

# Banking and Finance In China

By

FRANK M. TAMAGNA

*With a Preface by T. V. SOONG*



INQUIRY SERIES

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INSTITUTE OF PACIFIC RELATIONS

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Behind the grim military resistance of the Chinese people lies the unspectacular but equally important financial mobilization of the country to meet the emergencies of war. The whole question of Chinese wartime banking and financial development has been hitherto almost a closed book to western readers but is here authoritatively described in a pioneer study. For all business men, research workers and officials, whether westerners or Chinese, it will remain for many years the definitive work in its field. Dr. Tamagna has based his study on first hand information and on contacts with leading Chinese bankers and officials.

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T. V. SOONG

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*To My Parents*



## FOREWORD

This study forms part of the documentation of an Inquiry organized by the Institute of Pacific Relations into the problems arising from the conflict in the Far East.

It has been prepared by Frank M. Tamagna, LL.D., Ph.D., Foreign Economist, Federal Reserve Bank of New York; author of *Italy's Interests and Policies in the Far East* (1941). The study has been prepared by Dr. Tamagna in his private capacity, and it does not purport to represent the views of the institution with which he is connected.

The Study has been submitted in draft to a number of authorities, many of whom made suggestions and criticisms which were of great value in the process of revision.

Though many of the comments received have been incorporated in the final text, the above authorities do not of course accept responsibility for the study. The statements of fact or of opinion appearing herein do not represent the views of the Institute of Pacific Relations or of the Pacific Council or of any of the National Councils. Such statements are made on the sole responsibility of the author.

During 1938 the Inquiry was carried on under the general direction of Dr. J. W. Dafoe as Chairman of the Pacific Council and since 1939 under his successor, Dr. Philip C. Jessup. Every member of the International Secretariat has contributed to the research and editorial work in connection with the Inquiry, but special mention should be made of Mr. W. L. Holland, Miss Kate Mitchell and Miss Hilda Austern, who have carried the major share of this responsibility.

In the general conduct of this Inquiry into the problems arising from the conflict in the Far East the Institute has benefited by the counsel of the following Advisers:

Professor H. F. Angus of the University of British Columbia

Dr. J. B. Condliffe of the University of California

M. Etienne Dennery of the Ecole des Sciences Politiques.

These Advisers have co-operated with the Chairman and the Secretary-General in an effort to insure that the publications issued in connection with the Inquiry conform to a proper standard of sound and impartial scholarship. Each manuscript has been submitted to at least two of the Advisers and although they do not necessarily subscribe to the statements or views in this or any of the studies, they

consider this study to be a useful contribution to the subject of the Inquiry.

The purpose of this Inquiry is to relate unofficial scholarship to the problems arising from the present situation in the Far East. Its purpose is to provide members of the Institute in all countries and the members of I.P.R. Conferences with an impartial and constructive analysis of the situation in the Far East with a view to indicating the major issues, which must be considered in any future adjustment of international relations in that area. To this end, the analysis will include an account of the economic and political conditions which produced the situation existing in July 1937, with respect to China, to Japan and to the other foreign Powers concerned; an evaluation of developments during the war period which appear to indicate important trends in the policies and programs of all the Powers in relation to the Far Eastern situation; and finally, an estimate of the principal political, economic and social conditions which may be expected in a post-war period, the possible forms of adjustment which might be applied under these conditions, and the effects of such adjustments upon the countries concerned.

The Inquiry does not propose to "document" a specific plan for dealing with the Far Eastern situation. Its aim is to focus available information on the present crisis in forms which will be useful to those who lack either the time or the expert knowledge to study the vast amount of material now appearing or already published in a number of languages.

The present study, "Banking and Finance in China," falls within the framework of the third of the four general groups of studies which it is proposed to make as follows:

I. The political and economic conditions which have contributed to the present course of the policies of Western Powers in the Far East; their territorial and economic interests; the effects on their Far Eastern policies of internal economic and political developments and of developments in their foreign policies vis-à-vis other parts of the world; the probable effects of the present conflict on their positions in the Far East; their changing attitudes and policies with respect to their future relations in that area.

