

Renminbi: A Century of Change

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This article provides an overview of the evolution of the renminbi in the twentieth and twenty-first centuries.¹ In tracing the political and economic changes of the modern currency system, we find that 1992 was the first year that the renminbi became a real currency and the first year of Chinese monetization. Nonetheless, one cannot forget its preludes and overtures.

Since the late Qing Dynasty, China has attempted to establish a modern currency system based on its national fiscal capacity. However, the fiscal foundation of the late Qing Dynasty was unsubstantial, and its customs duty policy was controlled by foreign powers, with the British diplomat Robert Hart serving as Inspector-General of Custom Service from 1863 to 1911. Furthermore, the Qing government could only charge a tariff rate of 5 percent (*zhi bai chou wu*), the low rate effectively acting as indemnity for Western powers's victory in their invasion of China.² Half a century of continuous foreign invasion and civil wars, as well as enormous foreign debt, completely exhausted the Qing government's treasury. Thus, after failed efforts to issue currency based on national finance, and continuing into the early republic era, China had stuck to the silver-standard currency system, using silver as medium of exchange. In the 1930s, the government of the Republic of China once again endeavored to modernize the currency system, yet, due to international circumstances, witnessed the rise and fall of fiat money based on the modern fiscal system. Since the Chinese Communist Party (CCP) took power in 1949, the renminbi has undergone a long evolution, from the 1949–50 hyperinflation crisis, to the “de-monetization” and “de-linking” of the Chinese economy during the Mao Zedong periods. Today, the renminbi faces the competitive

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environment of financial globalization, particularly the challenges and opportunities of its internationalization.

Prelude: Currency Under the Kuomintang

Between 1935 and 1936, the Kuomintang (KMT) government adopted the fiat money system, issuing the fabi, which translates as “legal currency.” The main reason for the issuance of the fabi was the outbreak of the major economic crisis in the West in 1929. As a result, the four countries that had silver-trade agreements with the government of the Republic of China reneged on the agreements to provide China silver at the contract price.

China did not produce silver; its supply relied on other countries. In other words, the stability of the silver standard in China depended on the supply of silver from abroad. When the crisis broke out in 1929, prices of precious metals escalated, the countries that should have supplied silver to China, at the agreed-upon price, no longer did so, and China was running short of silver.

Nevertheless, it should be noted that during the early period of the Great Depression, silver prices dropped severely, especially when measured against gold. This is because countries that traded with China, such as the United States, Britain, Japan, and India, were on the gold standard at the time and had low demand for silver. By 1932, the price of silver had dropped by more than half. The silver-producing states in the United States, while negligible in economic terms, were highly influential in politics. They successfully lobbied the Roosevelt administration to prop up the price of silver. In 1934, the Silver Purchase Act was passed, authorizing Franklin D. Roosevelt to nationalize silver in the United States, allowing people to deliver their holdings to the Mint in exchange for payment from the federal government. By 1935, the price of silver went back up by more than three times compared to the low point in 1932.³

The fluctuation in the price of silver had another effect on China. When the price fell between 1929 and 1932, the exchange rate of China’s silver-standard currency also fell, improving China’s exports and resulting in substantial trade surplus. When other major economies sank, the Chinese economy prospered. However, from 1931 to 1933, one after the other, those economies abandoned the gold standard and, as a result, China’s silver currency sharply rose in value. China’s international trade volume fell and trade surplus became trade deficit. Now China had to export precious metal to make up for the deficits. Thus, when the rest of the world was starting to recover from the Great Depression, China’s economy started to slide into crisis.

When the price of silver rose in the international market, the silver stock within China was depleting. Encountering a severe shortage of currency and capital at an early stage of capitalism, China fell into a crisis similar to that of the late Middle Ages in Europe, just before the curtain was lifted on early capitalism. During that period, trading with the East had drained the silver stock in Europe, resulting in a silver crisis and a prolonged war. Defeated countries were then under great pressure to find new trading routes to the East, as well as new sources of silver and gold. They later became exploiters in the so-called discovery of the New World. At the time, most of the silver in Europe found its way to China, the eastern country with the highest trade surplus.

