

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

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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.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 administered 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. ROWE, 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

3) Cf. paper on social, economic and other changes in one of the regions in Zhejiang province by R. Keith SCHOPPA, *Contours of Revolutionary Change in a Chinese County, 1900-1950*, in: *The Journal of Asian Studies*, Volume 51, No. 4 (November 1992), Association for Asian Studies, Ann Arbor 1992, pp. 770-796.

4) Abert FEUERWERKER, *Economic Trends in the Republic of China, 1912-1949*, Michigan Papers in Chinese Studies No. 31, The University of Michigan, Center for Chinese Studies, Ann Arbor 1977, p. 77.

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 lijn (likin), the interior tax, which had for years hampered the development of trade.⁶ 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

5) P. T. CHEN, *Public Finance*, in: *The Chinese Yearbook, 1935-1936*, Shanghai 1936, p. 1298.

6) The Chinese promise to remove lijn played a particular role in the negotiations concerning Chinese customs autonomy in the 1920s. Lijn was officially abolished as of 1. 1. 1931. For more details on the closing down of the stations authorized to collect lijn, 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).

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 Ziwen) 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 Lifu 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.

were dependent on these four large institutions. The Central Bank of China did not function along the same lines to similar institutions in Western Europe did, instead it was an institution whose main goal was to provide short-term loans to the government. Although in 1928-1937, 128 new bank branches were established, most frequently in the coastal regions, we can say that the modern banking system in China was not sufficiently developed.¹¹ This system mostly served the government, which continuously struggled with financial difficulties, caused by a constant fiscal deficit. The growth of expenses was mainly caused by settling loans and an enormous increase in financial instruments spent on the armed forces. Considering that in the latter part of the 1930s, 40-50% of governmental expenditure went to the army and a full third was used to pay loans, there was little left for other expenses.

In 1927-1935, the nationalist government in Nanking issued many bonds, mostly in an attempt to meet the rising costs of the growth in military expenditure. During World War II, spending on the armed forces grew even more; at the end of the nationalist regime's existence, its army had about 5 million men and gobbled up 70-80% of government expenses. Such behaviour from the ruling elite was not new in China. The Qing regime dealt with the unfavourable financial situation by issuing state bonds in order to generate the finances it needed to pay war reparations to Japan after the lost war in 1895, as well as to pay for damages to international powers in accordance with the Boxer Protocol of 1901, as well as other fiscal commitments. In 1912-1926, the domestic debt burden continued growing - for example, state bonds were issued in connection with the "reorganization loan" to Yuan Shikai's regime and Japanese loans from 1918. Nevertheless, the total value of Chinese state bonds held by foreigners did not markedly increase - in 1913, foreigners owned bonds to a value of USD 526 million, while in 1931 it was USD 696 million.¹²

11) For details on the modern Chinese banking system cf. Frank M. TAMAGNA, *Banking and Finance in China*, Institute of Pacific Relations Publications Office, New York 1942, pp. 121-196. For information on the development of the Chinese banking system, see also Linsun CHENG, *Banking in modern China: entrepreneurs, professional managers and the development of Chinese banks, 1897-1937*, Cambridge 2003. Cf. legislative changes concerning banking and other financial services in Michal TOMÁŠEK, *Dějiny čínského práva* [A History of Chinese Law], p. 260.

12) For more information, see C. F. REMER, *Foreign Investments in China*, New York 1933, pp. 123-147.

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.¹³ 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.¹⁴ Compounding this, China annually spent higher amounts on debts than it received in the form of new loans.¹⁵

Table I: Development of the Index of Retail Prices in China in 1937-1948 (Year 1937 = 100)

Year	1937	1938	1939	1940	1941	1942
Index	100	176	323	724	1980	6620
Year	1943	1944	1945	1946	1947	1948
Index	22 800	75 500	249 100	627 210	10 340 000	287 700 000

Source: Albert FEUERWERKER, *Economic Trends 1912-49*, in: *The Cambridge History of China*, Volume 12, Republican China 1912-1949, Part 1, ed. by John King FAIRBANK, Cambridge 1983, p. 114. Cf. Arthur N. YOUNG, *China and the Helping Hand, 1937-1945*, Cambridge (Mass.) 1963, p. 435.

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-

13) Arthur N. YOUNG, *China's Fiscal Transformation, 1927-1937*. in: *Strenuous Decade: China's Nation Building Efforts, 1927-1937*, ed. by Paul K. T. SHIH, New York 1970, p. 112.

14) James E. SHERIDAN, *China in Disintegration. The Republican Era in Chinese History, 1912-1949*, New York, London 1977, p. 222.