II. The political and economic conditions which have contributed to the present course of Japanese foreign policy and possible important future developments; the extent to which Japan's policy toward China has been influenced by Japan's geographic conditions and material resources, by special features in the political and economic organization of Japan which directly or indirectly affect the formulation of her present foreign policy, by economic and political developments in China, by the external policies of other Powers affecting Japan; the principal political, economic and social factors

which may be expected in a post-war Japan; possible and probable adjustments on the part of other nations which could aid in the solution of Japan's fundamental problems.

III. The political and economic conditions which have contributed to the present course of Chinese foreign policy and possible important future developments; Chinese unification and reconstruction, 1931-37, and steps leading toward the policy of united national resistance to Japan; the present degree of political cohesion and economic strength; effects of resistance and current developments on the position of foreign interests in China and changes in China's relations with foreign Powers; the principal political, economic and social factors which may be expected in a post-war China; possible and probable adjustments on the part of other nations which could aid in the solution of China's fundamental problems.

IV. Possible methods for the adjustment of specific problems, in the light of information and suggestions presented in the three studies outlined above; analysis of previous attempts at bilateral or multilateral adjustments of political and economic relations in the Pacific and causes of their success or failure; types of administrative procedures and controls already tried out and their relative effectiveness; the major issues likely to require international adjustment in a post-war period and the most hopeful methods which might be devised to meet them; necessary adjustments by the Powers concerned; the basic requirements of a practical system of international organization which could promote the security and peaceful development of the countries of the Pacific area.

EDWARD C. CARTER  
*Secretary-General*

*New York,*  
*October 15, 1942*

## PREFACE

Few Americans or Europeans have thought of China in financial and banking terms. Pre-war China was generally regarded as a vast country densely populated by poverty-stricken farmers and fringed by a few Westernized factory cities. Since the outbreak of war, however, China's financial mobilization has been an indispensable foundation for her military effort, and her monetary and financial sacrifices have been almost as severe as her direct losses in the war itself. Though it appears but little in headlines abroad, China's struggle against the grim danger of runaway inflation is one of the most momentous problems in the Far Eastern war. A sound banking system, safeguarded and further developed, will not only facilitate China's war efforts, but will immensely simplify and aid the important process of foreign financial cooperation with China after victory is won.

To appreciate China's present financial situation, and to prepare for the problems of reconstruction, it is necessary to know what the present banking system is, and how it developed.

Traditional native banks were functioning for many generations before the advent of banking and financial reforms during the last thirty, and especially the last fifteen, years. With prophetic insight, Dr. Sun Yat-sen, founder of the Chinese Republic, foresaw the need for a thorough reorganization of China's financial, industrial, and transportation systems, and for a comprehensive plan of national reconstruction and development. Shortly after his death, the present National Government was established in Nanking. Beginning in 1928, steps were taken to reorganize the entire fiscal system with a refunding of the public debt, the consolidation of revenues, the unification of banking and currency, the establishment of tariff autonomy, and the establishment of a new system of budgetary and fiscal control.

These measures came none too soon. In 1929, the world depression began. Two years later Manchuria was invaded. Still China's finances and credit remained firm. In 1936, a rapid and difficult shift from "hard money" to a managed currency was accomplished. In 1937, Japan attacked North and Central

China, and cut off our coastal trade with the rest of the world. Emergency measures were then required to cope with the new and extraordinary burdens of the war. Throughout the war period runs the thread of banking and financial development and policy.

Until now there has been no single book to which a Western reader could turn for an account of this development. Dr. Tamagna's comprehensive and up-to-date survey is therefore especially timely. It is the result of careful work, extending over several years. This volume may stand for a number of years, therefore, as the standard work in its field.

T. V. SOONG

*Washington, D. C.*  
*October 8, 1942*

## AUTHOR'S PREFACE

The purpose of this study is an investigation of the organization and development of banking and finance in modern China. The study consists of an Introduction, which sets forth the general scope of the investigation, and three Parts, each divided into four Chapters—dealing with the native money market (Chapters I, V, IX), the foreign money market (Chapters II, VI, X), the modern money market (Chapters III, VII, XI) and the relationship between the financial structure and the agricultural, commercial, industrial and public sectors of the Chinese economy (Chapters IV, VIII, XII).

