with coins of pure nickel. No provision has yet been made for coining 50 cent and dollar pieces, but there is talk of coining such units with some silver in them. It was reported (in a confidential cablegram of January 6, 1936, from the American Consulate General at Shanghai): "According to a reliable source, Leith Ross has advised the Chinese Government to abandon existing standard of 880 for silver coins" (presumably the 50-cent and one-dollar pieces) and to substitute an alloy of .500 silver. It was also stated in the same cablegram that Leith Ross made inquiries of London whether the blanks could be promptly supplied. It further stated that "dies have been or are about to be ordered from Philadelphia".

The large profit possible from counterfeiting 10 and 20 cent pieces, and the lack of effective control possessed by the Nanking Government in several of the provinces, may induce the Government eventually to put some silver in these coins. Already counterfeit coins have appeared, though of an inferior kind. When the equipment and technique of producing nickel coins is acquired somewhere in the East, the number of counterfeited coins will greatly increase. On the other hand, the Government makes so large a seigniorage profit out of the nickel coins that it will be most reluctant to put any silver in 20 cent pieces.

How many 50 cent and dollar coins will be issued is very uncertain. The less the silver content, the greater the seigniorage profit, but the greater also the incentive to counterfeiters. On the other hand, if 50 cent and dollar notes are used, the requirement of a 60 per cent cash reserve and 40 per cent security would operate to eliminate any seigniorage profit possible. The Central Bank finances would be stronger if more 50 cent and dollar coins were minted with, say, 300 to 500 fine silver content in place of 50 cent and dollar notes. That fact may induce the Government to risk counterfeiting, and the slight chance of a price of silver high enough to make the bullion value (at 30 cents yuan exchange) greater than the nominal value of the coins.

56. How much of the outstanding silver has been turned in to the Government banks?

Only a small portion of the total outstanding silver coins have as yet been obtained by the Nanking Government. It is estimated that in

Shanghai less than 200 million yuans in silver have been received, but the exact amount is not known as no figures are published. The note issue of the Government banks (Central Bank, Bank of China, and Bank of Communications) increased about 425 million yuan and its cash reserves increased 300 million yuan, according to their published figures. But on January 28 it was reported that those three banks had only 127 million yuan in silver. Perhaps the remainder was in foreign exchange and gold.

At the time the nationalization order went into effect there was estimated to be about 300 million yuan of silver stocks in Shanghai so that if the figure of 150 million in stocks on January 27 is at all close, the amount of silver turned in by people and private banks must have been very small, even allowing for exports.

About 20 million of the 40 million yuan of silver dollars held by foreign banks of Shanghai have been turned over to the Central Bank of China. None of the 10 millions held by Japanese banks have as yet been turned in, but it is reported that it is expected they will soon do so.

There is probably about 1½ billion yuan of silver coins hoarded, in circulation, and in non-Government banks throughout China. In some areas the silver yuans still circulate freely, and almost everywhere subsidiary silver coins are still used. With the price of silver as low as it is, the incentive to smuggle out coins has ceased, but the reluctance to exchange silver coins for notes or nickel coins remains great, especially in the areas removed from strong Nanking control.

57. What has happened to business conditions since the nationalization of silver?

Conditions have improved in China since November, but the improvement is not marked. Prices of all kinds and in various parts of China have risen from 5 to 15 per cent. Stock and bond prices turned upward (bonds dropped precipitously in February, due, it is claimed, to bear raids for political reasons, but have since recovered). Exports are higher than last year and imports are lower -- so much so that for the first time in many decades China is experiencing a favorable trade balance. As a consequence of the altered trade balance, the pressure on yuan exchange is reduced and China has a better chance to prevent her exchange from slipping from its present mooring.

There has also occurred some increased activity in railway improvement and new construction, and there is apparently a more optimistic outlook in trade and financial circles. In Shanghai, however, retail business is below the 1935 level, and new building construction is reported to be declining.

58. How has the United States been affected by the trend of business in China from 1933 to 1936?

For the first time in a decade or more, we are having a large excess of imports from China instead of a large excess of exports to China. Our exports to China have suffered a sharp drop. As a consequence of China's depressed state of business, we lose also through indirect trade. An impoverished China purchases less from other countries, as well as from the United States, and those countries -- Japan, Great Britain, India, Germany -- in turn buy less from us as well as from others.

In addition to this loss of direct and indirect trade, is the hidden loss of future trade resulting from the establishment of trade barriers that are seldom removed. China has found it necessary to raise tariffs sharply on a great many items in order to reduce her imports so as to keep her silver from flowing out. Once an industry grows up behind tariff protection, it has proved very difficult to remove the duty, and international trade is, to the extent the barriers remain, reduced even after the depression disappears.

Further, the income from foreign investments in China has been reduced, and that loss, whether by British, Japanese, or Americans, has adverse repercussions on industry, American and foreign. The rate of improvement in China's transportation system is slowed up -- because losses of investors discourage further loans. China's loss of better transportation facilities is no other country's gain.

The losses sustained by the United States from the depression in China cannot be all or even mostly allocated against our silver policy. The depression in China is a consequence of several factors independent of the rise in the price of silver -- world wide depression, currency depreciations, political disruption, Japanese aggression, civil strife, and climatic disasters. It began long before we developed a silver purchase program and is continuing after the world price of silver dropped to a low level. Yet it could hardly be gainsaid that the rise in silver prices contributed to her difficulty.

So far as the losses to the United States are concerned, they are easily exaggerated. The portion of these losses allocatable to our silver program seems important when itemized, but actually the quantitative total constitutes a negligible portion of our national income -- even allowing for the repercussion on agriculture.

H. MONETARY PROBLEMS THAT CONFRONT CHINA NOW.

59. Will a fall in the price of silver force China back on the silver standard?

It is held in some quarters that any further fall in the price of silver will drive China back on the silver standard. It is claimed that just as the sharp increase in silver prices drove her off, so a marked fall will force her back.

There are some grounds for this view, but they do not appear to be strong ones. It does not at all follow that because a high price forced her to abandon silver a low price will force her back. The factors involved with China off the silver standard differ materially from the factors which are significant with China on the silver standard. The effects in China of a fall in the price of silver now would not be the converse of the effects the rise in the price of silver had there in 1934-1935. The Chinese monetary situation is essentially a different one today than it was when China was on the silver standard, and hence a duplicate movement does not have a duplicate effect, nor an opposite movement an opposite effect. The effects of a change has to be determined in the light of the new factors introduced into the situation.

Nevertheless, there is a possibility under the new (that is, the present) situation in China that a sharp drop in the price of silver might force China back on the silver standard. But it is only a slim possibility; slim because the exceptional sequence of events necessary to bring it about is not likely to occur just because the price of silver falls.

The sequence of events that might force China back would be as follows:

(a) First, because the low price would induce many in China to buy silver, either to hold in form of bullion as a good investment, or to be made into jewelry, plate, etc. (Something of that sort is apparently going on in India right now.) The resultant demand for foreign exchange might be great enough to break the present pegged rate because the Government has at its disposal only a relatively small margin of specie and exchange reserves to use in support of the yuan. Furthermore, those reserves, insofar as they consist of silver, would yield smaller amounts of foreign exchange as the price of silver declined.

(b) Secondly, the fear, or expectation that the fall in the price of silver would have such an effect would induce speculative raids on the yuan and also a flight of some capital.

The Government could, of course, attempt to relieve the pressure against the yuan by imposing an import duty on silver high enough to offset the fall in its world price. However, China's experience with

smuggling out of silver during the past year doesn't offer much hope that a duty on imports of silver would be effective in checking inward smuggling if the drop in price -- and hence the import duty -- were a sizeable one.

The pressure against the yuan might well be great enough to force it to depreciate even though purchases of silver (by residents of China) were discouraged through an import duty, and even though the purchasers of foreign silver would not be able to dispose of their acquisitions to the Government.

