



AN EVALUATION OF THE TRADE
AND EXCHANGE CONTROLS OF
WAR-TIME CHINA

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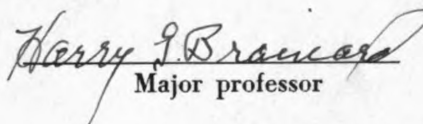
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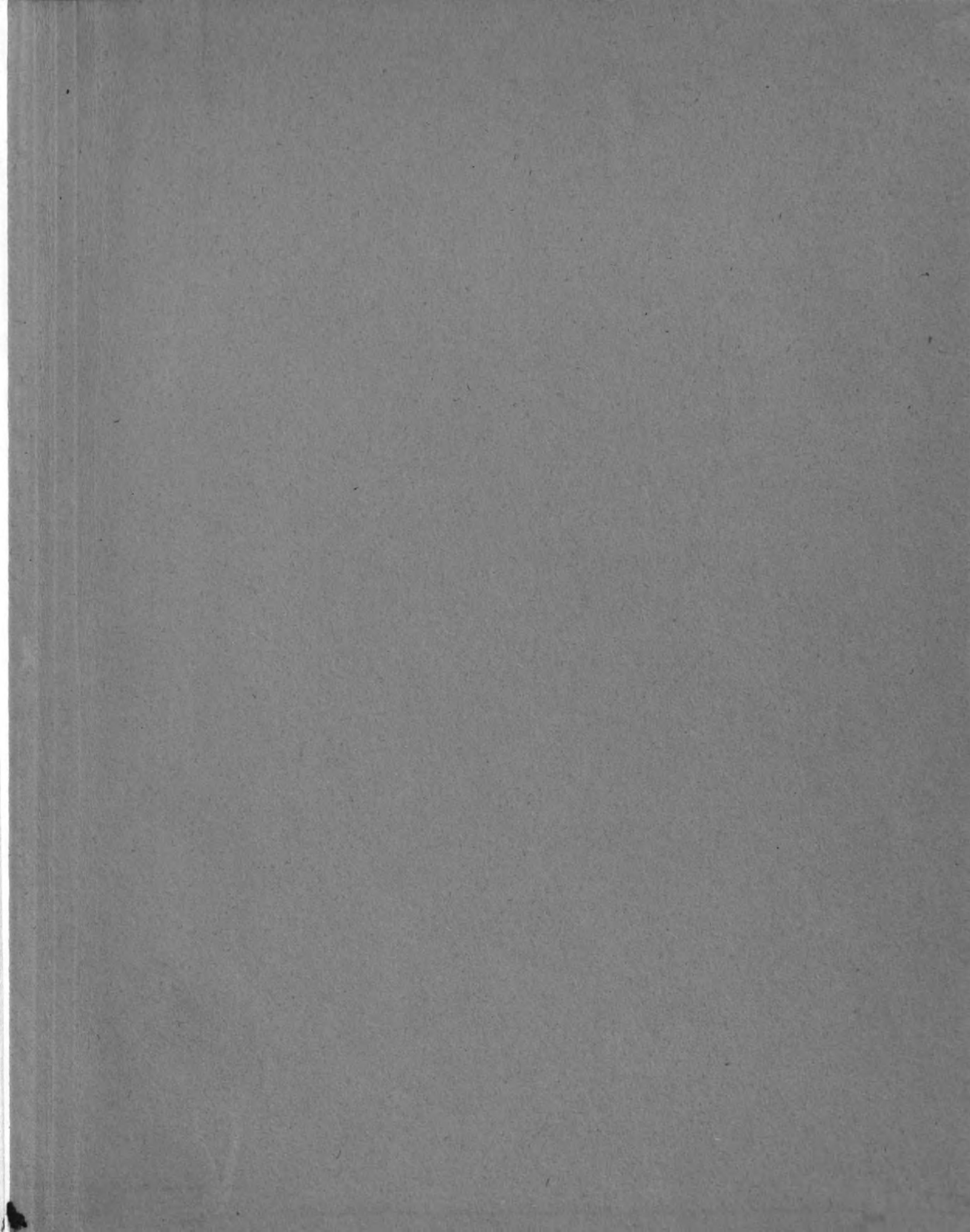
Ta-Nien Lu

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AN EVALUATION OF THE TRADE AND EXCHANGE
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Ta-Nien Lu

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Chapter I Introduction

The nature and purpose of this thesis

The purposes of this thesis are: (1) to make a general survey of trade and exchange controls, and (2) an evaluation of them in war-time China (1937-1948), beginning with the Sino-Japanese war and ending three years after V-J day. Before 1937 there was no trade or exchange control in China¹, and most of the up-to-date data are not available, therefore this long period covering 12 years is the most suitable one. Various policies and practices adopted by the Chinese Government will be discussed in detail, and at the same time showing how effective they were. Comments made by the public and economists will be presented. General comparison with other countries who adopted trade and exchange controls will also be made. Tentative conclusion will be made by the writer to predict the future of foreign trade of China. Recommendations for improvement in view of a sound national economic welfare of China as well as the prosperity of the whole world is the core of this thesis. The whole period is divided into several sections according to the pattern of control policies. This chapter begins with tracing the trend of foreign trade and foreign exchange market in the pre-war period.

¹ Here we use the term "exchange control" in the much narrower sense. See L. W. Towle: International Trade and Commercial Policy, 1947, Harper & Brothers, Publishers.

The trend of foreign trade and a free exchange market
before the war

China's foreign trade during the whole past years has shown invariably an unfavorable balance of the trade. In many respects she was a backward member in the family of nations. Therefore, she had to import many of the industrial materials for economic reconstruction as well as daily necessities such as cotton, flour, rice, wool, fertilizer, etc. Before 1937 China normally imported yearly about U. S. \$350,000,000 worth of goods and exported goods yearly valued at about U. S. \$200,000,000². The excess of imports over exports amounting to about U. S. \$150,000,000 yearly was paid for regularly out of remittances from overseas Chinese, of foreign credit and loans, of some invisible items of payments, and sometimes by exporting gold and silver bullion.

What was the general pattern of imports. The following table will show in detail:³

The main composition of Chinese imports
(1934-1936 yearly average)

Item	Value
Metals and mineral ores	U.S. \$30,000,000
Machinery and instruments	20,000,000
Vehicles and vessels	13,000,000

² China Trade Monthly, Sept. 1947. In order easily to compare with later years, figures used here are in terms of American dollars. Due to inflation, the Chinese dollar was depreciated so severely that it cannot be used as a standard.

³ T. K. Liu, "China's balance of trade" in Central Bank Monthly of China, Jan. 1946.

The main composition of Chinese imports (cont.)

Miscellaneous metal manufactures	U.S. \$12,500,000
Chemicals and pharmaceuticals	13,000,000
Cotton and textiles	50,000,000
Flour, wheat, rice	50,000,000

The exports were mainly agricultural products including tea, soybeans, peanuts, tung oil, bristles, etc. occupying 58 percent of the total exports⁴. Manufactures for exports only occupied 26 percent, and minerals, chiefly tin, antimony, tungsten, constituting about 9 percent. Others belong to animal products.

Insofar as the imports from and exports to countries were concerned, the United States of America dominated both in imports and exports for several years before the war. Japan occupied the second place in its exporting to China, while Germany moved up from the fourth place to third, displacing Great Britain in 1935. In the order of the countries to which China's exports were dispatched in 1935, the United States headed the list and Hongkong, very largely a transit port, occupied the second place. Followed in order were Japan, Great Britain, France, Germany, British India, and other European countries were insignificant. Here it will be seen how important is the commercial relation

⁴ P. C. Chen, *Economic Reconstruction of China*, p. 78, published in Chungking, 1944.

between the United States and China. The following statistics show in detail:

The Sources of Chinese Imports⁵
1934-1935

(Unit: Chinese dollars)

Countries	Value in thousands of Chinese dollars		Percentage in total	
	1934	1935	1934	1935
U. S. A.	\$ 271,732	\$174,930	26.15	18.92
Japan	126,886	139,593	12.21	15.10
Germany	93,389	103,385	8.99	11.18
G. Britain	124,647	98,232	12.00	10.62
F. Indo-China	41,606	59,973	4.01	6.48
Nds. India	63,427	58,356	6.10	6.31
Others	317,292	290,222	30.54	31.39
Total	\$1,038,979	\$934,695	100.00	100.00

The Destination of Chinese Exports⁵
1934-1935

(Unit: Chinese dollars)

Countries	Value in thousands of Chinese dollars		Percentage in total	
	1934	1935	1934	1935
U. S. A.	\$ 94,435	\$136,410	17.63	23.67
Hongkong	101,001	94,489	18.85	16.47
Japan	81,232	82,059	15.16	14.24

⁵ See Report of The Bank of China for the year 1935.

