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MONETARY AND FINANCIAL REORGANIZATION IN NORTH CHINA

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1. The Federal Reserve Bank of China

The unification of currency and the stabilization of the financial system are conditions of primary importance for the economic reconstruction of a state. Upon its foundation in December, 1937, in the 26th year of the Chinese Republic, the Provisional Government of the Republic of China was confronted by the need of adopting some measures for monetary and financial reorganization in North China. Under this pressure, the Government established on March 10, 1938, in the 27th year of the Republic, the Federal Reserve Bank of China and announced its monetary and financial program in a statement issued on that occasion.

Since its establishment, the Federal Reserve Bank has consistently effected various measures for currency unification and financial control in North China in accordance with the provisions of the Federal Reserve Bank of China Act, upon which it was founded. Authorized to function as a central bank, it issued the so-called Federal Reserve notes, which were given the status of sole legal tender. As opposed to this new legal tender, the old notes issued by the banks under the former régime came to be known as the old legal tender notes, whose circulation was subsequently banned in this region except under the conditions set forth in the Old Currency Adjustment Act.

2. *Repudiation of the Southern Notes*

The first measure required in connection with the issue of the new legal tender notes was the disposion of the old notes. Of these notes, however, the so-called northern notes and the southern notes required different methods for their elimination. Various notes enumerated in Articles 2 and 3 of the Old Currency Adjustment Act[1] were originally allowed

1) Article 2: The hitherto circulated Bank of China notes and the Bank of Communications notes (marked on the face there of Tientsin, Tsingtao or Shantung) and the notes of the Provincial Bank of Hopei and the East Hopei Bank can be circulated for one year from the date of enforcement of this act.

The notes specified in the foregoing paragraph shall circulate for the time being at the value of one yüan per one yüan of the legal tender.

Article 3: The hitherto circulated notes of the Central Bank of China and those issued by the Bank of China and the Bank of Communications in the areas other than those specified above can be circulated for three months from the date of enforcement of this act.

Those notes specified in the foregoing paragraph shall be circulated for the time being at the value of one yüan per one yüan of the legal tender.

to circulate at par with the new Federal Reserve notes, but the period of their circulation was restricted in order that they might be retired at the earliest possible date. According to Article 3 of the said act, the southern notes were allowed to circulated only until June 10, 1938, after which they were banned by the Provisional Government.

After the expiration of the stipulated period, there remained in circulation in North China, in accordance with the Old Currency Adjustment Act, only those currencies known as the northern notes, comprising the Central Bank of China notes and the Bank of Communications notes, officially marked Tientsin, Tsingtao and Shantung, and also those issued by the Provincial Bank of Hopei and the East Hopei Bank. Thus all the southern notes as well as other miscellaneous notes that had hitherto circulated in North China were banned from this region as from June 10. The Shantung and the Shansi *piao* will be dealt with later since they were subject to a different set of legal provisions.

3. *Devaluation of the Northern Notes*

The elimination of the southern notes and other miscellaneous bank notes was accomplished in accordance with the process just described. With reference to the northern notes, the Old Currency Adjustment Act provided in Article 2 that their circulation could be prohibited on and after March 10, 1939, in the 28th year of the Republic, one year after the enforcement of the act. The measures adopted in connection with the northern notes consisted of the first devaluation of 10% effected on August 8, 1938 and the second devaluation of 30% on February 20, 1939, or a total reduction in value of 40%. The second devaluation was partly meant as a warning of the impending prohibition of circulation scheduled to go into effect on March 10, 1939. It should be pointed out, however, that, in terms of foreign exchange, the old yüan stood at 8d. as against the new currency which was maintained at 1s. 2d., or a difference of

6d. This exchange rate applicable to the old currency represented a depreciation of about 50% in value. It was reported, therefore, that the 40% devaluation was a somewhat conservative estimate of this difference. The Government decree relative to the second devaluation, which was made public on January 3, 1939 by the Treasury Department, allowed for a notification of 50 days running between January 1 and February 19. The total devaluation of 40% became effective as from February 20, 1939. Despite this devaluation, the year-end period of account settlement observed in accordance with the lunar calendar was passed peacefully without serious disturbance.[2]

In spite of these differences in the value of the two currencies, the relative values which prevailed in the foreign concessions showed that the new currency was at a discount of between 6 and 8 yüan per 1000 yüan of the old currency. This reflected clearly the attitude of non-cooperation taken by the third power banks in China with regard to the new currency, and it became apparent that further measures were necessary to support the Federal Reserve notes.

4. *Prohibition of Contracts in Terms of the Old Currency*

In view of the anticipated completion of the currency unification on March 10, 1939, in the 28th year of the Republic, the first anniversary of the foundation of the Federal Reserve Bank of China, and in accordance with the plan pursued by that bank under the Old Currency Adjustment Act, the Provisional Government issued on February 10, 1939 a law, a decree and a Finance Ministry ordinance. These regulations purported to enforce: (1) prohibition of new contracts in terms of the old currency; (2) conversion of pending loan and deposit agreements into agreements payable in terms of the new currency; and (3)

2) Paul Einzig, World Finance, 1938—9, pp. 151—152

automatic conversion of old agreements left unconverted on and after February 20, into agreements payable in Federal Reserve notes at 60% of the original amount. These rulings represented another legal step taken toward the desired unification of the currency.

5. *Status of the Moratorium*

The currency unification in North China was completed for the most part by March 10, 1939 and the circulation of the old yüan notes was prohibited. One of the problems that arose in connection with this new development was the status of the moratorium that had been enforced in North China mainly on the basis of the Financial Stabilization Law promulgated by the old authorities as soon as armed hostilities began in Shanghai.