(c) Thirdly, a depreciation of such large dimensions might conceivably follow a sharp break in the price of silver (or appear to be in the offing after a short period of decline) as to create a very serious monetary situation for China. The pressure might be so great as to engender widespread flight from the yuan (into dollars, sterling, gold and silver). This in turn might engender fear of inflation, and thus stimulate further depreciation, and so on.

The Chinese Government might not object at all to a 25 or 35 per cent depreciation, but most assuredly would not wish a precipitous and sustained decline. In the event of such a decline, the ordinary operations of the international adjustment of balances -- i.e., increased exports from China, decreased imports, etc., etc. -- could not be depended upon, in the case of China particularly, to move with sufficient rapidity to check the sharp downward movement in exchange.

Would a resumption of silver convertibility of note issues at such a time stop the decline?

(d) Fourthly, confronted with a decline of major proportions and the accompanying danger of inflation, the Chinese Government in desperation might attempt to stem the drop in yuan exchange by return to the silver standard, at some rate near the then existing lowered level of exchange rates. By offering to redeem outstanding notes with silver, the depreciation would necessarily stop, as the yuan would then be tied at a fixed rate to the price of silver in gold (or sterling, or dollars).

That might solve her immediate problem, though it is possible that at such a time her small reserves, which would already have suffered some decline, might not be enough to check the flight from the yuan even at a low rate of exchange. The yuan would stop falling only if the Government could obtain specie reserves to meet the demand for foreign exchange, and the demand for redemption of notes. The low rate of exchange which would then exist might stop the external drain and even reverse the flow. The internal drain, however, would be more difficult to stop. If domestic redemption were refused, pressure on the yuan would continue, and increase the external drain.

Being aware that a drop in the price of silver might start such a sequence, would not the Nanking Government return to the silver standard as soon as the price of silver began to fall?

If she returned to silver soon enough, would she not avoid the danger of a runaway depreciation?

She might avoid those consequences, though it is not at all certain that China's specie reserves are adequate to keep her on the silver standard (see Section 60 below). But, in any case, she would be at this time reluctant to return to the silver standard - especially with silver at the lowered price of 30 cents an ounce or so: (reasons for her hesitation to return are outlined in Section 63). And unless the Chinese authorities were convinced that a silver standard were the best for China she would not be warranted in returning merely because of the fact that silver was falling in price so long as there existed no immediate danger of a precipitous decline in the yuan. The chances of such a decline occurring if silver fell in price 5 or 10 cents an ounce are remote. It has never occurred in modern times except when civil war, breakdown, invasion, or foreign war was in process.

If silver should slide down to 30 cents, China could let the exchange drop to the new parity (say 24 or so) and reasonably expect the pressure on the yuan to cease. With a 24 cent yuan, the balance of payments would in time even strengthen her exchange position. It is barely possible that the drop in the yuan rate would not be enough to stem the demand for foreign exchange, but unless internal political disturbances occur, it appears unlikely that the downward pressure would not cease at the lowered yuan rate.

60. Will the Nanking Government be able to keep the sterling-yuan rate at the present level of 14 $\frac{1}{2}$ d.?

Her chances of keeping her exchange rate stable are fair. Much depends on the political situation in the Far East and on our decision with regard to China's silver.

Factors tending to strengthen the yuan.

Factors favoring stability of yuan exchange are:

(a) Her recent trade trend is toward a marked reduction in her usual unfavorable balance of trade.

(b) There is some talk in the press of a probable renewal of foreign investments in China, both by Japanese and the British,

(c) Immigrant remittances to China should increase with world recovery.

Each of these changes, if they take place, will increase the supply of foreign exchanges.

(a) The shift in trade would be particularly important. Last year China's unfavorable balance of trade amounted to 344 million yuen. If this year China did not have to send that amount abroad, her exchange position would be considerably strengthened. However, the reduction in the import excess has been especially marked only since November (February figures are not yet available). Seasonal variations are large in China's recorded trade, so it cannot yet be known whether the noted change presages a definite shift or is due mainly to unusual conditions.

The other two items mentioned are less important.

(b) If foreign investments to China are made they will most likely be tied up with purchases of goods. They will, for the most part, increase imports and not provide additional exchange (i.e., more than enough to pay for the added imports). Besides, the amount of foreign investments under existing troubled conditions, and with China's bad record on loans, is not likely to be large this year.

(c) Immigrant remittances to China are a big item in her balance of payments, but the increase likely to take place in 1936 could hardly be more than 25 to 50 million yuan at best.

Altogether improvement in the balance of payments depends chiefly on the shift in trade, and on the extent to which funds which have flown from China in the past few years will return.

Factors tending to weaken the yuan.

Factors counting in favor of the possibility of further depreciation of the yuan are:

(a) The political uncertainty in China.

(b) The fact that the Government does not have much reserve to work with.

Both of these factors give rise to a lack of certainty as to the future course of the yuan.

(a) The domestic and international political conditions in Asia are not such as to create confidence in the stability of the Nanking regime, or in the prospects of peace. An important Southern group refuses to co-operate with the Nanking group unless Chiang Kai-shek adopts a much stronger program against Japanese aggression. Nor can

the Russian-Japanese-Chinese relationships be said to be growing less ominous in their possibilities for conflict. To cap it all, large Communist groups in China seem to have a disturbingly large amount of vitality.

(b) Government cash reserves are small. The total cash reserves of the three banks are only one-half billion yuans -- consisting of silver, foreign exchange, and gold. Part of these reserves are silver yuans recorded at this nominal value. Probably their gold and foreign exchange reserves do not exceed 100 million U. S. dollars.

Moreover, a large part of this reserve cannot, of course, be used to support the yuan. Almost never (Brazil did it in 1930 during very troubled political times) does a Central Bank let all its specie reserves go before permitting exchange to depreciate and/or restricting exchange transactions. As the more of the 100 million is used, the greater will become the pressure both from speculative sources and from those who wish to get their funds out of the country through fear of inflation. China cannot control exchange operations with enough effectiveness to peg the rate at the present level if the pressure becomes very severe. She would be unable to stop bootleg operations in exchange - even if she did effectively limit the official operations. The task of successfully controlling exchange operations is a difficult one for such highly centralized and highly organized states as Germany and Italy. For the Nanking Government the task would be insuperable. Once the exchange reserve began to decrease rapidly, nothing except outside aid could stop the yuan from some decline in actual rates - though obviously the normal or "official" rates could be kept up.

A confidential cable did report that E. Kann "well known Shanghai silver expert" stated in a private interview that one bear raid, "understood to have been led by Japanese banks in Shanghai", was successfully met with the payment of 30,000,000 U. S. dollars. It is doubtful, however, if without support a raid of double or triple that amount could be met.

Would it make any difference in the strength or weakness of the yuan if the U. S. would purchase silver from China?

Yes, it would. It would have some influence on:

(a) The amount of outstanding silver people will turn into Government banks in China.

(b) The value of those reserves.

(c) The degree of confidence speculators and others would have in the yuan.

If we refuse to purchase any more of China's silver, the value of her reserves, actual and potential, will drop. The psychological effect of our refusal to purchase more silver, or convey some assurance that the foreign silver market will be supported by us (it would be difficult to keep such a decision secret in China for long) would be two-fold. It would increase the pressure on the yuan in anticipation of depreciation, and check the exchange within China of silver for notes. There are still some $1\frac{1}{2}$ to 2 billion ounces of silver outstanding in China which the law requires to be exchanged for Government notes or new coins. How much of it will be turned in during the next year depends partly (only partly) on prospects of exchange.

If, on the other hand, we indicate a willingness to purchase more, or give assurance that we will support the silver market, or the yuan, the opposite effect will be induced. Her foreign reserve would be increased by the conversion of silver to gold; confidence in the future of the yuan will be somewhat strengthened. As a consequence, more silver would be turned into the Government banks, some of the capital which has left China in the past year might return, and foreign investors would regard additional investments in China less unfavorably.

