

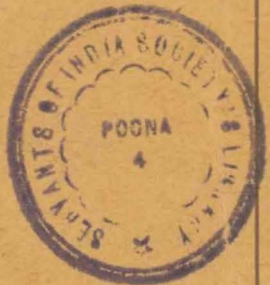
CHINA COUNCIL SERIES NUMBER TWO

China And Foreign Capital



4

By W. Y. LIN



CHINA INSTITUTE OF PACIFIC RELATIONS

CHUNGKING, CHINA

1945



China
And Foreign Capital

By W. Y. LIN
Director, Research Department,
Bank of China, Chungking

This paper is a portion of a larger study on Foreign Investments in China. It was submitted by the China Institute of Pacific Relations as a document for the Ninth Conference of the I.P.R. held in January 1945. The author alone is responsible for statements of fact or opinion in this study.

CHINA INSTITUTE OF PACIFIC RELATIONS
CHUNGKING, CHINA 1945

Price: Thirty-five Cents

This volume is produced in full compliance with the government's regulations for conserving paper and other essential materials.

Printed in the United States of America
Copyright, 1945, by the
CHINA INSTITUTE OF PACIFIC RELATION

FOREWORD

This pamphlet is one of a series organized and prepared by the China Institute of Pacific Relations for use at the Ninth Conference of the Institute of Pacific Relations held at Hot Springs, Virginia, in January 1945.

Like others in the same series, the present study has been submitted to a number of students of Chinese affairs for suggestions and criticisms, many of which have been taken into consideration during the process of revision. However, in view of the fast moving events and rapidly changing conditions in wartime China no one can assume that the findings and conclusions in the various papers are final.

All statements of fact or of opinion appearing in the following pages do not, of course, represent the views of the China Institute of Pacific Relations; for they are made on the sole responsibility of the author himself. The China Institute of Pacific Relations nevertheless considers this series of pamphlets to be a timely and valuable contribution to an understanding of Chinese affairs and, in presenting them in printed form, ventures to hope that they will enjoy a wider circulation than the limited number of delegates present at the Conference.

To Mr. K. C. Li of Wah Chang Trading Corporation, New York City, the China Institute of Pacific Relations feels deeply indebted for having made these publications possible. Special mention should also be made of Miss Hilda Austern of the Institute of Pacific Relations for her invaluable assistance in the publication of this series.

LIU YU-WAN
Executive Secretary
China Institute of
Pacific Relations
Chungking, China

May 1, 1945

CONTENTS

INTRODUCTION	1
PATTERN OF CHINESE ECONOMY	4
POLICY AND PRINCIPLES	11
THE PROSPECTS OF INTERNATIONAL LENDING	20
CHINA'S CAPACITY TO BORROW FOREIGN CAPITAL	28
PUBLIC BORROWINGS AND PRIVATE INVESTMENTS	38
CONCLUSION	49

I. INTRODUCTION

In a paper entitled "The Future of Foreign Investment in China," prepared on the eve of World War II when China was alone bearing the brunt of Japanese aggression and when her destiny was being subjected to an unprecedented test, we came to the following conclusion:

"The political outcome of the Sino-Japanese war, more than anything else, will determine and define what part foreign capital and technique will play in the future economic development of China. A victorious Japan will spell disaster for foreign capital and enterprises in China, because exclusive exploitation of China's resources is the basic tenet of Japan's policy in China. A free China, on the other hand, will offer bigger opportunities for foreign participation and cooperation. Faced with widespread destruction and general impoverishment, and eager to industrialize and to reconstruct, China will find in foreign investment a necessary means to an end."¹

In the intervening years since these lines were written, so much change has taken place with such far-reaching consequences as to call for a re-examination of the problem of foreign investment in China in the light of the world's recent political and economic developments as well as of China's new international position and her domestic requirements. Though it is no part of our intention to dwell upon the political trends and developments at home and abroad, it would nevertheless be absurd to ignore their deep and decided bearings upon our problem, for neither has international investment been free from repercussion of international politics, nor can it be expected to flourish in a nationalistic world. The analysis made and the conclusion reached in 1939, though still valid insofar as they were based on the striking contrast between the Free

¹ W. Y. Lin: *The Future of Foreign Investment in China*, reprinted in Kate Mitchell and W. L. Holland's *Problems of the Pacific*, 1939, N. Y., 1940, p. 243.

and Occupied areas of China in the matter of policies and practices with respect to foreign investments, fail to present a realistic picture of future problems and prospects because of the subsequent developments. These are: (1) The fires that first broke out at Lukouchiao soon spread into a world conflagration. The sudden outbreak and rapid extension of the European war, the surprise invasion of Soviet Russia and the ruthless attack upon Pearl Harbor have not only resulted in gigantic and joint efforts of the United Nations to win the war but also made the Sino-Japanese conflict an indivisible part of the global war both in scope and in strategy. Its settlement became an integral part of the world settlement. Just as the outcome of the war is more assuring, so the pattern of peace will be more encouraging and more enduring.

(2) The Atlantic Charter, the Joint Declaration of the United Nations and the Mutual Aid Agreements, while defining in general terms the war aims of the United Nations, have emphasized the economic objectives which are deemed the material foundations of the liberty and welfare of all peoples. Within the framework of these solemn declarations, we can discern a developing, though dim, outline of a new international commonwealth of nations and a new era of international collaboration to win the peace after the war is won. The International Conference on Food and Agriculture, the establishment of the United Nations Relief and Rehabilitation Administration and the International Monetary and Financial Conference, though but a few landmarks in the long and arduous road towards rebuilding peace and prosperity, augur well for the shape of the world economy to come. In these international gatherings, there is a general and growing recognition of the need for a new outlook, a new machinery and a new method of approach, if the renewed efforts are not to end in disappointment and disaster.

(3) On the other hand, the abolition of the extra-terri-

territorial and related rights in China and the beginning of negotiations for new Treaties between China and respectively, the United States and the United Kingdom have removed once and for all an outstanding grievance which was as annoying as the system was anomalous; and with it, the entire legal and financial fabric to which foreign investments and enterprises in China were long accustomed and under which they were accorded a special position and many a special privilege. The new international position which China has won for herself has given rise to new problems as well as new responsibilities, as regards not merely the treatment of foreign investments and interests already here but also the provision of minimum conditions essential to their re-entry. How these problems will be met and the responsibilities discharged will condition for many years to come the prospects of foreign investments in China.

In view of these vital political developments, not to mention the basic economic changes which will be dealt with later, it appears desirable to consider the problem of foreign investment in China as an instrument both of post-war international collaboration and of national economic reconstruction of China. The following pages will attempt to show the importance of foreign capital from the standpoint of China's national income as well as her balance of international payments; to discuss the policy and guiding principles relative to its effective utilization; to evaluate the possibilities and prospects of a revival of international lending; to examine the potentialities and problems of China's capacity to borrow; and finally, to analyze the relative merits of various types of foreign investments and the possible channels through which they may be procured and promoted.

II. PATTERN OF CHINESE ECONOMY

Though possessing important manufacturing industries, China remains preponderantly an agricultural country, for approximately eighty percent of her population are engaged in agriculture. The economic organization and position of China, the level and composition of her national income and the nature and terms of her foreign trade all take color from this fact. No analysis of China's economic problems will be sound unless adequate consideration is given to this dominating pattern of the Chinese economy.

Towards understanding the problem of foreign capital in China, it is no less important to study at the outset the size of China's national income and the position of her balance of international payments—the internal and external manifestation of the sum total of her economic activities—and in the light of these findings, to show the need for foreign capital in the future economic development of China, if such development is not to be unnecessarily retarded and restricted.

The national income of China cannot be stated with certainty and even estimates are few and by nature conjectural. Drs. Wong Wen-hao and D. K. Lieu have estimated China's pre-war per-capita income at CN\$40 and J. Lossing Buck at CN\$52.19, both of which seem to be an underestimate, because a large part of the farm produce, which is directly consumed by the farming population, never appears in monetary terms and because of the relatively low average level of internal prices prevailing in China before the war. More recently, Dr. Tachung Liu has attempted to arrive by different methods at a rough approximation of the pre-war average annual national income of China during the period 1929-1934. Whether by the "final products" produced in the economy, the "value

added" by different fields of economic activity, the "distributive shares" received by the different sections of the population or the manner in which the income received was disposed by the people, the final result of the computation, which is naturally identical, gives a total national income of CN\$35.2 billions and a per capita income of CN\$78.30, the details of which are reproduced as follows: ¹

	<i>Total Income</i> In billions of CN\$'s	<i>Total Population</i> In millions	<i>Per Capita</i> <i>Income</i> CN\$
Agricultural	27.1	360	73.5
Modern Industry	0.8	2	416.0
Other Trades and Industries	6.0	75	80.0
Governmental Service	1.3	13	100.0
Total Average	<u>35.2</u>	<u>450</u>	<u>78.3</u>

On the basis of Dr. Liu's preliminary figures, the Central Planning Board of China, in their study of China's National Income and Capital Formation, have arrived at a revised but tentative estimate of CN\$33 billions for the national income or a per capita income of CN\$73.30, by taking into account the probably lower rural income in the outlying border provinces and by deflating the price index, when the base period is shifted from 1929-1934 to 1932-1936.