Part I—The Historical Background: Banking in China before 1927—traces the formation of the financial institutions from the early beginnings of Chinese history to the period of transition of modern China to the National Government.

Part II—The Structure of Money Markets in China, 1927-1937—describes the organization of the three money markets, the technique of credit and the policies of Chinese and foreign banks under the National Government, during the course of a decade characterized by political peace and economic progress.

Part III—Wartime Developments: The Money Markets in China After 1937—examines the changes which occurred in the three money markets after July 1937, under the impact of the Sino-Japanese war and the prospects of post-war financial and economic reconstruction in China.

Although an effort has been made to bring the book up to date as of the middle of 1942, the conditions described refer generally to the situation existing before considerable changes had been brought about by the outbreak of the Pacific war and the Japanese occupation of the Treaty ports in China.

The basic material for this study was collected by the author during the course of a personal investigation on money and banking in China in 1936 and was presented to the Graduate Faculty of Yale University for the degree of Doctor of Philosophy in 1937. Words can hardly express the extent of the author's obligations to the late Professor James Harvey Rogers,

for advice offered during the period of planning and early preparation, and to Professor Ray Bert Westerfield, for his painstaking co-operation and criticism in all phases of the study.

The field work of investigation in China was carried on in Shanghai, Nanking, Tientsin, Peiping, Kalgan, Hankow, Canton and Hongkong. The author wishes to acknowledge the cordial assistance offered by foreign and Chinese banks, whose officials supplied him with material, information and advice. He is personally indebted to Mr. E. Kann, of Shanghai, whose files on banking and monetary problems proved of inestimable value, and to Mr. Li Ming, Chairman of the Joint Reserve Board of the Shanghai Bankers Association, whose advice in revising the manuscript and checking it for possible errors of fact was of great help. Dr. D. K. Lieu, Director of the China Institute of Economic and Statistical Research, Dr. Franklin L. Ho and Dr. H. D. Fong, Directors of the Nankai Institute of Economics, and Dr. John Lossing Buck, Professor of Agricultural Economics at the University of Nanking, all contributed information and comments. Thanks are also due to Mr. William L. Holland who gave the author access to materials collected by the Institute of Pacific Relations, and to Mr. Peter Bernstein and Miss Hilda Austern for their valuable help in editing the manuscript.

For the information supplied and the assistance rendered by numerous organizations and individuals in China and in the United States, some of which cannot be mentioned by name here, the author wishes to express his special thanks. In particular, he is indebted to the International Secretariat of the Institute of Pacific Relations for assistance, and for making possible the publication of this study. Needless to say, the author alone is responsible for any statements of fact or opinion contained in this study and their interpretation should not be construed as representing the views of the Institute of Pacific Relations, nor of any institution with which the author has been or is connected.

FRANK M. TAMAGNA

*New York*  
*September, 1942*

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## BANKING AND FINANCE IN CHINA

## INTRODUCTION

Behind the magnificent military resistance and the outstanding economic effort of China lies the unspectacular work of financial mobilization. The Chinese banks, which in peacetime led the country on the path of modernization, in wartime provided through their branch system a network of strategic centers for the general mobilization of economic resources. Admittedly, the problems and difficulties confronting them were tremendous. Immediate ways and means had to be found for supplying credits in foreign currencies to the Government and for meeting internal war deficits several times larger than peacetime expenditures; at the same time, funds had to be provided for financing the westward movement of productive equipment, technical staff and skilled workers and for promoting rural rehabilitation, transportation facilities and industrial development in free China. For more than five consecutive years Chinese banks have been confronted with this arduous task; it is evident that, under war conditions, the required rate of credit expansion could not have been achieved without recourse to artificial creation of purchasing power. However, the rise in prices, which since the middle of 1940 has been the dominant element in China's economy, cannot be explained on monetary grounds only—for high prices are basically the result of scarcity, which reflects conditions of insufficient production, hoarding and inadequate transportation facilities.