It is possible that our refusal to aid China may be countered (for a consideration - either economic or political) by British action in the form of a loan, or assurance to China of support to the yuan. England may even buy China's silver with funds from her Stabilization Fund in the hope of some day selling it to India or the United States, if necessary at a loss. England is eager to keep the yuan from falling, and is also seeking political and economic plums in China. Since 40-cent silver is low, she might feel such a venture worth while.

China's exchange appercart will, of course, be upset should hostilities break out in the Far East, or should the political split within China grow very acute.

Altogether it cannot be said that the outlook for yuan exchange is more than fair. There was a rumor of an impending drop in yuan exchange in the fall, but it is probably grounded not so much on economic grounds, which are at the moment favorable to maintenance of the present rate, but on political grounds, and decisions of foreign governments, not yet clearly indicated. (A report of February 24, 1936, from the Treasury Attaché at Shanghai contained the statement that a local Chinese broker had advised his friend Leigh (prominent in the pro-Japanese group) to buy gold dollars as the yuan will depreciate 25 per cent by September.)

I. MONETARY PROGRAMS CHINA MUST CHOOSE FROM.

61. What alternatives in monetary policies confront China now?

There are three courses open to China:

(a) She can continue to follow her present program of a "managed" currency - with a choice of minor variations. She can peg her exchange to some leading currency, or maintain an independent exchange rate, altering it as she deems such action necessary.

(b) She can return to the silver standard -- either in the form used before November 1935, or in some modified form.

(c) She can adopt a gold or gold exchange standard, or a gold and silver standard - i.e., bimetallism.

62. If China is determined to continue a "managed" currency, she has a choice.

She can peg her yuan (a) to the yen, (b) to sterling, (c) to the dollar, or (d) she can plan to tie the yuan to none of them and shift her peg from time to time as she sees fit.

(a) Will the Chinese dollar be tied to the yen?

Not by free choice unless a bargain is struck! The Japanese yen is a relatively unimportant unit in world trade and finance, and it has proved to be stable neither in its ratios with other currencies, nor in its purchasing power at home. If China ties the yuan to the yen, it will be only because she has been either forced to do so by Japan, as has probably been the case with the Manchoukuoan currency, or bribed to do so with a big loan or other concession from Japan.

(b) Will China join the sterling area?

During the past five months the official sterling rate in Shanghai has been kept fixed. Therefore, it may be said that the yuan has already joined the sterling area. Yet it is not certain that she will continue to do so, especially if bargaining is possible. The Chinese Government can alter the official rate whenever they wish. They are not yet - so far as is known - committed to any specific policy. The decree of November 4th merely requires that "the rate be kept stable at its present level" but doesn't specify in what currency.

Though China has nothing to gain by joining the yuan to the yen, her situation is different with sterling. A good deal of China's foreign financial dealings are transacted in sterling; England and numerous (not all) other sterling area countries have maintained a

fairly stable price level in the last few years. By joining the yuan to the British pound, China's price level -- after the initial adjustment -- will have gained some stability from the steadying influence of England's price level. Since the Japanese yen is more likely than ever to stick closely to sterling if the yuan joins the bloc, China will also be assured stable exchanges in a large number of currencies important to her.

(c) How does China feel about the dollar?

The dollar, together with other gold currencies, is more important in China's trade than are the sterling currencies. One-third of China's trade is with gold currencies as against one-fifth with sterling currencies. Moreover, the dollar is tied to gold, whereas sterling is footloose. And finally -- at least prior to our silver program -- China regarded the United States as her best -- and only disinterested friend, a powerful friend, and one possibly more dependably anti-Japanese than is England. China might prefer -- offers of economic or political assistance being equal -- to tie her currency to the dollar rather than to sterling.

(d) Will she pursue an independent course, altering her peg from one leading currency to another as the situation changes?

This is what China now claims to be doing, though, as stated above, so far the official sterling rate has remained unchanged. The advantage of this procedure is that it leaves China a relatively free hand to alter her rates from time to time as she deems wise. The disadvantage lies in the fact that if her currency is not linked to a leading unit she may lose the steadying effect of that currency. It takes a stronger and more experienced government to successfully manage a currency not pegged to a leading currency than one that is so pegged. Also she may be able to get some concession for linking her currency to one or the other of the chief currencies.

A pegged rate is not an unbreakable tie.

Even if the yuan is pegged to one or the other currencies, she remains -- unless commitments of some sort are made -- free to shift her peg from one currency to another. There are difficulties in such shifting, but they are not very important provided no commitments are made, and provided the country to whose unit the yuan may be pegged does not come to feel it has a vested interest in such a tie-up.

Therefore, even if yuan remained pegged to sterling, or shifted to the dollar, the act would not necessarily be regarded as a permanent arrangement unless the step were taken with that understanding in return for some concession.

The above alternatives vary only very slightly from each other.

They are each a form of "managed" currency. On economic grounds alone it would not matter much to China which currency she tied her yuan to, though it might make some difference in her international political relationships.

The situation is different for the other party to the tie-up. It would make some economic, as well as political, difference to the country whose currency the yuan is pegged to. The economic effects are listed in Sections 65, 66, 67 below. So far as China is concerned, she would doubtless tie her yuan to the currency whose country will offer her most for the "partnership". If no offer is forthcoming, she will probably continue her present course, inasmuch as England appears to be taking at the moment a sympathetic, and possibly helpful, interest in China's economic predicament.

However, is China bent on maintaining a managed currency? May she not wish to return to the silver standard, or adopt some other form of metallic standard?

65. Will China return to the silver standard?

China is at present on a "managed" currency standard. The Government banks will give paper notes, or new nickel or copper coins in exchange for silver coins, but the paper money is not convertible into specie. Leading foreign exchanges are kept stable by operations by the Government on the exchange market. Though her specie reserves include silver coins and silver bullion, China is now definitely off the silver standard.

Will she choose to return?

The arguments that might be advanced in favor of a return are:

(a) The Chinese people have for centuries been in the habit of using silver specie as money, and are most reluctant to part with their silver pieces. A return to the silver standard would help restore confidence and permit business to proceed on its accustomed path.

(b) For a country so primitive in its economy, so lacking in effective centralized political control, and so inexperienced in modern banking methods, and so beset with major domestic and foreign political troubles, a metallic standard is the best safeguard against marked inflation, counterfeiting, irredeemable currency, exchange depreciation, and other monetary disorders.

(c) The silver standard has its drawbacks, but for China it is the traditional currency, and in the light of its history and possible alternatives it is the best standard for China to adhere to - at least

until the time comes when it can adopt some other standard without the dangers that such adoption would bring in its train now.

The arguments against a return -- many Chinese financiers and economists believe -- are stronger:

(a) The silver standard at best operated passably only because until the turn of the century foreign trade and international finance played a very minor role in China's economy and because in the years before 1873 silver had a stable price in terms of gold. Since then it has worked, on the whole, rather badly. China's exchange, being tied to the price of silver, was subjected to broad monthly and annual fluctuations. Even in the years before the depression, it was not uncommon for yuan exchange to fluctuate 15 per cent during a year. In 1928 it fluctuated over a range of 30 per cent!

Fortunately for China, the depression caused the price of silver to fall, and with it, of course, fell yuan exchange. China, therefore, had the benefit for the first few years of the depression of a rising internal price level (it rose about one-fifth), and a sharper falling external price level (it fell almost one-half), at a time when other countries were experiencing falling internal prices and relatively rising external prices. This happy combination lasted, however, only a few years, and then silver began rising in price and her troubles grew.

Though China's internal currency situation has been - as described earlier in the report - very chaotic, the cause has been the absence of unified currency and banking laws, and the lack of centralized Government control. However, the poor currency system cannot be allocated to the fact that China was on the silver standard, nor will the improvements -- described earlier in the report -- inaugurated in 1931 and 1933 be much affected by the standard China elects to adopt.