The Destination of Chinese Exports (cont.)

Countries	Value in thousands of Chinese dollars		Percentage in total	
	1934	1935	1934	1935
G. Britain	\$49,806	\$49,463	9.30	8.58
France	21,142	24,245	3.95	5.07
Germany	19,159	28,926	3.57	5.02
British India	22,161	20,345	4.14	3.53
Nds. India	14,700	15,251	2.74	2.65
Others	132,097	119,706	24.66	20.77
Total	\$555,733	\$576,298	100.00	100.00

Before the war a free foreign exchange market was maintained. The exchange rate was determined by the supply and demand of bills of exchange each day in the Shanghai money market. The Bank of China as well as many other commercial banks together formed a foreign exchange market, but actually some leading foreign banks in China played the leading role. This is an abnormal phenomenon in an independent country. It is because that before the war many big importing and exporting business firms were concentrated in the hands of foreigners who naturally conducted many of their transactions with their own banks in China. Besides, overseas Chinese remittances were largely through foreign banks.

A new foreign exchange standard

Before November 4, 1935 China was a silver standard country, hence the foreign exchange rate fluctuated not only with its natural forces, i.e. supply and demand of bills of exchange, but also with the price of silver to gold. This was undesirable, because it hampered both imports and exports and especially discouraged foreign investment. In addition, the American Silver Purchase Act of 1934 raised the silver price in the world market, thus induced huge outflow of silver bar. This resulted in drastic contraction of Chinese currency. A nation-wide depression was predicated.

It was under such an emergency condition that the Chinese Government proclaimed a new managed paper standard on November 3, abandoning the use of the old Chinese silver dollar. The following provisions were made: ⁶

(1) Beginning November 4, 1935 the paper money issued by three Governmental Banks would be the only legal tender called Fapi. No transactions made by silver dollars would be permitted.

(2) There would be no restrictions on the selling and buying of foreign exchange bills. This was to stabilize the value of new currency.

(3) The foreign exchange rate was pegged to British pound sterling at the rate of one Chinese dollar to 1 shilling and 2.5 pence, which was the average rate of the preceding five years.

⁶ See the documents issued by The Ministry of Finance of China Nov. 3, 1935.

From the above it may be seen that this was a foreign exchange standard. Through its pegged rate to stable British pound, it was also linked to a stable ratio with U. S. dollars, around U. S. \$30 to 100 Chinese dollars or one Chinese dollar to U. S. \$0.30. Thus foreign investment in China was greatly encouraged and imports as well as exports were also stimulated to a high point. Besides, the new pegged rate slightly undervalued the Chinese monetary unit in its external value. The domestic price level thus was kept from falling further and even rose gradually to the normal level of 1933.⁷

One year and a half after adopting such a new monetary policy, China had a stable currency. She had launched a large-scale rehabilitation and reconstruction program. For a while it seemed that China was well on the road to economic prosperity. Given another decade or two of peace and stability, China would have been proud of her achievements.

The happy state of affairs, however, was short-lived. The Japanese invasion in July of 1937 brought China's economic progress to a standstill. Insofar as foreign trade and the money market were concerned, there were many disturbances. These will be discussed in the following chapters.

⁷ K. C. Yao, World Monetary Policy, 1941, Part II. On silver standard. Published in Shanghai.

Chapter II The Beginning of control (1948-1941)

Loose control adopted

With the outbreak of the Japanese invasion in North China and later in Shanghai, foreign trade had been more or less disturbed. Although all seaports were still open, the communication facilities had been handicapped, resulting in a moderate reduction of both imports and exports. It is noticeable to see that in the first ten months of the war the Chinese foreign exchange rate still kept the same as before (one Chinese dollar to 1 shilling and 2.5 pence).⁸ No restrictions were imposed on the application of foreign exchange. This is because at that time the monetary authority thought the source of supply of foreign exchange might not be reduced in great amount. With export still going on, the overseas Chinese remittances were still not halted. The authorities neglected, however, the possibility of flight of capital in large scale.

It was not until March 12, 1938, after the moving of the Nationalist Government to the hinterland, giving up Shanghai, Nanking, and other big cities, that the flight of capital began to be felt as a great pressure on the foreign exchange market. Then the Government began a very loose control of exchange. A regulation for the examination⁹ for the legitimate application of foreign exchange was promulgated

⁸ Ibid.

⁹ See the Regulation promulgated by Ministry of Finance March 12, 1938.

which was good only for the old pegged rate--one Chinese dollar to one shilling and 2.5 pence or around U. S. \$0.30. It aimed to maintain the Chinese dollar's external value at pre-war value and at the same time to prevent speculative uses and flight of capital. The so-called legitimate uses included any kind of commercial uses for imports and exports (but with a list of priorities), shipping and insurance fees, living and touring expenses of eligible persons abroad, and other justified uses which were considered as necessary and appropriate. Those not within the above prescribed field were rejected for the procurement of foreign exchange in order to avoid abuse in speculation and the flight of capital. However, this ended in failure, since it was too loose in definition of commercial uses. This topic will be discussed in a later section.

At that time (1948) the Central Bank of China was taking charge of examining whether the applications were eligible or not. Since then the black market appeared as a result of the limited supply of foreign exchange. As J. B. Condliffe pointed clearly "attempts to peg the rate of exchange at a level above that warranted by the state of the market have invariably been accompanied by the appearance of a black market in which the pegged currency sells at a discount."¹⁰ Here is found a good example in war-time China.

¹⁰ J. B. Condliffe, *The Reconstruction of World Trade*, p. 237, 1940. Published by W. Norton & Co., N. Y.

The black market gradually rose to eight pence and then to five pence in 1939, i.e. dropping down the Chinese dollar's external value to only one third of its previous value.

This rather reduced the supply sources of foreign exchange for the government from exports and oversease Chinese remittances, because the official rate was too low. Therefore, the Central Bank of China was forced to set another rate called "commercial quotation" at seven pence in June 1939, but maintaining an official rate the same as before.¹¹ Thus a considerable amount of supply of foreign exchange was transferred to the government, preventing its flow to black market. This is the beginning of a dual rate of exchange, although it was cancelled in 1941 and later resumed in 1944 and 1947.

In 1939 an Examination Committee for foreign exchange applications under the Ministry of Finance was established to take over the work done formerly by the Central Bank of China, leaving the Central Bank only carrying about the actual operation of Foreign Exchange Equalization Committee.¹² It was early established during the new monetary policy period in 1935. This Fund was appropriated at the amount of ten million pounds, including a portion of the Sino-British loan through two British Banks in Shanghai

¹¹ L. W. Wang, "Whither official rate", Financial Review, May, 1943. Published in Chungking.

¹² Ibid.

and two Chinese Governmental Banks. The main operating spot then was at Hongkong and later moved to Chungking and funds were greatly increased.¹³

Turning pegged rate to U. S. dollar

Before 1939 the stable rate between Great Britain and the United States was around one pound to U. S. \$4.86. After a few months it was dropped to even below U. S. \$4.00¹³ and had the tendency of falling further as the consequence of proclamation of war against Germany. The Chinese Government then turned its pegged rate to U. S. dollars instead of to British pounds. This was a natural result, as a foreign exchange standard always seeks a stable foreign currency for its links. China was not an exception at that time, and happy to say this proved a successful one in finding an ever stable currency like the United States dollar through the war time.

Comments on this period

It is regretful to say that the Chinese government was too slow to respond to the flight of capital at the beginning of the war and to adopt a method of control. During a nation-wide war it is but natural that the total demand for means of foreign payment constantly tends to outrun the supply by a wide margin. This implies a large scale in flight of capital. Therefore, most belligerent countries usually practice exchange control as soon as war

¹³ Ibid.

begins.¹⁴ The Chinese Government's attempt to maintain an undesirable long-time fixed external value of her own currency during war at the expense of nearly ten million British pounds seems not worthwhile. As the war situation became worse and the sources of foreign exchange became more and more scarce, available exchange should have been used for important uses only, namely the procurement of adequate supplies of strategic materials abroad. Had those precious reserves been preserved in a large proportion, there would have been a more stable economy during the last stage of Sino-Japanese war. The Government might have used the funds to buy machines or raw materials from abroad and import to hinterland to enhance production, because most of the goods at that time were scarce and prices were extremely high, leading to a deteriorating national economy.

