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CHANGES IN CHINESE CURRENCY AND THEIR EFFECT UPON COMMODITY PRICES

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IN discussions of the economic situation which has prevailed in the world during the past seven years, the term 'world depression' is frequently heard. This term is often used as if there actually were, or had been, an economic depression which (1) weighed equally upon all commercial peoples, (2) lasted during the same period of time in all countries, and (3) was caused by factors inherent in world commercial relations and not by conditions that could be controlled within national boundaries.

In this paper there is outlined evidence which leads towards the opposite conclusion, namely, that there is and was no such thing as a so-called world depression, and that the fundamental causes of economic depression, even though world wide in extent, nevertheless lie within the control of individual countries. The evidence outlined in this paper is small compared with the large mass which is available, and which leads an increasing number of people to draw the conclusion that the control of currency values is the world's foremost among many serious problems.

For many years previous to October 15, 1934, the Chinese currency was on the silver standard. By this statement is meant that the principal currency of China was silver coins and bars together with banknotes redeemable in fixed amounts of silver. Since silver was the basis of the currency, commodity prices in China were influenced by changes in the purchasing power of silver.

Before 1870 the currencies of most nations were on the silver or bimetallic basis. In the 1870's the nations began to place their currencies upon the gold standard and to demonetize silver. This process of demonetization continued until recently and resulted in lessening the world's demand for silver. As a consequence of reduced demand, the purchasing power of silver in England in terms of wholesale commodity prices fell from an index number of 209 in 1887 to 55 in 1931.[1] In the United States the purchasing power of silver fell from an index number of 202 in 1887 to 48 in 1931. In

[1] Figures from report of Committee for the Study of Silver Values and Commodity Prices, Ministry of Industries, China, *Silver and Prices in China*, tables 1 and 2.

these calculations the purchasing power of silver in the period 1910 to 1914 was considered 100.

While in the United States and in England the falling value of silver was reflected by a declining purchasing power of silver in terms of other commodities, in China, where silver was the currency, its falling value resulted in a continuous rise in the average level of commodity prices. According to figures compiled by the Nankai Institute of Economics in Tientsin, wholesale prices in China rose from an index number of 48 in 1887 to 162 in 1931. This rise in average wholesale prices indicates a decline in the purchasing power of silver in China from an index number of 209 in 1887 to 62 in 1931. These figures for the decline in the purchasing power of silver in China are similar to those for the United States and for England. A similar correspondence, with temporary exceptions, was observed throughout the period 1887 to 1931.

Between 1887 and 1931 the price level of China rose at a fairly even rate which averaged more than 2 per cent. per year. There was no drastic inflation during or following the World War. There was no deflation in 1920. There was no panic in 1929. From 1929 to 1931 commodity prices rose. If the United States had been on the silver standard during the period 1887 to 1931, a similar history probably would have been theirs.

The decline in the purchasing power of silver previous to 1931 was world wide and reasonably uniform in degree in different places. Only in China, or in other countries on the silver standard, was this decline the factor which determined the trend in the average level of wholesale commodity prices.

In the early part of 1931, the purchasing power of silver in England, in the United States, and in China reached its lowest point and began to rise. In the United States and in England the lowest purchasing power of silver occurred in February; in North China, in May; and in Shanghai, in August 1931.

As the purchasing power of silver rose above the low point, commodity prices in China fell. According to the index number compiled in Shanghai by the Chinese National Tariff Commission, when 1926 prices are equal to 100, wholesale prices fell from 130 in August 1931 to 108 in December 1932, to 98 in December 1933, to 90 in July 1935, the lowest point. The decline was interrupted in 1934, but altogether it was about 31 per cent. The decline would have been greater but for monetary measures taken by the Chinese Government.

There are several factors which may account for the rise in the value of silver which began in 1931. First, the long-time decline in the purchasing power of silver had apparently caused the production of silver to fall behind the rate of production of basic commodities in the world.[1] This effect appeared about 1913, if the relative production of silver and basic commodities during the years 1880 to 1914 is considered normal. Perhaps by 1931 the continued lag in the annual production of silver had influenced the world's silver stocks sufficiently to bring about a reaction towards a higher value for silver.