This moratorium, the text of which represent a slight modification of the original regulations, was enacted on December 15, 1938, in the 27th year of the Republic, to take effect retroactively as from November 1 of that year, and was calculated to remedy the situation then prevailing, namely, the financial confusion caused by the run on Chinese banks and the anticipated concentration of the deposits withdrawn from these banks in the banks of third powers. After a lapse of a year and a half from the date of original enactment, however, this law was considered to have more or less outlived the conditions which it was designed to remedy. Furthermore, demand for its revocation was gradually gaining strength for the reason that its continued enforcement would make necessary the granting of certain considerations to those who would suffer loss through maintaining deposits in the prohibited currency. There were, on the other hand, some who opposed the proposed move, claiming that the cancellation of this provision might still result in a run on Chinese banks and a consequent financial panic. They argued that even if the moratorium law were left in force, the losses that would be suffered by the depositors would be insignificant if they were given ample time to withdraw their old currency accounts, and that any deposits which might still remain unconverted would probably belonged to a limited number of country land-owners. They favored further extension of the moratorium, recommending that those who still held deposits in the old currency should be urged to trasfer them into new currency accounts in order that they might minimize their losses. These arguments would seem to indicate that the problems concerning the status of the moratorium could be solved as soon as the old currency deposits were converted into new currency accounts. Thus analyzed, the question seemed to hinge almost entirely upon the extent to which the holders of the remaining old currency deposits were likely to cause financial disturbance in North China, and it seemed as though time would eventually provide an easy solution to this problem.

Regardless of whether the moratorium is abrogated or kept in force, however, there remains the general question of the manner in which the old currency deposits are likely to be affected by the repudiation of the old currency. According to the regulations which went into effect on February 10, 1939, placing restrictions on loans or deposit agreements in terms of the old yüan currency, bank deposits in the prohibited currency were assumed to have been converted into Federal Reserve currency accounts. With the disappearance of the old currency notes, therefore, the moratorium ought to be considered as automatically void. Inasmuch as the old currency deposits were repayable, on and after February 20, in Federal Reserve currency at the rate of 60% of the original amount, unless otherwise provided, the moratorium may be considered to have become ineffective on and after that date in so far as it referred to agreements negotiated in terms of the old currency.

6. *Repudiation of the Old Currency*

On March 10, 1939, in the 28th year of the Republic, the first anniversary of its foundation, the Federal Reserve Bank of China made new headway in its currency and exchange control program. These achievements consisted of the prohibition of the old circulation of the old currency and the concentration of foreign exchange in its own hands. Leaving the matter of exchange control for later discussion, let us summarize briefly the measures adopted for the banning of the old yüan currency.

Legally speaking, the prohibition of the circulation of the old currency was accomplished on March 10, 1939 and the northern notes that remained were nominally banned on and after that date. While the currency in North China was thus unified through the issue of Federal Reserve notes and by ban blaced on the old notes, in reality the Federal Reserve notes were unable to force their way into those districts in which order was not yet fully restored. In order, moreover, to prevent the infliction of undeserved losses upon innocent people in the bandit-infested districts, some approporiate measures had to be taken in connection with the Old Currency Adjustment Act. According to the rulings announced on March 8, North China was divided into two general areas, namely, the Federal Reserve Bank districts and the bandit-infested districts. The former comprised the area in which the circulation of the Federal Reserve notes could be enforced in consequence of the proparatory work that had already been accomplished, and a declaration to this effect was to be issued by the commander of the troops garrisoned in each locality. The latter area comprised the remainder of North China.

In the Federal Reserve Bank districts, the circulation of the old currency was made illegal after March 11. In the remaining districts, the ban was to be issued contemporaneously with the restoration of order, by order of the commander of troops in each district, with a notification period of two months, during which the old notes were exchangeable with the Federal Reserve notes at 60% of their original value.

7. *Penalty for the Violation of Financial Regulations*

Along with the promulgation of these regulations which were designed to enlarge the area of circulation of the Federal Reserve notes, the Government announced its intention of Consolidating the new currency to the Chinese public by enacting on March 11 the Law against Financial Disturbances. Police Control Regulations were also issued for the Prohibition of the Old Currency, which were calculated to enforce upon the Chinese the restrictions relative to the old currency by Chinese police organization in cooperation with the Japanese gendarmerie. At the same time, the consular ordinance issued on March 9 warned the Japanese residents in these districts that those who circulated the old currency, or remained in possession of it for the purpose of negotiating it would be expelled or penalized. It was stipulated also that flagrant offences by foreign residents would be severely punished.

Thus every effort was made to consolidate the position of the Federal Reserve notes and to prohibit the circulation of the old yüan notes in the Federal Reserve Bank districts. The foreign settlements in Tientsin proved to be a most serious obstacle to the effective accomplishment of this Government policy. It is true that since the end of 1938 the British authorities in Tientsin, and subsequently the French authorities as well, have shown a more conciliatory attitude by accepting payment of taxes, dues, charges for water and electricity, etc. in terms of the Federal Reserve notes. Nevertheless, this was more an attitude of acquiescence than of active cooperation in support of the new currency. Under such circumstances, it was hardly possible to expect cooperation from the authories of the foreign settlements in Tientsin for the prohibition of the currency. Moreover, it was most difficult to enforce in Tientsin the Law against Financial Disturbance due to the presence of these foreign settlements. In anticipation, therefore, of the offences which were likely to be committed in the British and the French settlements, the Government adopted a most stringent method of making arrests at military inspection station, not only of Chinese but also of Japanese and foreigners who were in possession of the illegal notes.