The precise figure is, however, less important than the consensus of opinion that the level of China's national income is very low and lower than that of any other great country. The estimates of China's national income seem to show conclusively that China's capacity to produce is as limited as her capacity to save is negligible. Furthermore, the damage and destruction of the war, the accompanying dislocation and disruption of the productive processes, the disappearance of pre-war savings

¹ Ta-chung Liu: *Some Preliminary Notes on the National Income and Post-war Industrialization of China* (Mimeographed), Washington, 1943.

through war time currency instability and the disinvestments through obsolescence and depreciation, would appear to have resulted in a further reduction of the national income which is already much too small. On the other hand, in view of the extremely low level of per capita income and the large proportion spent for necessities of life, it would be difficult to reduce consumption without impairing the physical and moral well-being of the masses of the people. Moreover, to impose enforced savings under such circumstances would entail a complete control of consumption, together with the whole apparatus of a strict regimentation of the entire economy, including such measures as rationing, governmental allocation of resources, investment control, steep taxation of high incomes as well as complete control of foreign trade. These measures would not only require rigid enforcement and effective organization but must also command the sympathy and compliance of the common people, neither of which do we seem to possess. In the new world environment of tomorrow and in the interests of world prosperity and peace, let us hope, such an exigency need not arise at all.

“One of the obvious solutions is for industrially advanced countries to extend long term credits to China which will correspondingly reduce the necessity for China to control consumption through regimentation. The initial difficulties of the process of industrialization having been overcome, the productivity of the Chinese economy will be such that the repayment of the principal of such foreign assistance may not become too onerous.”²

Whether China will be compelled, much against her will, to undergo a prolonged period of privation and controlled economy will, therefore, depend in a large measure upon the willingness or refusal of the more advanced countries to provide her with the capital facilities of which she stands in need.

If the analysis of China's national income seems to point to

² Ta-chung Liu: *op. cit.*, p. 18.

the utilization of foreign capital as an instrument of her national economic development, the examination of her balance of international payments would further fortify our conclusion. In a debtor country, like China, the maintenance of an international equilibrium would, theoretically, require either a surplus on commodity and service accounts to take care of interest or dividend payments on past obligations and investments or, as is more normally the case, a credit balance on capital account to meet debit balance on current accounts. Actually, however, the inflow of foreign funds in the pre-war years had never been large enough to compensate for the persistent trade deficits and the cumulative service charges. On the contrary, the net outpayments on account of past obligations or investments have invariably exceeded the inpayments of new foreign capital and credits, as the following estimates will clearly show:

**ESTIMATED INTERNATIONAL MOVEMENT OF
CAPITAL IN CHINA, 1928-1936^a**
(In Million of CN\$)

<i>Year</i>	<i>Net Inward or Outward (—) Capital Movement</i>	<i>Net Outpayments for Services and Profits Remitted</i>	<i>Net Outpayments on Account of Capital and Interest</i>
1928	100.00	242.00	142.00
1929	170.00	277.60	107.60
1930	202.00	309.40	107.40
1931	43.60	165.70	122.10
1932	60.00	141.00	81.00
1933	30.00	108.00	78.00
1934	— 130.00	117.60	247.60
1935	— 250.00	102.40	352.40
1936	— 365.50	147.80	513.30

"The peculiarity of China's balance of international payments is obvious, while the adverse balance of trade would appear to indicate that China is in the stage of an immature borrower, receiving a continuous inflow of foreign funds largely in the form of imports. The excess of outpayments over the new capital imports would seem, on the other hand, to point to a

^aCf. W. Y. Lin: *The New Monetary System of China*, Shanghai, 1936, p. 118.

mature stage in China's international borrowings and to postulate the presence of an exactly opposite situation, a favourable balance of trade, which is non-existent. While it may be admitted that, in the past, the excess of outpayments on account of both commodity imports and service charges had been met by the surplus on account of invisible exports, principally in the form of overseas emigrants' remittances, it remains true that for a debtor country like China the international equilibrium would be threatened, unless foreign capital continues to come in on a reasonably large scale."⁴

Such was the pre-war position of China's balance of international payments. This will be expected to undergo further deterioration following the war. The traditional import surplus may be expected to increase just as the gap to be made up will be greater. On the one hand, the huge and urgent demands for consumer goods and capital equipment for replacements and to meet obsolescence as well as for post-war expansion in consequence of the industrialization program, will entail a great increase in imports. On the other hand, exports can hardly be expected to increase at all, because of the diversion of foreign demands to other sources of supply, the fostering of domestic production in foreign countries and the extensive employment of substitutes, for which the difficulties of China's war-time production and transportation are largely responsible. It would be difficult and almost impossible in the immediate post-war years to regain the competitive position of Chinese exports in the world and to recapture the markets lost through alternative sources of supply of the discovery of synthetic products.

While the gap to be bridged will naturally be wider in view of the probably much greater increase of imports over exports, the traditional compensating factor in the form of overseas remittances will, unfortunately, be smaller. The destruction of the war, coupled with its dislocation to the economic life in Malaya and the Dutch East Indies and more particularly, the

⁴W. Y. Lin: "The Future of Foreign Investment in China," reprinted in *Problems of the Pacific, 1939*, New York, 1940, p. 250.

extensive use of synthetic rubber will have serious repercussions upon the economic position of the Chinese emigrants there, and consequently, upon their ability to remit home.

Moreover, in an agricultural country which China will continue to be for some time to come, the restoration of international equilibrium is at once more precarious and more difficult. It is more precarious, because its international position is dependent upon the exports of a few staple agricultural products which are subject to much greater fluctuations in world prices. Because of the secular decline in agricultural prices, the terms of trade have moved consistently against such a country, and this condition may continue. It is more difficult because neither its capacity to produce nor its cost-price structure is sufficiently elastic to permit of smooth and swift adjustments which the international position may require. Consequently, as the experience of many an agricultural country in the pre-depression years has shown, a continuous inflow of foreign capital, in whatever form and through whatever channels, will be the *sine qua non* for the maintenance of a sound and stable international equilibrium for China.

“Greatly reduced overseas remittances and foreign expenditures seem to be in prospect for China. Consequently China may be faced after the war with extreme difficulties in meeting debit balance on trade accounts which will occur if her needs for consumer and capital goods are to be satisfied through imports from abroad. Unless foreign assistance is to be forthcoming, China will be forced to maintain a severe exchange control and to rely upon her domestic resources, with consequent inflationary pressure and strain on the standard of living, for whatever reconstruction or development plan is applied.”⁶

There is, therefore, a *prima facie* case for an extensive utilization of foreign capital in the post-war economic development of China. Inspired by the success of the Soviet and Nazi experiments and impelled by the fear of imperialistic domina-

⁶ Frank M. Tamagna: *Banking and Finance in China*, International Secretariat, I. P. R., N. Y., 1942, p. 362.

tion and financial control, there remains, however, a body of opinion, though waning in influence, which would prefer to see China rebuilt and developed on the basis of her own resources. Nevertheless, neither the Soviet nor the Nazi experience is of wide applicability. Apart from the basic difference in political institutions, Russia has probably a greater quantity of natural resources than any other country in the world, while Germany possesses a highly efficient industrial machine and an extremely valuable productive asset in the form of highly trained scientific labor. Moreover, circumstances have conspired to force them to rely upon their own strength, for they had been more or less cut off from the world and denied of any access to the world capital markets. In the new environment of the post-war world, there will exist, let us hope, neither the occasion nor the necessity for China to follow their path. Important as national planning and self-reliance may be as factors of economic development, the regimentation of the economy, which the adoption of the Russian or German experiment would necessarily entail, would be for China economically as futile as it is politically dangerous.

III. POLICY AND PRINCIPLES

Following the teachings of Dr. Sun Yat-sen¹ and embodying the contemporary climate of considered opinion, the Eleventh session of the Fifth Central Executive Committee of the Kuomintang adopted, on September 11, 1943, a resolution to welcome foreign capital and technique in the post-war economic development of China, and, as an encouragement to international economic collaboration, to remove the hitherto legal restrictions upon foreign participation in joint enterprises in China. The resolution is as momentous in its significance as it is commendable in its outlook, for it marks the definite formulation of a policy towards foreign capital and the beginning of a new epoch in China's international economic relations.

In view of the paramount importance of the resolution and in order to evaluate its bearings upon our problem, it is perhaps pertinent to reiterate the few salient principles which purport to give form to the new policy, namely: (1) "To show a spirit of close cooperation with China's friendly powers, all restrictions applying to Chinese-foreign joint enterprises shall be revised. Hereafter no fixed restriction shall be placed on the ratio of foreign capital investment in joint enterprises. In the organization of Chinese-foreign enterprises, except for the Chairman of the Board of Directors, the General Manager need not necessarily be a Chinese. The terms and conditions with respect to joint enterprises shall be negotiated by the parties concerned

¹ Dr. Sun Yat-sen's *International Development of China*, published in 1921, was the first systematic plan on the development in China of railways and highways, river conservancy and irrigation, new ports and modern cities, basic industries and public utilities with the aid of international capital. The idea received further emphasis in his lecture on the Principle of Livelihood delivered on August 10, 1924, cf. *San Min Chu I, The Three Principles of the People*, translated by Frank W. Price, Calcutta, 1942, pp. 274-5.

and shall become effective upon the approval of the Chinese Government.