Long before China's acute monetary difficulties arose she was advised to abandon the silver standard in favor of the gold exchange standard (the gold exchange standard is now practically equivalent to a dollar exchange standard). Five times - 1903, 1908, 1912, 1918, 1929 -- extensive reports were made by commissions (three of them composed of foreign experts) recommending such a shift.

(b) The fact that China has long adhered to the silver standard is not a weighty reason why she should continue to do so under fundamentally altered conditions. It is true that the people are accustomed to coins, but the bulk of the peasants use copper coins and these they will continue to use (though of altered denominations) under any standard. People in business, and in cities, are using notes more and more, and the notes of the Government banks have wide acceptance and will be used still more as the Nanking Government extends its power.

The danger of inflation always exists. It took place in numerous provinces while China was on the silver standard, and it will doubtless occur again if the Central Government is seriously weakened. But -- the Chinese hold -- the Nanking Government is fully cognizant of the danger of inflation and are going to bend every effort to balance the budget and keep her exchange stable. Were they to return to the silver standard, there would be no additional guarantee that inflation would not occur. The same forces that cause inflation when a country is off a specie standard, cause inflation when a country is on. The only difference is that in the latter case the government is forced to abandon the specie standard en route.

The protection against inflation and depreciation, they feel, is a strong Central Government, peace, and business recovery -- three factors that are not necessarily introduced by adherence to the silver standard, nor kept away by a "managed" currency standard.

(c) Most important of all the objections they have to a return to the silver standard now is that they have no assurance that if they return the price of silver will be kept stable in the near future. Silver is now 40 cents and they fear the possibility of a rise to 50 or even 60 cents with recovery, or with an increase of American purchases. Were that to happen after she had resumed the silver standard at the 40 cent parity, her monetary and credit structure would be subjected to a repetition of 1934-35 monetary troubles.

Nor can she avoid that difficulty by putting less silver in the yuan. Were she to do that, her yuan rate would depreciate now in proportion to the silver content, and later appreciate when (or if) silver rose in price.

Could she not avoid that difficulty by waiting until the price of silver rose and then return to the silver standard?

The first effect of rising price of silver would be renewed smuggling of silver out of China, and slowing down of exchange of silver coins for notes within China.

Even if China were willing to let that happen, and even if she adjusted the silver content of her yuan unit so that at 60 cents an ounce for silver her exchange rate could remain 30 cents (by putting $\frac{1}{3}$ ounce instead of $\frac{3}{4}$ of an ounce in her yuan), her exchange rate would thereafter remain tied to the price of silver.

Would China be willing to tie her exchange to a 60-cent an ounce, or a 50-cent an ounce silver (with a yuan content of $\frac{3}{5}$ of an ounce) without adequate assurance that the price of silver would be kept stable at that level?

If such assurance were forthcoming, the program of a return to the silver standard would not be subject to so many disadvantages. After the initial adjustment, the silver standard would become almost equivalent to the gold standard, since the assumption is that the price of silver in terms of gold (or dollars) was to be kept the same. But can such adequate assurances be given?

Might China adopt a compensating silver bullion standard feasible for China?

Very unlikely. China could - after more of the outstanding silver were turned in - adopt a sort of fluctuating silver bullion standard, and attempt to keep her exchange rates stable by altering the silver content of the yuan in proportion to the change in the world price of silver. Since there presumably would be no silver in circulation (except in subsidiary coins with low silver content) the alteration in the yuan buying and selling price of silver bullion, so far as was necessary to keep the yuan exchange rate stable in terms of gold, would create no significant domestic monetary difficulties, nor alterations in the exchange rate.

It is very unlikely that China would adopt such a system. It has little advantage over a "managed", or dollar, or sterling exchange standard, which it resembles very closely, and has some important drawbacks. For example, it presupposes that there is a world price of silver, whereas in effect there are only dollar prices of silver, or sterling, or yen prices of silver, etc. Obviously, the price of silver in terms of various currencies move no closer together than do the respective currencies. The question of adequate assurances by the United States of a stable price of silver at a pre announced level is one that has political rather than economic consequences within the United States. Though, if the price is much higher than the present one, there arises the question as to whether even we could keep up the price for many years. There is a statutory limit to our purchases, and when that is reached - what then? Even at a low price, it is a step that needs careful political evaluation.

Though the Chinese authorities might not like to return to the silver standard at all - or under the above conditions (unless some concession, some political or economic gain is granted them), the alternative to a non-return might encourage them to do so. Were, for example, the United States to find it necessary to withdraw completely from the European and Asiatic silver market (i.e., buy only output of American mines) the price of China's silver might fall sharply. This would be even more likely to happen if the United States found it necessary to make such a withdrawal known to the Chinese (as it would be very apt to leak out). Such a move on our part might have international political consequences that would need to be considered. It would, however, reduce the value of China's silver holdings and might, therefore, be a factor in her decision.

64. Would China adopt a gold exchange, gold or bimetallic standard?

Gold standard a doubtful possibility.

The possibility of her adoption of a gold standard without outside aid is very slim. Her reserves are too small to justify such a course. The chance that she could not maintain it would encourage speculative attacks, and an internal as well as external drain of gold. If she wished to link the yuan to gold she would prefer the gold exchange standard and not the gold standard.

Gold exchange standard resembles dollar or sterling standard.

The gold exchange standard is much like the dollar standard, provided the United States would permit gold to flow to China if she adopted such a standard. The merits and demerits are much like those considered under the pegging of the dollar to the yuan, except that in the latter case more prestige would be attached by the act to the dollar, and a yuan linked to the dollar would have more political value here than a yuan linked to gold, though in effect the process is almost identical at this time. Another difference that makes it a little less desirable from China's point of view at this time, is that a gold exchange standard presupposes the legally established par value of the yuan in terms of gold. It, therefore, is more troublesome to alter the exchange value than would be the case if the yuan were merely pegged to another currency.

Bimetallism presents some of the difficulties of a silver standard.

If China alone has to adopt bimetallism without satisfactory assurance of a stable price of silver, she would be in danger of finding herself approximately in the same predicament as she would be if she returned to the silver standard. If the price of silver dropped she would have to spend what gold and foreign exchange she had to pay for the silver offered her. With her gold and foreign exchange spent (for silver) she would then in effect be on the silver standard.

Nevertheless, bimetallism for China would have some advantages over the silver standard, assuming she made the current market ratio her official ratio. If the price of silver rose she could exchange some or all of her silver for gold without subjecting her exchange rate to alterations.

If she could be assured that the price of silver would not fall below current levels, the danger of being forced back on the silver standard would be removed. Bimetallism (at current rates) might provide her with an easy transitional period to a gold standard if, or when, the price of silver would rise. With China's $1\frac{1}{2}$ or so billion ounces added to the potential market supply -- as would be the case were she to adopt bimetallism -- the world price of silver will have a more difficult time rising above her mint (i.e., if established at the current market) ratio. If she could be reassured that silver would not drop below her mint price, she might well give serious consideration to its adoption.

Again the question arises as to the domestic political expediency of giving China any assurances that the price of silver will not drop below 40 cents, and at the same time be perhaps accused of encouraging China to keep the price of silver down to 40 cents by adopting bimetallism at that ratio. If, on the other hand, we first raise the price of silver, we increase its chances, in China's view, of a subsequent drop which would force China back on the silver standard.

64. Which course would we prefer China to take?

(a) For obvious political reasons it would be preferable were China to return to the silver standard. But on economic grounds, it might be difficult to convince China (without some concession to her) that such a course is in her best interests.

(b) A much better case could be made on economic grounds for her return to the bimetallic standard. Two possible objections from our point of view to bimetallism are: (1) China may want assurances that the price of silver will be kept from falling, and (2) silver advocates might object to stabilization of foreign silver at the low price of 40 cents and ounce. Since, however, the domestic price could be kept up, and the possible alternative be a lower foreign price of silver, and complete abandonment of the silver standard by China, the latter objection may not be serious.