8. *Disposition of the notes of the Provincial Bank of Hopei and of the East Hopei Bank*

On March 10, 1939, the first anniversary of the Federal Reserve Bank of China, the period of notification provided in the Old Currency Adjustment Act expired, and in accordance with tne stipulation of Article 2 of that act, the ban was placed on and after March 11 on all the old currency notes that had circulated in North China, including those issued by the Provincial Bank of Hopei and the East Hopei Bank. In consideration of the fact, however, that these two banks had been in collaboration with the central bank and that their notes had been given a similar status as the new legal tender, it was arranged that their notes should be allowed to remain in circulation in the Federal Reserve Bank districts at par with the Federal Reserve notes for a further period of two months beginning March 11, and in the bandit-infested areas from the date on which the declaration might be issued. Furthermore, during the two-month period in question, these notes were made exchangeable at par with the new legal tender notes as in the case of the old yüan notes.

The right of note issue that had been exercised by the above-mentioned two banks was transferred to the Government in the form of purchase, and the banks were offered by the Federal Reserve Bank loans equal in amount to the notes redeemed by the latter during the two-month period. It was reported that the total issue of the Provincial Bank of Hopei and the East Hopei Bank amounted, respectively, to approximately 65 million yüan and 8.5 million yüan. Incidentally, the period of notification expired in the Federal Reserve Bank districts on May 15, but was extended twice, each time for a further period of two months.

9. *Disposition of the Shantung and Shansi Piao*

It has been shown that in accordance with the Old Currency Adjustment Act, all the old bank notes, excepting the northern notes and those of the Provincial Bank of Hopei and the East Hopei Bank, were banned three months after the date of promulgation of the said act. It has been mentioned also that the so-called Shantung and Shansi *piao*, comprising the notes issued by the Shuntung People's Bank, The Shansi Provincial Bank, the Bank of Local Railways of Shansi and Suiyuan, The Sui-Hsi Farmers' Bank and the Tsinpei Salt Bank, were subject to different rulings as set forth in the Proviso to Article 4 of the Old Currency Adjustment Act.[3]

These latter currency notes required different treatment from the others due to the non-existence of civil order in the area of their circulation and to the lack of the records of the issuing banks. The proclamation issued in connection with these notes read in part as follows: "The subsequent inquiry has revealed the fact that the resources of these banks were extremely slender and that due to their long dormancy, there is no prospect of their re-opening for business in the near future. Under the circumstances, it is out of the question that their notes should be exchanged with Federal Reserve notes at par. In view of the fact, however, that the loss to the general public that may result from the reduction of these notes to their actual values would seem excessive it has been determined that they shall be exchanged with the legal tender at values to be separately announced." Under this proclamation, there was announced on January 31, 1939 an Ordinance regarding Currency Adjustment under

3) Article 4: Of the hitherto circulated currency notes, those which are not mentioned in Articles 2 and 3 of the Act shall circulate for a period of three months under provisions set forth in the preceding article. However, the notes issued by the Shantung People's Bank, the Shansi Provincial Bank, the Bank of Local Railways of Shansi and Suiyuan, the Sui-Hsi Farmers' Bank and the Tsinpei Salt Bank are subject to separate regulations.

the Proviso to Article 4 of the Old Currency Adjustment Act, in which the Government announced its policy for the disposition of these bank notes.

It was determined that the Shantung and Shansi *piao* were to be handled on an equal basis with the northern notes, being acceptable until February 19 at 90% of the original value and thereafter at 60%, and until their circulation should be entirely prohibited on March 10. In consideration of the fact, however, that the total amount of the Shansi notes in circulation reached some 20/25 million yüan and that the period prior to the enforcement of the ordinance was exceedingly short, the Provisional Government later announced, for the benefit of lawful citizens, that until March 10, these notes were to be exchangeable with Federal Reserve notes at 90% of the face value. It was reported that the total amount of the Shantung People's Bank notes that then in circulation would reach approximately 8 million yüan. The small-denomination notes will be dealt with in the next section together with all other such notes circulated in North China.

10. Disposition of Notes of Small-Denomination and Coins

Article 5 of the Old Currency Adjustment Act stipulated that notes of less than 1 yüan in denomination and coins were subject to different rulings to be announced later. The Minor Note and Auxiliary Coin Adjustment Act promulgated on May 31, 1938, in the 27th year of the Republic, permitted the circulation of these madia of exchange for a period of three years from the date of enforcement, namely, June 1, 1938. All new issues of minor denomination notes by banks other than the Federal Reserve Bank, however, were prohibited. While some 30/40 million yüan of these minor currencies were estimated to be in circulation, many of the small denomination silver notes subsequently disappeared from the market to be replaced after June 1, 1938 by 10, 20 and 50 cent notes issued by the Federal Reserve Bank. Although there remained also in circulation copper coin notes of the Provincial Bank of Hopei issued in the name of the Hopei Metropolitan Bank, these were not subject to the provisions of the above-mentioned act (Article 5).

The coins that still remain in circulation today comprise the 5, 10 and 20 cent nickels and the 1/2 add 1 cent copper coins issued by the East Hopei Bank, Japanese and Manchoukuo coins, and the 5 cent coins of the Mêng Chiang Bank. Old Chinese copper coins are no longer to be seen in the market having been replaced by the 1/2, 1 and 5 cent notes of the Federal Reserve Bank.