The system of exchange control finally adopted was not an appropriate measure because it was not strong enough to prevent capital flight. The major part of the legitimate uses were commercial, but this resulted in every transaction being claimed to be commercial. Just as M. Auboin, former Director-General of the Bank for International Settlements, recounted in detail, "It is soon realized, however, that--as if by chance--all calls for foreign

¹⁴ Like Great Britain practiced exchange control right after the declaration of World War II. See E. Stein and J. Backman, War Economics, 1942, Chap. 10, Wartime foreign trade control. Published by Farrar & Rinehart Co., N. Y.

currency are needed for commercial purposes. Moreover--also by chance--the influx of currencies slackens and the quantity available falls well below the figure corresponding to the country's exports. It therefore becomes necessary to carry the measures a stage further and to decide that all foreign currencies derived from exports are to be handed over compulsorily to the monetary authorities".¹⁵ Therefore, it is also regretful to see that the Chinese Government did not comprehend this point at the very beginning of war, leading a very loose method of control and thus letting out a great amount of flight of capital. The method of compelling all the exporters to sell their proceeds in foreign exchange so as to ensure the success of exchange control was not put in practice until 1939.¹⁶

Still one more thing neglected at the beginning of the war was that exchange control had to be accompanied by trade control in order to make it more effective. The foreign trade and financial policies of a nation locked in total war are dominated by two aims: (a) making the most advantageous use of foreign sources of materials and products in order to maximize war production and supply, and (b) gaining every possible advantage in economic warfare. For

¹⁵ A. Piater: Exchange Control: A general survey. Paris, 1940. Requoted from J. B. Condliffe, The Reconstruction of World Trade, 1940, p. 238.

¹⁶ S. Y. Lu, "Our foreign exchange policy in retrospect" in China Trade Monthly, Feb. 1949. Published in Shanghai.

accomplishment of these aims centralized and detailed controls must usually be exercised over imports, exports, foreign exchange and shipping, indeed, over all aspects of international intercourse.¹⁷ For example, luxuries and non-essential goods must be prohibited from entering in order to preserve limited source of foreign exchange during war for an economically weak nation. If this is not practiced, there is still a great leakage which will foster the growing of a black market, because although those aforesaid goods cannot apply for exchange to import, exchange may be obtained from the black market. The Chinese Government did not prohibit luxuries and non-essential goods until on July 1, 1939 a list of "Prohibited Imports during Time of Emergency" was promulgated.¹⁸

¹⁷ E. Stein and J. Backman, War Economics, Chap. 10, Wartime trade control.

¹⁸ S. Y. Lu, "Our foreign exchange policy in retrospect" in China Trade Monthly, Feb., 1949. Published in Shanghai.

Chapter III More strict control with a new pegged rate (1941-1946)

A new pegged rate

It was not until Dec. 1941 when Japan attacked the whole world that Chinese seaports were all blockaded leading to a standstill of nearly all normal foreign trade. Hongkong, a great transit port of export, was also occupied by the enemy and, therefore, could not be used as a source of supplying foreign exchange. What was worse was that at that time the overseas Chinese remittances decreased in a large amount due to the world war, especially in south Pacific areas such as British Malaya, Phillipine, Indo-China, and Siam where there were usually many Chinese.¹⁹

At that time only Shanghai produced goods and a meager amount of foreign goods came through occupied areas. Following the reopening of the Ledo road through India, only munitions, machinery, or some strategic materials were allowed due to the low capacity of this road. Another way, i.e. by airlift through the Himalaya Mountains, involved much risk. In a word, the whole feature of balance of

¹⁹ According to Professor C. F. Remer the overseas Chinese remittances contributed quite a part as to make up the balance of payment before the war. The figures according to Prof. Remer are as follows:

(millions of Chinese dollars)					
1928	Imports	\$1,794	Exports	\$1,487	Remittances \$250.6
1929	"	1,898	"	1,523	" 280.7
1930	"	1,984	"	1,342	" 316.3

See Remer, Foreign Investment in China, 1932.

payments changed: less exports but even fewer imports, less overseas remittances, and more advances paid by the United States for all the expenses incurred by the U. S. armies and air forces in China, which accumulated to a big amount. All this necessitated the enforcement of more strict control of foreign exchange. Such a blockade situation also explained why the official rate was pegged to U. S.\$20 beginning in 1942 through 1945, although later another dual rate was introduced. Because the rate was too low in comparison with its real purchasing power, there were very few applications for foreign exchange that were eligible, so only government purchasing or other official uses and a few strategic materials bought by some private factories could take advantage of it. The official rate then was only a nominal one, leaving other uses supplied by the black market.

State operation of exporting business

In order to procure more foreign exchange supplies irrespective of the low official rate, the Chinese Government entered the export business as a state operation and state monopoly. There was a prescribed price set for the purchase of agricultural products intended for export. After collecting through agencies of government, the products were then sent to many state factories to be inspected, processed, packed, and finally exported through some special transportation facilities like airlift to go abroad. There were four

main commodities falling in this government purchasing and government exporting field: tung oil, tea, silk, and hog bristles. But tungsten, an essential strategic mineral, was bartered with the Allies in exchange for munitions or to pay for foreign debts.

In 1941 a Foreign Trading Committee was established under the Ministry of Finance to deal with the promoting of exporting business. There were other government owned corporations to take charge of the actual work, such as Fooching and Fuhua Co. for tung oil and hog bristles, Chinese Tea Trading Co. for tea, and Chinese Silk Enterprise Co. for silk. It was admitted that there were some achievements especially in experimental works for enhancing quality and promoting standardization. As a whole, however, although this policy was found expedient, it brought about little profit either to the government or the people and proved to be a failure.²⁰ This is because:

(1) The price set for the purchase of these products was usually too low to allow producers a normal profit, resulting in a decrease in production. The government tried to press down the price as low as possible, so as to take some profit from it and also have a lower price in foreign market. But the government neglected to realize that under a free competitive economy it is impossible to maintain

²⁰ As commented by Chang Chia-Chu in China Trade Monthly, September, 1947.

production in the long run when the profit is too low compared with other kinds of production. In addition, under the acceleration of inflation the prescribed price sometimes lagged far behind the cost. This not only led to curtailed or stopped production but also forced these products into the Japanese occupied areas, forming a leakage in the flight of foreign exchange.

(2) Due to the low efficiency in collecting, handling, and transportation, not much profit went to the treasury. Huge administration expenses and other wasted expenses also contributed to the failure.

A new set of regulations for foreign exchange promulgated

A new set of regulations governing the application for foreign exchange was promulgated in 1942 and later revised in 1944 in order to meet a new economic situation of a nearly blockaded China.²¹ It consisted of the following:

- (1) For Governmental enterprise and organization
- (2) For manufacturing factory and firm
- (3) For eligible individual

The private industrial and commercial uses were quite limited in a narrow field unlike the earlier loose control of 1938-1941. Only machinery, instruments, important raw material and other goods of strategic importance were allowed to enter. These eligible goods together with government purchasing had to be approved by the War Production

²¹ Here used is the revised one. See Central Daily News, June 15, 1944.

Board (established in 1944). It had to be certified that they were essential in war time and eligible for import. Then the Board issued an identification letter stating the approved airlift tonnage. To this letter there had to be attached an appraised value sheet describing the kind, name, use, quantity, unit price, total value, name of the selling firm abroad, etc. All these documents had to be presented to the Central Bank of China when applying for exchange.

The following qualifications were necessary for private uses:²¹

"(1) Officials dispatched by government on special mission,

(2) Sickmen who could not be cured in a domestic hospital or for whom medicines are not available in China,

(3) Newspapermen sent by news agencies and approved by the Ministry of Propaganda of the Kuomintang Headquarters,

(4) Visiting professors granted only travelling expenses,

(5) Those who have a family living abroad and have sufficient reason not to be able to return to China. The maximum amount will be U. S. \$300 monthly,

(6) To pay life insurance premiums abroad which were contracted before Dec. 8, 1941,

(7) Students going abroad for postgraduate study and who have passed the examination held by the Ministry of Education,

(8) Factories or commercial firms sending their staff abroad for research work or other important missions and approved by the government. Those who have branches abroad or holding their own foreign assets are not eligible."

A rampant black market forced adoption of a dual rate.

During the war most of the big industries were destroyed and agricultural production much reduced. Government expenditures increased while sources of tax revenue rapidly dwindled. The Chinese Government then unfortunately was compelled to resort to inflation as a measure to cover urgent needs. The result was the skyrocketing of commodity prices. The following is an interesting table showing the yearly increase of the price index:²²

General index of wholesale prices of 22 basic commodities in war capital Chungking 1937-1945 (Jan.-June 1937=1)

Date	General index
1937 June	1.00
Dec.	.98
1938 June	1.03
Dec.	1.04
1939 June	1.20
Dec.	1.77
1940 June	3.36
Dec.	10.94

²² Central Bank Monthly, April, 1948, statistics appendix.

