On Fiscal, Monetary and other Economic Problems of Chiang Kai-shek’s Regime (1928-1949)

ALEŠ SKŘIVAN, JR.

In the mid-1928, Chiang Kai-shek’s units took control of Beijing and Tianjin in effect terminating the Northern Expedition, which had started two years earlier. In October 1928, Chiang Kai-shek initiated the formation of a new central government, a step that was to become the beginning of a new era in China’s modern history. For China, Chiang’s government to a large extent represented the long-awaited hope for the end of the dramatic period of instability, chaos and general disintegration. At first sight, Chiang seemed to be a charismatic leader with a great opportunity to lift China and remove its principal problems. In addition, he had many indisputable advantages when compared to his competitors. He gained the support of many prominent representatives from among the Chinese economic elites and, more importantly, his previous military achievements won him the respect of many western powers, for which he and his government were - in the given circumstances - the most suitable partners on the Chinese political scene.

After the formation of a new, nation-wide government, Chiang presented a very ambitious programme for the stabilization and modernization of China, which focused on economic goals. Especially in the first years, Chiang tried to reorganize Chinese society according to his ideas and to achieve western-inspired economic, legal and social reforms. After a lengthy polemic, a new Civil Code was published, based on the French, German and Swiss models. For more information on the legislative changes, see Michal TOMÁŠEK, Dějiny čínského práva [A History of Chinese Law], Prague 2004, pp. 249-270.

1) In the late 1920s, China also established tariff autonomy and thus could freely begin to form a new customs policy. With the help of the new planning bodies, the Nanking government began supporting infra-

1) For more information on the legislative changes, see Michal TOMÁŠEK, Dějiny čínského práva [A History of Chinese Law], Prague 2004, pp. 249-270.
structure expansion, building important new railways and roads. Foreign advisors were hired to improve the economic situation. An extensive plan for the formation of a new, efficient educational system was developed. In 1934, a bill for a new school reform was formulated, which was intended to improve the quality of education, guaranteeing at least a minimum level of education to all children. 2

It soon became apparent that imposing modernization and revitalization changes would be an intensely demanding and complicated task. Chiang’s reform plans generally ended as unrealized visions or were only completed in a reduced, deformed way. This failure was due to several factors, which influenced the reform process to varying extents. Chiang’s government could form and approve a promising and pragmatic programme of economic and other reforms, though the capacity of the Nanking government to push through the introduction of such reforms in practice was somewhat limited. Chiang and his army never really gained control over the whole of China. Large border regions of China were completely beyond his government’s authority. Despite some provinces being officially administrated by the Nanking government, they were in reality under complete control of local warlords. Even in provinces directly occupied by Chiang’s soldiers, the Nanking government’s capacity to influence the everyday life of the general population was tenuous. The government controlled the higher and middle administrative bodies, yet at lower levels administration was traditionally in the hands of rich families. In the country, this powerful elite was represented by the largest landowners, who formed the economically strongest stratum, often while also functioning as local usurers. Their children were sent to study in order to take control of pivotal offices in the local or provincial administration. The local level was thus often characterized by a very close personal interconnection between government machinery and the economically strongest groups. This elite (gentry) in reality had at its disposal almost unlimited powers in local matters and to a large extent was independent of the central government. The generally restrained attitude of the local gentry contributed to the fact that the impact of the afore-mentio-

2) For more information on educational system problems in the period before the formation of Chiang’s government, see Ka-Che YIP, Warlordism and Educational Finances, 1916-1927, in: Perspectives on a Changing China: Essays in Honor of Professor C. Martin Wilbur on the Occasion of His Retirement, Joshua A. FOGEL and William T. BOWE, eds., Boulder 1979, pp. 183-195.

ned reforms and changes in the lives of the people was somewhat minimal. Influenced by the gentry, many Chinese followed the old regulations and established customs, despite some of them no longer being legal. 3

Nevertheless, the status and behaviour of the gentry were only one of many reasons why the reform results lagged behind original expectations and for the failure of the reform plans. The continuing lack of stable power within China, military conflicts (both battles with the Japanese and several local conflicts), various and often protracted economic problems and, last but not least, the demoralization of the Nanking government, which led to widespread corruption, were among other important and easily-identified causes.