(2) "Aliens may, in accordance with the provisions of Chinese law and regulations and upon the approval of the Chinese government, finance their own enterprises in China.

(3) "Negotiations for foreign loans for state enterprises shall be centralized. Private individuals may negotiate foreign loans for their enterprises and such loan agreements shall become effective upon the approval of the Government.

(4) "With respect to the state enterprises in the future, the Government shall early and separately determine the respective fields to be financed by foreign investments or by borrowings from abroad."

Indeed, the resolution may legitimately be welcomed not only as a formal declaration of policy with respect to foreign capital in China, but also as a general definition of the guiding principles governing the various types of possible foreign investments in the future, such as joint investments, direct investments, public and private borrowings. Insofar as it represents a new departure of policy, its significance far surpasses the immediate problem of foreign investments with which it deals. For one thing, it shows a timely recognition of the fact that prosperity, like peace, is indivisible and that China is willing and ready to play an effective role in international economic collaboration, not so much as a market of 450 million customers as "an economic ocean capable of absorbing all the surplus capital"² of the more advanced countries. The utilization of foreign capital in the post-war economic development of China, if energetically and effectively carried out, will contribute substantially towards the maintenance of world prosperity and world peace. It reflects a painful realization of the risks to which China has been exposed in her dependence upon a "Burma Road" and of the dire necessity of rapid and extensive indus-

² Sun Yat-sen: *International Development of China*, reprinted from the 2nd edition, Calcutta, 1942, p. 6.

trialization, with the aid of foreign financial and technical assistance, so as to enable her to be a guardian of the peace and order in the Far East—a role to which China is, by her geographic foundations and demographic heritage, logically entitled.

Important as the resolution may appear from the standpoint of future world peace and prosperity, to infer therefrom that foreign capital would necessarily follow in its train, irrespective of the attendant conditions and circumstances, would involve a misleading oversimplification. It may be recalled that a similar, if not an identical, resolution was adopted at the First Session of the Fourth Central Executive Committee of the Kuomintang in December 1931, to the effect that in accordance with Dr. Sun's *International Development of China*, foreign capital and technique should be welcomed with a view to the development of Chinese industries and the promotion of world prosperity. Save for a brief episode of technical collaboration with the League of Nations³ in the establishment of the National Economic Council which was engaged principally in the development of highways, river conservancy and health centres, and except for the American Wheat and Flour Loan of 1931 and the Wheat and Cotton Loan of 1933, China has been denied of access to the world capital markets.

Unpleasant as it is to recall, the failure of the previous resolution to produce the desired results is not, however, difficult to explain. Neither the world financial developments nor the domestic political situation appeared to afford any reasonable basis for the fulfillment of such exaggerated hopes. The Great Depression, accompanied and accentuated by the World Financial Crisis, involved the main creditor countries in severe losses through a series of defaults⁴ and the subsequent freezing of

³ League of Nations: Council Committee of Technical Collaboration with China, *Report to the Council of Its Technical Delegate on His Mission to China from the Date of Appointment until April 1, 1934*, Nanking, 1934.

⁴ League of Nations: *Report of the Committee for the Study of International Loan Contracts*, Geneva, 1939, p. 7.

debts. While investors looked askance at any investment or enterprise abroad, Governments placed restrictions of various kinds upon the flotation and sales of foreign securities, in order to fortify the position of the currencies and to protect investors from the consequences of excessive and unscrupulous lending of the pre-depression period. Whatever little international lending there remained, was confined largely to the promotion of exports or to purchases within the same currency area. The world financial outlook was therefore anything but encouraging.

On the other hand, the Japanese invasion of Manchuria in September, 1931, the cradle of World War II, soon followed by the outbreak of the "Shanghai Incident" in January, 1932 and the incessant intrigues in North China, brought threatening clouds on the Far Eastern political horizon. Furthermore, in the celebrated "Amau Statement" of April 17, 1934 which foreshadowed the "New Order in East Asia," Japan by expressing her opposition to the work of the League of Nations and other foreign experts in China, practically arrogated to herself the right to determine the conditions on which foreign assistance would be acceptable. In the field of domestic politics, the situation was neither satisfactory nor stable. It is clear that neither the financial situation nor the political outlook then prevailing was auspicious for the realization of the aspirations of the 1931 resolution. In the light of past disappointments and as a guide to our future policy, it cannot be overemphasized that any extensive and effective utilization of foreign capital in China is conditional upon a combination of international and internal circumstances, which are not necessarily fortuitous, nor always fortunate. It is, therefore, imperative to examine, on the one hand, the prospects of a revival of international lending and, on the other, the problems connected with China's capacity to borrow, to which we shall refer in the following sections.

Before proceeding to a discussion of the problems and prospects of international investments in China, it may perhaps

be helpful to postulate a few basic principles which will, in our opinion, give effect to the fundamental policy, as defined in the Central Executive Committee's resolution of 1943. Such principles must not only appear sound in theory but must also be sufficiently attainable to bring them into the realm of practical politics.

Fundamentally, when a country borrows it renders itself liable thereby to meet in future years the service charges on the sums borrowed, and the more it borrows, the more do these charges pile up against it. It is, therefore, a cardinal principle of sound international finance that a country should only borrow from abroad for capital development of a type likely to improve its balance of international payments in the future. Any attempt to bring in foreign capital without at the same time taking steps to better equip the productive capacity of the country and to provide the loan services out of such increased productive efforts will entail a heavy burden alike on the national budget and on the international equilibrium. Both the needs of our post-war industrialization and the position of our balance of payments would seem to dictate the employment of all foreign capital for productive purposes.

As a corollary to the foregoing principle, it should perhaps be further emphasized that productive employment of foreign capital, important as it is, will not in itself ensure its most economic or effective utilization, unless it is closely and completely coordinated with a definite and detailed plan of economic reconstruction. If foreign capital in the immediate post-war period is likely to be scarce, relative to the urgent and widespread needs for it, it will be essential to ensure that the available foreign capital should be put to the best possible use. The satisfaction of various competing claims would have to proceed in accordance with a list of priorities with respect to industries as well as to regions, based on national needs, and not be left to

the blind and often irresponsible operations of the market or the whims of men.

In addition to the fixing of priorities, it is important to provide in the scheme of economic development a maximum and a minimum: a maximum, according to the post-war requirements and a minimum, according to the ability to borrow from abroad. The whole plan should be flexible and amenable to modifications in the light of foreign capital actually available. Should China fail to borrow as much as she needs, it will be unnecessary and unwise to curtail proportionately the originally budgeted expenditure for each and every one of the projects under contemplation. A better procedure would be to satisfy the most urgent requirements fully, leaving aside projects which are postponable or of lesser importance, so that basic needs of economic reconstruction may be met first, to be expanded or extended only when, and if, further foreign capital becomes available.

In view of the necessity of repayment and servicing of foreign loans and the difficult problems of transfer connected therewith, all foreign loans should be strictly confined to essential purchases and expenditures abroad. All the cost of domestic materials and labor which are procurable within the country should not be defrayed out of the proceeds of foreign loans. In estimating the volume of foreign funds required and in making negotiation or application therefor, care should be taken to ascertain the nature of the needs and the relative extent to which foreign loan and domestic currency are respectively required.⁵

In the past, in order to ensure China's capacity to pay, specific revenues, like the customs or the salt or railway receipts have been assigned as hypothecation for foreign loans, leading to an infringement upon China's sovereign rights in the matter

⁵"The local currency needs in connection with the project shall be entirely or very largely financed locally without the assistance of the Bank." Cf. U. S. Treasury: *Preliminary Draft Outline of a Proposal for A United Nations Bank for Reconstruction and Development*, Sec. 4, paragraph 7 b.

of financial and railway administration.⁶ Instead of assignment of specific revenues or receipts, all future borrowings should be secured against the general credit of the country. More emphasis should henceforth be placed on the general improvement, as a result of the productive employment of the loan, of the financial and economic capacity to meet the stipulated service. "If future lending is not to bring disappointments, it must be related much more directly to profit earning possibilities. Government guarantees are of no help if the economic structure of a country is such that payment is impossible, and in those circumstances the security which guarantees appear to give are illusory."⁷

On the other hand, it has unfortunately become a disturbing feature of international finance that long-term capital, because of the fears of war or currency depreciation, has very largely been held in the shape of short-term funds which move capriciously from one center to another and often against interest differentials. This shortage of long-term foreign capital, in face of China's pressing needs, lays open the danger of substituting short-term money for long-term capital development purposes, because if loans are recalled on short notice or repaid in a few years, it will almost be certain to arrest the capital development which requires a considerable time to complete and to cause undue disturbance to financial stability. China should be cautious and resolute enough to refuse to accept short-term money for purposes for which it is not properly applicable.⁸

As a matter of encouragement to foreign capital and enter-

⁶ J. E. Baker has prepared a table showing Chinese railways classified according to the degree of foreign participation which shows that the earlier contracts provided greater foreign supervision. "Transportation in China," *Annals of the American Academy of Political and Social Science*, Nov. 1939, p. 167.

⁷ Royal Institute of International Affairs: *The Future of Monetary Policy*, London, 1935, p. 166.