The first and the second devaluations of 10% and 30%, respectively, enforced upon the old yüan currency on August 8, 1938 and February 20, 1939 were also applicable to notes of minor denomination and coins but the exception granted to the Provincial Bank of Hopei and the East Hopei Bank notes were recognized in connection with the minor currencies of these banks as well, which were allowed to circulate at par with Federal Reserve Bank notes. The Old Currency Adjustment Act (Article 4) does not make any stipulation with reference to minor currencies issued by the Shansi banks and the Shantung People's Bank. But the ordinance issued under this act on January 31, 1939 regarding the Shantung and the Shansi *piao*, rendered these currencies legal until May 31, 1941, in the 30th year of the Republic, along with other similar coins and notes issued in North China. Incidentally, these small denomination notes were legal tender until February 19, 1939, in the 28th year of Republic, at 90% of the face value, and thereafter at 60%. As for the minor currencies in Shansi, it may be assumed that in view of the peculiar conditions prevailing in these districts, they were subject to a devaluation of 10% until March 10 and of 40% thereafter. Due to the lack of conclusive data, however, it is impossible to arrive at any accurate judgement as to the interpretation of Article 2 of the Ordinance Relative Minor Denomination Currency.

11. Completion of the Old Currency Adjustment

The foregoing discussion indicates the steps that have been taken to realize the condition set forth in the Old Currency Adjustment Act of March 10, 1938, in the 27th year of the Republic. It has been noted that, of the various old yüan notes in circulation, the southern notes and the miscellaneous notes were withdrawn from circulation within three months of the abovementioned date, and that the northern notes, with the exception of the notes of the Provincial Bank of Hopei and the East Hopei Bank, were banned as indicated. The Shantung and the Shansi notes were subsequently withdrawn and auxiliary currencies of less than 1 yüan denomination were also included in a definite schedule for eventual elimination.

The program for currency unification in North China through the issue of Federal Reserve Bank notes thus reached the end of its first stage, namely, the exclusion of the old currency. The second stage of the program, which has since been in operation, consists of the reorganization of the financial structure on the basis of a unified currency. What, then, are the policies under which the Federal Reserve Bank pursues its monetary operation at this stage of its financial program? These policies may be said to consist or a further consolidation of the Federal Reserve notes, a reorganization of the system for the control of Chinese banks, immediate concentration of exchange in its own hands and a reorganization of the bank's own internal economy with a view to facilitating the successful performance of these functions. Having reviewed in the preceding section the program for the introduction of the Federal Reserve notes as a domestic currency and the elimination of the old yüan notes, we shall now proceed to a discussion of the progress that has been achieved by the Federal Reserve Bank in connection with exchange control.

II. MEASURES FOR CONTROLLING FOREIGN EXCHANGE

1. Establishment of Foreign Exchange Fund

A further important measure required to secure the consolidation of the new legal tender in conjunction with monetary unification was the concentration of foreign exchange in the hands of the Federal Reserve Bank and allocation to the legal tender of privileges of convertibility into foreign currency. Toward this end, the Federal Reserve Bank, on October 5, 1938, in the 27th year of the Republic, set up a foreign exchange fund by setting aside a portion of its foreign currency balances. Subsequently, the bank endeavored to utilize this fund on behalf of the " link trade ", at a fixed rate of 1s. 2d. per yüan, in competition with the trade in the old legal tender operated from Tientsin. This preliminary effort, however, proved ineffective in preventing the flow of commodities into the old currency market and the concentration of export business in foreign banks, with the consequent monopoly of import business with third powers by foreign merchants. The foreign trade control exercised in Tsingtao also proved to be ineffective due to geographic limitations, as trade activities were carried on in foreign settlements or other localities which lay beyond the reach of restrictive regulations. Under the circumstances, the need for a more stringent control of foreign trade activities was felt for some time.

2. Concentration of Exchange upon Twelve Commodities

It was on the occasion of its first anniversary that the Federal Reserve Bank of China determined to adopt more stringent measures of exchange control. Its policies in this respect were indicated in detail in the statement issued at the time President Wang, who, in referring to the efforts made to secure currency unification, remarked that : " With reference to the exchange values of the legal tender, we are gratified to note that the bank has successfully pursued to Government's policy of maintaing it at parity with the Japanese currency. Regarding its exchange values with other currencies, efforts have been made to increase, first of all, foreign currency reserves, with a portion of which a exchange fund was set up to enable the legal tender to function as a foreign trade currency. As a sequel to this step, it has been determined that a new ruling shall be put into effect on March 11, requiring export business in certain stipulated products of North China be concentrated in this bank. It is superfluous to state that this requirement, together with an equilibrium in international trade balance, will become a most important factor in the stabilization of the value of the legal tender and its exchange rate at 1s. 2d."

The proposed plan for foreign exchange concentration, designed to enhance the external value of the legal tender, was put into effect on March 11, 1939. On the preceding March 2, there was issued a maritime customs notice regarding the passage of goods through customs for exportation and trans-shipment, and a Federal Reserve Bank notice regarding the enforcement of these regulations. The customs notice specified that in clearing the designated goods through customs, the exporter should present a certificate of the sale of exchange approved by the Federal Reserve Bank, or an export permit issued by the supervisor of maritime customs. The Federal Reserve Bank notice, on the other hand, included regulations covering the sale of exchange for import business, which stipulated that the entire proceeds of exports had to be applied to payment for imports into North China. The commodities which were placed under this rigid control comprised the following twelve articles specifically mentioned in the customs announcement.

Eggs and egg products, walnuts (including those in shells), peanut oil, peanuts, apricots, cotton seed, leaf tobacco, vermicelli and macaroni, coal, woolen carpets (including wool-and-cotton textiles and carpets), straw braids, and salt.

It should be noted that, in addition to these twelve commodities, there were certain varieties of goods such as iron, raw cotton, and wool, which, while being free exports, were nevertheless placed under control by a special Government ordinance.