Five hundred years later, it was in the East that a similar situation occurred. During the 1920s and 1930s, just when the Republic of China began to enter its golden age of growth – in which industrialization and urbanization took place simultaneously – the crisis of silver, resulting in deflation and in turn economic depression, hit capitalist development hard. Just like the Qing Dynasty before it, the Chinese government failed to create a fiat money system, since the credibility of the issued currency would have been ruined by the silver drain and the resulting credit crunch.

In 1935, Japan invaded and occupied northern China. They ran up the price of silver in the territory by buying up what they could, further pushing the outflow of silver from China and drastically reducing the government's precious metal reserve.

In summary, the republic's move to abandon the silver standard and adopt a fiat money system was ill-fated. First, the timing of the reform was not right – it was forced upon the government by the major capitalist crisis of 1929 in the West. Second, the invasion of northern China by Japan in 1935 further exacerbated the draining of silver, depleting the government's reserve. Moreover, the government, in preparation for war, had to use precious metals to purchase weapons, equipment, and materials from overseas.⁴ Meanwhile, a large portion of the military equipment used by Japan in its invasion of China had been supplied by the United Kingdom and the United States.⁵ The pressure of war further exhausted China's stock of precious metals. The fiat money system was doomed, and after the total invasion by Japan in 1937, hyperinflation plagued China.

The period of hyperinflation lasted twelve years, from 1937 up until 1949, and even into 1950. In 1948, the KMT government replaced the *fabi* with a new currency, the gold yuan, which was not backed by gold but by the government's U.S.-dollar reserve. The KMT leadership made the bold move of adopting the gold yuan to save the currency system.⁶ This

was the final step in the long endeavor to establish a modern fiat-money system, first backed by precious metal, then by other hard money. Nevertheless, not only did this not resolve the prolonged crisis that had emerged since the modern currency system had been adopted, but it had also led to the end of KMT rule in the mainland.

This financial disaster was, on the surface, a consequence of the move to the gold yuan, for which the KMT government borrowed forty-eight million dollars from the United States, making use of this foreign hard currency supported by the Bretton Woods system. At the time, the KMT government's policy for stabilizing the gold yuan was commitment to a fixed rate of exchange with U.S. dollars. However, because of trade deficits, the basic premise for doing so—an adequate inflow of U.S. dollars to support currency value—was missing. Therefore, the gold yuan only lasted four months and collapsed after the United States refused to help with its resuscitation. Financial speculations became rampant, with government officials leading the rush to buy up gold bars. The underlying fact is that the republic elites, including senior officials from the financial bureaucracy, could do no more than submit to the hegemonic outside powers, resulting in a condition of incomplete sovereignty.

By the end of 1948, the fiscal and financial system of the KMT government was in complete collapse. It was no longer enough to support military expenditures for the army. Soldiers were demoralized because their salaries became worthless the day after they were received. It was impossible for the KMT to sustain its ruling power over the country. This was the main reason that, despite outnumbering their enemies, the KMT's formal and modernized troops were defeated by the People's Liberation Army, which was armed with outdated armory ("millet plus rifles," as the CCP put it). Moreover, the latter had the broad support of peasants, who helped by bringing supplies to the front, motivated by the Communist Party's idea of land revolution. Along with the military defeat came the collapse of nearly four decades of efforts by the old republic elites to pursue modernization. Even if the KMT was serious about implementing political reforms, as requested by Chinese democrats and Western politicians, it would have been impossible for them to salvage their power to rule. The demise of the old republic can be attributed to the failure to establish a modern fiscal and financial system, as well as the disintegration of a modern currency system. Even if the KMT regime had been successful in consolidating its position among the numerous elites, its failure would have remained inevitable.

A comparison can be drawn between the deterioration of the KMT and the role of the Communist Party in the Jinggang Mountains Soviet in the 1930s.

The Jinggang Mountains region had been a traditional agricultural society, whose economic mode was incompatible with a modern fiscal-financial system. Hence, the consequences of rigid replication of the Soviet system overburdened the peasants and the economy of the area collapsed. Furthermore, some CCP cadres also proposed anti-besiegement position warfare, which could only be possible with modern military support. Thus, the dogmatic imposition of the Soviet economic system in conditions for which it was inappropriate, first led to economic collapse, followed by political failure and military defeat, ultimately forcing the whole base to relocate.