⁸ Cf. T. V. Soong: "Lessons of Chinese Money Policy" in A. D. Gayer (ed.) *The Lessons of Monetary Experience*, N. Y., 1937, pp. 358-9.

prises, not only should the discriminatory features in the existing Chinese laws be forthwith revised in accordance with the 1943 resolution of the Central Executive Committee of the Kuomintang, but also all foreign enterprises duly registered with the Chinese Government should be accorded national treatment. While it is legitimate that measures should be taken to safeguard against any infringement upon sovereign rights or alienation of control, the inflow of foreign capital should not be handicapped by any limitation of profits or restrictions upon their remittance abroad.⁹ In fact, as the past experience has shown when the prospects of business are good and the possibilities of exchange instability negligible, the profits of foreign enterprises, instead of being fully remitted home, are as often reinvested or "ploughed back into business" for the purpose of expansion.

Finally, with a view to avoiding a frenzied scramble for foreign loans which has characterized Chinese Governmental borrowings in the past and which is likely to repeat itself in view of China's pressing post-war needs, and in order to ensure a most economic utilization of foreign capital and its close coordination with the plan of the national economic reconstruction, there should be set up a governmental organization to take charge of all matters relating to the planning, execution, examination and supervision of all projects for foreign loans. Specifically, such a body should have the authority to negotiate foreign loans for the state enterprises, to approve of other loan agreements as negotiated by private individuals as well as of projects of direct or joint investments, as indicated in the 1943 resolution of the Kuomintang. Moreover, it should be vested with full power to fix a scheme of priorities in the distribution of available foreign capital and to budget for all payments and receipts arising out of the international flow of funds. In the

⁹ Cf. League of Nations: *Report on Exchange Control*, Geneva, 1938, p. 26.

light of the probable tendency of the post-war international lending which, we believe, will be both selective and collective, it is imperative that such a machinery as we have suggested should be set up now to prepare the projects or the programs and to present them when occasion arises.

IV. THE PROSPECTS OF INTERNATIONAL LENDING

Large-scale international investment has played a vital and constructive role in the economic life of the nineteenth century and was one of the main instruments by means of which the economic statesmanship of the post-war decade attempted to reconstruct the war-torn economy of Europe. But since the thirties "the system of international investment lies shattered, and the idea of international lending is viewed with profound misgiving both in debtor and in creditor countries. Debtor people regard international loans as a barrier to their future prosperity; creditor countries as the grave of their accumulated savings."¹ What, then, are the prospects of a revival of international lending and what part will it be expected to play in the post-war reconstruction of the world economy? To answer these questions intelligently, it is necessary to know the causes of the breakdown of international lending.

Admittedly, much of international lending and borrowing in the twenties was "reckless, extravagant and wasteful,"² but more fundamentally, it was a lack of appreciation of the total national and international framework in which international investment is to function and flourish that lies at the root of the trouble.³ Neither the economic foreign policy of the creditor nations, nor the international position of the debtor appeared to provide an expanding basis of world trade on which international investment must ultimately depend. "There was little heed of the signs that many nations were not sufficiently prepared to undergo the adjustments and pursue the policies neces-

¹ Royal Institute of International Affairs: *The Problem of International Investment*, London, 1937, p. 14.

² Sir Arthur Salter: *Recovery*, London, 1932, p. 101.

³ Cf. National Planning Association: *On the Future of International Investment* (Preliminary, Mimeographed), Washington, 1943.

sary to permit the growth of international commerce that was necessary to permit the growth of international investments." ⁴ The failure of the creditor countries to adjust their trade and tariff policies to enable loans to be repaid in goods and the deterioration in the position of some important debtor countries which specialized in the export of primary products accentuated serious difficulties of transfer, lead to exchange controls, import quotas, bilateralism and other obnoxious practices which are destructive of national and international prosperity.

The revival of international lending in the post-war period is therefore conditional, not so much upon the urgent need of capital for reconstruction or the availability of savings for productive investment, as upon a healthy and developing international political and economic environment. International lending would be impossible except in an atmosphere of assured international peace. The end of the war and the general political settlement that will follow will expectedly usher in a period of enduring peace, if a wider, permanent and better system of general security, as envisaged in the Atlantic Charter, is to be established.

Moreover, in the Atlantic Charter and Mutual Aid Master Agreements we can discern a new pattern of world economy that will emerge from the war. The keynotes of the economic policy outlined in the Points 4 and 5 of the Atlantic Charter are, first, non-discrimination and second, expansion.

"Fourth, they will endeavour, with due respect for their existing obligations, to further enjoyment by all states, great or small, victor or vanquished, of access, on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity.

"Fifth, they desire to bring about the fullest collaboration between all nations in the economic field, with the object of securing all improved labor standards, economic advancement, and social security."

⁴ Herbert Feis: "Foreign Investment in A Post-war World," *Fortune*, July, 1942.

These two themes are repeated in a reverse order and in greater detail in Article VII of the Anglo-American Mutual Aid Agreement of February 23, 1942, which became the pattern for identical agreements between the United States and other United Nations. By this agreement, the eventual terms of settlement of lend-lease obligations

“shall include provisions for agreed action by the United States of America and the United Kingdom, open to participation by all other countries of like mind, directed to the expansion, by appropriate international and domestic measures, of production, employment and exchange and consumption of goods, which are the material foundations of the liberty and welfare of all peoples; to the elimination of all forms of discriminatory treatment in international commerce, and to the reduction of tariffs and other trade barriers.”

Thus the implementation of these solemn undertakings demands both negative action to reduce the obstacles to free trade and positive action to coordinate national economic policies and direct them toward reemployment and reconstruction. “But the removal of discriminatory practices and other trade barriers is merely the negative side of a policy whose positive aspect is ‘economic advancement’ and expansion.” “Access on equal terms to the trade and the raw materials of the world was hampered before the war not so much by formal restrictions as by the lack of resources of would-be purchasers.”⁵ To achieve the economic aims of the Charter would therefore require, internally, the working out of national policies of full employment and security⁶ and, internationally, the coordination of national policies towards a balanced growth of international trade, whereby the living standard of the nations may be raised.

If our reading of post-war economic objectives is correct,

⁵ “The Atlantic Charter After Two Years,” *The Times*, London, August 11 and 12, 1943.

⁶ The Beveridge report, for example, explicitly invokes Point 5 of the Charter: “The proposals of this Report are designed as a practical contribution towards the achievement of the social security which is named in the closing words. The proposals cover ground which must be covered, in one way or another, in translating the words of the Atlantic Charter into deeds.”

then not only will the international economic framework be auspicious for the revival of international lending but international investment may be expected to serve as an effective instrument towards the attainment of full employment and growing trade.

"The provision of foreign capital will be one of the most important international economic and financial problems of the Post-war period. Many countries will require capital for reconstruction, for the conversion of their industries to peace time needs, and for the development of their productive resources." "International investment for these purposes can be a significant factor in expanding trade and in helping to maintain a high level of business activity throughout the world."⁷

On the other hand, there has been an enormous increase in the capacity to produce during the war. The output of the American economy is now, for example, more than 50 per cent higher than in any peace-time year, which means that the total of civilian demand will have to be increased by roughly half and then kept at this figure if there is not to be mass unemployment. The expansion of the metal, engineering and machine tool industries in the United States, the United Kingdom and the Soviet Union has been highly spectacular. "To lend the products of such industries to such countries as China for the improvement of communications or the development of local industries there, may so greatly and rapidly increase the productive and the exporting capacity of the borrower as to involve little risk, especially if some elastic system of amortization is arranged,"⁸ and at the same time provide a growing market for the products of these industries.

On the other hand, there are countries with an urgent need for capital for reconstruction but with a greatly impaired capacity to save. On the other hand are other countries, particularly

⁷ U. S. Treasury: *Preliminary Draft Outline of a Proposal for a United States Bank for Reconstruction and Development*, Preamble Para. 1 and 4.

⁸ League of Nations, Report of Delegation on Economic Depressions, Part I, *The Transition from War to Peace Economy*, Geneva, 1943, pp. 95-6.

the United States, growing rapidly in wealth and prosperity with a large and growing margin of savings. Surely, this is precisely the type of situation for which international lending will perform its work, just as it did in the nineteenth century. Surely, moreover, this is a situation in which international lending offers prospects of great mutual advantage, in which the investors in the lending country may hope to get a materially higher return by lending abroad than by investing at home, while the borrowing country may nevertheless obtain the capital they need much more cheaply by borrowing from abroad than by relying on their own resources.⁹ Prima facie, there is a decided need for a revival of international lending, if full employment and world prosperity are to be attained.

Fully alive to the disappointing, if not disastrous, consequence of international lending in the twenties and mindful of its supreme importance as an instrument of international economic collaboration for world prosperity and world peace, it is imperative to study the probable pattern of post-war international lending, to analyze the possible sources from which long-term capital may be forthcoming and to examine the problems on the successful solution of which large-scale international lending must ultimately depend.

Like the last war, but in a much greater degree, this war will result in a redistribution of the international lending power of the three principal creditor countries of the inter-war period. Political and military defeat, followed by Nazi occupation and exploitation, will have reduced the capacity of France to lend abroad. "France will emerge from the war with a diminished industrial potential, weakened both absolutely, in comparison with her pre-war capacity, and relatively, in comparison with the industrial capacities of other nations."¹⁰

⁹ Cf. Royal Institute of International Affairs: *The Problem of International Investment*, London, 1937, pp. 7-8.