Secondly, the sharp rise in the value of gold that began in 1929 made gold expensive with respect to silver as a store of imperishable value for purposes of hoarding. Perhaps this fact caused many private individuals to hoard silver instead of gold, thus raising the demand for silver.

A considerable rise in the value of silver had occurred many months before the United States or any other country had passed any laws tending towards the remonetization of silver. The London Silver Agreement, which tended to increase the demand for silver, was signed in July 1933, when silver had already been rising in value for about two years. It was ratified by the United States in December 1933. The silver purchasing policy of the United States became effective in August 1934, more than three years after silver had begun to rise in value.

The fall in the commodity price level of China that began in 1931 had brought about a severe economic depression in China by the end of 1933.[2] As wholesale prices fell, less flexible prices failed to decline correspondingly. These less flexible charges included wage rates, debt service charges, transportation fees, and retail prices. Industrial production was sharply curtailed. Imports, which were at a high level in 1931, declined drastically in value and in volume. The flow of credit from urban to rural centres was stopped and was replaced by a liquidation, whereby funds began to accumulate in cities.

The distress in agriculture was acute. The prices received by farmers for rice, wheat, barley, millet, kaoliang, cotton, and other products fell much lower than the prices which they paid for salt, sugar, cloth, cooking oils, and other essential goods. Farm wage rates failed to decline. Taxes were not reduced.

The farmers sell about 20 per cent. by weight of the principal

[1] *Silver and Prices in China*, Chapter II.

[2] Lewis, A. B., *Economic Depression in China*, a series of nine articles, Dept. of Agricultural Economics, University of Nanking, mimeographed 1935.

crops which they produce.[1] They depend upon the money thus obtained to purchase what would be considered by most western farmers the barest necessities. Their inability to purchase these necessities, to pay their normal debts, to pay their taxes, to pay their rent, and to hire labour constituted an economic depression in a society where the average level of consumption, on western standards, is very low.

Anybody who still thinks that the falling prices which give rise to an economic depression are due to over-production of commodities should go to China. In the midst of the unusual distress which already existed in China as a result of the rise in the value of silver, news came of the legislation on silver which was pending in the United States. In August 1934, when the Silver Purchase Act began to operate, commodity prices in Shanghai were at a level of 99·8, compared to 130·3 in August 1931, if 1926 prices are 100. On this basis the index number of the purchasing power of silver was 100·2.

As soon as the American Silver Purchase Act began to operate, the purchasing power of silver resumed its rise. Unusually large quantities were shipped out of China during the months of August, September, and October 1934. In order to prevent a further loss of monetary metal and also to halt the decline in commodity prices in China, the Chinese Government on October 14, 1934, announced that a tax of $7\frac{3}{4}$ per cent. would be collected upon all coined silver exported from China, and that uncoined silver exports would pay a tax of 10 per cent. In addition, an equalization fee, to be announced each day, would be collected in an amount sufficient to equal any remaining profit that might be gained by purchasing silver in China for sale on the London or other foreign markets.

In the British Crown Colony of Hong Kong, which had an independent currency based upon silver, no measures were adopted in October 1934 to disconnect the currency from silver. Instead, the currency was held to such a level in foreign exchange that no profit could be gained by purchasing Hong Kong credits, converting them to silver, and exporting the silver to London. The currency was held strictly to the silver standard.

The differing effects upon the purchasing power of their currencies which were produced by the diverse policies of Hong Kong and China are best observed by reference to the accompanying chart. On Chart 1, the purchasing power of silver in the United States is shown to have risen from an index number of 99·7 in July 1934 to

[1] Buck, J. L., Preliminary data from the study: *China, Land Utilization*, University of Nanking.

a maximum of 149·4 in May 1935, from which it then declined to a level of about 130 in September, October, and November. In England it rose from an index number of 102·7 in July 1934 to a maximum of 166·4 in May 1935, from which it declined to a level of about 140 in September, October, and November. In Hong Kong, where no steps were taken to divorce the currency from the silver standard, the purchasing power of the currency rose from an index number of 109·1 in July 1934 to a level of 142·7 in June 1935, an index number equal to that for the United States. The purchasing power of silver in Hong Kong then continued to rise, until in October it had reached a height comparable to that for England.