The procedure to be followed for the export and import of these commodities can be briefly summarized in the following manner.

(1) In case the specified goods are to be exported, or shipped to Central or South China for exportation, (a) to any place other than Japan and Manchoukuo, unless a permit is obtained from the supervisor of maritime customs for exportation without negotiation of relative documents, exchange covering the entire and exact amount of the goods expressed in terms of foreign currencies, other than the Japanese, the Manchoukuo, or the Mêng Chiang Bank currency, must be sold to exchange banks in North China against the Federal Reserve notes at a rate higher than 1s. 2d. or the equivalent in other foreign currencies. (b) In case of exportation to Japan or Manchoukuo, exchange covering the entire amount of the goods in terms of the Japanese or the Manchoukuo currency (or the Federal Reserve currency) is to be sold at par to exchange banks in North China against the Federal Reserve notes. Except with the permission of the supervisor of maritime customs, exchange sold under the foregoing requirements must be collectable abroad or in Central or South China within five months of the shipment.

It was imperative, therefore, that when exporting the exporter should present to the customs officials a certificate approved by the Federal Reserve Bank showing a sale of exchange or a customs permit for shipment without negotiation of documents. In so far as the above-mentioned commodities were concerned, this ruling enabled the Federal Reserve Bank to concentrate all export exchange in its own hands.

(2) The sale of exchange for import business was subject to the following general principles. On receipt of applica-

tions from exchange banks for the sale of foreign exchange to cover sales to their own clients, the Federal Reserve Bank was required to sell to them (a) exchange on Japan or Manchoukuo, in case their sales were in the currency of either of these countries, and (b) English or American currency when their sales consisted of exchange on any other country. Each exchange bank, however, could purchase from the Federal Reserve Bank foreign exchange in any particular currency to the extent to which it (and its other offices in North China) had sold to the latter foreign exchange in the same currency. The importer, who had purchased from any exchange bank foreign exchange supplied by the Federal Reserve Bank, was required to supply all the pertinent information required by the central bank and also to present to the latter a customs certificate of importation as soon as the necessary formalities had been completed.

The amount of foreign exchange to be supplied by the central bank to ordinary exchange banks in connection with import business, was limited to the extent to which the central bank had purchased export exchange from these banks. This stipulation is accounted for by the fact that the concentration of foreign exchange in the hands of the central bank was designed, not only to accumulate foreign exchange funds, but to facilitate the supply of imported materials required for construction work in North China.

The twelve commodities which were placed under exchange control consisted of staple foreign products of North China. While there were critical comments in certain quarters to the effect that the selection of these commodities was made from a list of products which were under the monopoly of foreign merchants, it was apparent that in this selection a certain amount of care had been exercised to mitigate to the shock that might presumably be felt by foreign interests.

In its initial stage, foreign exchange control aimed solely at the utilization of export proceeds as import funds without placing any restriction on imports. However, in view of the need of developing North China and of rendering secure the living conditions of the people in this area, the central bank, prior to the enforcement of exchange control on March 11, published a preferential list of commodities with respect to which it offered to facilitate the sale of exchange, and asked the public for support for its policies. In enforcing this exchange control, the Federal Reserve Bank reorganized its procedure and established a foreign exchange department at its head office in Peking with branch departments in Peking, Tientsin, Tsingtao Yentai, Weihaiwei, Chinan and Shichiachuang, all of which handled exchange business.

The system of exchange control, which went into effect after these preliminaries failed to enlist support of foreign banks and merchants partly because they misconstrued the regulations and partly because they feared a disruption of their export business. This attitude of non-cooperation, however, was due largely to political reasons. Economically, the system was subjected to criticism because of its unfavorable effect on commodity prices in North China. While the exchange value of the legal tender was maintained at a fixed rate of 1s. 2d., commodity prices were determined for the most part by the exchange rate of the old yüan currency which stood at 8d. The efforts of the Federal Reserve Bank to control exchange were inaugurated in October, 1938, when the bank set up a foreign exchange fund as a means of promoting foreign trade under the link system. In this early stage, a good deal of difficulty was experienced in controlling exchange and direct transactions, on the one hand, and in maintaining, at the same time, an exchange rate of 1s. 2d. The new exchange control system, which was put into effect after these rather unsuccessful preliminaries was calculated, not only to augment the foreign currency balances of the central bank, but also to render these balances available in negotiating payment for imported materials, inasmuch as the system was strictly applicable only to the twelve commodities previously mentioned. Nevertheless, subsequent developments made it clear that some corrective measures would have to be adopted to overcome the discrepancy involved in the dual exchange rate, namely, 1s. 2d. for the new legal tender and 8d. for the old.

3. *Premium on the Old Currency*

While the exchange concentration schedule covering twelve commodities was duly put into effect on March 11, the recession of the old currency did not take place as readily as had been anticipated. On the contrary, the old currency continued to command, in the foreign settlements in Tientsin, abnormally high premiums, which at one time rose as high as 500 yüan per 1,000 yüan of the old currency. This state of affairs was due partly to the deflation of the old currency. More essentially, however, this situation must be attributed to the following considerations: (1) that in view of exchange concentration, foreign banks began to release a smaller amount of the old currency notes than previously, demanding at the same time payment for import exchange and remittances in terms of the old currency, and (2) that in selling remittances on Shanghai, the Bank of China and the Bank of Communications also insisted upon payment in the old currency.