The war experience has demonstrated the advanced degree of development reached by the Chinese credit system. At the close of the first decade of the National Government, in 1937, the trend of China's modern banks was directed toward concentration of reserves, mobilization of funds and co-ordination between the credit market and the agricultural, industrial and public sectors of the national economy; the bases were laid for long-term financing of agricultural rehabilitation, industrial development and Government outlays. The growing importance of the Chinese modern banking system was made evident by the progressive liquidation of the old-style native financial institutions and the withdrawal of foreign banks from a posi-

tion of autonomous predominance in the foreign exchange market to a position of "necessary co-operation" with China's monetary authorities. In the modern money market, the four Government banks (the Central Bank of China, the Bank of China, the Bank of Communications and the Farmers Bank of China), backed by expanding resources, the prestige gained through successful currency and exchange management and the participation of the National Government, appeared ready to assume the financial leadership of the country.

Despite the increasingly important role played by Chinese modern banks, the problems of banking and finance and the functions of credit in the economic development of China failed to attract adequate attention from Chinese and foreign economists. The reason can probably be traced to two traditional elements; namely, owing to the position of foreign banks in Treaty ports, foreign merchants had no need to establish contacts with Chinese banks, while the problems connected with the practices of money exchange were of more immediate importance in a country where silver, copper, paper, domestic and foreign currencies were promiscuously used. The monetary reform of November 3, 1935 abolished the silver standard and introduced an exchange standard managed by the Government banks; this made it possible for the Government banks to obtain control immediately of the exchange market, and to supply the war chest with considerable sums in foreign exchange and to expand indefinitely currency and credit when required by the emergency. It may be said that the monetary reform of 1935 marked the passage of China's economy from a hard money basis to a credit standard, which, though in accord with modern monetary tendencies, was admittedly novel and involved fundamental changes in the monetary and banking systems.

These problems have been approached from the long-term prospects of financial development and the significance of such development on China's peace and war economy and post-war reconstruction. In order to evaluate the relationship between banking and finance and the various other economic activities, it has been necessary to trace the formation of financial institutions and practices and to investigate the internal organization and business methods of Chinese and foreign banks. Of fundamental importance is the distribution of the banking resources and functions among three money markets—each of

which enjoys considerable autonomy in its special field of operations, no close co-ordination ever having been attempted among them.

The native money market is formed by those institutions, organizations and individuals handling, in the traditional Chinese way, business connected with monetary and financial transactions. During the course of centuries, the native money market developed in decentralized units and without national co-ordination. Native institutions originated as the product of local needs, remained independent of support or supervision from central authorities and established local self-regulating bodies (guilds) which contributed toward maintaining the decentralization of activities and certain differences in methods of management and business. Native banks and their guilds are the central institutions of the native money market; they are connected with older forms of the Chinese economy, particularly small business and industry, and in times of crisis they are the initiators of speculative movements. Despite the defects in native banking, the system has a definite place in China's financial organization.

The foreign money market was introduced into China during the second half of the XIX century and consists of those institutions and organizations which handle monetary and financial business under foreign control. Foreign banks are situated in a few Treaty ports, Shanghai being the outstanding financial center of the country; they are legally exempt from the jurisdiction and regulations of the Chinese authorities, owing to the special rights of extraterritoriality. Along with foreign exchange transactions, the activities of the foreign banks are directed toward the financing of foreign trade and foreign firms in China. Under such legal and political conditions, the foreign banks form an element which cannot easily be absorbed into China's national financial organization. This situation still exists, although the Japanese occupation of the Treaty ports has altered fundamentally the relative position of foreign banks.

The Chinese modern money market was established during the first quarter of the XX century. It comprises those institutions, organizations and associations, official and private, handling monetary transactions under the laws and regulations of the Chinese authorities and along the lines of modern Western business methods. In the course of the last fifteen years modern



banks have developed into a highly centralized financial system, closely connected with the National Government. The mercantile character of the modern banking system is made evident by the predominance of current, or short-term, liabilities. As no adequate facilities for rediscount or realization of slow assets are provided, the banks are not in a position to engage independently in large-scale long-term operations such as industrial or agricultural financing would entail.