As has been suggested, the application of an efficient new governmental economic policy and the related economic revitalization of China, which were also intended to solve long-term fiscal problems, were an important part of Chiang’s reform programme. Since the fall of the monarchy, no Chinese government had succeeded in securing control over tax collection to prevent extensive “evasions”. In practice, a substantial part of the taxes collected stayed in provinces or were seized by one of the warlords. Roughly half of all state income came from maritime customs and tax revenue from salt. Though the central government was in charge of collecting the important land tax, the collected amounts nevertheless stayed, with only a few exceptions, in the provinces. Through the decree of 1928, the nationalist government formally yielded the collected amounts to the provinces, which meant that in practice it surrendered economic control of the segment of the Chinese economy which produced roughly two thirds of gross domestic product. From the 1920s, the situation was so precarious that Beijing’s financial control almost disappeared. 4 The following years did not bring any improvements as the government’s tax income kept decreasing: from 86 million Chinese dollars in 1922, it dropped to 47 million Chinese dollars in 1928. The situation became critical in 1926, when the provincial administration, in


effect the warlords, kept 38 million Chinese dollars from the taxes collected, with only 9 million reaching Beijing.5

In the decade before the beginning of the war with Japan in 1937, the nationalist government had considerable achievements in the fiscal sphere. It abolished lijin (likin), the interior tax, which had for years hampered the development of trade.4 Tax collection was centralized and the tax offices were given a more efficient central management system. All tax offices were transferred to the authority of three governmental institutions – Customs Service, Salt Monopoly Administration and Internal Income Administration. The tax collection system was made more efficient and, after China achieved the tariff autonomy, it resulted in a substantial increase in government income. Nevertheless, the outbreak of war with Japan in 1937 resulted in the nationalist government losing control of the coastal provinces and important ports, which necessarily lead to a considerable decrease in tax revenue.

One of the primary tasks of the nationalist government was imposing order on the monetary system, which in China had been completely chaotic for decades. In 1914, the silver dollar was officially proclaimed the national currency of the Republic of China. In the 1920s and 1930s, the outflow of silver from China increased and the silver standard was no longer sustainable. During the “military administrators” government, bizarre currencies were in circulation. Prices were mostly stated in taels, units of silver standard, which was quite confusing. A tael was a unit of bullion, which had a specific weight and purity. One of the problem was that tael value in different areas fluctuated and the tael did not have a stable rate linked to the coins in circulation.7 After a considerable exertion, the Nanking government managed to enforce the abolition of the tael in 1933. As part of the currency reform in 1935, the circulation of silver dollars was banned and a new currency, commonly called the fabi, introduced.8

During the Guomindang’s rule, the modern Chinese banking system was dominated by four institutions, all controlled by prominent people in the regime, who used them as political tools, as well as for their personal enrichment. It was generally believed that the Central Bank of China was dominated by H. H. Kung (Kong Xiangxi), the Bank of Communications was run by clique of Chen brothers,9 the Bank of China was controlled by T. V. Sung (T. V. Soong, Song Zizhen) and, last but not least, the Farmers Bank of China was dominated by high-ranking Chinese army officers.10 Banks in the provinces

7) Customs statistics were calculated in Haiguan taels. After the abolition of the tael in 1933, they were usually compiled in Chinese dollars or in the Customs Gold Unit (hereafter referred to as CGU). The CGU was introduced in 1930 to make certain foreign trade payments; the fixed exchange rate to USD was set as 1:0.40. The nature of the CGU gradually changed and it was in fact released into circulation for general use. Cf. the addition of the Czechoslovak crown to the list of currencies with fixed exchange rates to the CGU, SHAC-MCSA, Part One: Inspector General’s Circulars, Reel 24, 679 (1) 26916, Circular No. 5211 (29. 1. 1936), signed by F. W. Maze (Inspector General).
8) Fabi, legal tender officially valid in the entire country. The bank notes contained the word yuan in Roman script. The monetary system reform was to be based on the introduction of a modern currency supported by foreign currency reserves, which were established in China primarily thanks to extensive American purchase of silver. From 1935, the use of silver as currency was banned and only bank notes issued by the Central Bank of China, the Bank of China and the Bank of Communications were legal. For more information, see Lloyd E. EASTMAN, Nationalist China during the Nanking decade, 1927–1937, in: The Nationalist Era in China 1927–1949, Cambridge University Press, Cambridge 1991, pp. 41 and 46.
9) The Chen brothers influence was based on their positions in the Guomindang apparatus. Chen Guofu was the party’s secretary general (1929–1932), the head of its Organizational Department (1933–1936); from 1928 he was in charge of the party’s Security Department, later the Committee for Investigation; in 1937–1945, he was the Minister of Education. Chen Guofu controlled Guomindang party machinery from the position of the head of the personnel department of Chiang’s secretariat.
10) For more information on the position of the “big four” in Chinese banking, see Zhaojin JI, A history of modern Shanghai banking: the rise and decline of China’s finance capitalism, Armonk, New York 2003, pp. 172-195.