There were several other reasons which also accounted for the abovementioned situation. These consisted (1) of a heavy demand for the old currency due to the approach of the marketing season for millet and kaoliang and to the purchase of cotton from towns in inner China; (2) to the prevalence of a rumour that heavy exports of wheat were shipped to Manchoukuo because of a shortage of stocks in that country and the consequent bulling by importers ot the old currency as import funds; (3) to increase in imports resulting from the insecurity in the European situation and the general tendency to convert money into commodities; (4) to propaganda put out by foreign banks with reference to the Federal Reserve Bank announcement made at its general meeting in connection with its foreign currency reserve; and (5) speculative manoeuvers undertaken to secure the depreciation of the legal tender in connection with these various developments. One of the most significant results of this disparity between the two currencies was an advance in the price of commodities in general, and of cotton yarns and cloths, flour and other staple products in particular (prices in Tientsin were said to be about 40% higher than in Shanghai), and the consequent northward flow of these commodities.

In the Federal Reserve Bank districts also, there occurred an inevitable rise in the prices of such commodities as cotton yarns and cloths, dyestuffs and wheat, and concomitant advances in the retail prices of daily necessities in general. This, together with the cessation of the sale of tobacco by the British and the American tobacco trusts, presented a serious threat to the life of the masses in North China. Regardless of whether one considered such high premiums as abnormal, or denied the existence of currency inflation, it was an indisputable fact that the situation called for the immediate adoption of corrective measures. Inasmuch as there were those who believed that the value of the new legal tender had depreciated, its consolidation was seen as an urgent necessity.

4. *Rise in Commodity Prices*

It has been explained that the effort of the Federal Reserve Bank to stabilize commodity prices in North China at the 1s. 2. level was directed along two different avenues, namely, the exchange control inaugurated in 1938 by the establishment of an exchange fund, and the commodity control imposed upon export materials. Prior to the adoption of the exchange concentration measures, however, the realities of the situation were such that commodity prices in these regions were more or less governed by the exchange value of the old currency quoted at 8d. While this situation was remedied so far as the twelve commodities were concerned, there remained certain difficulties which could not be obviated until the control was extended to include all export commodities. These difficulties began to reveal themselves contemporaneously with the political conflicts that ensued in connection with the old currency. The raising of the exchange rate from 8d. to 1s. 2d. was a measure unfavorable to export trade, and resulted in an inevitable and corresponding decrease in imports. While a healthy export trade necessitated low domestic prices, the decrease in imports gave rise to high commodity prices which conflicted with the interests of the parties concerned, and the holders of the Federal Reserve notes were naturally compelled to bear losses. In the face of such disadvantages, foreign banks and merchants refused to cooperate with the Federal Reserve Bank and the conflicts between the forces that supported these two currencies were inevitably brought to the surface. Thus, because of the presence of the foreign settlements in Tientsin, the old legal tender actually commanded a more dominant position as a foreign trade medium than the new currency.

In seeking to consolidate the position of the Federal Reserve notes, in the face of these adverse circumstances, nothing short of the retrocession of the foreign settlements or the blockade of the port of Tientsin seemed at all adequate. These, however, were projects which could only be carried out by means of essentially political manoeuvers. An alternative method, though necessarily of a privisional nature, was the unrestricted sale and purchase of Federal Reserve notes against the old currency at par in connection with the import and export of all commodities, except the twelve articles previously mentioned. This method, however, could only succeed if the Federal Reserve Bank permitted unrestricted sale of foreign currency. Otherwise, it would defeat its own ends by attracting only import business to the central bank, while export business would go entirely to foreign banks. Under these circumstances, it was a foregone conclusion that the 1s. 2d. exchange rate should be enforced to cover all exports to third powers.

5. *Extension of the Exchange Concentration System*

In the foregoing discussion, we have traced the course of events which led up to the enforcement of a more drastic measure, namely, an extension of the exchange control of exports—probably the most readily accessible method under the circumstances. As for the degree of extension, those on the field strongly recommended the extension of control to all exports. It was their opinion that while, from the domestic point of view, the old currency might be banned on and after March 11, externally it still remained as a dominant foreign trade currency, except in so far as the twelve restricted commodities were concerned, and that the proposed extension would remove this dual aspect of the old currency and the political influence that supported it in the foreign settlements, thereby eliminating its circulation externally as well as internally. The only drawback to this proposal which was anticipated was the shrinkage of the export trade of North China with third countries. It was reported in some quarters, however, that past experience in controlling export exchange would not warrant such a pessimistic outlook.

Various investigations conducted in connection with the proposed measure led to the conclusion that the supply of materials from Japan should be augumented and that the exchange control should be extended so as to cover all exports. The only questions raised in this respect were as to the steps which Japan might take to reconcile her conflicting policies of supplying materials to North China while seeking to increase her foreign currency balances, and the practical measures for lowering commodity prices in order to deprive the old currency of its convertibility into foreign currencies and concurrently replacing it by the Federal Reserve currency. It was argued that import control was a corollary of effective exchange concentration and that adjustment of international receipts and payments was not possible unless items of invisible trade were similarly regulated. In still another respect, it was important to consider the effect of foreign trade control upon the manufacturers of exports and, in general, the methods of preventing decrease in imports.