(c) The third best alternative is that China should either peg her yuan to the dollar, or unpeg it from sterling.

65. Why would England like to have the Chinese yuan joined to sterling?

There are several advantages that would accrue to England if China definitely became one of the sterling-area countries:

(a) The more countries joined to sterling the less sensitive will England's price level be to price changes occurring in the gold countries. To illustrate by an extreme case. If all countries joined sterling except the United States, England would be in a stronger position to influence either the American price level or dollar exchange rate. In other words, United States' position would be similar to that of China's pre departure. China was in her monetary predicament not because she had a silver standard, but because no one else was on silver. The analogy is not perfect (for reasons we cannot go into here), but it is close enough to illustrate the point.

(b) The prestige of sterling will be enhanced. More business would be done in sterling, with the result that London would become a little more important as a money market. Her bankers, bill brokers, and

insurance companies would have a little more business to transact. Doubtless, too, she probably would enjoy the experience of insinuating what she thinks is a well deserved rebuke to the United States for its silver program.

(c) The more sterling countries there are, the stronger will be England's position around a conference table with the gold countries should an international monetary conference take place.

The sole disadvantage from England's point of view is that the more currencies there are tied to sterling, the less autonomy can she have in the determination of her price level and exchange rates. Not as between sterling and gold (she would increase her power in that relationship), but between herself and other sterling countries. However, the advantages enumerated above of getting China to join sterling are doubtless more important.

66. Would not the United States obtain similar benefits if China tied the yuan to the United States dollar?

Not as much as would England, but possibly enough to make it worth while if we have to pay very little for it. The advantages would be much the same, substituting New York for London, etc., except that more Chinese trade, more prestige, more international financial business in New York means less to the United States than it does to England. This is true partly because of England's greater need for foreign trade, and her traditional role in international finance, and partly because the United States is a coming nation and England is a going one.

There are, however, political considerations that counsel caution in any attempt to link the yuan to the U. S. dollar. Any action which would strengthen the political and economic ties between the United States and China is to be carefully weighed in the light of international political considerations. In this evaluation the strong prospects of war in China - either foreign or domestic - and the strong possibility of either a Japanese controlled China or a Communist controlled China, and the reaction Japan would have to such a move on our part, must not be overlooked.

67. What difference does it make whether the yuan is linked to the dollar or to sterling?

The economic advantages have been listed above. The total value to the American nation is not great enough to warrant steps which will involve the United States more deeply in the Far Eastern situation unless it fits in with our Far Eastern policy. Nor are the economic gains great

enough to justify an offer of large loans or other costly favors. But if the price to be paid by us be small, it might yield a net economic gain.

Internationally, the step would indicate to Japan that the United States is not wholly unconcerned in her expansion program in Asia. The step would encourage China and possibly cause Japan to proceed more warily in her attempt to swallow China. Whether or not this would be desirable depends, of course, on the diplomatic policy we wish to pursue in the Far East.

68. What would China like to obtain from the U. S. now?

More purchases of her silver at as favorable a rate as possible, or possibly some assurance of support of the yuan at current rates or even at a moderately altered one. She needs more gold or foreign exchange with which to support her yuan.

The Nanking Government would also be glad to get the enhanced prestige at home, and the somewhat increased political strength in her relations with Japan and England that favored treatment by the U. S. would give it. It would also be eager to secure the additional financial support a safer yuan would supply to the Government.

The Nanking Government may also try to interest the U. S. in promoting more foreign investments in China, or in securing some long-term credits, like the wheat loan of 1933.

It may be also that she may be hoping to maneuver the United States in a position more favorable to China politically - in her difficulties with Japan - by raising the issue of the Consortium, or renewing the service payments on the defaulted loans, or a linking of yuan and dollar at a price.

69. Why should we buy silver from China?

(a) It will help improve business conditions in China and we will secure some benefit from her recovery.

(b) It will help keep the yuan from depreciating, and thereby protect our exporters who compete with China's producers and those who sell to China. It will also prevent keener Chinese competition in our domestic market. Furthermore, if the yuan should depreciate, Japan might possibly feel it necessary to permit the yen to fall a little as on some items competition between the two countries is very keen.

(c) Our purchases will decrease our gold holdings and increase the gold holdings elsewhere. This is desirable at this time, though to be

sure the amounts involved in purchases of silver from China are too small to be important.

(d) For every ounce of silver purchased at low prices, the United States Government makes a handsome seigniorage profit. A profit that curiously enough is not at the country's expense, though it reduces slightly the total interest payments the Government has to make to certain groups by reducing the amount the Government needs to borrow.

(e) Silver at the current (foreign) price is not a bad investment. Until our purchase program ends it is not likely to go much lower. After that it may drop, but the drop is not certain. It is not yet clear what will become of China's $1\frac{1}{2}$ to 2 billion ounces, nor how the Indian people will continue to react to low silver prices. Moreover, the current low silver prices may stimulate industrial uses enough to maintain the demand for silver at a 40 cent level.

Besides, no matter what happens to silver, it will probably remain in our monetary system at the book value of \$1.29 an ounce. With so much gold with which to settle any adverse international balance that may develop, it is extremely unlikely that we shall ever be forced to sell our silver stocks. It will remain part of our specie reserves, and continue to be recorded at its monetary value after issue.

(f) We should get something in return for buying China's silver in addition to her good will.

70. What has China to offer us?

(a) Return to the silver, or bimetallic standard (discussed above, Sections 63 and 64).

(b) The yuan could be pegged to the dollar. The yuan is at present linked to sterling - de facto, though not de jure. The official sterling-yuan rate has remained the same, the dollar-yuan rate has not. If we wished to have the yuan linked de facto to the dollar, China might offer that. If, however, it be felt here that the economic and political gains from such a step do not outweigh the international political objections which may exist, China might offer to unpeg the sterling rate and pursue an exchange policy that appears independent, as follows:

(c) The yuan could be pegged (de facto, not de jure) at a point halfway between the movements of the sterling-dollar cross rate; or it could be pegged to first one or then the other currency intermittently, according to which was lower, or which higher, or midway, or some other pre-arranged basis.

It were better for us if the yuan were not listed among the sterling group for the very reasons that it would be good for England if it

were. China could follow the practice of Canada, and peg their exchange neither to sterling nor the dollar, but move in between, when one or the other moves in terms of the other. In that way England would be deprived of such political and economic strength that would adhere to it if the yuan remained definitely in the sterling group. At the same time the United States would not be saddled with the responsibility of helping the yuan maintain its present level, nor with the odium of defeat if the yuan slipped her moorings. We could support her exchange or not, as we saw fit at the time, and not because we were under any specific or implied obligations to do so.

(d) New 50-cent and dollar coins could be minted with some silver, and the amount of such coins issued could be expanded. It is true that the coins cannot contain much silver without exposing her currency to a repetition of her former difficulties in the event of a rise in silver prices, but the coins could be put in circulation with a reasonably small proportion of bullion - say enough to safeguard it in the event of \$1.29 silver.

The advantages of getting China to put silver in her larger coins (and if possible in a new coined 25-cent piece) would be two:

(1) The administration would avoid the onus of having driven silver out of China's monetary system by our silver policy, which was designed to increase the world monetary use of silver.

(2) It would somewhat reduce the world stock of silver for sale, and increase world monetary use, and also check such decline in popularity of silver in China that might eventually result if silver loses its monetary status there.

Inasmuch as China is already contemplating issuing such coins with some silver content, they would hardly be adverse to increasing the number enough to publicize the news that China is going to use considerable quantities of silver in her new circulating media.

(e) We could obtain assurance that nothing prejudicial to our economic interests will be arranged with either Great Britain or Japan without our acquiescence.