¹⁰ "France Impoverished," *The Economist*, London, June 12, 1943, "Decay of French Industries," *The Economist*, London, April 10, 1943.

Though uninvaded by the enemy, the international financial position of Great Britain has undergone a serious deterioration. The long interruption of trade connections, the development of industries in many overseas countries will likely result in a decline of visible exports, while the sales of securities, the loss of earnings from Malayan rubber, which may be a permanent loss in view of the development of synthetic process, and the probable rise in the world price level will greatly reduce the real incomes from overseas investments. What the British balance of payments is likely to be in the immediate post-war period can, of course, only be conjectured, but current discussions seem to agree that the potential deficit will amount to as much as £250 to £350 million at the pre-war prices, as compared with a pre-war average deficit of only £40 million.¹¹ Under such conditions, neither would foreign lending be possible nor would it make any direct contribution to the solution of the British exchange problem.

"Indirectly and in the long run, wise lending will help to establish trade connections and to create new foreign markets, but since the primary object of exporting in the post-war period will have to pay for imports, any exports for which we do not receive payment will make our immediate position worse rather than better."¹²

This sombre picture of recent financial deterioration, serious as it is, must not, however, be allowed to mislead us into thinking that Britain is permanently disabled as a potential leader. On the contrary, in the light of the enormous war-time extension of plants and equipments which are convertible to meet peace-time requirements and of the great expansion of metal, engineering and machine tool industries, and taking into consideration the imperative need of maintaining employment

¹¹ Cf. National Planning Association, *Britain's Trade in Post-war World*, Washington, 1941, A. J. B. "Aspects of U. S.-British Post-war Economic Problems," *Bulletin of International News*, Royal Institute of International Affairs, London.

¹² *Bulletin of International News*, *op. cit.*

at home, coupled with the experience and organization of London in the conduct of foreign investments, we are inclined to believe that, after the immediate post-war disturbances have subsided, Great Britain will again be able to lend abroad, provided forms can be found which will be appropriate to the changed circumstances and provided the methods employed, the channels utilized and the control exercised are such as to involve the minimum of dislocation.

Indisputably, the United States will emerge from the war as the largest creditor nation and the greatest potential lender of the world. According to an official American report, her post-war balance of payment would, in the absence of special steps to prevent it, be confronted with a surplus of probably between \$1 and \$2 billion a year.¹³ In the field of industry, in the three years, 1941-1943, the American government has spent \$15.5 billion on industry and \$4.5 billion for plant and equipment, additional to that in existence at the beginning of the war. The total \$20 billion represents roughly one-third of the estimated replacement value of pre-war manufacturing plant and equipment. In many lines of production, prefabrication and assembly lines have increased the output to a rate which is nothing short of astounding.¹⁴ Financially and industrially, the United States will be destined to play a leading role in the economic reconstruction and development of the world.

There exists, therefore, no doubt of the capacity of the United States to lend abroad. But whether she will be ready and willing to do so is, of course, another question. The dismal failure of American international lending in the twenties is largely a result of the failure of American trade policy to adjust to the dictate of her financial position. Will the Americans admit the responsibilities which their creditor position has of necessity entailed and reorientate their economic policy in the

¹³ Cf. *The Economist*, London, November 27 and December 4, 1943.

¹⁴ Cf. "The American Arsenal," *The Times*, London, April 20, 1944.

light of their new position and its new requirements? Indeed, considering the relatively large degree of economic self-sufficiency and the long history of tariff and the powerful and experienced pressure groups it has built up, the prospects of any dramatic and sudden reversal of American economic policy may appear distant and discouraging,¹⁵ nevertheless if Americans are to profit from the experience of the years between the two wars and if peace is to be won after the war, America must be prepared not only to lend abroad but also to adjust her economic policy to enable foreign lending to be made and continued for the benefit of all. Sound international investments require not merely that the debtor be sound. "It is necessary that the creditor, too, should follow a sound policy. A sound policy in this case means that, after he has built up a certain volume of investments he should allow his debtors to fulfill their obligations by causing his own export surplus to be replaced by import surplus."¹⁶ This is not a matter of choice, but a mathematical and material necessity. In foreign investment, as well as in other fields, the United States, by virtue of her financial position and industrial power, will be expected to play the role of world leadership, provided that Americans are ready to recognize the new position they have attained and the new responsibilities that their new position has necessarily imposed. The power and prestige of the United States as well as the future prosperity and peace of the world are most intimately involved in their handling of this problem. Both public understanding and public policy are needed, for the issues confronting the Americans in this field are of grave import not only for the United States herself but for the rest of the world as well.

¹⁵ Cf. "American Trade Policies," *The Times*, London, November 15, 1943; "The Great Contradiction," *The Economist*, London, October 9, 1943; E. H. Carr: *Conditions of Peace*, London, 1942, Chap. 7.

¹⁶ "International Lending," *The Times*, London, November 4, 1943.

V. CHINA'S CAPACITY TO BORROW FOREIGN CAPITAL

While it is readily recognized that foreign capital will play an important part in the economic development of China, it is less generally realized that economic and effective utilization of foreign capital is dependent upon the presence of certain basic conditions. It depends as much upon the ability and willingness of foreign countries to lend as upon China's capacity to borrow or receive. In the past, the question of foreign loans to China, as distinct from foreign direct investments, has invariably been examined from the angle of China's ability to pay—to meet interest and amortization charges, with the result that attention has been centered on the provision of guarantees or the hypothecation of revenues without adequate consideration of the uses to which the borrowings were to be devoted. This narrower approach of China's ability to pay should be replaced by the broader concept of China's capacity to borrow. For, given certain conditions under which China would be able to borrow on reasonable terms and to employ the proceeds for productive purposes, the imposition of guarantees and the assignment of revenues would be unnecessary; otherwise, as the defaults and arrears in the past have shown, they would be worthless. The ability to pay deals with the short-run problem of transfer; the capacity to borrow treats from a broader angle the long-term prospects of the adequacy of natural resources for economic development and of the adaptability of the institutional set-up to the changes which the large-scale importation of capital will necessarily involve. The prerequisites of the capacity to borrow, like "the foundations of modern industry," as Professor Tawney has well emphasized, "are both material and psychological. It depends partly on the command of neces-

sary natural resources, partly on scientific knowledge, partly on the existence of habits and institutions which enable the knowledge to be applied and the resources to be exploited." ¹

Potentially, the availability and, in certain directions, the abundance of a variety of natural resources in China and the primitive stage of their present development, coupled with the physical and moral quality of her people, according to the findings of those who are entitled to an opinion, would appear to afford ample opportunities for future developments.

"The people's industry, traditional skill and capacity to live and work under conditions of bare existence . . . combined with the natural resources of the country, are the foundations on which a considerably greater structure of natural wealth can be built than has yet been achieved. In spite of immediate troubles—and the more because of the low level from which an upward movement will begin—it remains true, as all observers have long agreed, that if only the fundamental conditions required to encourage the flow of capital to productive enterprises can be secured, there is an opportunity for economic development on a large scale—perhaps a greater opportunity for the capital resources of the world being productively and beneficially employed than is to be found in any other greater country." ²

Fundamentally, there must exist not only a reasonable degree of internal and international political stability but also a prospect that such stability will for a considerable period be maintained. The end of the war will be expected to bring about settlement of international differences and, in addition, to create an international instrument capable of dispensing justice and enforcing law and order among the nations of the world—"the establishment of a wider and permanent system of general security," in the words of the Atlantic Charter. Internally, stability means unity and unity must take its root in democracy. The resolution with respect to the early establishment of a constitutional government, adopted by the Central

¹ R. H. Tawney, *Land and Labour in China*, London, 1932, pp. 129-130.

² Sir Arthur Salter, *China and the Depression*, Nanking, 1934, p. 13.

Executive Committee of the Kuomintang on September 11, 1943, as the political objective of China's post-war reconstruction, is a welcome step towards the realization of the democratic ideal. Although the Bretton Woods proposal for a United Nations Bank for Reconstruction and Development stipulates that decisions with respect to applications for loans shall be governed by only economic considerations irrespective of the political character of the government of the country requesting a loan, it is, nevertheless, obvious that democracy and international collaboration are interwoven and inseparable.

The close bearing of internal and international stability upon the state of public confidence and upon the inflow of foreign capital cannot be overemphasized. Neither can be attained, unless arrangements are now made which will give an assurance that for some time to come, neither China's domestic politics nor her foreign relations will be endangered by renewed disorder or disputes.

Apart from those measures of a political nature, certain other steps are needed to assure the public of the sincere purpose of the Government and to acquaint them with the facts of the situation. In this respect, the formulation of China's post-war economic policy and the legal definition of the scope and conditions of foreign investments in China would help greatly towards a clarification of the outlook and a promotion of confidence. Admittedly, industrialization of China is the avowed policy of the Government and some progress has been made in the planning of the program; yet as regards the respective fields of public and private enterprises and the Government's policy towards the latter, the position to date appears to call for prompt enlightenment with respect to the first and positive encouragement with respect to the second.