When the People's Republic of China (PRC) was established in the mainland between 1949 and 1950, the capacity to continue the modern paper-currency system was weak. The mainland's gold reserve had almost entirely been moved to Taiwan to become the precious metal reserve for the establishment of a relatively stable paper-currency system on the island. On the other side of the strait, the PRC adopted a paper-currency system based on credibility of sovereignty, but was not backed by a precious metal reserve. In practice, it prolonged the harsh consequences of the inflation crisis that had lasted thirteen years since the old republic had adopted a paper-currency system. Some researchers theorize that the early years of economic chaos under the new regime were due to its being closed off from the free market. But this misses the point: under the circumstances, whether the economy was referred to as a planned or a free-market one is of no substantial significance. The inflation that the PRC faced right from the start was not a problem of planning or market, but a problem of lacking the base necessary to back its currency. It was a question of precious metal reserve.⁷

Overture: The Hyperinflation Crisis of 1949-50

The new PRC inherited the hyperinflation crisis of the old republic.⁸ The new central government had to adopt a series of measures to suppress inflation and prevent the deepening of the already-severe currency crisis. They closed the speculative markets that had fueled inflation in the past. The value of a bank deposit was anchored to a certain quantity of the "three whites" (white rice, white flour, and white cloth), which were essential to people's livelihoods.⁹ Simultaneously, the new government pushed forward large-scale rural land reform. By 1951, when land reform had been fully implemented across the country, it was possible to detach the rural population in China, accounting for 88 percent of the total population, from the modern monetary economy. One could say that it was the land reform that allowed peasants to break away from the

crisis of modernization in one single move, relieving the government from the pressure of the possibility that inflation might spread to the countryside. Thus, China was by and large able to achieve social stability.

In brief, the precursors to China's establishment of a modern financial system were the hyperinflation crisis of the old Republic after attempts to pursue modern currency reform, as well as the measures of the new PRC, in its early years, to suppress that inflation. These two factors are crucial for understanding the evolution of China's financial system in the 1950s, with the renminbi as the currency.

We should not simply equate the early modernization of China, from the late Qing dynasty to the old Republic, with the advancement of Chinese society. Putting together the history of the Chinese people's reckless pursuit of modernization over the last one hundred years, and looking at its continuous repercussions, we may discover that what repeatedly alleviated major crises was actually de-modernization.

Land reform also facilitated China's de-linking from the Western model of modernization. This is because the essence of the land reform was an overall renewal of the peasant economy. During its founding years, the PRC had relied on the complete resumption of the peasant economy to transcend the severe crisis brought on by the old Republic's pursuit of modernization. Land reform enabled peasants to own land, raising their motivation for production, and, in turn, raising land productivity. Therefore, urban demand for produce was satisfied, to the extent that supply was greater than demand. Currency as the medium of exchange for industrial/agricultural commodities between rural and urban sectors was thereby stabilized.

De-monetization and De-linking

In June 1950, the Korean War broke out. In October, China officially entered the war. Because of China's participation in the war, a Sino-Soviet strategic alliance took shape. The former Soviet Union provided military support to North Korea, and aided China in building infrastructure and military production. This, in turn, stimulated demand in the Chinese urban sector and led to a boom in war commodities. On the one hand, this process sped up industrialization and urbanization in China, requiring a large amount of rural labor to move to the cities to participate in building industrial infrastructure. On the other hand, because heavy military industry was indispensable for winning the war, the former Soviet Union was willing to provide strategic subsidies for China's industrialization, regardless of cost. Hence, a source of foreign capital became available to the urban economy, which, in turn, brought the necessary conditions for a

monetary economy. The renminbi, as a medium of exchange, was poised to greatly facilitate the urban and industrial economy, causing demand for the expansion of its supply.

The origin of the Chinese planned economy can be traced to the management system necessary to accommodate the production lines transplanted from the former Soviet Union in 1950. Yet, in those early days, no one in the CCP had a clear idea of what a planned economy was. It was the introduction of production lines into northeast China from the Soviet Union that required the CCP's Northeastern Bureau to work with the management requirement of the Soviet model factories. The Northeastern Small Planning Commission was therefore set up.¹⁰ By 1952, it had become an institutional arrangement for industrial infrastructure in most Chinese cities. More than six hundred infrastructure projects had been initiated and were about to be launched, as arranged by the central government. It was at this point that the Planning Commission was set up at the state level.

