

# Legacies of Definancialization and Defending Real Economy in China

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## People's Lives and Property

Confronting the triple trap of the COVID-19 pandemic, economic downturn, and ecological crisis, the Chinese leadership has reiterated that “China puts the people’s interests first – nothing is more precious than people’s lives.” This kind of people-centered governance philosophy is ostensibly meant to protect the lives and health of the people, while defending people’s property under the basic system of collective ownership. Since 1949, China has struggled to maintain its national sovereignty over land resources and the financial system through policies of capital control and definancialization. Historically, China has practiced financial containment and control of speculative capital for about forty years. China has integrated itself into the world economy and to a certain degree into Western-dominated financial institutions since the 1970s. It has gradually relaxed or removed some of the limits on foreign banks, insurers, and money management firms. China approved the establishment of more than one hundred foreign banking and insurance institutions in the country, such as Allianz, Cr dit Agricole Corporate, BlackRock, and Schrodgers. However, it has never relinquished its goal of capital control and its financial opening is comparatively limited. Foreign investors who want to enter China’s domestic capital market are subject to strict control. Qualified Foreign Institutional Investor is allowed, but its quota has a very small value. Foreign capital is not yet predominant in China’s domestic capital market.

On March 2, 2021, in a news conference on the development of banking and insurance held by the State Council, Guo Shuqing, party secretary of the People’s Bank of China and the China Banking and Insurance Regulatory Commission, claimed that

it is inevitable to see foreign capital inflows. For now, the size and speed of foreign capital inflows remain controllable.... Foreign-funded institutions generally observe Chinese laws in their operations. The amount of their

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total assets, loans and deposits in the Chinese market is on the rise, but the proportion is in decline. For example, foreign-funded banks now account for only 1% of China's banking industry, down from 1.3% and 1.4% before. Their market competitiveness is limited.<sup>1</sup>

At the Boao Forum on April 19, 2021, Fang Xinghai, vice chairman of the China Securities Regulatory Commission and member of the China Securities Regulatory Commission Party Committee, stated that foreign investment in China's stock markets started to rise rapidly after their shares were included in the MSCI and Financial Times Stock Exchange indexes. However, the proportion of foreign holdings in Chinese stocks currently stands at 5 percent. Moreover, foreign investors in Chinese listed companies are still subject to a 30 percent ownership cap and have limited derivatives tools at their disposal in Chinese markets.<sup>2</sup>

China owns the largest financial capital firms in the world. Among the top ten banks globally, according to Tier 1 capital, the top four are China's state-owned banks: Industrial and Commercial Bank of China, China Construction Bank, Agricultural Bank of China, and Bank of China. JPMorgan Chase, Bank of America, Wells Fargo, and Citigroup come after.<sup>3</sup> The Chinese state, as the largest shareholder, controls and manages the bank operations. Hence, China's large financial institutions are organized on a similar basis to its large state-owned industrial enterprises. All of them are headed by leading member groups of the Communist Party of China (CPC).<sup>4</sup> As Guo Shuqing explained, "to integrate the leadership of the Party into corporate governance, we should guarantee the Party's role at the core of leadership through mechanisms like cross appointment and the integration of intra-Party supervision into corporate regulations."<sup>5</sup> To a large extent, a leading member group of the CPC is obliged to ensure that the state-owned institutions play the role of social enterprises serving public interests and strengthening the real economy (that is, the nonfinancial sector), which can thereby largely guarantee people's employment and livelihoods.

A research report disclosed that 90 percent of banks' profits went back to the real sector. In 2019, listed banks made ¥1.7 trillion of net profit, 87 percent of which (¥1.2 trillion of supplementary capital + ¥280.9 billion of financial dividends) was returned to the real entities. It contained two parts. First, the big portion (¥280.9 billion) of dividends was distributed to state-owned shareholders (including the finance department, social security fund, and state-owned enterprises), which eventually acted as fiscal spending to the real economy. The smaller portion (¥206.9 billion) was distributed to nonstate shareholders and ultimately went to citizens. Second, retained capital indirectly supports the real sector by leveraging credit and bond purchases to the real sector again. Based on the core Tier 1 capital adequacy

ratio of 10.9 percent, the capital of ¥1.2 trillion can support the issuance of enterprise loans of ¥10.9 trillion.<sup>6</sup> As Andrew Sheng, a former central banker and financial regulator, elaborated, “China uses state-owned enterprises to implement long-term goals, such as modernisation of infrastructure, job stability, regional development and provision of social utilities.” A review of forty years of Chinese state-owned enterprises’ performance has found that they operate more like social enterprises, and are not wholly for profit.<sup>7</sup>