On the other hand, and of particular importance to our problem, the legal status and position of foreign enterprises in China must be early and clearly defined so as to leave neither

doubt nor ambiguity in the mind of prospective investors as regards the nature and kind of enterprises in which they may be allowed to operate either by simple registration or through special concession, or by joint participation with the Chinese Government or business, as well as with respect to the terms and conditions relative to each of these possible methods of operation. An official translation of existing laws affecting foreign enterprises in China, the amendment of discriminatory features, if any, in accordance with the 1943 Resolution of the Central Executive Committee and a codification of new rules and regulations along the lines just indicated would contribute in a large measure towards the clarification of the position which is now obscure and the perfection of a legal framework which is the very essence of security. In addition, if the laws are to give real protection, it is equally important to have adequate machinery for their enforcement particularly since the relinquishment of the extra-territorial system. Perhaps a broader concept of the due process of law and an assurance of its impersonal enforcement will do more than anything else to afford a genuine protection against arbitrary discrimination and denial of justice.*

It remains to consider the problems connected with fiscal and monetary stability and the necessary measures for their solution. Seven years of protracted war have naturally given rise to many financial difficulties in the way of budgetary deficits and currency depreciation, from which no nation at war can be entirely immune but on the solution of which the inflow of foreign capital must depend. Efforts must be made towards the re-establishment of budgetary equilibrium, rehabilitation of currency at home and the restoration of China's credit abroad.

Stress must be laid upon the necessity for the maintenance of budgetary equilibrium as a prerequisite to the stability of currency and the return of confidence. It is true that consider-

* Cf. Chiang Kai-shek: *China's Destiny* (in Chinese), Chap. 6, Sec. 3, pp. 177-186.

able financial progress has been made in recent years through the improvement of administrative machinery, the tapping of new sources of revenue, the introduction of tax collection in kind and the increasing centralization of the fiscal system. Nevertheless, it is regrettable that the Government must rely, and will continue to rely, upon borrowings to meet the deficits and that the expenses required for demobilization and reconstruction will offset to a large extent the economy arising out of reduced military expenditures after the conclusion of hostilities. Apart from the traditional measures aiming at enhancement of revenues and the retrenchment of expenditures, it would appear desirable to adopt the innovation, first introduced by Sweden, of preparing and presenting two entirely separate budgets annually—a "capital budget" and a "current budget." The latter, which includes all running expenditures like defense, administration, the interest on government debts, etc., should always be covered out of ordinary revenue; while the former, since its expenditures are all of a kind which are balanced by the creation of additional capital assets owned by the nation, should be financed out of loans.

In the field of currency, the consequences of the war are no less disturbing, if not disastrous. The flood of note issues, for which the policy of public borrowing is largely responsible, in the face of dwindling supplies of goods as a result partly of the enemy's blockade and partly of the dislocation and destruction that war inevitably entails, combined with the psychological reactions that always accompany, and accentuate the difficulties, has unfortunately undermined the position of the currency and upset the equilibrium between domestic and world prices. To foster confidence in the currency and to restore equilibrium between internal prices requires, in addition to a balanced budget, either a deflation of the cost-price structure or a devaluation of the currency. Either measure would obviously involve economic dislocations and disturbances, depending

upon the causes of the disequilibrium and the extent of the maladjustment. In the position in which China will find herself following the war, neither drastic deflation nor drastic devaluation would appear to fall into the realm of practical politics. The most desirable course of action would appear to be a judicious combination of both, after a period of satisfactory experimentation. It is certain that domestic prices will fall rapidly following the end of the war, through the reopening of the internal and international means of communications and the extension of the areas in which the national currency will circulate as the sole legal tender. When the fall of prices has reached a level at which China's balance of payments will no longer be subject to undue strains, then it may be time for the authorities to undertake the stabilization of the currency in the light of China's domestic and international requirements. The *de facto* stabilization must precede the *de jure*, if the dangers and the difficulties inherent in a premature stabilization are to be avoided.

The participation in the International Monetary Fund will of course enable China, under certain conditions, to avail herself of the Fund's resources in tying over a temporary disequilibrium in her balance of payments and in gaining a little time, when the cause of disequilibrium is more deep-seated, to work towards the fundamental readjustment of the income and price structure. But a large stabilization loan would be more helpful at the initial period of monetary reconstruction. Currency stability will not be achieved by any nation in isolation; but it is none the less true that the work of basic adjustments must begin at home.

Hardly less significant from the standpoint of China's future borrowings is a readjustment of her pre-war and war-time foreign public debts with a view to an early restoration of her credit abroad. The total pre-war foreign debts of China in all currencies under the jurisdiction of the Ministry of Finance

outstanding as of January 1943 was equivalent to approximately U.S. \$307,000,000, of which 73.4 per cent was in sterling, 17.3 per cent in U.S. dollars and the balance principally in Dutch, French and Belgian currencies. Not all of the pre-war debts are of the same quality, nor should they be treated alike. A general consolidation and conversion, though simple in procedure and economical in effect, would likely involve injustice. It would be better to weigh the equities in each case and to negotiate separately with the representatives of the bondholders with a view to effecting settlement along some such general principles as follows: first, a gradual resumption of interest payments according to a scale varying with the different rates of interests charged on different classes of debts; secondly, amortization to begin after the period of transition on a schedule which will take account of the seniority, security, pre-war quotations and other factors relevant in each case as well as the prospects of China's balance of international payments.

In addition to her pre-war indebtedness, China has also been able to borrow or obtain large sums from abroad through financial aid agreements, stabilization credits and barter arrangements. The financial aids to China, amounting, respectively, to U.S. \$500,000,000 from the United States, announced on February 7, 1942 and £50,000,000 from the United Kingdom concluded on May 2, 1944, are a direct transaction entered into by the governments concerned and, being political in purpose and nature, they establish no obligation of an ordinary financial character. Insofar as their final settlement will be deferred until after the end of the war, they will be subject to mutual negotiations in the interest not only of the countries concerned but also of lasting world peace and security.⁴

⁴ Article II of the U. S. Financial Aid to China Agreement of March 21, 1942 reads "The final determination of the terms upon which this financial aid is given, including the benefits to be rendered the United States in return, is deferred by the two contracting parties until the progress of events after the war makes clearer the final terms and benefits which will be in the mutual interest of the United States and China and will promote establishment of lasting world

With respect to stabilization credits, there are, first, the £5,000,000 extended by the two senior British Banks in China under the British Treasury guarantee in 1939, which remain outstanding and, then, the U.S. \$20,000,000 and £5,000,000 in 1941 from the American and British Treasuries, which have been liquidated.

Apart from the Financial Aids and the Stabilization Credits, neither of which would seem likely to present serious problems affecting China's external credit, there remains to be considered a series of barter arrangements whereby China has been granted export credits with which to make purchase of industrial materials and war supplies against the delivery of mineral and agricultural products from China. Altogether they amount, in principal, to approximately U.S. \$402,000,000, of which U.S. \$250,000,000 came from the Soviet Union, U.S. \$120,000,000 from the United States and a little over U.S. \$32,000,000 from the United Kingdom.⁵ The payments on account of principal and interest amounted to about U.S. \$93,000,000, leaving U.S. \$359,000,000 outstanding. The Japanese blockade and the loss of Burma have resulted in temporary, though involuntary, arrears with respect to the interest and repayment of these credits, yet for the consideration of China's

peace and security. In determining the final terms and benefits full cognizance shall be given to the desirability of maintaining a healthy and stable economic and financial situation in China in the post-war period as well as during the war and to the desirability of promoting mutually advantageous economic and financial relations between the United States and China and the betterment of world-wide economic and financial relations."

⁵ The details of these credits are as follows:

<i>Lender</i>	<i>Date</i>	<i>Amount</i>	<i>Term (years)</i>	<i>Interest Rate</i>
a) Soviet Russia:	March 1938	US\$50,000,000	5	3%
	July 1938	50,000,000	7	3%
(b) United States:	Feb. 1939	US\$25,000,000	5	4%
	April 1940	20,000,000	7	4%
	Oct. 1940	25,000,000	5	4%
	Feb. 1941	50,000,000	7	4%
(c) United Kingdom:	March 1939	£188,000	4	5%
	Aug. 1939	2,859,000	14	5%
	June 1941	5,000,000	20	3½%

credit abroad and the possibilities of further borrowings along these lines, it is imperative that negotiations with the respective governments should be undertaken at the end of the war with a view to a resumption of their servicing and amortization, preferably after the period of the post-war readjustment, when the restoration of the internal cost and price relationship would expectedly enable the producers to increase their production to meet the deliveries as required by the repayment schedules.

There are further questions of financial machinery and business practice which, though less fundamental than those just considered, are no less important, because the facilities they provide or deny will greatly help or hinder the future of foreign investments in China. Methods of business organization and corporate financing must be improved and modernized. At present, the corporation as a form of business organization in China is limited in application, and corporate securities with a few exceptions are almost unknown. Unless steps are now taken which "will make for technical efficiency in handling modern capital equipment, will insure the impersonal enforcement of business law, and will develop the control of business operations through effective accounting,"⁶ and unless the domestic investors are accustomed to modern methods of corporate financing and ready to put their savings in corporate securities, there is perhaps little hope for either joint investments or corporate borrowings on national or international capital markets.