1941	June	17.26
	Dec.	28.48
1942	June	41.62
	Dec.	57.41
1943	June	112.50
	Dec.	200.53
1944	June	544.70
	Dec.	548.60
1945	June	1,553.00

The price level rose to one thousand and five hundred times that of the pre-war level after eight years of war and just two months prior to V-J day. The Chinese people lost their faith in the national currency and began to hold gold and especially U. S. currency. The primary function of money as an instrument of payment and store of value was separated. It is interesting to note that the depreciation of the Chinese dollar both reflected in its internal value and external value at a nearly equal degree, all keeping up with the speed of the inflation. The price of United States currency in the black market, taking average yearly, was thirty times the pre-war price in 1942, 100 times in 1943, 300 times in 1944, and 1,000 times in 1945, i.e. \$3,300 for one U. S. dollar in comparison with the pre-war rate of \$3.33.²³ The lagging behind of the

²³ Ibid.

depreciation of the external value may be explained by the fact that in a nearly blocked economy the foreign currency still cannot be used as a means of payment for imported goods in a large scale.

This black market mainly formed by speculation and other illegitimate commercial uses was never found in pre-war China. The black market for other kinds of foreign exchange such as bills, checks followed the U. S. currency. Such a situation naturally handicapped overseas remittances, hence the government set another dual rate of \$500 in 1944 to absorb these special remittances and to prevent exchange from flowing into the black market.²⁴

²⁴C. Y. Wu, "A new foreign exchange measure" in Central Daily News, December 1, 1944.

Chapter IV Back to free trade market and later strict control (1946-1947)

The economic setting following V-J day

After the close of the war with the prospect of trade opening again, many goods came out of hoarding, thus reducing prices temporarily. The value of the Chinese dollar in the black market rose from a low of \$3,000 to \$500 (in terms of one U. S. dollar)²⁵ in November, 1945. Not only victory, but the fact that the Nationalist money was being demanded in huge quantities in regions held by the Japanese helped to enhance its value.

However, this situation changed three months later owing to the continuing of civil war. The government was still financing itself by the issuance of paper money with a consequent rise in prices again. This caused the value of the Chinese dollar to fall to \$2,000 to one U. S. dollar at the beginning of 1946.²⁶ Because of the civil war, shortage of supplies, crippled agrarian production, interruption of transportation, and soaring of commodity prices, the return to pre-war economic conditions was hampered.

A new measure of exchange control

Following V-J day, the people clamored for economic freedom, and this resulted in the government relaxing some

²⁵ E. D. Hawkins, *America's Role in China*, p. 48. Published by Institute of Pacific Affairs, 1947, N. Y.

²⁶ *Ibid*, p. 48.

of its economic controls. Through the first half year after victory, the official exchange rate was still maintained at \$20, but state operation of exporting was relaxed, allowing private exporters. Due to such a low official rate, however, actual exporting continued to be frozen, only importers were rushing out to send orders. It was not until March 2, 1946, that the official exchange rate was revised to \$2,020 and at the same time new sets of regulations governing foreign exchange and foreign trade were promulgated.²⁷ Such a rate still highly overvalued the Chinese dollar. According to Prof. T. Y. Wu's computation of the purchasing parity, the exchange rate should have been \$6,000, which would have equated the Chinese and U. S. A. price levels.²⁸ Such an overvaluation was because the government wanted to achieve price stabilization through importing large amounts of cheaper foreign goods. It might still encourage a great many essential equipment and materials to rebuild her post-war industries. But the government neglected the fact that under continuing inflation, overvaluation of the Chinese dollar and pegged exchange rates, only the importers benefited as the domestic prices still were going up. The black market rate soon exceeded the official rate, but the monetary authorities still clung to a pegged rate idea,

²⁷ See Regulations promulgated by Chinese Government in Feb. 25, 1946.

²⁸ A detailed computation is made by him in "An ideal rate of exchange", an article in Central Bank Monthly, Feb. 1946.

leaving it unchanged. The official rate was so low that exporting was decreased in a large scale while the price of imported goods were far below those of goods produced at home. The result was that the home industries were virtually on the brink of collapse. Then once more the official rate was raised to \$3,350 in Aug. 1946.²⁹

The new exchange control measures promulgated on February 25, 1946 involved the following special features:³⁰

(1) To designate certain banks as Appointed Banks to act on behalf of the Central Bank of China to engage in foreign exchange transactions.

(2) Appointed Banks might buy foreign exchange at official rate arising from the following transactions:

- a. Export or reexports from China
- b. Remittances from abroad
- c. Other foreign exchange

(3) Appointed Banks might sell foreign exchange at the official rate to the public only for the following purposes:

- a. To pay the cost of the approved imports
- b. For legitimate personal requirements
- c. For other legitimate purposes authorized by the Central Bank of China

²⁹ China Trade Monthly, September, 1947.

³⁰ The China Economic Yearbook, 1947. Published in Hongkong.

(4) A person applying for the exchange was required to sign a certificate stating that he did not possess and had not made and would not make arrangements from other sources.

(5) Appointed Banks should report every transaction to the Central Bank in a certified form bearing every detail on each day.

The new pattern of foreign trade--nearly a free market

At the beginning of reopening of foreign trade in 1946, only very few goods were prohibited; even goods non-essential for an economic rehabilitation country could get in provided the transportation facilities allowed, and thus importers could apply for foreign exchange. Therefore at one time, there were goods such as plastic articles, nylon or rayon hosiery, high quality toilet articles, foreign brand cigarettes and wine, sun-kist oranges and other non-essential goods congesting the market coming largely from the United States.

The total value of imports in 1946 in terms of United States dollars was about \$610,000,000 (nearly double the pre-war figure), exports \$160,000,000 (nearly three-fourths of the pre-war figure), and having an excess of imports over exports amounting to \$450,000,000.³¹ This was

³¹ See The Chinese Economic Yearbook, 1947.

the highest figure in China's trade history. Because the official rate was always lower than the black market rate, overseas remittances tended to pass through the black market rather than official channels. The figure of overseas Chinese remittances for 1946 was only about \$30,000,000 in terms of United States dollars, only equal to one-third of the normal years before the war. The result was that China consistently failed to balance her foreign payments and was compelled to draw on her dwindling exchange reserves, dissipating U. S. \$450,000,000 out of the reserve funds U. S. \$500,000,000.³² What an adverse trend it was!

Insofar as sources of imports and destination of exports were concerned, the dominant place of U. S. A. was unchanged and, in fact, occupied a more important position, accounting for about fifty percent of the trade. Japan and Germany disappeared from trade entirely. Great Britain declined its position to only five percent.³³

The protracted depression of China's post-war export trade may be traced to a variety of causes: reduction in production, poor transportation facilities, lack of adequate financing. Above all, the dislocation between domestic prices was the main factor deterring exports. This was

³² Chinese Economic Review, P. I. Chu, "Foreign exchange problem", May 1948.

³³ The Chinese Economic Yearbook, 1947.

caused by an unrealistic rate of exchange--a rate that deviated far from purchasing power parity. Chinese exporters, therefore, found their prices extremely high and unattractive in the world market in terms of overvalued official rate.

The beginning of a general license and quota system

After the foreign exchange reserve was nearly drained by unwise spending, the government was compelled to announce an entirely new set of regulations for the control of imports in a general license and quota system. The objective of this system was to reduce the adverse balance of trade, to afford protection to home industries, and to encourage the importation of capital goods as against consumer goods.³⁴

Prior to November 1946, only five kinds of goods needed a special license; others could be imported without restriction. Beginning November 17, 1946 a license was required for all imports. A license had to be obtained prior to the importing of goods from the Export-Import Board, a new organization for control of trade. Most of the imports were also subjected to a quota allocation in value, except machinery and equipment. Four sets of import schedules were promulgated: (1) those needing only a license, (2) those

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As advocated by T. V. Soong, the Premier of Nationalist Government.

needing both a license and subject to quota, (3) those suspended temporarily, including many non-essential goods, and (4) those prohibited to be imported, including many luxuries and competitive goods.³⁵ Under each schedule the articles were listed by tariff numbers, so that made it specific and concise. The amount of the quota was set every three months, with a total amount in value and a break-down of this figure on the basis of the varieties of goods. The total value and the value of the various categories of goods were successively revised in accordance with the changing economic situation. Exchange control thus tended to be more strict, because only those who had a license could apply for foreign exchange.