This rise in the purchasing power of the currency in Hong Kong was calculated on the basis of a corresponding fall in commodity prices. This fall in commodity prices greatly intensified the economic depression in Hong Kong.

As soon as the export tax and equalization fee were imposed on exports of silver from China in October 1934, the Chinese currency fell in value in foreign exchange approximately by the total of these fees. The purchasing power of the currency in China declined from an index number of 104·1 in October 1934 to 100·1 in February 1935. About the first of April 1935, the export levies were discontinued. The Chinese bankers, however, agreed with the Government not to export any more silver under any circumstances. This agreement, together with measures to prevent smuggling, constituted a practical embargo on the exportation of silver.

Although the Chinese currency was actually not on the silver standard in foreign exchange after October 14, 1934, nevertheless, strong efforts were made to hold its value in foreign exchange as high as these conditions would permit. Rumours of impending devaluation were denied vigorously, although devaluation in foreign exchange had in fact occurred. As a result of these efforts, Chinese currency took some small part in the rise of the value of silver, and its purchasing power had risen to a level of about 110 in the months of July, August, and September 1935. In the summer of 1935, the economic depression in China reached its severest depth.

During the year following October 14, 1934, the redemption of bank notes in silver was nominally maintained, but an increasing number of restrictions were imposed upon this redemption. By the summer of 1935, much silver had disappeared from circulation, because of hoarding and smuggling out of the country. Premiums on silver in relation to bank notes were available almost everywhere. Internal as well as external barriers to the free movement of silver were common; and wherever such barriers existed smuggling was taking place. It is safe to say that in the summer of 1935 currency conditions in China were in a state of chaos.

The primary cause of this chaos had been the rise in the value of the currency beginning in 1931. Therefore, when the Chinese Government set about reconstructing their currency in the autumn of 1935, their first step was to allow the currency to fall in value in foreign exchange. This fall was accompanied by a corresponding rise in basic wholesale commodity prices, and by a slower rise in average wholesale prices. On November 3, 1935, the Government announced that the notes of the three Government Banks would henceforth be legal tender, and that the currency would henceforth be stable in foreign exchange at the level then prevailing. Since the Central Bank of China was the only source of foreign exchange, this decree stopped the depreciation of Chinese currency which had begun about two weeks before. Basic wholesale commodity prices stopped rising at once, but average wholesale prices continued to rise slowly towards a point where they would be in adjustment with the reduced value of the currency.

As shown on Chart 1, the purchasing power of Chinese currency in terms of average wholesale prices fell from an index of 109·8 in September to 96·8 in November 1935 and had declined to 94·5 in May 1936. Wholesale prices were therefore at a level of almost 106, when 1926 prices equal 100, and were probably due to rise eventually to a level above 110, or to about that which had prevailed in 1930 and 1932.

In Hong Kong, where the currency had been permitted to absorb the full effect of the rise in the value of silver, much greater depreciation was required in order to reduce the currency value to an accustomed level. This depreciation began in October 1935. The purchasing power of the currency fell from an index of 139·7 in October to 118·6 in November and to 107·5 in December, in terms of wholesale import prices. The currency was then stabilized in foreign exchange, all connexion with silver redemption having been abolished. The level of stabilization was such as to restore the customary parity of about 90 Hong Kong cents for one Chinese dollar. By April 1936, the purchasing power of Hong Kong currency had fallen to 99·2. Eventually a purchasing power parity between the Hong Kong and Chinese currencies will probably be fully re-established.

About December 9, 1935, after the Chinese and Hong Kong currencies had left the silver standard completely, the price of silver began to drop precipitously, and by February 1936 the purchasing power of silver in England and in the United States had declined to index numbers of 93 and 89 respectively. This decline, due apparently to a change in the United States silver purchasing policy, had