The order of attractiveness to the United States of the various programs China could adopt are:

- (a) Return to a silver or a bimetallic standard.
- (b) Link the yuan to the dollar.
- (c) Unpeg the yuan from sterling, as described above.

(d) New silver coins, and (e) assurances of protection of our economic interests in China could accompany any of the above three.

P. S. -

A report by M. B. Davis in Nanking, dated February 10th, just received, states that he is informed the dies (for the new 50-cent and dollar coins) which on January 6 had been reported to have been ordered (See Section 55, page 37) from Philadelphia, are now being ordered in London instead. For the past few years, according to Mr. Frantz, Bureau of the Mint, China has been obtaining her dies here.

APPENDIX

Includes only tables on China's foreign trade.

Numerous other tables bearing on China are available in the Division files.

Foreign Trade of China, 1929 to date

(values in thousands of yuan)

Month and year	Gross exports		Gross imports	
	Including	Excluding	Including	Excluding
	Manchuria	Manchuria	Manchuria	Manchuria
1929	1,582,441	1,070,523	1,996,299	1,627,935
1930	1,394,166	944,414	2,069,385	1,747,215
1931	1,416,963	915,169	2,256,276	2,018,406
1932	768,077	569,464	1,655,558	1,541,583
1933	612,293		1,358,978	
1934	535,733		1,038,979	
1933 - Jan.	62,034		103,066	
Feb.	50,311		114,450	
Mar.	45,337		149,258	
Apr.	37,193		148,558	
May	51,576		153,026	
June	50,230		110,971	
July	62,612		104,168	
Aug.	51,404		101,292	
Sept.	48,651		89,841	
Oct.	47,975		95,446	
Nov.	54,239		96,801	
Dec.	50,730		92,103	
1934 - Jan.	50,796		106,214	
Feb.	38,051		83,485	
Mar.	40,211		100,115	
Apr.	41,161		101,724	
May	49,348		95,807	
June	49,184		86,966	
July	44,949		74,478	
Aug.	44,077		75,042	
Sept.	41,814		78,120	
Oct.	42,711		79,745	
Nov.	49,838		84,252	
Dec.	43,595		73,031	
1935 - Jan.	55,305		90,715	
Feb.	41,546		67,428	
Mar.	39,079		97,776	
Apr.	41,595		104,348	

Treasury Department, Division of Research and Statistics.

Foreign Trade of China, 1929 to date (Continued)

(Values in thousands of yuan)

Month and Year	Gross Exports	Gross Imports
1935 - May	40,814	96,689
June	41,253	91,942
July	45,975	64,790
August	45,378	56,459
September	45,972	54,695
October	48,516	61,581
November	60,276	72,737
December	70,590	65,534
1936 - January	70,773	61,199

Treasury Department, Division of Research and Statistics.

April, 1936.

China (excluding Manchuria) - Trade with United States - January 1933 to date
(Thousands of yuan)

	Gross exports											
	1933			1934			1935			1936		
	Total : exports	Exports to U. S.	Percent of total	Total : exports	Exports to U. S.	Percent of total	Total : exports	Exports to U. S.	Percent of total	Total : exports	Exports to U. S.	Percent of total
Total exports	612,292	113,146	18.5	535,735	94,435	17.6	576,299	196,411	23.7			
January	62,034	11,118	17.9	50,796	9,923	19.5	55,305	12,460	22.5	70,773	23,664	33.4
February	50,311	7,744	15.4	38,051	8,385	22.0	41,546	9,667	23.3			
March	45,337	8,219	18.1	40,211	11,157	27.7	39,079	11,296	28.9			
April	37,193	6,265	16.8	41,161	7,961	19.3	41,595	10,688	25.7			
May	51,576	10,544	20.4	49,348	8,073	16.4	40,814	10,791	26.4			
June	50,230	11,016	21.9	49,134	7,413	15.1	41,253	10,066	24.4			
July	62,612	15,418	24.6	44,949	6,800	15.1	45,975	10,599	23.1			
August	51,404	11,480	22.3	44,077	7,247	16.4	45,378	8,596	18.9			
September	48,651	8,919	18.3	41,814	5,559	13.3	45,972	10,071	21.9			
October	47,975	7,212	15.0	42,711	6,822	16.0	48,516	11,563	23.8			
November	54,239	8,359	15.4	49,838	7,374	14.8	60,276	12,559	20.8			
December	50,730	6,852	13.5	43,595	7,711	17.7	70,590	18,055	25.6			
	Gross imports											
	1933			1934			1935			1936		
	Total : imports	Imports from U. S.	Percent of total	Total : imports	Imports from U. S.	Percent of total	Total : imports	Imports from U. S.	Percent of total	Total : imports	Imports from U. S.	Percent of total
Total imports	1,358,980	297,469	21.9	1,038,979	271,733	26.2	924,694	174,930	18.9			
January	103,066	22,162	21.5	106,214	29,835	28.1	90,715	18,537	20.4	61,199	12,361	20.2
February	114,450	28,340	24.8	83,485	34,150	40.9	67,428	14,254	21.1			
March	149,258	28,804	19.3	100,115	27,962	27.9	97,776	18,350	18.8			
April	148,558	27,249	18.3	101,724	22,160	21.8	104,348	17,254	16.5			
May	153,026	31,459	20.6	95,807	27,037	28.2	96,689	16,077	16.6			
June	110,971	20,362	18.3	86,966	20,556	23.6	91,942	22,878	24.9			
July	104,168	21,798	20.9	74,478	18,298	24.6	64,790	11,968	18.5			
August	101,292	23,171	22.9	75,042	19,498	26.0	56,459	10,925	19.4			
September	89,841	19,915	22.2	78,120	18,583	23.8	54,695	9,154	16.7			
October	95,446	27,089	28.4	79,745	15,296	19.2	61,581	9,916	16.1			
November	96,801	23,991	24.8	84,252	18,314	21.7	72,737	11,928	16.4			
December	92,103	23,129	25.1	73,031	20,044	27.4	65,534	13,689	20.9			

China (excluding Manchuria) - Foreign trade by leading countries, 1929-1935
Value (millions of yuen)

Gross exports

	1929	1930	1931	1932	1933	1934	1935
Total exports	1,070	944	915	569	612	536	576
United States	199	195	178	92	113	94	136
Hong Kong	260	236	219	116	121	101	95
Japan	189	154	165	104	96	81	82
United Kingdom	118	81	75	55	49	50	49
France	86	65	51	35	32	21	29
Germany	33	31	27	22	21	19	29
British India	27	28	28	33	29	22	20
U. S. S. R.	23	6	14	27	6	6	4
All other countries	135	148	158	85	145	142	132

Gross imports

Total imports	1,620	1,723	2,002	1,524	1,359	1,039	925
United States	318	329	479	413	297	272	175
Hong Kong	306	309	327	88	48	30	20
Japan	300	329	316	183	132	127	140
United Kingdom	170	151	179	183	154	125	98
Germany	91	88	122	110	108	93	103
British India	81	204	123	97	72	43	35
U. S. S. R.	4	4	16	23	22	9	8
Netherland India	83	69	82	91	79	63	58
All other countries	267	240	358	336	447	277	288

China (excluding Manchuria) - Percentage distribution of value of foreign trade by leading countries, 1929-1935; percent change in 1934 and 1935 from 1933; and percent change in 1935 from 1934

Gross exports

	Percent of total value							Percent change from 1933:1935 percent		
	1929	1930	1931	1932	1933	1934	1935	1934	1935	change from 1934
Total exports	100	100	100	100	100	100	100	- 12.4	- 5.9	+ 7.5
United States	19	21	19	16	18	18	24	- 16.8	+ 20.4	+ 44.7
Hong Kong	24	25	24	20	20	19	16	- 16.5	- 21.5	- 5.9
Japan	18	16	18	18	16	15	14	- 15.6	- 14.6	+ 1.2
United Kingdom	11	8	8	10	8	9	9	+ 2.0	-	- 2.0
France	8	7	6	6	5	4	5	- 34.4	- 9.4	+ 38.1
Germany	3	3	3	4	3	4	5	- 9.5	+ 38.1	+ 52.6
British India	2	3	3	6	5	4	3	- 24.1	- 31.0	- 9.1
U. S. S. R.	2	1	2	5	1	1	1	-	- 33.3	- 33.3
All other countries	13	16	17	15	24	26	23	- 2.1	- 9.0	- 7.0