Recent banking rules have not only strictly restricted how much money foreign banks can transfer into China from overseas, but also required many foreign banks to make fewer loans and sell off bonds and other investments. Moreover, domestic and foreign banks were ordered to limit their balance sheets to show only slight growth from last year. This was because China had loosened limits on foreign purchases of bonds, and many foreign banks had been buying more bonds for sale to foreign customers, expanding their balance sheets. Foreign investors had increased their holdings of Chinese bonds by about \$150 billion.<sup>8</sup> According to UN Conference on Trade and Development statistics, China surpassed the United States by taking in \$163 billion worth of direct investments in factories, office buildings, companies, and other assets in 2020.<sup>9</sup> According to *China’s Balance of Payments Report 2020*, foreign direct investment to China was \$212.5 billion.<sup>10</sup> How to keep the tremendous national wealth in people’s hands and fight against privatization is always a big challenge for any ruling party if it upholds a pro-people ideology.

### **When Did Finance Become an Alienated Force?<sup>11</sup>**

China has visibly carried out capital control whenever national sovereignty is endangered. There are historic legacies of definancialization in the seventy-year pursuit of modernization. From 1949 to 1950, a supplies-based value system in three domains was introduced along with the establishment of the People’s Bank of China’s unified monetary system for the whole country. At that time, the bank monitored social inflation and used the price index to determine the amount of money when deposits were withdrawn. In other words, it was a monetary system fully pegged to material supplies such as millet, rice, cotton, and coal. After receiving Soviet aid to implement national industrialization in the 1950s, China’s monetary and financial system was based on the Soviet planned economy, where only one renminbi of currency could be issued for every twelve renminbi of goods produced, which could be called financial containment or definancialization. At that time, finance was only allowed to exist as an intermediary for commodity transactions, and it was not allowed to have other functions—even its savings function was very weak. Therefore, the total volume of finance was very small, and most of the materials were arranged and distributed by national planning.

The distribution of daily necessities relied on vouchers or tokens, and on a work point system that was popular in rural areas. Money was replaced by a voucher system to prevent an emergence of a rent- and profit-seeking class.

Finance has gradually become an alienated force within the economy since the implementation of reform and the opening up to the world economy. Starting from the U.S. president Richard Nixon's visit to China in 1972, China began to introduce a large amount of Western equipment and technology, and all of these purchases into China turned into foreign debts. By the mid- to late 1970s, China faced a foreign debt crisis similar to that of Latin America. The debt crisis contributed to the reform period, which included the reassertion of the role of money as an element of capital. It also made other forms of productivity into monetized factors, such as land. Debt repayment in the 1970s and '80s relied mainly on agricultural products and processed goods made from agriculture such as cotton weaving, bamboo weaving, and woodware, which accounted for 80 percent of China's total exports. The Western equipment and technology imported by China were obsolete production lines, so it was impossible to use the goods produced by these lines to counter sell to the West to obtain hard currency to pay off the debt. This was also the reason that Latin America and all developing countries fell into a debt crisis and were eventually resubordinated to the West economically via neoliberalism.

Under such a system of world trade dominated by the West, it is necessary for productive enterprises to retain foreign exchange, so that there are funds to purchase raw materials and other needed inputs. This meant that China was increasingly marketized and became export oriented. Nevertheless, domestic production remained central to China's five-year plans. So, the dual-track system, mixing state and market, was proposed in 1979 under the pressure of foreign debt. Apart from labor, technology, capital, and foreign exchange, land also became increasingly a factor of production in a more marketized model. A large number of township-village enterprises were developed, which relied on possession of their own land, viewed as a factor of production in market terms, though the gains of development were kept at the local level. Therefore, land increasingly took a dual-track form in these township-village enterprises affecting the structure of local government. In the late 1980s, the township-village enterprises expanded rapidly. Local economies led by township-village enterprises accounted for one-third of the value added of the national industry.

The central government wanted to take over land revenues. In 1987, the land management law was proposed, requiring local governments not to take possession of the proceeds of the primary land market, requiring that land proceeds be paid to the central treasury for unified manage-

ment, and, by then, the Central Rural Policy Research Institute set up the China Rural Trust and Investment Corporation. Local governments were required to pay differential land rent from agricultural and industrial land to the central government, which in turn would make investments in local agricultural infrastructure and water conservancy, among others. However, all local governments resolutely successfully opposed this. During that period, the local economy was very strong and local governments were not willing to make concessions.