6) The Chinese promise to remove lijin played a particular role in the negotiations concerning Chinese customs autonomy in the 1920s. Lijin was officially abolished as of 1. 1. 1931. For more details on the closing down of the stations authorized to collect lijin, and their transformation into other purpose offices, see the telegrams sent to and from the office of the general inspector of the Chinese Maritime Customs Service from the turn of 1930 and 1931. For example: The Second Historical Archives of China, Nanjing, The Maritime Customs Service Archive (hereafter referred to as SHAC-MCSA), Part Five: The Policing of Trade, Reel 236, 679 (1) 1304, Telegrams to Frederick Maze, received from Wenchow (22. 12.), Swatow (22. 12.), Kowloon (3. 2. 1931).
China’s generally high foreign debt was another great problem that the Nanking nationalist government had to deal with. Arthur Nichols Young, who worked as a financial advisor to the Chinese government for almost 20 years, classified the structure of Chinese debt as possibly the most complicated in the world. This is hardly surprising – it comprised liabilities for numerous loans obtained during the imperial period, reparations that China pledged to pay in signing the Boxer Protocol of 1901 and the chaos of governmental bonds issued after the revolution in 1911. These obligations were a huge burden for the nationalist government – in the first fiscal year of its existence, it had to spend half of its income on paying the principal and interest on the principal, and until the war with Japan, it paid an average of 33% of its entire income for this purpose. Compounding this, China annually spent higher amounts on debts than it received in the form of new loans.

Table I: Development of the Index of Retail Prices in China in 1937-1948

<table>
<thead>
<tr>
<th>Year</th>
<th>1937</th>
<th>1938</th>
<th>1939</th>
<th>1940</th>
<th>1941</th>
<th>1942</th>
</tr>
</thead>
<tbody>
<tr>
<td>Index</td>
<td>100</td>
<td>176</td>
<td>323</td>
<td>724</td>
<td>1980</td>
<td>6620</td>
</tr>
<tr>
<td>Year</td>
<td>1943</td>
<td>1944</td>
<td>1945</td>
<td>1946</td>
<td>1947</td>
<td>1948</td>
</tr>
<tr>
<td>Index</td>
<td>22 800</td>
<td>75 500</td>
<td>249 100</td>
<td>627 210</td>
<td>10 340 000</td>
<td>287 700 000</td>
</tr>
</tbody>
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The nationalist government’s foreign debt continued to increase after 1937. After December 1941, foreign aid continued at a higher rate; an American loan of 500 million American dollars (contract from March 21, 1942), a Bri...
tish loan of 50 million pounds (contract from May 2, 1944) and, more particularly, the aid based on the Lend-Lease Act, which in 1941-1946 exceeded 1.5 billion dollars were most important. 16 In short, the Japanese attack against Pearl Harbour and the beginning of the war in the Pacific strengthened the position of Chiang’s Chongquing regime and nationalist China, which until then had received aid mainly from the USSR. 17 became an important factor in general considerations, most notably in those of the United States, 18 which until the end of the war strove to keep China in the war against Japan at any cost. These financial aids helped Chiang’s regime survive the war even though foreign aid was far from a universal panacea to its economic problems. In relation to this, we have to bear in mind that the means from abroad were primarily misappropriated by the Guomindang elite or used for questionable purposes.