Once the State Planning Committee was set up, industrial infrastructure projects were launched in many cities, facilitating non-agricultural employment on a large scale. More than twenty million young and middle-aged peasants were mobilized by the government to go to the city in support of industrial infrastructure. Because of this, cities needed large supplies of grain and agricultural commodities. This, in turn, required the government, who was in the service of state industrial capital, to conduct a large number of transactions with peasants. Meanwhile, it also required the government to increase the money supply for transactions involving industrial and agricultural products. However, the peasants, who had just benefited from the land reform and resumed a highly diversified peasant economy, were comfortable in their modest, self-sufficient ways and did not have incentive to increase trade volume. Thus, the agricultural-commodity trade did not grow. This was the transaction-cost conundrum – the difficulty of transaction due to too many trading parties. It led to the undersupply of agricultural commodities, particularly grain, in the cities. Such was the context in which the central government began the unified purchase and sale system in 1953. The motivation behind this was the practical difficulties of smoothly running the economy, rather than some ideological tenet.

The transaction cost conundrum was resolved by the collectivization movement initiated by Mao. Four hundred million Chinese peasants were put into about forty thousand cooperatives, and the state would purchase their products at market price on a unified basis. By then, it had been three years since peasants resumed production and, in that time, they

accumulated enough agricultural products for this big buyer, the government. Furthermore, the deposit system in place since 1950, based on the “three whites,” had already reestablished the credibility of state-owned banks, and the value of the renminbi was stable. Thus, the government’s unified purchase and sale endeavor went smoothly. Thereupon, the renminbi stood out as the credible sovereign currency that facilitated urban and rural exchanges.

Nevertheless, the all-out Sovietization came with high political costs.¹¹ In 1955, Mao organized a discussion among personnel in charge of more than thirty new ministries, proposing an assessment of the all-out Sovietization. Following this, in 1956, disagreements emerged between China and the Soviet Union on major international events. The first of such divergences was over the 1956 Hungarian Revolution. The Soviet Union had begun tightening its control over Eastern Europe, while the CCP rejected the Soviet Communists’s actions and their understanding of themselves as the patriarchal party. Nevertheless, the CCP reserved its opinions to preserve international Communist solidarity. Regardless, Soviet leaders were not thrilled. Second, also in 1956, in accordance with the Sino-Soviet Treaty, China took back the military base of Port Arthur and the Zhongchang Railway. In effect, China took back all the remaining holds of Soviet interest in the country. This led to a series of rifts between the two nations, including the Soviet Union’s abrupt end to industrialization aid to China as soon as the First Five-Year Plan concluded in 1957. This became the main reason for the derailment of the newly established system of using a monetary economy to facilitate industrial and agricultural product exchange.

From the start of the Second Five-Year Plan period in 1957, industrial capital investment from the Soviet Union changed to a form of trade and was priced accordingly. In 1960, all investments and technical aid were completely withdrawn. The necessary condition for continuing industrialization—a simultaneous increase in capital intensity and upgrade in technical skill—could no longer be met. As a result, the Second Five-Year Plan failed to carry on and materialize. Meanwhile, due to heavy deficits, the Chinese government halted its efforts, after only three years, to increase the monetary supply and apply monetary measures to substitute for the Soviet investments. In 1960, China faced fiscal crisis due to its reckless pursuit of industrialization. This led to a change in development strategy and a new slogan of self-reliance, struggle, pain, and hardship.

China’s early experiences of industrialization showed that if capital-intensive industrialization was to be maintained, it would be necessary to procure industrial equipment from Western countries, including the Soviet Union. Furthermore, the only production lines available for

acquisition during the Cold War were those technologies already obsolete in the West. As such, the goods from these production lines could not be sold to overseas markets. Therefore, the cost of industrial equipment could only be repaid with agricultural products and rare minerals. This liability that took shape in the 1950s during the primitive accumulation of industrial capital led to the sudden eruption of economic crisis in 1960. The state's unified purchase and sale of agricultural products as a way of repaying foreign debt became an even more prominent strategy. Currency no longer carried the function of facilitating exchange – it remained only a method of accounting for state-owned enterprises and village organizations as on-the-book assets or liabilities. Relying on organizations both in cities and the countryside, especially village organizations that secured permanent membership as well as equal land distribution per capita, was sufficient to ensure the creditability of the renminbi. In other words, it became possible to avoid hyperinflation, just as in the old Republic.