China actually started to have a foreign exchange surplus at that time, enabling it to pay off its foreign debts from the 1970s, while also building up its foreign exchange reserves. This gave China a certain degree of financial autonomy. In 1989, political turmoil broke out and the United States sanctioned China. However, China negotiated with the United States to have the blockade lifted. The United States agreed to remove most of the sanctions, but still maintained sanctions in areas such as technology and military. From that point on, China's currency issuance was related to its holdings of U.S. dollar foreign exchange reserves. In other words, China's currency has been more or less anchored to the U.S. dollar since the early 1990s. There was an over-issuance of currency in 1993, which quickly led to inflation of up to 24 percent in 1994. There was also a burst of real estate prices and the stock market. As long as currency issuance is partially dependent on foreign exchange reserves, a triangle of foreign reserves, debt, and currency is formed and it is difficult to establish a truly autonomous monetary policy. The financialization of land resources is one of the consequences and it has not yet successfully been brought under control.

### Financialization of Land Resources

Since the 1978 reform, China has experienced intermittent deficit crises, and the fiscal constraints faced by local governments have been a major cause of large-scale land expropriation. The central government responded by decentralizing the tax and revenue system, so that local governments became dependent on local revenues. Starting in 1984, local governments expropriated farmland for industrialization in order to generate income – the period of *land for local industrialization*. In 1994, China was confronted with a triple crisis – a balance of payments, a fiscal deficit, and a banking system crisis. This period also saw its headlong embrace of globalization. The central government then implemented another drastic reform of the tax and revenue system. Before 1994, about 70 percent of local tax revenues went to local governments, but since then, about 50 percent has gone to the central government. To compensate for a drop in their share of revenue, local governments again expropriated farmland to invest in commercial projects.

This was the period of *land for commercial fortunes*. Since 2003, local governments have increasingly mortgaged farmland in order to obtain loans from commercial banks. This was the period of *land for bank loans*.<sup>12</sup>

Land has become the main income of local governments, accounting for more than 80 percent of finance in many places. In 2008, driven by the ¥4 trillion bailout investments in response to the global crisis, the balance of local government debts nationwide increased significantly from ¥5.5 trillion in 2008 to ¥24 trillion by the end of 2014. Local governments mainly used construction land in reserve and the assets attached as collateral for bank loans. In order to maintain the debt chain without breaking, the debt can only be extended by borrowing new loans to repay old loans. This means that the nature of local governments' land policy has changed from *land for bank loans* to *land for supporting debt*.<sup>13</sup>

The central government has been trying to curb the expansion of the real estate bubble. Unfortunately, it has not yet been successful. One of the main reasons is the weakening real economy, making local governments increasingly rely on land revenue to cover their debts. Now China has intermingled internal bubbles – a real estate bubble, a debt bubble, and an investment bubble. Nevertheless, although financialization has become an alienated force in the economy and society, the government is struggling to break the curse of debt/finance through political and disciplinary power.

One of the recent examples of financial evolution is Ant Financial, an affiliate of Alibaba Group, the largest fintech in China and even the world. The formation of Ant as a new giant enterprise is against the backdrop of four decades of reform and open-door policy, which led to astonishing economic growth, but also a worship of individualism and consumerism. Ant, as a symbol of successful private entrepreneurship, is obviously against putting people at the center.

### **Alibaba's Ant: Too Big to Risk**

On November 3, 2020, Ant Group's initial public offering in Shanghai and Hong Kong was suddenly halted at the last minute. It was expected to be the world's biggest initial public offering, after investors signed up for \$37 billion worth of shares. Alibaba Group Holding Limited, the multinational tech company specializing in e-commerce, owned roughly a third stake in Ant Group, while the largest single shareholder was Jack Ma. Ant targets vulnerable groups. This advance of fintech capital works with formal banks to centralize financial holdings. It utilizes big data to discover and exploit customers' weaknesses. And it takes advantage of high interest rates to hedge the risk of lending to a large number of vulnerable groups. Ant Group is almost too big to fail. Let us see how an ant became a giant.