With these problems in mind, the plan to accord to the Federal Reserve Bank notes convertibility into foreign currencies was conceived as an extension of exchange control to all export commodities. This decision was announced by President Wang of the Federal Reserve Bank on July 6, 1939, in the 28th year of the Republic, and was put into effect on July 17. Inasmuch as the new measure was nothing more than an extension to all export commodities, of the exchange control that had already been enforced upon twelve articles, it was essentially though not absolutely similar to the previous regulations. With respect to all export or shipment to Central and South China, while it remained necessary, as in the past, to present a certificate of sale of exchange approved by the Federal Reserve Bank or a permit for export negotiation of relative decuments issued by the supervisor of maritime customs, in certain instances where drawing on exports or application for export permit was considered unnecessary, exceptions were to be granted involving a remission of required formalities. Such exceptions were recognized as applicable in the following cases: (1) when exporting goods totalling less than 100 yüan in value (although the twelve commodities previously mentioned were subject to the control regardless of values); (2) in the case of traveling supplies and household goods in transit; (3) in the case of shipping supplies such as fuel, provisions, tools, etc., required by the boats on which they were carried; (4) in the case of commodities of a perishable native such as vegetables, fruits, fish, etc.; (5) in the case of books; (6) in the case of paintings and examples of calligraphy, not including antiques; (7) in the case of newspapers and periodicals, and (8) in the case of packing materials frequently in transit. It was apparent that these exceptions were provided for the benefit or small-scale traders and manufacturers. Whether certain specific lots should be subject to free exportation was to be determined by the customs house upon examination.

Another point at which the new regulations differed from the old was as regards the limit within which import exchange was to be provided. That is to say, exchange for import business was to be granted up to 90% of exports, the remaining 10% being for extra-trade purposes. For example, legitimate remittances by foreign residents for such purposes as the support of their families could be purchased within this 10% limit under permit issued by the head office of the Federal Reserve Bank. It was thus stipulated that those who wished to remit funds in support of their families residing abroad be allowed to do so within the minimum limit, 10% of export proceeds being reserved for this particular purpose.

It was provided also that those who sold export exchange in the Mêng Chiang districts could clear export through any North China maritime customs free of restriction. Under this stipulation, the Mêng Chiang districts, which are under independent political authorites, are enabled to hold foreign currency balances independently against exports from these districts.

Similarly as in the case of the previous exchange regulations, the methods of the new exchange control were made public by a maritime customs notice and a Federal Reserve Bank proclamation, the former announcing the procedure necessary for export or shipment, and the later for import. No exportation of goods was permitted without the sale of relevant exchange, unless permitted by the supervisor of maritime customs or by the provisions of the exchange control regulations. In clearing the goods through the maritime customs, it was necessary to present either a certificate of sale of exchange approved by the Federal Reserve Bank or an export permit issued by the supervisor of maritime customs. Other provisions such as those relative to (1) the sale of exchange at 1s. 2d. for export to countries other than Japan and Manchoukuo, and (2) the sale of exchange at par for export to the last-mentioned two countries; were essentially the same as in the earlier regulations.

With reference to import transactions, exchange banks are authorised to apply to the Federal Reserve Bank for a sale of import exchange in cover of their own sales to clients. On receipt of such an application, the central bank sells (1) yen exchange, in case the original sale of the exchange banks consists of exchange on Japan or Manchoukuo, and (2) pounds sterling or American dollars in case the sales consist of exchange on other countries, subject to the limit of 90% of the export exchange which the central bank has purchased in the past from each bank in the respective currencies. The importer has who has purchased exchange under this procedure is required, as he was under the old regulations, to submit the necessary report, or clearance certificate, to the central bank. The only new element in the regulations consists of the following stipulation, which is a corollary of the 90% restriction placed upon the sale of import exchange.

Upon receipt a request from exchange banks to sell exchange in cover of their own sales to clients under remittance permit issued by the Finance Ministry (this power being assigned temporarily to the President of the Federal Reserve Bank), the central bank is allowed to sell (1) yen exchange in case the original sale of the bank making application was on Japan or Manchoukuo, and (2) pounds sterling or American dollars in case the original sale was in other foreign currencies, subject to the limit specified in the permit, and in accordance with the prescribed procedure.

In connection with the enforcement of these new regulation, the Provisional Government has declared its intention in a statement issued regarding the plan for the completion of the exchange control system. The statement reads in part, " the present measure is no more than an application of the export exchange concentration system on a wider scale. It does not deviate from the past policy of the Government of giving equal privileges alike to natives and foreign nationals who accede to these regulations, nor does it involve discrimination of any kind whatsoever. It is specifically understood that all legitimate and lawful contracts now pending shall be given as much fair consideration as is possible under the circumstances. It has been the desire of the Government to let the Federal Reserve currency function not only as a medium of foreign trade, but also for extra-trade purposes. In fulfillment of this desire, an arrangement has been made, in extending the exchange concentration system, whereby a portion of export proceeds is made available for payments for such extra-trade purposes, such as remittances of funds by foreign nationals to their families residing abroad. This particular provision will undoubtedly benefit those foreign nationals who are resident in the North China districts."

It has been indicated that the exchange control measures originally designed to control some twelve commodities were extended to include all exports. What, then, is the status of imports? In the above-mentioned statement, the Government announced that "in view of the fact that exchange control is now enforced upon all exports, the provisional list of preferential imports has been enlarged to a considerable extent so as to include materials necessary for the development of North China and practically all important daily necessities. Importers are requested to cooperate with the Government, and to select their imports from this list as far as possible." Simultaneously with this statement, the Government issued a list of preferential imports, which comprised some 95 commodities. While this measure was adopted in consideration of the effect that might result from the extension of exchange control upon all exports, it merely requested the voluntary cooperation of importers without formulating compulsory restrictions. Hence the problems of import control have still to be solved in the future.