Under this system, the government was successful, as Customs returns showed a decrease in imports. The amount of foreign exchange sold by the Central Bank of China within three months amounted only to U. S. \$24,000,000.³⁶ However, as a result, a great number of factories were unable to obtain sufficient supplies of raw materials to continue their operations.

There was no country discrimination in the quota. Therefore, it was a "global quota". It was not used for a

³⁵ Chinese Economic Yearbook, 1947.

³⁶ P. I. Chu, "The foreign exchange problem" in Chinese Economic Review, May, 1948.

bilateral bargaining weapon as France or Switzerland had done.³⁷ It only aimed at the balance of trade.

However, the quota system practiced by China still had its defects. Due to the insufficient amount of allocated quota and difficulty of applying for foreign exchange, smuggling flourished, which reduced the custom duties, and a black market for foreign exchange became rampant.

A new and higher pegged rate

During the first and second months of 1947, the economic crisis was growing more serious than ever before as shown in the general price level which doubled within a few days, and the foreign exchange rate in the black market which jumped over \$10,000, while the official rate was still maintained at \$3,350. The old gold-selling policy practiced by the Chinese Government since 1943 used as a slight and temporary retardation of the inflation spiral proved to be ineffective, because it failed with a limited amount of gold to recall ^{a huge amount} ~~unlimited~~ issuing of currency notes in circulation.³⁸ Gold price and U. S. currency price soared much higher than commodity prices. The government then in February 1947 announced a program to help exporters by means of 100 percent

³⁷ Detailed description of these two countries in practicing quota system may be found in J. B. Condliffe, The Reconstruction of Trade.

³⁸ This was a unique measure adopted by the Chinese Government to retard inflation. Chinese people like to hoard gold as a means for store of value. The gold was formerly loaned by U. S. A. during war time amounting to U. S. \$300,000,000. After five years of selling at comparatively low prices, this was nearly exhausted.

subsidies to be financed by a special tax on certain imports. But this measure was withdrawn when the United States suggested that any subsidy to exports under the American tariff would mean the imposition by the United States of a corresponding increase in import duties.³⁹

A new set of so-called Emergency Economic Measures was promulgated in February, 1947. By virtue of these measures a ban was put on free transactions in United States currency and gold, and a detailed program for promoting exporting was settled,³⁹ others belonging to prohibition of hoarding and speculation. The official rate was hiked to \$12,000, nearly four times the former one, which was even exceeded by the black market rate. United States currency was prescribed to be redeemed in Chinese currency at this rate. Hereafter, any transaction of gold and United States currency would be illegal and hence confiscated. The new step provided a great impetus to exports and overseas remittances. Together with the redemption of United States currency in a large amount, the government secured a considerable amount of foreign exchange reserves.

Such an optimistic outlook, however, lasted only three months. In the summer of 1947, this exchange rate lost its effect again in the face of continuous inflation. Once

³⁹ E. D. Hawkins, *America's Role in China*, p. 49.

the black market for foreign exchange nearly disappeared but now was resumed. Legal punishment proved to be ineffective.

Comments on this period

From V-J day to November 1945 may be regarded as a nearly free trade phase. Almost no restriction was imposed on imports. Consequently, the market was flooded with cheap foreign goods and home industries were all but ruined. Free trade is surely desirable for each country and the world as a whole, but it seems necessary to let a war-devastated country like China have its transitional period (as defined in ITO) to readjust its balance of payments. Hence, a non-selective importing policy at the very beginning on V-J day was surely open to bitter criticism.⁴⁰

Furthermore, free trade can be effectively practiced by a free exchange market, i.e., let the exchange rate be determined by demand and supply. But China adopted an over-valued pegged rate which deviated far from the purchasing power parity, so exports could not be freely exported.

The later period of strict control of trade still had some defects. The low efficiency in the issuance of licenses, the unrealistic quota, the small amount of value allocated in each class, had caused inconvenience to the

⁴⁰ May be seen from many papers and magazines around year 1946.

industrial and business circles alike. Due to the small amount imported, prices of these goods soared and yielded a so-called quota-profit to the importers. This is because according to Professor Haberler's study,⁴¹ a price differential between the domestic and the foreign market that exceeds the cost of transportation between two markets will appear when a quota system is applied. This was well illustrated in the case of China, as most importers were described as reaping an excess profit that they never had before.⁴²

⁴¹ V. Haberler, *The Theory of International Trade*.

⁴² A comment made by the *Chinese Economic Review*, Vol. IV, No. 8, May 29, 1948 indicated the gross profit of importers ranged from 300 percent to 671 percent.

Chap. V A flexible market rate and new monetary reform
(1947-1948)

A flexible "market rate" adopted to promote exports

Not long after the new exchange rate revision to \$12,000, exports once more came to a standstill as a result of the cost due to the inflation. Pursuing a cautious policy the authorities were hesitant to do anything until June, 1947 when regulations were put into effect for government purchasing of main exporting goods.⁴³ Complementary to this, an entirely new set of provisions for exchange control was promulgated on August 18, 1947.⁴⁴

In accordance with this revision, a Foreign Exchange Fund Committee was established. Maintaining the official rate at \$12,000 to U. S. \$1, which was still applicable to certain channels specified by government (such as some essential imports: rice, wheat, flour, coal), the committee was authorized to make daily quotations of the so-called "market rate", basing the decision on which foreign exchange demanded for imports and supplied from exports was to be settled.⁴⁵ The first quotation, announced on August 19, 1947 stood at \$39,000, which was nearly equal to the black market,

⁴³ C. C. Chang, "China's foreign trade" in China Trade Monthly, September 1947.

⁴⁴ Ibid.

⁴⁵ S. Y. Lu, "Our foreign exchange policy in retrospect" in China Trade Monthly, February, 1949.

so by this means the black market was eliminated.⁴⁶ Then beginning on August 19, 1947, there was a dual rate again: the official rate and the "market rate". The "market rate" was much closer to the black market, so it was a realistic one and nearly a free market rate and, therefore, was a more desirable one. In November of 1947, due to the exhaustion of foreign exchange reserves, exchange for essential imports was obtained at "market rates", leaving the official rate only a nominal one.⁴⁷ All imports were treated under "market rate". The proceeds from exports and overseas remittances were required to be sold to the Central Bank of China, also at the "market rate".⁴⁸ It was confidently expected that this measure would curtail the previous huge profits of importers and protect domestic goods from severe competition of cheaper foreign goods under an overvaluation of Chinese dollar rate. Furthermore, the prices of exports would not remain unduly high in the world market as before. Thus encouragement would be given to the exporting business, helping in the balance of trade. Overseas remittances would also return to governmental channels, augmenting the exchange reserves.

⁴⁶ Ibid.

⁴⁷ Ibid.

⁴⁸ Ibid.

Appreciation of the new system

This new system of a flexible exchange rate was much better than a pegged one in view of maintaining a normal trade, since in a free exchange market without governmental stipulation the rate of exchange would be automatically adjusted by the law of supply and demand and exporters, being assured of a reasonable margin of profit, would endeavor to expand export trade, with much benefit to the national economy. Although this this new system still did not abandon exchange control, it gave consideration to the black (free) market rate.

It appeared on the surface that the foreign exchange rate, by virtue of a less flexible rate, might contribute an economic stabilizing factor. This was so thought by the common people, but not by the economists. This was why after V-J day the Chinese monetary authorities were reluctant to revise an unrealistic exchange rate when it had deviated far from internal values. Just why is explained by G. N. Halm,⁴⁹ "Knowing that the public, because of a previous experience, might identify the inflation by an open exchange depreciation, they (government) wish to conceal the inflation by avoiding an exchange depreciation". The Chinese Government was under just such an expectation to maintain an overvalued pegged rate during the later inflation stage after V-J day.

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G. N. Halm, *Monetary Theory*, 1946, p. 240. Published by the Blakiston Company.

But what was the net effect of all the attempts so far made? In the earlier days, such action simply amounted to the granting of a huge subsidy by the government to importers, at the same time penalizing exporters. When it was finally realized that the rate had to be revised, and was accordingly revised, it was soon apparent that each revision acted as a strong stimulant to the price level, because the adjustment was too vigorous.⁵⁰ Had the official rate been flexible to the free (black) exchange market rate, its effects would be better than a pegged one. Now, through two years of bitter experience after V-J day, the Chinese government began to adopt such a realistic system. It was thus admired by many economists in China at that time.⁵¹

The importing-exporting link system

Although the idea of a flexible rate system was desirable, its practice still ended in failure. The Foreign Exchange Equalization Committee later could not see its way to make rates realistic so as to avoid being accused of aggravating runaway inflation. This accusation, although not justified, had been made by the public. As a result of the Committee's cautious attitude towards too frequent adjustments of rates, the disparity between the official and black market rates had soon become wide, resulting from the runaway inflation.⁵²

⁵⁰ P. I. Chu, "Foreign exchange problem" in Chinese Economic Review, May, 1948.