In the matter of financial machinery, there is a need for a genuine Central Bank and an international investment company. In recent years, the centralization of the note-issue and the holding of reserves against the deposits of commercial banks have, admittedly, strengthened the position of the Central Bank; yet with respect to its resources and its independence as well as the weapons of financial control at its disposal, much remains to be done and improved. An independent and powerful

⁶ Cf. Remer: *Foreign Investments in China*, New York, 1931, p. 234.

Central Bank will be indispensable to the maintenance of fiscal and monetary stability and reform in this direction will be particularly welcome in view of the important part it will be expected to play in the post-war international financial collaboration.

On the other hand, under the leadership of the government banks, the strong Chinese commercial banks may be in a position to organize an international investment company or companies along the line of the China Development Finance Corporation (or through an extension of its activities) which would act as an intermediary between industry and private investors. The proposed organization would assist in making arrangements regarding the flotation of corporate securities, would take part in the underwriting and financing of long-term capital issues and in the founding of new corporations for various lines of enterprises on the basis of Sino-foreign joint investment and joint control. Recent examples of joint participation of both the Chinese and foreign banking interests in the flotation of some of the railway construction loans seem to offer possibilities of extending the principle of partnership investment between foreign and domestic capital to the wider field of industry, provided the investment machinery as herein suggested is devised and developed.

The problems here presented may make the prospects of foreign investments in China seem somewhat gloomy; nevertheless, they must be viewed in the perspective of China's permanent potentialities of economic development and in the light of the new national will to industrialize and to provide the basic conditions for its realization. Whatever shortcomings and handicaps there may be, they arise largely from remediable causes and, as such, are removable by human efforts. We may, therefore, confidently look forward to a solution of these problems and an early perfection of the institutional framework within which foreign capital and enterprise will be expected to pursue their business and prosper.

VI. PUBLIC BORROWINGS AND PRIVATE INVESTMENTS

To an average Chinese, foreign investment in China has usually meant the operation of foreign banking, commercial shipping and manufacturing firms or public utilities in the Treaty Ports and, to a much smaller extent, the purchase by foreigners of Chinese Government and railway securities publicly issued in London or New York. Indeed, according to Professor Remer, direct investments and government obligations formed in 1931, respectively, 78.1 per cent and 21.9 per cent of the total foreign investment in China. It is, however, important to note that they are not the only forms of foreign investments, important as they may have been in the past, and that their relative importance may change with the new international status of China and the new developments on the world capital markets. We shall describe the various types of foreign investments and discuss their relative merits in the light of China's requirements as well as of the world's financial trends.

The types of foreign investments may broadly be divided into three main categories, namely: (1) direct governmental transactions under which may be included the Lend-Lease operations and the export credit guarantees; (2) public issues by governments and private corporations; (3) business investments, either in the form of direct investment or joint participation or under a concession from the government. We shall describe and discuss them in turn.

(1) *Direct borrowing by one government from another:* The loan of U.S. \$500,000,000 from the United States to China announced on February 7, 1942 and the £50,000,000 from the United Kingdom, concluded on May 2, 1944, are excellent examples. This is a very important form of international in-

Investment and may be expected to continue on an increasing scale, especially in the immediate post-war period for the purpose of financial rehabilitation, paving the way for the revival of private investments. But such loans depend entirely upon the existence of good-will and friendly relations between the governments concerned; as such, they are governed more by political or strategic considerations than by economic or business calculations and consequently are less dependable and more sporadic. They must obviously depend as much upon the foreign policy and domestic politics of the lending and borrowing countries, as upon the broader considerations of world security and world prosperity. On the other hand, their amounts are likely to be larger and, because they are arranged directly without either the formalities incidental to a public issue or the intermediary of the capital market, the cost of this type of borrowing is usually lower and the terms more reasonable. Based on international good-will, they will be expected to further friendly relations between governments concerned and to contribute towards democratic unity and world peace. In view of China's stupendous post-war requirements, this type would appear to be most suitable, if there is no political string to these transactions. The possibilities along these lines should be early and energetically explored.

(2) *Lend-Lease Operations*: In its essence, lend-lease is an emergency program for pooling the resources of the United Nations in a common war effort without the elaborate system of financial agreements and obligations that characterized the last war. Though novel and different in form, yet in substance as well as in principle, the Lend-Lease operations of the United States for the transfer and export of defense articles and for the rendering of training and repair services to the government of any country whose defense is deemed vital to the defense of the United States, constitute not only a vital "weapon for victory," but also a new technique in international lending, especially if

account is taken of the enormous volumes of industrial materials and equipment that have been exported to the United Kingdom and the U. S. S. R. for the building and expansion of the British and Russian war-time production. The amounts authorized from appropriations to the President or by transfers from other appropriations have totalled over sixty billion U.S. dollars, of which nearly twenty billion, or one third, had been supplied up to the end of December, 1943. About 54 per cent of the amount actually transferred represented munitions, including ships; nearly 21 per cent covered industrial materials and products and the balance of 25 per cent shared almost equally by agricultural products and services, such as shipping, repairing, and training. Fundamentally, lend-lease was invented to solve difficulties inherent in other nations' shortage of U.S. dollars. Great hopes have been built on the extension of the principles of lend-lease in the field of international lending, for the basic difficulty of the shortage of dollars is likely to continue for a long time after the war. For the maintenance of full employment at home, and for the promotion of world prosperity and world peace, long-term international investment must not only be made, but made in the spirit of Lend-Lease. For a short time, it would be the easiest and probably the cheapest way to avoid a post-war depression and at the same time help the reconstruction of countries devastated by the war.

The continuance of Lend-Lease into the post-war period will naturally depend on how its war-time operations will be settled which, in turn, depends as much upon the foreign policy as upon the domestic politics of the United States. Though it may be premature to speculate on the part Lend-Lease will play in the post-war world, it is perhaps fitting to note the technical difficulties connected therewith. In the first place, if repayment of Lend-Lease is insisted upon the question boils down to the basic difficulty of all loans that the debtor can only pay in goods which the creditor must accept. Is America willing

And ready to do so? Then, if Lend-Lease is to make a contribution to the solution of the problem of international trade and finance, not only capital goods for special schemes of construction but also a portion of the ordinary everyday exports of American industry must be lend-leased. Is the American public willing to extend Lend-Lease to the regular transactions of ordinary commerce? Notwithstanding the spirit of generosity and practical collaboration that has characterized Lend-Lease, there is ground for skepticism as regards its long-range applicability.

(3) *Export Credit Guarantees*: These are credits for a period of two to five years and sometimes longer, extended for the purpose of financing exports from the lending countries. The credits guaranteed by the British Export Credit Guarantee Department and the Export-Import Bank of Washington, particularly in the early period of its history, are operations of this type. The Sino-British agreements of August 18, 1939 and of June 5, 1941 as well as the Export-Import Bank's series of loans to China against the delivery of wood oil, Yunnan tin and wolfram are good illustrations.

From the viewpoint of the lending country, the export credit guarantees, which help directly to encourage exports and, in fact, to correlate them with credits in the nature of "tied loans," would minimize the initial exchange difficulties which public issues would usually entail. Moreover, the risk involved is smaller, because the term is shorter, usually of two to five years, and under the British scheme, repayment normally begins before all the goods are exported, and the exporter is able to withhold deliveries if default occurs or appears to be imminent. From the borrower's standpoint, the relatively short term of the credits must, however, be uneconomic. A short term credit would not be appropriate for capital goods which have a long life, for the borrower would have to repay his debt in full before he had received any substantial return from his equip-

ment. This may either involve the borrower in transfer difficulties, if not in default, or prevent him from buying further equipment as he may require it. In view of the enormous increase in the productive capacity in the United States, Great Britain and the Soviet Union and of the need of expanding exports in order to maintain full employment at home, this type of international investment will be expected to increase in relative importance. As we have seen, China has borrowed large sums of this type of credit during the war; it appears incumbent upon her to study and select the particular types of projects for which export credit guarantees would be most suitable and to arrange the schedule of amortization in the light of her balance of payments prospects.

(4) *Public Issues by the Government or Private Corporations*: The flotation and sale of securities publicly issued in London or New York through Issue Houses and in conformity with legal routine and other formalities have been a very important type of international investment. Most of the pre-war foreign obligations of the Chinese Government, such as the Anglo-German Loan of 1898, the Reorganization Loan of 1913 and all the Chinese Government railway loans are examples of this type. Though there has never been a single issue by Chinese corporations, some borrowings have taken place, particularly from Japan.

The new issue market has been a predominating channel through which large sums of capital have moved from the well-developed to the less-developed countries for the development of railway, roads, public utilities, etc. If the issue is large, the credit standing of the borrower good and the risk of exchange instability negligible, it is a particularly suitable method. Otherwise, it may be either uneconomic, for the per unit cost of capital would be larger when the issue is small, or unavailable when the financial and economic prospects of the borrower fail to warrant the risks involved. With respect to its future possi-

abilities, neither the recent financial developments nor the credit standing of the Chinese Government or corporations appear to justify any extensive employment of this form of international investment. For one thing, governments in the lending countries have placed, in one form or another, restrictions on or supervision of the issue and sale of foreign securities and, as we are inclined to believe, these regulations will be continued for some time following the war, not only for protecting the general investing public but also for the safeguarding of currency. For another, China would have, first, to rehabilitate her external credit, through the renewed settlement of past obligations that have fallen in arrears and the adjustment of railway loans in a manner and on terms acceptable to the bondholders. And then, in view of the relative unimportance in China of corporation as a form of business organization and of their small size, it would take many years before they can hope to borrow from the new issue market abroad.