Collectivization of Agriculture and State Industrialization

From 1954 onward, China began to produce heavy equipment, such as tractors and automobiles. However, the sale of these industrial goods became a big problem. In 1955, various industrial bureaus had all raised requests to the central government for the sale of industrial products to the countryside. Given that peasants were dispersed in the household economy, urban industrial products simply were not marketable to rural regions.¹² Therefore, in conjunction with the 1956 socialist reform of the urban economy, the central government had driven rural regions to reorganize cooperatives into larger collectives. The township was used as the management unit for this larger-scale agricultural economy. Four hundred million peasants had been organized into forty thousand cooperatives to facilitate the deployment of agricultural machinery and other urban industrial products to the countryside.¹³

The collectivization in 1956 was, in effect, the expropriation of peasants. It took away peasant households's fundamental land-ownership rights, earned with hardship through land revolution. The power to industrialize agricultural operations, on a scale of thousands of hectares, was given to the townships. With that, rural finance's basic function shifted to helping the state complete primitive accumulation of industrialization, appropriating the surplus from agriculture through the price-scissors model.

After the establishment of Advanced Agricultural Producers's Cooperatives in 1956, fiscal and financial systems, including agricultural

financial systems (that is, agricultural banking systems), were set up at the Advanced Cooperatives, or township, level. State authorities, such as the purchase and sales department and the grain department, were deployed to carry out unified purchase and sale. In 1958, cooperatives were renamed “people’s communes” and administered at the township level, like the Advanced Cooperatives. Thereby villages across the country were organized into ninety thousand units. They became carriers of the state fiscal and financial system, as well as grain commerce, essentially transforming into all-in-one centers for the exchange of industrial and agricultural products, as well as fiscal and financial clearing.

The state’s primitive accumulation of industrial capital could only rely on rural collectivization. The people’s communes set up tractor stations (later renamed agricultural-machinery stations) and built factories for five minor industries, including agricultural machinery and agricultural equipment, as well as supporting facilities. Industrial products could thereby find their way into rural sectors. Now, the state could send, according to its plans, various industrial products (not marketable overseas), such as the Soviet Union’s models of lathes, drilling machines, and shining machines, to the towns. The prices of such products were relatively high and their purchase required financial support from the Agricultural Bank, which was mandated to give loans to the communes. Low-level production teams were forced to sell their agricultural products to the state at very low prices. Consequently, the people’s communes increasingly went into debt.

The state, in suppressing prices for agricultural products while raising prices on industrial products, generated profits (known as price scissors) in the exchange between industrial and agricultural products. In this way, the state appropriated seven hundred to eight hundred billion yuan from the rural sector, through collectivization up to 1978, as primitive accumulation for industrialization.

State industrialization is capital intensive and internally decreases labor demand. A dual structure between the city and the countryside thereby began to take shape. In this historical experience of primitive accumulation, peasants were the most affected. Yet, it was not merely a result of the currency system, but rather of the price scissors between industrial and agricultural products, without which there would be no Chinese industrialization. Taking stock of the process temporally, it took China only about thirty years to achieve the primitive accumulation necessary for state industrialization, a much shorter time than it took the West to appropriate the wealth and slave labor from its colonies on four continents, which it used to enter into *its* era of industrialization.

In this exchange between agricultural and industrial products, with collectivization as the carrier, peasants who sold products to the state did not always receive cash in return, and the function of the currency was not entirely achieved. This was because internal fiscal and financial clearing was completed at the commune level. The state was still using a non-monetary exchange system between industry and agriculture. Since the system would not lead to large-scale expansion in money supply, it would not create a basis for inflation. The state appropriated a large amount of agricultural surplus, permitting only a small quantity of agricultural products onto the market, which resulted in a large difference between free-market prices and official prices. Nevertheless, since few people had cash to make transactions, the system did not imply inflation. Instead of using currency, basic urban consumption was allocated entirely in vouchers. In this stage, currency had essentially become a secondary voucher. The primary voucher system determined allocations for residents, while currency was simply an intermediary for procuring those allocations.