The monetary program of the Federal Reserve Bank involving the old and the new currencies was brought to its last stage, at least for the time being, by the enforcement of the new exchange concentration system. Nevertheless, the conflict between the two currencies remained unsolved on account of the existence of the foreign settlements in which the old yüan notes remained in circulation. Internally, moreover, monetary unification was not completed because of the presence of the districts in which the new currency had failed to make headway on account of civil disorder, despite the fact that it was declared to be the only legal currency after March 11. Under the circumstances, more stringent measures had yet to be enforced for the purpose of enhancing the status of the new legal tender and of rendering it an important factor in industrializing North China and stabilizing the life of the people.

6. *Consolidation of the Federal Reserve Notes*

It is now possible to suggest several methods that could be and ought to be adopted in order to enlarge the area of circulation of the Federal Reserve currency and to enhance its exchange value. These methods may be briefly summarized.

Consolidation of the position of the new legal tender in North China is an urgent need which requires full cooperation from various quarters. The policies that guided the activities of those in the field were established along the lines (1) of encouraging economy among the Japanese and Japanese institutions working in those districts; (2) of restricting the number of visitors and travelers in North China; (3) of restraining them from reckless spending; (4) of restricting imports from third countries on the part of Japanese remaining in the area, etc.

There was enforced on August 3 the Curreny and Foreign Currency and Foreign Curreny Control Law, which restricted the amount of currency that could be carried into the district without permit from 1,000 yen to 500yen. While this regulation was of doubtful effect in consolidating the new currency, its psychological effect was considered to be by no means negligible. Incidentally, the recent increase in the volume of the Federal Reserve note issue is probably indicative of the steady penetration of the currency into the more remote districts of North China. At the same time this situation calls for a deflationary measure in order to prevent the rise of commodity prices. While this problem is still under consideration by the authorities concerned, it has been reported that the Government is contemplating the issue of *tsai piao* (lottery tickets) in the near future, with a view to securing deflation and increasing its revenues.

Another problem which is discussed with most serious concern today is the question of adjusting the demand and supply of commodities and of lowering commodity prices, both of which have been seriously deranged by the recent flood in Tientsin. In order to achieve a more or less permanent policy in these respects, the Government has established the North China Commodity Price Adjustment Committee by combining the Temporary Relief Committee and Transportation Control Committee, both of which were organized at the time of the flood. This committee it is reported is to be a permanent body with three sub-committees for the adjustments of commodity prices, the supervision of the demand and supply of commodities, and the control of transportation; with the added duty of organising plans for North China in general.

As for the commodity mobilization plan in North China, a progressive project is said to be in preparation, dealing with the expansion of productivity and the development of district with a view to securing economic selfsufficiency in North China. The commodity mobilization plan on which a final decision is expected in February, 1940, is said to include a definite program dealing with the problems of import control, of which mention has been made elsewhere in this treatise.

7. *Regulation of Financial and Trade Relations with Central China*

Thus far, as we have seen, the monetary and financial program in North China has made steady progress, under the direction of the Federal Reserve Bank of China. By March 10, 1939 the first step of eradicating the old currency was brought to a more or less successful conclusion under the Old Currency Adjustment Act. The second step consisted of provisional enforcement, subsequent to this date, of exchange control involving twelve commodities, which provision was thereafter extended on July 17 to include all exports from North China. Thus to all appearances, the old currency notes were banned from the region, but in reality they remained hoarded either in the foreign settlements or in the bandit-infested areas, or they found their way into Southern China. Therefore, the old currency still remained in the region and competition with the new currency continued.

With the steady shrinkage of the areas of civil disorder and the concurrent expansion in the districts in which the new currency freely circulates, the exchange concentration system will place increasingly larger exports under control, eventually eliminating the dual exchange rates. However, the progressive unification of the exchange rate at 1s. 2d. will result in an increasing isolation of Central China, which has been placed in the same status as the third powers. In Central China, the Hua Hsing Commercial Bank established on May 1, 1939, began to issue Hua Hsing notes. These notes, however, did not enter into competition with the old yüan notes, being designated merely Hua Hsing notes instead of being referred to as the new legal tender. Furthermore, at first, the new currency was put into circulation in order to take advantage of the position held by the old currency (until it severed its relation with the latter on July 19). It was only natural, therefore, that Central China, in which the new notes were intended to function as the principal foreign trade currency, should be clearly separated from

North China, wherein the currency was unified under the Federal Reserve notes, to the exclusion of the yüan notes. In other words, the Federal Reserve notes were linked with the yen currency, while the Hua Hsing notes were not; hence there was no connecting link between the two currencies. This separation of the two currencies took place on June 10, 1938, when the flow of the old currency between the two districts was prohibited in North China. The cessation of monetary relationship between the two areas made it inevitable that North China should regard the other area in the same light as third powers, in so far as the flow commodities between the two areas was concerned, and that this fact should contribute further to the fall of the exchange rate. Inasmuch as the monetary measures adopted in North China were designed merely to unify the currency and not to isolate the region from Central China, the separation referred to made it necessary to adopt some measure for the reinstatement of financial and trade relationship between the two. Thus the situation gave rise to the question as to how the flow of commodities between the two areas could be adjusted. Subsequently, negotiations for an exchange agreement between the Federal Reserve Bank and the Hua Hsing Commercial Bank were inaugurated and a plan for linking the two currencies, which were maintained at 1s. and 6d., respectively, was decided upon at the sixth joint conference held toward the end of last September. The plan in question was prepared by the Hua Hsing Commercial Bank at the instructions of the Reconstruction Government, and preparation is being made by the two Governments concerned for the discussion of the plan at the seventh joint conference.

In exploiting the resources whether of North China or of Central China the aim is not destruction but the establishment of a new Asiatic order. Therefore, while it is inevitable that certain maladjustments should come to light in the course of this undertaking, they must be eliminated, no matter what the cost, for the new order must be established upon a solid foundation.