Alipay is a third-party mobile and online payment platform, established in 2004 by the Alibaba Group. The number of Alipay users reached 870 million in 2018. It is the world's number one mobile payment service organization and the second largest payment service organization in the world. According to statistics, Alipay had nearly 60 percent share of the third-party payment market in mainland China. Since 2013, Alibaba's Ant Financial Services have relied on mobile Internet, big data, and cloud computing to carry out micro financial services, including business segments such as Yu'eobao, Ant Credit Pay, Ant Cash Now, and Sesame Credit.

Ant Financial was getting bigger and bigger with the support of local governments and many financial affiliated sectors of state-owned institutions. The trend of financialization was partially intertwined with the process of privatization. In 2013, Alibaba partnered with Tianhong Asset Management Company Limited to develop Yu'eobao, a cash management tool. By the end of 2015, the number of Yu'eobao's users exceeded 260 million, with a scale of ¥620.7 billion, creating revenue of nearly ¥50 billion. In 2015, Tianhong Fund as the largest monetary fund in China was restructured from a state-controlled enterprise into a privately held enterprise, with Alibaba holding 51 percent of its shares.

In 2015, Ant and China National Investment & Guaranty Company Limited applied for the establishment of Zhejiang Internet Financial Assets Exchange Centre and received the consent of the Zhejiang Province government. In 2015, Ant completed its Series A funding round from state-owned institutions, including the National Social Security Fund, China Development Bank Capital Company Limited, and China Life Insurance Company. In 2015, China Post Group Corporation Limited took a 5 percent stake in Ant Financial. In 2016, Ant Financial completed its Series B funding round, the largest single private financing in the global Internet industry to date, with new investors including state-owned enterprises such as China Investment Corporation, China Construction Bank Trust Company Limited, private Primavera Capital Group, as well as further investments from state-owned institutions during the Series A financing.<sup>14</sup> In 2019, the Industrial and Commercial Bank of China signed a comprehensive and deep strategic cooperation with Alibaba and Ant Financial Services to accelerate cooperation in building digital finance.

Ant Group was deeply engaged in promoting the speculative debt economy. In 2010, Alipay issued more than ¥26 billion in loans to merchants on its platform through Alibaba Microfinance, earning more than ¥1 million in interest income on a single day. In 2011, Alipay was granted a microfinance license by Chongqing Municipal Government, and by 2013, Chongqing Ant Microfinance had a registered capital of ¥3 billion and used two times the leverage to lend about ¥6 billion to banks, creating an online microfinance

scale of ¥9 billion, while Ant Group's current capital scale of ¥35 billion was obtained through the high-speed issuance of asset-backed securities during the period. Alibaba accounted for less than 2 percent of the funds lent out on Ant's platform, with over 98 percent coming from financial institutions.

The largest contributor to Ant's revenue is its Alipay debit and credit services – that is, Ant Credit Pay and Ant Cash Now, which accounted for 39.4 percent of the company's revenue and 47.8 percent of its total profit. Of its ¥2.15 trillion in credit, business loans account for ¥0.42 trillion, leaving ¥1.73 trillion in consumer loans, charging an average annual interest rate of 15 percent, close to the regulator's red line of 15.4 percent, the highest annual rate for private lending. Ant Cash Now charged a daily interest rate of 0.05 percent, which means the annual interest rate is actually as high as 18 percent. Ant Financial's Alipay has continued as the leading force in Chinese mobile payments, with a 54.5 percent market share.<sup>15</sup> In this sense, Ant is indeed a loan shark wearing a high-tech coat.

Many young people were trapped in this kind of fintech debt. On November 13, 2019, just two days after the November 11 Singles Day shopping bonanza, Nielsen Corporation's *Debt Status of Young People in China Report* stated that the total credit product penetration rate for China's young adults had reached 86.6 percent, of which only 42.1 percent could pay off their debts in the same month, meaning that more than half were in debt because they could not pay off their loans in time. The average debt level of Chinese millennials was ¥120,000, equal to 1,850 percent of monthly incomes. Moreover, according to the People's Bank of China, as of June 30, 2020, the total amount of overdue credit cards outstanding for six months nationwide in China had soared to ¥85.4 billion, more than ten times the amount of ten years ago, with the generation born after 1990 accounting for almost half of these overdue borrowers.<sup>16</sup> This blooming debt economy could lead to potential social unrest. The central government is determined to break the curse of debt and finance through policies of capital control and antifinancialization, with some similarities with what happened during the 1950s.