The basic problem of Chinese banking and finance during the last fifteen years has been the need for co-ordination between the modern money market and the various sectors of the national economy. As the development of modern economic forms progressed more rapidly in banking than in other fields, modern bankers were confronted with the double task of providing funds for the traditional forms of economic activity and introducing new kinds of credit instruments for the financing of modern enterprises and the Government.

China is basically a rural country, with a fairly commercialized agriculture characterized by want of ready cash to meet consumption needs rather than productive requirements. Since banks limit their advances to productive uses and require liquidable types of security, they are not in a position to expand operations in rural financing unless productive rather than consumption credit can be distributed to farmers. Consequently, the individual money-lender, the merchant and the pawnshop are the primary sources of credit for the farmers. The terms and conditions under which this credit is granted vary greatly in the various districts and according to the particular nature of the lenders and borrowers, but usury is the characteristic evil of the countryside. This basic situation assumed a critical trend during the early 'thirties, when the outflow of silver from the interior to Shanghai exerted a deflationary pressure upon China's rural economy not dissimilar to that arising during the 'twenties in the United States as a result of the movement of funds from the rural areas to the capital markets. Late in the 'thirties, however, the financial plight of China's rural communities was, on the whole, probably eased by inflation, although the war brought about a social dislocation among farmers and a deterioration in the technical productivity of the agricultural economy. It is evident that the underlying causes of borrowing for consumption (poverty, social expenses,

banditry, lawsuits) could not be eliminated merely by supplying more credit or by adopting different bank policies. However, by redirecting the flow of bank credit from the Shanghai speculative markets to the interior, interest rates could be reduced, the use of productive credit expanded and the rural financial burden alleviated. On the basis of these postulates, modern banks during the early 'thirties fostered the introduction of a collective type of guarantee through the rural credit co-operative societies; this, as a limited experiment for bank lending, proved successful. However, as this bank credit was granted for short terms and secured by crops, it could not be invested in permanent rural improvements, such as the introduction of crops requiring mechanized equipment, the transfer of sub-marginal land to normal productivity and the increase of per capita and per hectare production. In 1937 the Agricultural Credit Administration was organized by the National Government as the intermediary between the lending banks and the borrowing agricultural co-operatives. At the same time, the Farmers Bank of China was authorized to issue debentures for fixed (long-term) loans to agriculture; this right, however, was not exercised.

During the course of the war, the Agricultural Credit Administration went fairly far in the establishment of the basic structure of rural financing, and credit and banking co-operatives played a vital role in the rural mobilization of the country. On the other hand, war conditions prevented the Administration from achieving its financial aim, which was to shift private funds from China's speculative markets to the rural areas; only public funds, supplied by the four Government banks and provincial institutions, were pumped into the agricultural field. Moreover, bank and co-operative credit continued to be granted for seasonal cycles of rural production; long-term credit for investment purposes was rather insignificant and certainly not adequate to cover the needs of the country.

Despite the industrial progress that probably will be made in the immediate post-war period, China will remain chiefly a rural country, and her reconstruction from the havoc of the conflict will depend basically upon the technical rehabilitation of the rural economy. This, in turn, will depend to a very large extent upon the ability of the financial system to make long-term funds available at relatively low rates to agriculture. While

the Agricultural Credit Administration will be in a position to direct the distribution of funds, the burden of raising them will rest with the modern banks, which are the most important depositories of the nation's savings.

This agricultural situation finds a counterpart in other traditional forms of the Chinese economy; namely, small trade and small industries. Despite the lack of modern credit instruments, large-scale trade, both foreign and domestic, has never been hampered by a shortage of bank credit; modern industrial enterprises, although generally under-capitalized, have usually been in a position to obtain financial assistance from ordinary and Government banks. Even the problem of post-war reconstruction in the modern trading and industrial fields will be of an economic rather than financial character, i.e., enterprises will find it more difficult to obtain goods and equipment than bank credit. On the other hand, with the decline of native banking during the middle 'thirties, small trade and small industries were left without adequate financing agencies: these banks were the only type of institution which granted the one sort of credit (unsecured loans) that small businessmen could use. Wartime inflation has temporarily alleviated the plight of both native banking and small business. Under the impulse of the war and the penetration of new political and economic forms in the hinterland, the modernization of business practices has probably proceeded at an accelerated pace; but despite this, isolated instances of public loan offices and unsecured lending by modern banks to small firms have failed to become general and accepted policy. Thus, the problem of direct financing of small trade and small industries by modern banks still remains unsolved. The importance of this petty credit cannot be measured statistically, but is undoubtedly very great.