(5) *Direct Investment*: Under direct investment by foreign corporations or nationals in commercial, financial and industrial undertakings and public utilities, business risks, and usually the legal ownership and management, remain with the investor. China offers a striking illustration of the truth of Hobson's statement that "the first foreign investors were merchants," for the first investments in China were direct business investments made by foreign merchants. By 1930, they constituted nearly 80 per cent of the total foreign investments in China. Under the protection of extra-territoriality, it was only natural that this type of foreign investment has particularly developed.

Direct investment is usually an investment in kind and, in contrast with fixed interest bearing securities, its yields vary with the fortunes of business and will not become an intolerable strain on the balance of payments in times of depression. Particularly in the fields of manufacturing and public utilities,

apart from the market it provides for local raw materials and the employment it gives to local labor, it means, with the importation of capital equipment, an introduction of foreign management and foreign technique and by emulation, dissemination and diffusion, a general economic development of the country in which the investment is made. On the other hand, it is only fair to point out that these direct investments are primarily made by trade considerations rather than for systematic or sustained national economic development. Moreover, they tend to create a network of foreign interests—manufacturing, shipping, insurance, banking and trading—in such great centers as Shanghai, Tientsin, Hankow and Canton.

Mindful of the preponderance of this type of foreign investment in China and of the natural desire of many to rehabilitate or rebuild their business after the war and in view of the fact that direct investment constitutes no less than fifty per cent of total American investments abroad and that it has received greater emphasis in British circles, it may be expected, given reasonable conditions in the matter of taxation and general security, to continue to play an important part in the industrial development of China. The fears of "imperialistic domination," though easily comprehensible in the light of past history, are now, with the abolition of extra-territoriality and the special rights associated with it, irrational and groundless.

(6) *Joint Investment*: This provides for joint participation and joint control in which a partnership may be formed between either the government and a foreign corporation, as in the case of China National Aviation Corporation, or between foreign and domestic private corporation. Hitherto the Chinese laws, by placing restrictions on such joint enterprises with respect to the ratio of share-holding, the majority of directors and the nationality of the Chairman of the Board, have made this form of investment less popular and less attractive.

However, this form of Sino-foreign joint investment seems

Do offer certain definite advantages over other forms in which foreign capital may be or has been employed. It will be governed more by the prospects of business earnings than by political interests and it will render unnecessary the assignment of specific revenues or other securities as was very common in China's past borrowings. And, as a method of corporate financing, profit-sharing equities, as contrasted with fixed interest-bearing obligations, are more flexible and, insofar as they secure to a large degree the automatic adjustment to the varying fortunes of good times and bad, less burdensome on the balance of international payments.

Apart from the legal disabilities which, as we have seen, it is the intention of the Chinese Government to remove, there are, perhaps, one or two inherent difficulties for which we hope some satisfactory solution may be found. First is the question of capital structure. Foreign interests are naturally better supplied with capital than the Chinese and, on the basis of equal contribution, either the size of the joint concern would be smaller than if the Chinese were in a position to pay up their full share, or the foreign partner may have to advance the deficient amount to the Chinese at an interest to be paid out of future profits. Are the foreign interests prepared to do so, if they can finance the business all on their own?

Another difficulty arises from the relatively much higher cost of capital in China than abroad. For well-known foreign firms, they may be able to borrow between 4 and 5 per cent in their home market, while for the Chinese, they would be considered very lucky if they succeed to borrow below 10 per cent. A yield of 8 per cent, which would be regarded as sufficiently remunerative for the foreign partner, might not suffice to cover the cost of Chinese capital. A dividend of 5 or 6 per cent would be a good return to the foreign interest, putting the balance into reserves or ploughing it back into business; to the Chinese a higher dividend might be very necessary. There may, there-

fore, easily arise difference of opinion with respect to both the dividend policy and the business policy, which it may be difficult to compromise.

Finally, big foreign manufacturing concerns usually operate their business in a vertical integration for reasons of economy. In the matter of joint participation, it may be difficult, if not impossible, to find a Chinese firm which has a similar type of vertical control from raw materials down to the marketing of the finished products. The foreign firm may have to participate with one Chinese firm in the production of raw materials, with a second, in the processing of the product, and with a third, in its marketing and distributive organization. While it is certain to reduce the operating economy, the participation with different Chinese firms means at the same time division of business control and possible divergence of business policies. Perhaps, to limit participation to any one of the productive processes, like the procurement of raw materials, or their fabrication or the marketing of the final product, would be a way out of the difficulty.

Notwithstanding these difficulties which, given good intentions on the part of both parties, will not be insurmountable and provided efforts are made to remove the hitherto legal restrictions and to ensure legal security and fair treatment, joint investment holds out one of the best prospects in the future of foreign investments in China. Neither purely foreign nor purely Chinese interest would be in a position to accomplish as much as when their hands were joined and it is not too much to say that in this kind of joint participation and joint control, which make possible the pooling of resources and the sharing of experience, lies the hope and the enduring basis of international economic collaboration.

(7) *Concessions*: Here, as in direct investments, foreigners are allowed for technical reasons to engage in the operation of certain projects or lines of industry, but they are permitted to

Engage only in specific lines of industries upon the sanction of the Government, with the privilege of monopoly or semi-monopoly during the life of the concession, with or without a guaranteed rate of return, but subject to the repurchase by the Government at cost or cost plus a reasonable compensation. This method was extensively employed in the economic development of Argentina, Brazil and Chile and contemplated in connection with the First Five Year Plan of Soviet Russia.

With the concession system, which owes its existence largely to local technical deficiency and under which compulsory training of native technical staff is usually made one of the conditions, the inflow of capital is invariably accompanied by the importation of technique and managerial experience. Moreover, since concessions are normally granted on the basis of a well-prepared scheme, they secure a much better coordination with the plan of national economic development and consequently avoid the haphazard developments or redundant capacities which often characterize private direct investments. On the other hand, a concession has only a limited life to run; it is here, as elsewhere, that political and economic stability is of paramount importance.

To sum up, in view of China's enormous post-war needs for foreign financial and technical assistance, any form in which or channel through which such assistance may be obtained on reasonable terms is to be welcomed, though possibilities of direct governmental operations and the extension of the Lend-Lease system would appear to offer to China the best advantages. On the other hand, judging from the trend of world financial developments, direct governmental transactions are destined to play a great role, at all events in the immediate post-war period and especially in the form of export credit guarantees. The extension of lend-lease though sound in principle and to be welcomed, will be most uncertain for it will be greatly influenced by the foreign policy and the domestic politics of the

United States. In the field of private investments, direct investments will certainly continue, though joint investments and the concession system may hold out much bigger and better prospects, if China offers a reasonable and real assurance of legal security and economic returns.

VII. CONCLUSION

How and how far foreign capital will actually and continuously be available to China depends almost entirely on whether the problems that we have outlined will be courageously faced and energetically tackled. Great as her potential capacity may appear in the way of human and natural resources; China needs to do without delay everything in her power to enhance and enlarge her actual capacity to borrow from abroad.

In view of the dismal failure to utilize effectively foreign capital in the past and mindful of the disappointing reception of Dr. Sun Yat-sen's "International Development of China" following the end of the last war, it is perhaps logical and legitimate to understand and to underline the basic institutional framework within which foreign capital and enterprises are to operate and prosper. International investment, like any other international undertaking, invariably involves mutual consent and bilateral agreement between the countries concerned. While the prospects of resumed international lending may be more promising than ever, to secure any large-scale international borrowing we must, nevertheless, do our part. Solemn pronouncements and vague promises will remain aspirations unless they are implemented by action and demonstrated by facts. China will find in the liberated European countries strong rivals competing for whatever international investment there is available. It is, therefore, imperative that no time should be lost, nor efforts spared, in providing the minimum conditions essential to an inflow of foreign capital and in promoting the good-will and good relations between China and the main lending countries, upon which the policy and prospects of international collaboration, in the economic as in the political sphere, must be dependent. Finally, the magni-

tude of China's post-war reconstruction and the probability competitive demands upon the world capital markets appear to require a planned guidance and purposeful utilization of foreign capital, if the misdirection of efforts and dissipation of resources, which she can ill afford, are to be avoided. Here, as elsewhere, we need a new outlook and new machinery.

PAMPHLETS IN THIS SERIES

1. China's Contribution to World Peace, by Kung-chu Hsiao.
2. China and Foreign Capital, by W. Y. Lin.
3. Industrial Planning in China, by Ching-chao Wu.
4. The Status of Aliens and Foreign Enterprise in China, by Wang Tieh-Yai.
5. China and Southeastern Asia, by Su-ching Chen.
6. The Local Government of China, by Kan-yu Wang.
7. The Far East in a New World Order, by S. R. Chow.
8. Security Minimum: Freedom from Fear, by Dis
Hsueh-feng Poe.

*Copies of the above may be purchased at the
Publications Office, International Secretariat
Institute of Pacific Relations
1 East 54th Street, New York 22, New York*