On November 2, 2020, one day before the Ant Group's initial public offering, the People's Bank of China, China Banking and Insurance Regulatory Commission, Securities Regulatory Commission, and State Administration of Foreign Exchange claimed that they had conducted regulatory interviews with Ant Group's actual controller Jack Ma, chairman Eric Jing, and chief executive Simon Hu. Some thought that it was because Ma openly criticized China's financial system on October 24, 2021, at the 2020 Bund Summit in Shanghai. Ma remarked that "China doesn't have a systemic financial risk [problem], China's finance basically doesn't have risk, the risk is instead from lacking a system.... Today banks are still operating with a



pawnshop mentality, needing collateral and guarantees are just like pawn shops.... China's financial pawnshop mentality is the most serious."

Afterward, *Caixin News* published a long list of Ant's shareholders, including both domestic and overseas capitalists and organizations. It was named a luxurious banquet for domestic and global capital. The domestic shareholders included state-owned institutions such as the National Council for Social Security Fund, China Life Insurance (Group) Company, China Post Group, China Development Bank, and China International Capital Corporation Limited. Overseas shareholders of individuals and organizations accounted for a total of 52.07 percent, which included private individuals such as Ma's investment partner Yu Feng, Hong Kong billionaire Li Ka Shing, and the Association Familiale Mulliez of France, as well as foreign governmental institutions such as Government of Singapore Investment Corporation Private Limited, Temasek Holdings Private Limited (Singapore), Public Investment Fund of Saudi Arabia (Saudi Arabia), Abu Dhabi Investment Authority (Emirate of Abu Dhabi), Khazanah Nasional Berhad (Malaysia), among others. Wall Street and City (London) financial groups accounted for 27.16 percent – namely, Silver Lake (United States) with 3.28 percent, Warburg Pincus LLC (United States) 3.12 percent, T. Rowe Price Group (United States) 2.74 percent, General Atlantic (United States) 2.74 percent, Carlyle Group 2.74 percent, Sanne Group (United Kingdom) 2.19 percent, BlackRock (United States) 1.45 percent, Baillie Gifford (United Kingdom) 1.44 percent, Discovery Capital Management (United States) 1.31 percent, Fidelity Investment Group (United States) 1.30 percent, Hedosophia Group (United Kingdom) 1.02 percent, Sequoia Capital (United States) 0.82 percent, Dragoneer Investment Group (United States) 0.82 percent, Coatue Management (United States) 0.45 percent, Credit Suisse (Switzerland) 0.44 percent, Falcon Edge Capital (United States) 0.27 percent, GGV Capital (United States) 0.11 percent, and BPAF (United Kingdom) 0.92 percent.<sup>17</sup>

In December 2020, the Central Political Bureau meeting of the Communist Party announced that it would "strengthen anti-monopoly measures and prevent disorderly expansion of capital."<sup>18</sup> Then it initiated a months-long antitrust investigation into Alibaba. In addition, Alibaba's influence was further weakened in the areas of education and media. Previously, Ma led a group of industrial and technology titans to set up Hupan University, an elite business academy, in his hometown of Hangzhou in 2015. On December 16, 2020, the branch of Hupan in western Yunnan Province was suspended. On April 9, 2021, Hupan in Hangzhou was told to suspend new student enrollments. Meanwhile, Alibaba was required to divest some of its holdings from China's leading private media groups.

On April 10, 2021, the State Administration for Market Regulation imposed a record fine of ¥18.2 billion (\$2.8 billion) on Alibaba. It represented 4

percent of its total domestic revenue in 2019, which was ¥455.71 billion. According to the State Administration for Market Regulation, Alibaba abused its market dominance status to force merchants to pick sides among the various e-commerce platforms on the market, known as picking one from two, and violated the rights of both merchants and consumers. The State Administration for Market Regulation's statement particularly highlighted that "Alibaba Group Holding Limited [was] set up in 1999 and registered as Trident Trust Company (Cayman) Limited, in George Town, Grand Cayman, Cayman Islands, a British overseas territory." As is well known, the Cayman Islands are a major world offshore financial haven for international businesses and wealthy individuals. To put it simply, Alibaba is too big to risk. It needs to be regulated based on the logic of protecting people's interests.