⁵¹ See many articles published in Chinese economic magazines in 1948.

⁵² "Notes and Comments" in China Economist, April 5, 1948.

Such a kind of criticism was not sound, because inflation was the main cause responsible for rising prices, not exchange rate depreciation. If there had been no inflation, a stimulus to the price level due to exchange depreciation would not continue for long. Both the internal value (price) and external value of money (exchange rate) are subjected to the control of quantity of money. The Chinese government tried to stabilize prices by manipulation of exchange rates without regard for the control of the tremendous increase of quantity of money. This procedure would appear to be placing the cart before the horse. It may be seen from the following table that irrespective of the government stipulated "market rate", the general price index still went up very fast.

Monthly comparison of "market rate" and
general price index in Shanghai

(Unit: market rate for U. S. \$1, base year 1936=1)

Month	Market rate	General price index
1947 Aug. Chinese \$	38,636	32,980
Sept.	41,635	43,253
Oct.	53,658	59,879
Nov.	62,771	66,587
Dec.	77,308	83,796
1948 Jan.	108,625	140,742
Feb.	138,630	201,552
March	210,308	325,769
April	324,000	510,700
May	474,000	704,300

Source of table: For market rate, from China Economist,
September 13, 1948

For general price index, from Central Bank
Monthly, April, 1948.

From the above it will be seen that there was still a great disparity between domestic price and the "market rate."

The government then gave up a flexible government "market rate" policy to avoid the accusation of raising prices and adopted a new foreign trade and exchange system which was put into force on May 31, 1948. The objectives were: (1) to make export and import trade interdependent, thus helping to achieve a balance of trade, and (2) to encourage exports by bringing their prices more in line with world prices, thus ensuring a certain margin of profit.⁵³

While exporters were still required to surrender their foreign exchange proceeds at the "market rate" as quoted currently (actually the "market rate" begun at the adopting of link system did not change), the Central Bank of China would issue a surrender certificate for a like amount to exporters. Then the exporters could sell their certificates at open market at a price agreed between the buyer and the seller, somewhere between the excess part, or over the "market rate" and the black market rate.⁵⁴ This

⁵³ China Economist, September 13, 1948.

⁵⁴ S. Y. Lu, "Our foreign exchange policy in retrospect" in China Trade Monthly, February 1949.

arrangement afforded the exporter a dual receipt: that obtained from the surrender at the "market rate" and a premium. The importers were thus compensated without draining the country's foreign exchange reserves.

The new practice proved to be satisfactory to all parties concerned except that there was a time limit for the validity of the surrender certificate in order to prevent profiteering through hoarding. This system was maintained until August 19, 1948, when a new monetary reform was instituted, and parity between the new Gold Yuan and U. S. dollar was fixed, along with rigid ceilings on commodity prices.

The New Monetary Reform

The New Monetary Reform was announced at a time when the nation was earnestly hoping for a change.⁵⁵ Inflation had already reached the stage where normal production was badly crippled, domestic industry and commerce were on the verge of bankruptcy,, the people were distressed at the high cost of living, and national finance was tottering. Amidst all this growing uneasiness, a change had to be, and it was made.

President Chiang on August 19, 1948 issued a mandate governing: (1) the issuance of a new currency to be called Gold Yuan, the old Chinese dollar was abandoned, (2) the surrender by the people of all gold, silver dollars,

⁵⁵ Before the Monetary Reform, the general price index in Shanghai had risen to the high peak 7,130,000 (the base year 1935 = 1). Chinese Economic Review, August 15, 1948.

and foreign currencies to the government, (3) the declaration by Chinese nationals of their assets in foreign countries, and (4) the tightening of economic controls.⁵⁶

The following points were developed in detail in the original mandate. The text is quoted below:

"1. A managed currency called Gold Yuan, backed by U. S. \$200,000,000 in gold and foreign exchange and other government properties amounting to U. S. \$300,000,000 will be instituted. Issuance of the new currency will go up to G.Y. 2,000,000,000 as a maximum amount, and a Note Issue Reserve Supervisory Commission will be established to conduct monthly inspection and keep custody. The old national currency will be drawn from circulation before November, 1948 at the rate of \$3,000,000 for one Gold Yuan to be converted. The exchange rate for U. S. dollars will be fixed at one Gold Yuan to U. S. \$0.25, or 4 G. Y. to U. S. \$1, and only can apply under control.

2. Gold, silver dollars, and foreign currencies held by the people are to be surrendered to the government at stipulated rates. Holding and transactions in gold, silver, and foreign currencies by the people are to be strictly prohibited, and importation and exportation of them are to be under control. Foreign exchange assets held abroad by Chinese nationals are to be registered with the Central Bank of China for control. Reasonable and appropriate utilization of such assets will only be provided to meet private needs as well as national interests.

3. Efforts designed to balance the budget will be vigorously made.

4. To balance international payments, ways and means for promoting exports and absorbing overseas Chinese remittances will be adopted, while domestic production will be encouraged and consumption restricted as far as possible in the case of supplies

⁵⁶The China Magazine, November 1948. Published in New York.

imported from abroad, so as to save foreign exchange. Imported quotas will be cut down, in view of American aid supplies.

5. Drastic measures, coordinated with the institution of Gold Yuan, will be adopted to control and stabilize prices, salaries and wages. After all these prices are converted in terms of Gold Yuan, at the current price of August 19, 1948, no increase will be permitted unless approved by the authorities. Payment of salaries and wages on the basis of cost of living index will be discontinued.

6. Inspection of warehouses will be enforced, and factory closures and strikes prohibited. Measures of economic and banking control will be tightened and strengthened, particularly with respect to the nature and amount of credits.⁵⁷

From the above it will be seen that owing to the introduction of a new currency and price ceiling, foreign exchange control went back to the old road of pegging a fixed rate again. However, this new measure did increase the control over foreign assets by the government, which was similar to what Germany and Great Britain had done in the strictest control of foreign exchange. Besides, the compulsory conversion of foreign currencies into G. Y. brought to the Central Bank of China another large amount of foreign exchange reserves.

The clearance certificate system

Had the Chinese government achieved a balanced budget right after the currency reform, the new Gold Yuan would have been a new sound monetary system, but owing to

⁵⁷ For a statement made by Dr. Hollington K. Tong, Director of the Government Information Office, see China Magazine, September 1948.

the civil war, the printing machine was still used as a means of financing the government. All efforts to attain a balanced budget failed, and later the maximum issue of Gold Yuan was abandoned. In November 1948 the Gold Yuan was depreciated to one fifth of its original value with a corresponding decrease in its exchange rate from Gold Yuan 4 to U. S. \$1 to Gold Yuan 20 to U. S. \$1.⁵⁸

The government instituted the Foreign Trade Link System on November 16, 1948. This system, while basically similar to the surrender certificate system, is distinguished from it in the following points:⁵⁹

"1. The link instrument is called Foreign Exchange Clearance Certificate, replacing the Surrender Certificate.

2. The new certificates are sold and bought at full prices and used in lieu of payment for foreign exchange for imports, without the necessity of paying a basic amount at the "market rate", which is no longer in existence, as was the case before.

3. The period of validity is extended to two months instead of one.

4. Buyers are confined to importers or others who are granted foreign exchange, and certificates have to be endorsed by the seller in each case."

This system was not changed until April, 1949 when the Communist army occupied Nanking. Recent materials, however, are not available.

⁵⁸ S. Y. Lu, "Our foreign exchange policy in retrospect", in Chinese Trade Monthly, February 1949.

⁵⁹ Ibid.

The price of the Clearance Certificate on April 15,⁶⁰ one week before the Communist army invaded Nanking, was G. Y. 60,000 to U. S. \$1, which was one thousand and five hundred times greater than the price settled eight months earlier (at that time the rate was G. Y. 4 to U. S. \$1). In comparison with the earlier period of inflation, after eight years of Sino-Japanese war, the foreign exchange rate depreciated only one thousand times, but now only eight months in the later period of hyper-inflation during the civil war, the degree of depreciation was much more than that.

The importing system was also relaxed, although the quota system still existed. There were other essential goods which were not covered by these quotas and the importation of which was forbidden before, but they were allowed to come in beginning in November 1948, provided persons holding foreign exchange assets were willing to use them for such imports. The purpose was to increase supply from abroad.⁶¹

⁶⁰ Ta Kung Pao Daily News, April 15, 1949.

⁶¹ China Trade Monthly, April, 1949.