15) In 1902-1913, China paid on average of 89.2 million Chinese dollars, in 1913-1930 it was 70.9 million; in the same periods it received on average 61.0 and 23.8 million Chinese dollars in the form of loans. REMER, *Foreign Investments*, p. 160.

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 Chongqing 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 partially 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

crop failure of 1940 (for the development of the index of retail prices, see Table I). In 1940-1946, prices in unoccupied China annually increased by approximately 300%. After the end of World War II, the situation improved for a short period of time, but in the last months of 1945 the price index started to soar.¹⁹ 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-

16) In 1941-1946 the overall sum was 2.2 billion dollars. The American obligation to finance American units in China, with the Chinese side charging expenses connected with the Americans using a fixed exchange rate between the American and Chinese currency (1:20) was another form of "aid" to China. The Chinese raised this demand in 1943; at the beginning of that year the real course was about 1:50, while at the end of it, it was 1:100.

17) F. F. Liu says that until the beginning of the war in the Pacific, the USSR loaned a total of 300 million dollars, while the USA only 170 million dollars; F. F. LIU, *A Military History of Modern China, 1924-1949*, Princeton University Press, Princeton 1956, p. 208. For general information on aid to China during the war with Japan, cf. Arthur N. YOUNG, *China and the Helping Hand, 1937-1945*, Harvard University Press, Cambridge (Mass.) 1963.

18) For more information on American policy towards China during World War II, cf. Aleš SKŘIVAN Sr., *Čína a Spojené státy 1941-1945* [China and the United States], Acta Universitatis Carolinae, Philosophica et Historica, Monographia LIII, Prague 1974. On American policy towards China in the first post-war years, see e.g. Jan WANNER, *George C. Marshall: tvůrce armád a aliancí* [George C. Marshall: Army and Alliance Maker], Prague - Litomyšl 1998, pp. 275-292. For material on Marshall's activities in China, see *United States Relations with China. With Special Reference to the Period 1944-1949*, Washington 1949, pp. 605-695.

19) FEUERWERKER, *Economic Trends*, p. 89.

20) Researchers differ as to the exact calculation of total foreign aid. Definitely the greatest share (over 90%) in total aid to Chiang's government was that of the United States. In this context, we have to be aware that most of the American aid was provided to Chiang in 1941-1946, while in the ensuing years, during the new civil war, its volume and extent changed dramatically. For more information on American aid to Chiang's government, see John King FAIRBANK, *The United States and China*, Cambridge (Mass.) 1983, pp. 336-353.

21) Harrison PARKER, *International Payments of Postwar China*, in: Pacific Affairs, Volume 21, No. 4 (Dec., 1948), University of British Columbia, Vancouver, p. 351.

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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.²² However, this emergency reform programme was merely the last gesture of desperate men who were stuck in economic chaos which they themselves had caused.²³ 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 astronomic growth of prices and the total collapse of the currency (Tables I and II).²⁴

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

	1942	1943	1944	1945
1 st half of the year	1:27-31	1:44-64	1:86-225	1:470-2250
2 nd half of the year	1:32-50	1:63-98	1:188-680	1:650-3250

Source: Young, Arthur N.: *China and the Helping Hand, 1937-1945*, Cambridge (Mass.) 1963, p. 437.

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 a 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 aid²⁵ 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.²⁶ 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.²⁷

22) The exchange rate of the new gold yuan to the existing currency was 1:3,000,000. The value of the American dollar was four new gold yuans. John King FAIRBANK, *Dějiny Číny* [A History of China], Prague 1998, p. 375.

23) Suzanne PEPPER, *The KMT - CCP Conflict, 1945-1949*, in: *The Nationalist Era in China 1927-1949*, Cambridge University Press, Cambridge 1991, p. 312.

24) For more information on the currency development in 1947-1949, see Richard C. K. BURDEKIN, Hsin-Hui I. H. WHITED, *Exporting Hyperinflation: The Long Arm of Chiang Kai-shek*, in: *China Economic Review*, March 2005, Issue 1, Volume 16, Elsevier, Oxford 2005, pp. 71-89.

25) For more information on American aid to Chiang's regime in the period from Japanese surrender until 1948, see William Gleason LANGER, *An Encyclopaedia of World History*, Boston 1972, p. 1338.

26) FAIRBANK, John King: *Dějiny Číny*, s. 374.

27) Cf. Chiang's opinions on the fall of his government in Lloyd E. EASTMAN *Who Lost China? Chiang Kai-shek Testifies*, in: *The China Quarterly*, No. 88 (December 1981), Cambridge University Press, pp. 658-668.