As early as 2014, Niu Wenxin, executive editor-in-chief and chief news commentator of CCTV Securities Information Channel, wrote a controversial paper to urge for "The Banning of Yu'e bao!" He criticized that Yu'e bao was an "evil financial" practice that contradicted the central government's principle that finance must serve the real economy:

Yu'e bao are "vampires" lying on the banks, typical "financial parasites." They do not create value, but profit from it by raising the economic cost of the whole society.... Specifically, let's assume the average return of 6% on Yu'e bao's ¥400 billion scale and a profit of ¥24 billion, Yu'e bao and the money fund will swallow about ¥8 billion (2% of ¥400 billion) and other Yu'e bao customers will share ¥16 billion. It seriously interferes with the interest rate market, seriously interferes with bank liquidity, and seriously pulls up the financing cost of industrial enterprises, thus intensifying the vicious circle between finance sector and industrial sector and seriously threatening China's financial and economic security.<sup>19</sup>

The abrupt decision of the government to call a halt to Ant's initial public offering was welcomed in both official and social media. Policies for monitoring have been proposed by the government since then. This means the government is capable of taking stringent measures to rein in financial giants. Though the historical context is different, especially because China is much more integrated into the global economy now, it is worth examining the first years of the People's Republic to draw lessons for today.

### History as a Mirror

In the following sections, we will discuss some legacies of capital control, definancialization, and experiences of defending the real economy in the period of financial containment (1949–89) in order to understand how China has continuously confronted the curse of financialization by political and disciplinary power, with the aim of defending public property and people's interests.

### The Silver Yuan Battle of 1949

In *Ten Crises: The Political Economy of China's Development (1949–2020)*, Wen Tiejun and his research team systemically trace the economic history of China, unraveling the complex domestic and global factors leading to cyclical crises and examining the corresponding counteracting policies and measures by the government to resolve or defer the crises.<sup>20</sup> In the first crisis (1949–52), an implementation of a supplies-based currency, together with policies of demonetization and financial containment, helped the newly born renminbi to be consolidated as its value was anchored to essential supplies. Land reform had also stabilized the rural sector and expanded the monetary demand by the peasants, which laid the ground for expansionary monetary measures by the government to solve the fiscal problem.

At the beginning of New China, the government started to fight the currency defense battle. The renminbi became the only legal currency. However, this did not fundamentally suppress inflation. The government then realized that the chief enemy of the renminbi was no longer the Kuomintang government's Jinyuanquan (banknote based on U.S. dollar reserves), which had lost its credit base as the old regime collapsed, but the silver coins, which had a long history of circulation and potential of appreciation under inflation. The credit foundation of silver coins remained robust. In the 1949 Silver Yuan Battle in Shanghai, where speculative capital was concentrated, the major means used by the new regime was a combination of military and political power. The CPC deployed military force to close down the silver coins market, politically declaring trading in silver coins illegal.

Shanghai was liberated on May 27, 1949. The following day, the Shanghai Military Control Commission announced regulations for using the renminbi and the abolition of Jinyuanquan, the old republic's currency. One renminbi (old) was equivalent to ten thousand Jinyuanquan. After June 5, the latter was strictly prohibited from circulation in the market. Given that Jinyuanquan's credibility was already close to zero, the conversion was conducted very smoothly. In seven days, a total of 35.9 trillion Jinyuanquan were collected, approximately 53 percent of the total amount issued by the Kuomintang government. Yet, the newly issued two hundred million renminbi existed only superficially in the market and did not enter into actual circulation – in reality, without equivalent commodities, the conversion of the currency had simply amounted to taking over the depreciation pressure of the Jinyuanquan.

Given that silver still functioned as currency, while the renminbi could only have a supplementary role in low-value transactions, silver became the target of speculation. To start with, 1 silver yuan was equivalent to 100 renminbi. By June 3, it had appreciated to 720 renminbi. On June 4, it suddenly spiked to 1,100 renminbi and the trend continued. On June 5,

the Eastern China Financial Commission and Shanghai Municipal Committee released 100,000 silver yuan in an attempt to suppress speculation on silver coins, but it was like a drop in the ocean. On June 7, the value of a silver coin had even gone up to 1,800 renminbi.

The failure of market-based measures was too much, and it was a big lesson for the new government. It was not until June 10, when the Shanghai Military Control Committee sent troops to close down the securities exchange building and arrested a number of speculators, that a heavy blow was dealt to speculation. Then the government announced the Measures for Management of Gold, Silver and Foreign Currency in Eastern China, prohibiting the free circulation and private trading of gold, silver, and foreign currencies. Starting on June 14, the banks launched value-anchored deposits. Using these kinds of low-cost, direct intervention measures, the government was able to mitigate price inflation for the time being.