Undoubtedly, the most telling expression of the sharp deterioration in unoccupied China’s economic situation was a dramatic rise in inflation, mainly caused by the excessive distribution of new banknotes in response to the rapidly growing fiscal deficit, which in turn had been principally triggered by increasing military expenditure. Prior to 1937, inflation was generally moderate, though it increased in response to Japanese aggression in China proper. A rapid increase in inflation occurred after the Japanese attack on Pearl Harbor. By the end of 1941, the inflation rate had reached 1:20. This trend was to be stopped by foreign loans, which was never a sufficiently practical instrument to be effective in improving the Chinese economy. The total sum of the foreign aid to China, from the start of the war in the Pacific in December 1941 to the rise of the communist regime in China in 1949, amounted to approximately 2.5–3 billion dollars. 20 Despite American aid, the financing of military forces was for the Chiang’s government an increasingly onerous burden, which as has been mentioned previously, comprised 70% of its expenses.

The Chinese government’s plans concerning the improvement of the foreign trade situation after the war failed to be achieved. First of all, it did not manage to eliminate or even reduce the markedly passive balance. Measures stimulating export and limiting import essentially had no effect. In fact, the situation in this respect deteriorated, as in 1946 and 1947 the Chinese foreign trade deficit reached 391 and 335 million American dollars respectively. If we also include supplies as part of the UNRRA with imports, we arrive at figures of 851 and 803 million USD, 21 with over half of the supplies being from the United States. Considering Chinese needs, only a small segment of the total import consisted of items which could directly aid and support the rapid revitalization and modernization of the Chinese economy.

Among other things, the nationalist government did not manage to halt the rapid growth in unemployment or sufficiently stimulate the revitalization of industrial production. For instance, in November 1946, the Ministry of the Economy released information that of 2441 factories left by the Japanese, they had managed to put into operation only 852. At the begin-
ning of 1947, the government tried to stabilize the economy through “reform measures”, which were announced on February 16, 1947. They comprised a wage freeze at January 1947 levels, the setting of maximum prices of some basic commodities (rice, cotton, fuel, etc.) and a ban on the use of gold, silver and foreign currencies in trade between non-commercial entities. At the same time, the government took steps towards limiting the outflow of Chinese capital to Hong Kong. The effect of these measures was minimal as the set maximum prices were in reality adhered to only sporadically, mostly in large cities. The reform had an impact only on the Shanghai-Nanking area, while in the country it had essentially no effect. Prices on the black market, which was expanding, grew rapidly. In approximately May 1947, the entire experiment collapsed.

The second attempt to halt the extraordinarily unfavourable economic development and to save the situation occurred on August 19, 1948, with the introduction of the Gold Yuan. However, this emergency reform programme was merely the last gesture of desperate men who were stuck in economic chaos which they themselves had caused. It was obvious from the very beginning that this measure did not have much prospect for success. The “reform” was based on the forced exchange of gold, silver and foreign currencies (approximately USD 170 million in total) for the new currency. Pressure for this exchange was again strongest in the Shanghai-Nanking area, though the situation was particularly difficult in Shanghai, where there were long-term ties between the Guomindang and local financial and business circles. Chiang’s son Jiang Jingguo was involved in exerting influence upon them. In connection with this, around 3000 businessmen and entrepreneurs were arrested for resisting the measure. Forced exchange also led to a fatal impoverishment of the Chinese middle class as the new currency’s value started to fall sharply. What followed was the total financial disaster of the nationalist regime, accompanied by the astronomical growth of prices and the total collapse of the currency (Tables I and II).

Table II: The Development of the Exchange Rate of American Dollar to the Chinese Currency (Fabi) in 1942–1945

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<th>Year</th>
<th>1942</th>
<th>1943</th>
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When seeking the causes of the Guomindang’s defeat, we undoubtedly have to look for answers in the military and economic spheres, but also in certain “spiritual exhaustion” or ideological insufficiency. The loss of credibility and respect from the general public, the Guomindang’s repressive policy, corruption in the governmental machinery, the failure of American mediation, as well as the inability of the nationalist government to implement the necessary reforms undoubtedly also played an important role. Chiang’s regime demonstrated an admirable capacity for self-destruction and even American aid could not save it. Nevertheless, we can find the opinion that the fact that Chiang and the Guomindang managed to lose the civil war was a truly remarkable performance. In fact, it is no mystery. The fall of Chiang’s regime and the victory of the communists were, in a way, merely the logical outcome of previous developments.