Gross imports

Total imports	100	100	100	100	100	100	100	- 23.5	- 31.9	- 11.0
United States	20	19	24	27	22	26	19	- 8.4	- 41.1	- 35.7
Hong Kong	19	18	16	6	3	3	2	- 37.5	- 58.3	- 33.3
Japan	19	19	16	12	10	12	15	- 3.8	+ 6.1	+ 10.2
United Kingdom	10	9	9	12	11	12	11	- 18.8	- 36.4	- 21.6
Germany	6	5	6	7	8	9	11	- 13.9	- 4.6	+ 10.8
British India	5	12	6	6	5	4	4	- 40.3	- 51.4	- 18.6
U. S. S. R.	-	-	1	2	2	1	1	- 59.1	- 63.6	- 11.1
Netherland India	5	4	4	6	6	6	6	- 20.3	- 26.6	- 7.9
All other countries	16	14	18	22	33	27	31	- 38.0	- 35.6	+ 4.0

China (excluding Manchuria) - Trade with United States by principal commodities, 1933-1935

Net exports

	Quantity			Value (Thousands of yuan)			Percent of total value			Percent change from: 1933			1935 percent change from 1934
	1933	1934	1935	1933	1934	1935	1933	1934	1935	1934	1935		
Total exports	-	-	- 113,146	94,435	136,410	100	100	100	- 16.5	+ 20.6	+ 44.4		
Tung oil (quint)	531,680	410,390	491,999	21,356	16,204	28,057	19	17	21	- 24.1	+ 31.4	+ 73.1	
Hides, skins and furs	-	-	- 21,042	19,035	15,565	19	20	11	- 9.5	- 26.0	- 18.2		
Raw silk (quint)	13,383	4,775	14,504	13,951	3,912	12,838	12	4	9	- 72.0	- 8.0	+ 228.2	
Sheep's wool (quint)	132,950	132,300	187,752	11,211	11,199	13,489	10	12	10	- .1	+ 20.3	+ 20.4	
Laces, embroideries, etc.	-	-	- 8,968	9,053	11,552	8	10	9	+ .9	+ 28.8	+ 27.6		
Raw cotton (quint)	80,347	22,296	25,010	5,754	1,601	1,803	5	2	1	- 72.2	- 68.7	+ 12.6	
Bristles (quint)	15,592	13,240	15,179	4,561	5,126	6,365	4	5	5	+ 12.4	+ 39.6	+ 24.2	
Sesamum seed (quint)	146,223	178,062	685,476	2,259	2,151	9,901	2	2	7	- 4.8	+ 338.3	+ 360.3	
Peanut oil (quint)	38,327	42,704	199,533	1,062	758	5,547	1	1	4	- 28.6	+ 422.3	+ 631.8	
Cottonseed oil (quint)	-	4,978	89,416	-	79	2,183	-	-	2	-	-	+ 2,663.3	
All other	-	-	- 22,982	25,317	29,110	20	27	21	+ 10.2	+ 26.7	+ 15.0		

Net imports

Total imports	-	-	- 297,468	271,732	174,930	100	100	100	- 8.7	- 41.2	- 35.6	
Raw cotton (quint)	769,743	583,748	275,902	66,550	52,946	24,245	23	20	14	- 20.5	- 63.6	- 54.2
Kerosene (1,000 liters)	351,160	234,644	180,914	51,159	21,368	17,606	17	8	10	- 58.2	- 65.6	- 17.6
Gasoline, fuel and lubricating oils	-	-	- 24,776	18,433	18,884	8	7	11	- 25.6	- 23.8	+ 2.4	
Leaf tobacco (quint)	241,805	287,097	66,791	26,213	30,585	7,468	9	11	4	+ 16.7	- 71.5	- 75.6
Timber	-	-	- 12,450	11,778	12,400	4	4	7	- 5.4	- .4	+ 5.3	
Wheat and flour (quint)	607,079	3,441,584	220,852	11,382	24,920	2,417	4	9	1	+ 118.9	- 78.8	- 90.3
Iron and steel	-	-	- 10,636	14,562	10,364	4	5	6	+ 36.9	- 2.6	- 28.8	
Automobiles, parts and accessories	-	-	- 9,445	14,467	9,811	3	5	6	+ 53.2	+ 3.9	- 32.2	
Aircraft and accessories	-	-	- 8,974	6,281	1,274	3	2	1	- 30.0	- 85.8	- 79.7	
Paper and products	-	-	- 7,173	4,656	7,593	2	2	4	- 35.1	+ 5.9	+ 63.1	
Machinery and tools	-	-	- 7,039	9,241	9,928	2	4	6	+ 31.2	+ 41.0	+ 7.4	
All other	-	-	- 61,671	62,495	52,940	21	23	30	+ 1.3	- 14.2	- 15.3	