Sixty-six years later, a similar forceful intervention into the speculative stock market occurred. With the entry of Chinese financial capital into the globalization process, China suffered from “long-short” war, stock market crashes, and exchange rate fluctuations in 2015.<sup>21</sup> The government spent trillions to bail out the market, together with the use of police force. On the morning of July 9, 2015, the vice minister of public security led a team, together with the Securities and Futures Commission, to investigate more than ten institutions and individuals suspected of malicious shorting of large-cap blue-chip stocks. This was the first time the security force led a high-profile intervention in the history of the stock market in China.

### **The Battle of Rice and Cotton of 1949**

In 1949, after the failure of silver coins speculation, private capital turned to speculation on staple grains and cotton. Through hoarding and market manipulation, speculators aspired to make windfall profits. It turned into the well-known Battle of Rice and Cotton. From mid-June to late July 1949 in Shanghai, where the highest concentration of Chinese private-sector capital was, a wave of speculative activity took place targeting essential commodities. They took advantage of the Kuomintang’s military blockade against the CPC government, the disorder sowed by the agents of the former, as well as natural disasters like flooding and storms in certain areas, to trigger speculation on grains, cottons, and other materials, deploying enormous sums of money. Led by the price of rice, followed by the price of yarn, a comprehensive inflation emerged. The price of rice in Shanghai increased drastically fourfold, while that of yarn doubled. At the same time, it also affected all of eastern and northern China, as well as regions in central and south China. The average price level in July rose by 1.8 times as compared to June.

Faced with the onslaught of the inflation, Chen Yun, head of the Central Finance and Economic Commission, noticed that speculators in Shanghai were hoarding mainly yarn, while in northern China speculators focused on grains. To avoid being attacked simultaneously on two fronts, he first turned his attention to the north. Starting on November 15, 1949, a daily shipment of ten million catties (one catty = six hundred grams) of grain was sent from the northeast to supply the Beijing and Tianjin regions. Concurrently, sixteen traders speculating on grains were arrested and punished. These measures overwhelmed the speculators and pacified the people. After sorting out this problem, Chen focused all his efforts on suppressing the inflation trend in Shanghai.

Even though Chen accepted that the increased money supply by the CPC was the main reason for the inflation, he believed that through deployment of goods (from the old CPC bases to big cities) inflation would be controllable. Before November 1949, the CPC fully exerted its well-organized system to raise material supplies from around the country. With grain, for example, the plan was to deploy four hundred million catties from Sichuan and ten million catties from northeast China to Shanghai on a daily basis (for a duration of half a month). Furthermore, liberated areas in northern and central China, in Shandong and so on, also supplied grains to various big cities on an ongoing basis. By the end of November 1949, the quantity of cotton yarn and cotton cloth controlled by the state-owned China Textile Company reached half of the total nationwide production.

Through a series of successive small price-level increases to attract investors to purchase commodities, the People's Bank of China absorbed eight hundred billion liquid funds in society. On November 24, 1949, the general price level was 2.2 times compared to that at the end of July. At this level, the quantity of goods under the central government's control was equivalent to the amount of monetary circulation on the market. On November 25, 1949, the central government directed a unified action in big cities across the nation to sell commodities. In addition to large-scale selling off, other coordinating measures in terms of taxation, credit, and so on put tremendous pressure on speculative capital. The Central Committee of Finance and Economy stipulated that: funds of all state-owned enterprises must be deposited in state-owned banks and must not be loaned to private banks or private enterprises; private-owned factories were not permitted to close down operations and had to pay normal wages to workers; tax collection was intensified and no delays were permitted; and, at the same time, underground banks were banned to block sources of funds to speculators.

The speculators had acquired commodities in large quantities, even borrowing to do so. Yet, from that day on, price levels did not increase further; rather, to the shock of speculators, they declined. After ten days

of continuous selling off by the government, the speculators could no longer hold their positions and had to sell at a low price. Because of this, price levels dropped by 30 to 40 percent. By then, the inflation storm that had lasted for fifty days finally came to an end under the CPC's command and coordinated actions. That was known as the Battle of Rice and Cotton.

The victory in the battle of speculation was decisive in consolidating the status of the renminbi. The key was not to rely on the Communist government having more hard currency, the silver yuan, or foreign reserves, but rather more hard commodities, the essential supplies of livelihood. As Chen put it, "people's confidence relies on staple grains in cities, on cotton gauzes in rural regions...how much we were able to get hold of determined our capacity to regulate market." This battle against the selling short of the renminbi can be presented as the best maneuver of government rationality combining political power and economic operation. It was the first muscle-flexing of the CPC in the economy. Henceforth, people understood that what stood behind the renminbi was more than the state's political power, but also an enormous reserve of material supplies stocked by the mobilization of the whole nation in the land revolution.