Chapter VI Summary and general evaluation of the policy

The objectives of exchange and trade controls practiced by the Chinese government during the past eleven years (1938-1948) were different through various periods, which may be appraised and summarized as follows:

1. 1938-1941

When China was forced into a total war against aggression, the primary objective of exchange control was to prevent the external value of the currency from depreciating as a result of the flight of capital. Exchange controls are in most cases introduced only in emergencies--war, political disturbances or economic crises.⁶² China was in the first case--war. Viewed from this point, exchange control in China was almost unavoidable.

China followed the path many countries had in Europe in World War I. As exchange depreciation was associated in the popular mind with the dreaded runaway inflation, many countries proceeded to carry out a policy in which the maintenance of exchange parity was a cardinal objective.⁶³ Here, it was another example in war-time China. She tried every means (mostly by buying and selling foreign exchange in unrestricted amounts) to maintain an old rate during the first year (1937) after the outbreak of the war. At the

⁶² League of Nations, Report on Exchange Control, 1938.

⁶³ Mirkse, Pagnar and others, International Currency Experience, Chap. 7. Published by League of Nations.

beginning of the second year (1938), exchange restriction was imposed, but still in a very loose way, to maintain the old pre-war rate--one Chinese dollar to one shilling and two and a half pence. This was done at a cost of ten million British pounds. This situation, which lasted for three years (1938-1941), resulted in the existence of a black market and the adopting of a dual rate (another higher rate for export) which have already been mentioned in detail in the preceeding chapters.

The Chinese government also adopted trade controls. She prohibited some imports during the time of emergency in 1939 in an attempt to prevent the squandering of foreign exchange. Still more important, for the purpose of augmenting foreign exchange resources, she proclaimed in 1938 that all proceeds of exports had to be surrendered to the Central Bank of China. All these measures were necessary for a war-time country practicing exchange control.⁶⁴

3. 1941-March 1946

After Japan engaged in a world-wide war, China was nearly a blockaded economy. The Chinese government adopted a new official rate pegged to the U. S. dollar which was only about one-seventh the previous rate (\$20 to U. S. \$1). Since inflation at that time could not be concealed, nothing could be accomplished by preventing exchange

⁶⁴ J. B. Condliffe, The Reconstruction of World Trade, Chap. 4

depreciation. Exchange control tended to be more severe, and its main objective was preventing the flight of capital and preserving scarce foreign exchange for more urgent and desirable uses such as buying munitions and essential raw materials. At that time little consideration was given to maintaining a favorable balance of payment because under a nearly blockaded economy, normal trade was halted.

The official pegged rate (Chinese \$20 to U. S.\$1) gradually became unrealistic due to the runaway inflation. This greatly hampered overseas remittances and exports. The Chinese government then practiced partial state operation and monopoly of the exporting business and a dual rate was set again for overseas Chinese remittances. This was desirable so as to have more foreign exchange resources. This was comparable in some degree with the multiple rate system adopted by Argentina and Chile,⁶⁵ but not so complicated and delicate as in these countries. The defect of China's dual rate system was that it was adopted too late, when remittances had already gone into the black market in a large amount. Even this dual rate could not adjust itself to the black market condition, rendering a dual rate still lagging far behind, thus ineffective in result.

3. March 1946-November 1946

Six months after V-J day, the Chinese government relaxed all the exchange and trade controls which had been

⁶⁵ Detailed discussion of Argentina's multiple rate may be found in V. Salera, Exchange Control and Argentine Market, 1941. Columbia University Press.

adopted in the war period. But trade was not back to a free open market as in the pre-war situation. It was still under loose control: foreign exchange applications had to be approved by the Central Bank of China; proceeds from exports continued to be sold to the Central Bank of China; and most imports were allowed except five kinds of goods requiring a license. Some imports were entirely prohibited. A new rate (\$2,000 to U. S. \$1) was proclaimed, which overvalued the Chinese dollar, aiming at encouraging large amounts of imports.

The new rate was not designed to be a pegged one, because the objective of maintaining an old exchange parity was not emphasized by the new regulation. So it was revised to \$3,350 five months later. But owing to the incessant inflation, the official rate always lagged behind the black market. With unselected imports and easy acquisition of foreign exchange, every kind of cheap foreign goods rushed in, resulting in a collapse of domestic industry and using up nearly all the foreign exchange reserves which had accumulated through eight years of war. Therefore, appraised from this point, this period ended in failure.

But as Prof. V. Salera pointed out, "Exchange control is a useful instrument for the purpose of maintaining an overvalued exchange rate".⁶⁶ The chief merits of such

⁶⁶ V. Salera and S. Enke, International Economics, 1947.

an overvalued rate is to enhance the terms of trade. Thus certain payments such as foreign debts can be made at lower cost in local currency and fewer goods and services are transferred to the creditor country in discharging debt service than would otherwise be the case.⁶⁷ Viewed from this point there was still some merit in China's over-valued rate. But although China is a debtor country, she did not need to pay all her debts at that time. This was due to the fact that the United States continued to loan large sums to China. Therefore, China did not benefit very much from over-valued exchange.

4. November 1946-August 1947

The introduction of a general license and a global quota system in this period rendered controls more severe than ever before. It was aimed at two objectives: protection of domestic industries and balance of payments. This was done because since the beginning of the year much cheaper foreign goods were rushed in, ruining the domestic industries. The latter objective, however, was especially emphasized, i.e., balance of payments. The global quota system was admittedly necessary when the country's exchange reserve was dwindling on a large scale. As N. S. Buchanan pointed out, quotas were also very popular in the early 1930's in order to

⁶⁷ Ibid.

protect the balance of payments. So China just followed old ways. Insofar as the license system was concerned, it was still deemed necessary, just as N. S. Buchanan and F. A. Lutz said in Rebuilding the World Economy,⁶⁸ "Import licensing need not be considered as a separate system of control. In order to make a quota system effective. . . . import licensing is indispensable."

5. August 1947-May 1948

Beginning in August 1947 the Chinese monetary authorities resumed the old way of a dual rate, setting a flexible "market rate" which was close to the black market rate and good for all imports and exports. The official rate remained unchanged even though it was only a nominal one. The fact that the Chinese government at first fought the black market and then acceded to it was criticized bitterly by the innocent public. But actually from an economic point of view, following or even recognizing the black market was good because it encouraged exports and may have had a reasonable influence on trade.⁶⁹ A black market is really a free market which reacts to the natural economic forces of supply and demand, and like Argentina, which has both an official

⁶⁸ N. S. Buchanan and F.A. Lutz, Rebuilding the World Economy, p. 239. Published by The Twentieth Century Fund, N. Y. 1947.

⁶⁹ Most Chinese economists were of this opinion. See economic magazines at that time.

market rate and a legally recognized free (black) market, permits the smooth flow of trade.⁷⁰

It was regrettable that the Chinese government later followed public opinion by leaving the flexible "market rate" less flexible and even pegged it for several weeks at a constant figure, leaving it behind the black market, so the desirable objective was not achieved, and the policy thus ended in failure.

6. May 1948-August 1948

Because the "market rate" tended to be unrealistic again, the exchange resources from exports and overseas remittances became less, mostly flowing into the black market. Then an entirely new system was introduced--the so-called export-import link system. This caused the balance of trade to settle down in equilibrium automatically, and there was no more unfavorable balance of trade if smuggling was ruled out.

7. August 1948--December 1948

Because inflation was deteriorating the whole economy seriously, a new currency reform was introduced--abandoning the old national currency and using another monetary unit called Gold Yuan. The new exchange rate was fixed at Gold Yuan 4 to U. S. \$1 and no fluctuation was to be permitted. In addition, ceiling prices of all

⁷⁰ For detailed description, see V. Salera, Exchange Control and Argentine Market.

commodities were set at the current level. Exchange and trade controls still continued, but tended to be more strict than ever before. This was shown by the nationalization of gold, silver, foreign currencies, and the registration of all foreign assets held by the people. According to L. W. Towle's opinion,⁷¹ it is essential for all holders of foreign currencies or claims in foreign currencies to sell to the central bank in order to make exchange control effective. Great Britain in 1939 was in this position. China was too late to adopt such an action and it is regrettable to say, she never succeeded in such a device.

Gradually after three months the Gold Yuan depreciated to G. Y. 20 to U. S. \$1⁷² and then the government proclaimed it to be a new official rate. The rate was pegged again and did not change until April, 1949 (Communists occupied Nanking). So China was in the vicious circle again. The government instituted the import-export link system again on November 16, 1948 in order to have a balance of payments. The global quota system still existed, but aimed at procuring more capital goods and raw materials. Approval of imports beyond the quota was allowed provided the traders could secure foreign exchange from their own resources, most desirably from the registered foreign assets in the Central Bank of China.