China (excluding Manchuria) - Foreign trade by principal commodities, 1933-1935

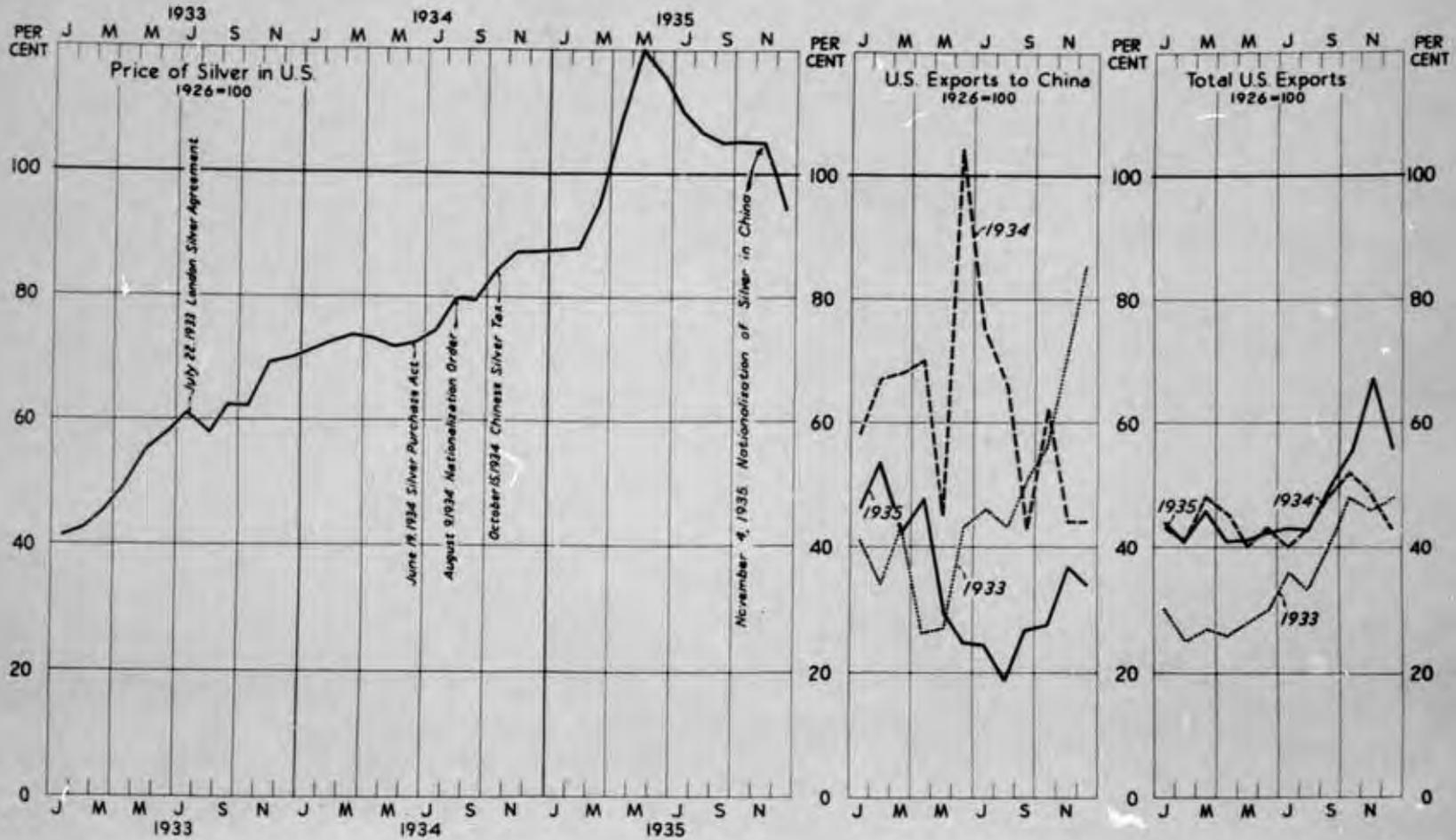
Net exports

	Quantity			Value			Percent of total value			Percent change from 1933 percent		
	(In thousands)			(Millions of yuan)						1933		
	1933	1934	1935	1933	1934	1935	1933	1934	1935	1934	1935	1934
Total exports	-	-	-	612	535	576	100	100	100	- 12.6	- 5.9	+ 7.7
Raw silk (quint)	47	33	46	48	24	36	8	4	6	- 50.0	- 25.0	+ 50.0
Cotton yarn (quint)	327	270	146	40	31	19	6	6	3	- 22.5	- 52.5	- 38.7
Eggs and egg products	-	-	-	36	30	32	6	5	5	- 16.7	- 11.1	+ 6.7
Tea (quint)	420	471	381	34	35	30	6	7	5	+ 5.9	- 11.8	- 16.7
Hides, skins and furs	-	-	-	32	29	24	5	5	4	- 9.4	- 25.0	- 17.2
Tung oil (quint)	754	653	739	30	26	42	5	5	7	- 13.3	+ 40.0	+ 61.5
Raw cotton (quint)	438	209	315	30	15	22	5	3	4	- 50.0	- 26.7	+ 46.7
Tin (ingots and slabs) (quint)	96	64	92	20	14	20	3	3	4	- 30.0	-	+ 42.9
All other	-	-	-	342	330	351	56	62	61	- 3.5	+ 2.6	+ 6.4

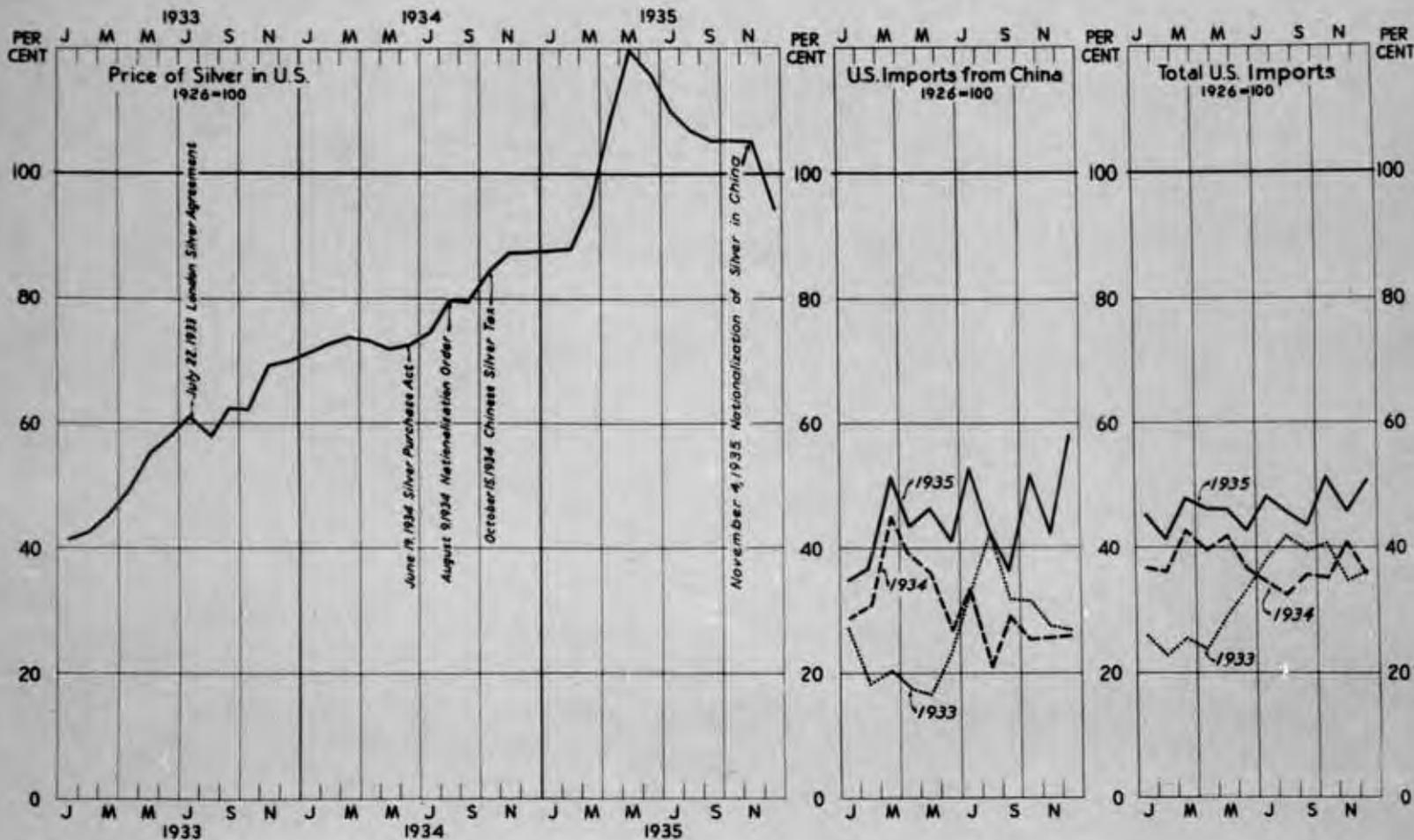
Net imports

Total imports	-	-	-	1,346	1,030	919	100	100	100	- 23.5	- 31.7	- 10.8
Rice and paddy (quint)	12,954	7,711	12,964	151	66	90	11	6	10	- 56.3	- 40.4	+ 36.4
Raw cotton (quint)	1,206	1,163	549	98	90	41	7	9	5	- 8.2	- 58.2	- 54.4
Wheat (quint)	10,715	4,649	5,209	88	32	35	7	3	4	- 63.6	- 60.2	+ 9.4
Kerosene (liters)	708,865	450,549	388,177	87	40	38	6	4	4	- 54.0	- 56.3	- 5.0
Cotton piece goods	-	-	-	58	27	21	4	3	2	- 53.4	- 63.8	- 22.2
Chemicals and pharmaceuticals	-	-	-	51	42	37	4	4	4	- 17.6	- 27.5	- 11.9
Paper and products	-	-	-	49	41	46	4	4	5	- 16.3	- 6.1	+ 12.2
Machinery and tools	-	-	-	43	59	66	3	6	7	+ 37.2	+ 53.5	+ 11.9
All other	-	-	-	721	633	545	54	61	59	- 12.2	- 24.4	- 13.9

U.S. PRICE OF SILVER AND U.S. EXPORTS TO CHINA



U.S. PRICE OF SILVER AND U.S. IMPORTS FROM CHINA



Office of the Secretary of the Treasury
Division of Research and Statistics

1124-0F