### **Supplies-Based Value System in Three Domains**

The Silver Yuan Battle and the Battle of Rice and Cotton were both strategic responses to speculation and they were executed by a state under the military's control. At the same time, it is also worthwhile to recognize the importance of the supplies-based value system in three domains that secured the value of surplus money held in common people's hands: (1) salaries of civil servants; (2) savings in banks; and (3) public bonds. The credit base of national financial capital was thereby consolidated.<sup>22</sup>

It is almost unimaginable today that in 1949 the accounting unit of the national fiscal budget was millets instead of the renminbi. This was in fact a long tradition in the liberated regions before 1949. Xue Muqiao, later director of the National Bureau of Statistics, recalled that despite diversity in species and supply volume, the total quantity of money in liberated regions was generally maintained around the average of thirty catties of millet per capita. Money would devalue if supply exceeded this amount; otherwise, money supply would be insufficient, and peasants would be harmed by deflation.

As the CPC entered the cities, the value of the renminbi was still unstable. Therefore, millet remained the accounting unit in the whole state system. For example, during the age of Soviet aid, the annual salary of an expert from the Soviet Union working in China was 18,000 to 20,000 catties of millet, whereas the chairman and vice chairman were paid 3,400 catties, a minister 2,400 catties, and a bureau director 1,800 catties of

millet. Taking millet instead of money as a unit of pricing was actually a way of anchoring value. The new regime anchored the value of money to essential supplies in three domains. The market was stabilized in this way to facilitate withdrawing newly issued money from circulation.

Despite differences in the domains, the strategy was basically anchoring value to material supplies. The renminbi served not only as a medium of exchange but also as a unit of accounting and a store of value, which are the classical functions of money. What secured its value were in fact essential supplies, including staple grains, cotton, and coal. The following is an explanation of the practices in the three domains.

- (1) The new government employed a large number of employees and workers in the public sector. In order to secure their basic livelihood, the Department of Labor and the Central Committee of Finance and Economy successively proposed solutions and suggestions for salary reform. After 1952, salary reform was implemented in major regions in north China, east China, south central China, southwest China, and northwest China. Taking salary point as the unit of salary was the main content of the reform. The salary point was set by five major supplies essential to livelihood: staple grains, edible oil, cloth, salt, and coal. Every salary point included 0.8 catty of staple food, 0.2 feet of white cloth, 0.05 catty of edible oil, 0.02 catty of salt, and 2 catties of coal. This levy and payment in material supplies without the medium of money helped greatly suppress the room for speculation in essential supplies. Therefore, salary point as an accounting unit was an important and effective measure in stabilizing employees' livelihoods.
- (2) Value-anchored savings catered to people's preference for material supplies over money. This way of saving had been first tried by Huabei Bank in north China during the revolutionary years. Renminbi was rendered into a unit of essential supplies and the value of the savings was secured by the amount of this unit. When money was deposited into a bank account, the value was rendered into certain units of essential supplies. In case the unit price rose, the difference in the value of money would be subsidized by the bank (the state).
- (3) Public bonds were sold at a price based on a basket of essential supplies (like rice, millet, and flour), then redeemed at the current price of the same number of supplies according to different maturities. The purchasing power of the money invested was thus guaranteed. Here, using public bonds as a means of saving was similar to its equivalent products in other countries. What was really creative was the credibility of bonds secured by essential supplies.

### Concluding Remarks

China has kept tight control over capital flows through political, disciplinary, and even military power. Throughout the 1950s and until the '90s, China insisted on capital control and financial containment for about forty

years. Afterward, China joined the global economy. In the meantime, Chinese leadership has apparently continued to retain an acute awareness of the risks of “disorderly expansion of financial capital” and has taken measures to attempt to contain it, generating discontent from U.S. and European financial interests that would like to see China go further down the road. China seems to have learned historical lessons on restricting the barbaric expansion of capital and breaking the curse of finance. It is important to take as reference the experiences of anchoring value to essential commodities for consolidating the renminbi’s credibility. Today, it is necessary to keep these legacies of definancialization and defending the productive economy alive, since the story of extreme financial speculation represented by Ant will only repeat itself if financialization continues. Profit-centered dominance by global finance capitalism, or people-centered governance over finance and strengthening the real economy: history urges us to make a choice for social justice.

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