⁷¹ L. W. Towle, International Trade and Commercial Policy, 1947. p. 465.

⁷² Ta Kung Pao Daily News, November 1, 1948. Published in Shanghai.

Chapter VII - Conclusion

The general pattern of China's trade and exchange controls

In conclusion, China's exchange and trade controls began at the war emergency time and did not end after the war was won. This is because after eight years of devastation, she needed a transitional period to restore her pre-war economic conditions. What is worse is that although a war against foreign aggression and invasion was won, a more serious civil war is going on. This caused the Nationalist government to turn to more strict control in order to maintain an adverse balance of payments. China never used trade and exchange controls as a weapon of commercial policy as Germany did in 1934 to have its totalitarian objective of waging war or to attain international political objectives by the intimidating technique of "Bloodless Invasion".⁷³ China's case is like Great Britain's after World War II. The exchange rate system was sometimes much like that of Latin-American countries. The British government began its controls right after the war against Germany: imports and exports were subjected to licensing requirements, control of transactions in foreign exchange and property was practiced.⁷⁴ After World War II, the British government still practiced trade and exchange control even more strictly than in the war period. This was caused by so-called "shortage of dollars".

⁷³ As termed by Paul Einzig in his book "Bloodless Invasion", 1939. Published in London.

⁷⁴ E. Stein and J. Backman, War Economics, Chap. 10.

China is now by no means an exception. The British have been trying every means to promote exports even at the expense of her people's living standard.

Latin-American countries, which are comparatively economically backward, export mainly minerals and agricultural products. China is quite akin with them. As Salera pointed out, Chile affords a good illustration of a country which has practiced an internationally nondiscriminatory form of exchange control.⁷⁵ It has also been proposed by A. H. Hansen that agricultural countries in need of diversifying their economies should make use of nondiscriminatory exchange control until they have achieved balanced economies.⁷⁶ Now China will belong in this case too, in addition to the similarity of having a dual rate sometimes.

Evaluation of administration and technique

The wide scope involved in these controls called for a tremendous organization to handle the control regulations. Because a bureaucratic government as China was, involves much red tape and low efficiency, normal trade was greatly hampered. Often the beneficial effect which was intended to result was jeopardized owing to bureaucratic handling. Such criticisms were usually made by Chinese traders and industrialists.⁷⁷ Even scandals involving

⁷⁵ S. Enke and V. Salera, *International Economics*, 1947.

⁷⁶ A. H. Hansen, *America's Role in the World Economy*, p. 186

⁷⁷ See most of the Chinese economic magazines published through 1946-1948.

government officials were not uncommon. They were accused of utilizing special rights to benefit themselves, such as bribery, squeezing, or other improper means. Therefore, it is suggested that the Chinese government have a good and scientific management system and have their staffs all well trained and equipped with the knowledge of international economics. A noted industrialist commented once, "The fact that there was such a wide divergence of actions in the government trade policy during past years is sufficient to demonstrate that the authorities were in need of a clear and definite understanding of the over-all situation and were apparently incompatible".⁷⁸ Another complained,⁷⁹ "In forming economic measures, the government in the first place lacked reliable statistical records to be used as a basis, and in the second place failed to heed sound public (industrial circles) opinions. Consequently, government measures were changed almost as soon as they were promulgated, causing complaints everywhere." Therefore, it could be said that China's present-day trade and exchange control measures are the result of many "trial and error" methods. The important problem--the dilemma of promoting trade and price stabilization--was left without any satisfactory solution due to the lack of statesmanship in the administration of

⁷⁸ China Trade Monthly, January 1948, p. 15, "An open letter".

⁷⁹ Ibid.

economic affairs. What is more important is the evil of hyper-inflation during the war situation which made more difficult the practicing of desirable and effective controls.

Whither controls after a member of ITO

China is a member of the United Nations and has signed the Bretton Woods Agreement (and later signed the ITO), therefore she is also a member of International Monetary Fund. According to this agreement, the members were required to declare their new exchange parity in 1946, but China postponed the announcement until August 1948, when the new currency reform was instituted. Because of unstable economic conditions in post-war China, she was still practicing exchange control, and it was hard to fix a new rate. In the agreement there was a transitional period to be allowed, so China could still practice her controls. (Even the ITO charter permitted quantitative restrictions in order to meet balance of payments difficulties as an exceptional case, although prohibited as a general principle.)

The international trade situation is complicated by the fact that most countries still suffer from the post war dislocation and the influence of their internal economics and to an uneven degree, from inflation in their domestic price levels. Only a few have by now restored a fair balance in their international financial situation. Therefore, many countries still are practicing trade and exchange controls.

China is not an exception, and still in her civil war condition, controls could not be removed right now. However, import restrictions, especially in a quota form, are not desirable for promoting world trade towards common prosperity. As Prof. J. Viner suggested, the privilege of imposing quantitative import restrictions to correct an adverse balance of payments can be abused. A country which embarks on an inflationary monetary policy has some degree of choice in the extent to which the necessary burden of economic adjustment shall be internal or shall be made to fall on imports.⁸⁰ Furthermore, according to F. A. Lutz's opinion⁸¹ a country that relies on the quota system to protect its balance of payments still needs an ample supply of international currency to finance a possible deficit. Import restrictions and exchange control are not ends but means. A favorable balance of payments is still not the ultimate goal, but the prosperity of the whole world through the promoting of trade is the ideal objective. Therefore it will never be forgotten that whenever the civil war is ended and the recovery of national economy realized, and her exchange reserves reach a reasonable level,⁸² passing through a so-called "transitional period", China will and should abandon all controls. She should follow the basic

⁸⁰ J. Viner, "Conflicts of principles in drafting a trade charter," *Foreign Affairs*, July 1947.

⁸¹ N. S. Buchanan and F. A. Lutz, *Rebuilding the World Economy*, p. 240, 1947.

⁸² As prescribed in the Charter of International Trade Organization.

and sound principles laid down in the International Trade Charter such as multilateral trade, most-favored nation treatment, reduction of duties, and elimination of preferences, to promote both imports and exports in the aim of maintaining world prosperity.

What is especially desirable is for an economically backward country like China to remove exchange controls after it is back to normal economic conditions. This would encourage foreign capital for reconstruction. The invitation must be made attractive at a reasonable exchange rate and thus permit the flow of earnings back to the investing country.

Prospects of China's foreign trade

It is earnestly hoped that a new era of economic reconstruction will be inaugurated in China as soon as the country has emerged from its present chaos. But the ability to rehabilitate quickly and to become an important factor in world economy will depend largely on an all-out endeavor to promote both her import and export trade. Since China has rich resources for producing some special goods which are needed by the world, she has the means to pay for necessary imports to enhance the standard of living of her teeming population.

The objective of a country's exports is to pay for its imports. China should try every means to promote exports in order to get more imports, especially capital goods for

post-war reconstruction. The present depressed export trade may be traced to a variety of causes. In the past the dislocation between the rate of exchange and commodity prices was a main factor deterring exports. Other factors are as follows:

(1) Lack of variety and quantity of exports.

Owing to the backwardness of methods of production, interrupted by war and in addition the hyper-inflation, normal production of exports cannot be greatly increased. Besides, exports are limited to agricultural products and minerals.

(2) Intense competition in the international market.

Chinese silk met severe competition from Japan, and the invention of rayon and nylon has reduced the market for silk seriously. China's tea has lost its predominant position due to diversity in grading standards and now is largely substituted by Ceylon tea. Tung oil trees now are grown in Canada and U. S. A.

(3) Difficulties in transportation and its high cost from hinterland producing areas to seaports, said to be higher than from the seaports to the United States.

These above handicaps, however, are not without solutions. They may be tackled as follows:

(1) Improvement of quality. This depends on the using of new techniques and equipment in producing exports. Careful

growing, careful selection, and good preparation, together with proper grading may stimulate the demand abroad.

(2) Increase of variety of goods. Many new exports can be greatly encouraged, such as some handicraft articles--laces, embroideries, silk woven goods, rugs, straw braid--which will have a ready cash market in the United States. Manufactures to export to South Pacific ocean areas are also a potential market.

(3) Financial aid and facilitating of transportation.

(4) A sound policy should be worked out under the cooperation of government and merchants.

For the distant future, China's economic progress will be greatly affected by the value of capital imported from abroad. Whether it comes from direct foreign investment or long-term loan, it will come in the form of imports. Therefore, whenever the civil war is ended, and assuming a new government will not adopt a self-sufficient idea, the future of importing business will be favorable, thus ensuring an international economic prosperity.

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