The role played by the leading modern banks in connection with the political unification of the country by the National Government can hardly be overemphasized. On the one hand, these modern banks, with their branches, were the only nationwide agencies for the collection of savings; as other institutions in a position to participate in public financing through savings accumulation had not developed, the burden of covering Government deficits rested entirely with the banks. On the other hand, through the handling of Government funds, modern banks became the distributors of public money throughout the

country and were in a position to participate actively in any project of economic reconstruction undertaken by the National Government. The National Government itself was not slow to recognize the decisive bearing of currency unification upon political unification, and the role of branch banking on national currency policies. Thus, the introduction of modern political and economic forms proceeded along parallel lines. The close collaboration, inaugurated in 1927 between the Shanghai bankers and the National Government, was based upon these well-founded economic and political interests.

Two outstanding and well-known personalities, Dr. T. V. Soong, former Minister of Finance and Governor of the Central Bank of China and now Chairman of the Bank of China, and Dr. H. H. Kung, Minister of Finance and Governor of the Central Bank of China, have dominated the policies of the National Government in the fields of financial reconstruction and war finance. Among the men who silently and unpretentiously carried out the obscure technical work of developing modern banking into an instrument of political unification and economic progress of the country, Chang Kia-ngau, K. P. Chen, and Li Ming have played leading roles. The name of Chang Kia-ngau is intimately associated with the rise of central banking. As vice-governor and general manager of the Bank of China from 1917 to 1935, he made it the leading public institution in the domestic market, the trusted financial agent of China abroad and the training ground for the younger generation of Chinese bankers. In 1935 he was appointed deputy-governor of the Central Bank of China. Mr. K. P. Chen, who is president of the Foreign Trade Commission and chairman of the Chinese-American-British Stabilization Board of China, is the outstanding leader in branch banking. Founder and general manager of the Shanghai Commercial and Savings Bank, he extended bank financing to industries and brought modern banking into contact with the common people of the rural areas through a widespread net of branch offices and subsidiary co-operative credit societies. Mr. Li Ming, in the management of his institution, the Chekiang Industrial Bank, adhered strictly to the practice of unit banking for foreign trade financing. As chairman of the Joint Reserve Board of the Shanghai Bankers Association, he played the leading role in the field of inter-bank co-operation and international financial relations in

the Shanghai market, fostering the establishment of organs for the mobilization of bank assets, the introduction of new credit instruments, and the development of new forms of Government and private long-term financing. These three men were responsible for the founding of the Shanghai Bankers Association, of which Mr. K. P. Chen and Mr. Li Ming were alternately chairman.

It has frequently been said that western economic institutions cannot be exactly transplanted to the Far East and that corporate business in China has usually retained, owing to the general social climate, the characteristics of partnership. Although such a statement is fundamentally correct, it needs some qualification. Even in the Western world, corporate business developed in the various countries according to the local social background and retained to various extents vestiges of the partnership type. It is natural that in China corporate business, recently imported from abroad, should go through a phase of adjustment and adaptation, during which traditional practices continue to prevail and evolve slowly under the modern forms. The introduction of capitalistic institutions, public or private as the case may be, in the field of banking has preceded similar development in other fields, and modern bankers have led all other business leaders in the use of new instruments and techniques. Far from interrupting this process, the war is facilitating it by bringing about a fundamental change in the social psychology of the Chinese people—a new sentiment of allegiance to the social group, besides, if not beyond, that given to the family, and the gradual acceptance of an objective “administration by law” instead of the traditional Confucian “administration by gentlemen.” The prospect of the social and economic structure of China after the war looks very complicated indeed; but there can be no doubt that the nation is evolving rapidly and the changes are bound to be far-reaching.

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