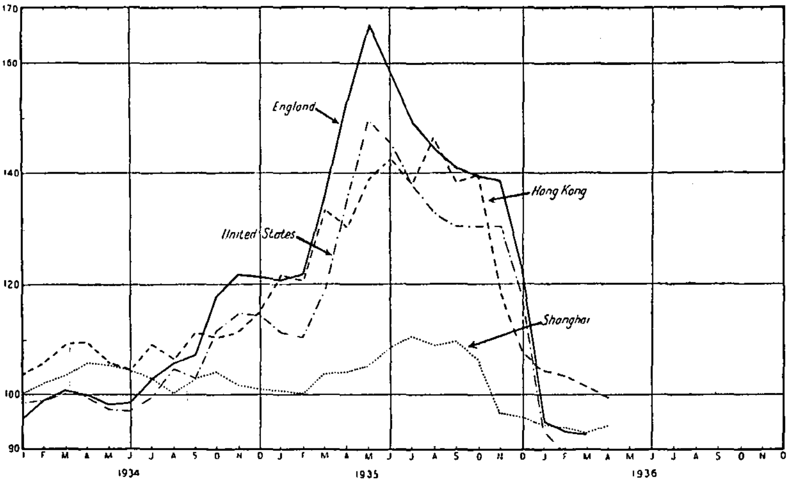

CHART 1. PURCHASING POWER OF SILVER, ENGLAND AND UNITED STATES, AND PURCHASING POWER OF THE CURRENCY, CHINA AND HONG-KONG, 1926 = 100

no effect upon the Hong Kong or Chinese currency values, since these currencies were no longer redeemable in silver.

The effect of Chinese currency changes upon Chinese farmers can be deduced from farm price relationships. On Chart 2, the relation between prices paid by farmers for commodities used in living and production and prices received by farmers for crops is shown. Although the indices refer only to conditions in the one locality of Wuchin, Kiangsu Province, near Shanghai, more extensive price studies have shown them to be typical of China.

The annual figures show that in 1932 prices received by farmers had fallen to a level of 161 compared with 189 for the retail prices paid by farmers, when prices in 1910–14 are 100. During 1933, when monthly figures were available, this discrepancy was widened. In 1934, a severe drought, comparable to that which occurred in North America, prevailed in the principal farming regions of China. For this reason, farm prices in Wuchin soared to a high point of 247 in November 1934. This rise was due to acute scarcity, sufficient to cause starvation in many areas, and in no wise relieved the agricultural depression. As the new crops came on, farm prices again fell below the relative level of prices paid by farmers.

The depreciation of Chinese currency in October 1935 brought about a sharp rise in farm prices, from which a partial reaction occurred. Retail prices paid by farmers were less strongly affected. By May 1936, the index number of prices received by farmers in

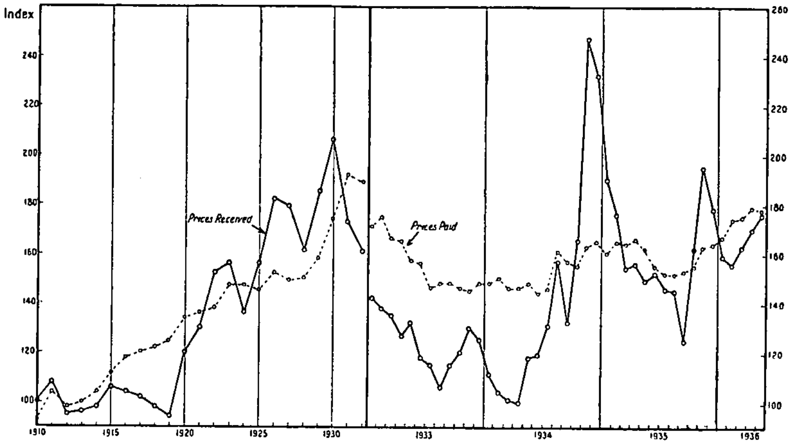

CHART 2. INDEX NUMBERS OF PRICES RECEIVED BY FARMERS, AND OF RETAIL PRICES PAID BY FARMERS, WUCHIN, KIANGSU, CHINA. 1910–14 = 100.

Wuchin, Kiangsu, stood at 176, while the index number of prices paid by them was 178, when 1910–14 prices are 100. If the Chinese Government continues to manage its currency so as to maintain a stable internal level of prices, the relationships between prices received and prices paid by farmers will undoubtedly continue to be equitable. If the currency is not made redeemable in a fixed amount of silver or gold, the Chinese Government can maintain a stable level of commodity prices as long as its governmental powers remain intact.