Given that currency was not carrying out its basic function, China at the time was still in the de-monetization mode of primitive accumulation. Neither the government nor the peasants and workers could use currency to signify wealth. The content of this de-monetization period (some may label it a typical planned economy) was no more than the government, on the one hand, appropriating rural surplus to support building industry, and, on the other hand, stabilizing people's basic livelihood. It ensured a twenty-eighty to one population ratio between the city and the countryside – urban residents (less than 20 percent of the total population), as well as industrial capital, extorting the limited surplus from peasants (over 80 percent of the population).

In fact, it was the cumulative effect of two different forms of primitive accumulation for industrialization – nation-centered industrialization in the first half of the 1950s, and the subsequent state-centered industrialization – that led to the explosion of institutional cost in the early 1980s. Since that enormous cost weighed on the peasants, a whole series of peasant issues emerged. This de-monetization stage continued into the 1990s. During this period, except for the mid- to late 1980s, price levels were basically stable and inflation was relatively under control.

Road to Monetization

Real monetization began in China in 1992, forced by fiscal difficulty. In the 1980s, after the completion of primitive accumulation, industrial capital started to expand and the pace of industrial development

accelerated. This was followed by continuous growth in employment. Basic livelihood was no longer a problem. Yet the state still allowed urban residents (about 20 percent of the total population) to enjoy the same full subsidies as those of the earlier stage of primitive accumulation. For example, a Beijing resident's needs, from food and housing to health care and funerals, were completely covered by state subsidies. A Beijing citizen's registered residency provided over a dozen vouchers funded by various subsidies. These subsidies, in turn, constituted the basis for various governmental sectors and affiliated enterprises to claim allocations from the state fiscal budgets, which involved many sectorial rights and interests.

In 1992, the state abolished the vouchers system, except in some villages in remote mountainous regions and along the border. The result of annulling vouchers, the primary system of allocation, was that currency, as price equivalence among general commodities, became the medium of market exchange. Thus, in 1992, the renminbi became a currency in the real sense, reviving its basic function of being the exchange intermediary. In other words, 1992 was the first year of China's monetization.

In 1978, all of the deposits in the banking system of China only came out to twenty billion yuan and loans to one hundred billion yuan or more. In the reform era before 1992, the annual banking deposits and loans had merely added up to a few hundred billion. The annual increase in financial assets amounted to only one or two hundred billion yuan. Finance of this scale was hardly significant. Yet, after 1992, the first year of monetization, money-supply growth experienced a sudden upsurge. The annual growth in M2, M1, and M0 were multiples of Gross Domestic Product (GDP) growth. Since then, money supply became like a runaway wild horse: impossible to rein back. China entered an era of high-speed monetization. In 1998, China faced the East Asian financial crisis and was on the verge of crisis itself. By that time, the financial system had already reached tens of trillions of yuan.

Within a short thirty-year period, the expansion in financial assets was staggering, basically leaping up one scale every ten years: in the 1970s it was one hundred billion, in the 1980s it became a trillion, after the 1990s it was ten trillion, and in the first decade of the twenty-first century it was one hundred trillion. Such was the dramatic change after monetization in China, with the renminbi as the tool.

It is noteworthy that the monetization reform in 1992 coincided with and was integrated into the "socialist market economy" as proposed at the fourteenth Congress of the Central Committee of the CCP. Thereupon, money supply had increased on a large scale to facilitate market exchange.

The government strove to transform those resources that were previously not for monetary transaction into assets that could be liquidated in cash. The government strongly drove the commercialization of housing, education, medical services, and so on. The economy and even social life became completely monetized. China's GDP experienced remarkable growth, and the tenet that one should look to money for everything became generally accepted in Chinese society.

The government sped up monetization, converting physical assets into financial assets that could be traded for money. As a result, the nation's total wealth substantially expanded as it became accountable in monetary terms. In the late 1990s, China's tangible assets already reached a scale of one hundred trillion. The renminbi played a vital role in this process.

Lessons from the Soviet Union's Disintegration

The Soviet Union had prioritized political reform. When the regime fell, the currency system it was based on also collapsed. Russian people's lifelong savings vanished overnight. The entire nation's resources, economy, and tangible wealth were plundered through rapid monetization by the fast influx of foreign financial capital, which appropriated a large amount of the institutional returns through the Tobin tax. The institutional cost of prioritizing political reform was the total collapse of the nation's monetary system, and the almost complete wiping out of people's wealth, accumulated by generations.

The lesson from the former Soviet Union is that if the nation's overall economy is not monetized, then even if it boasts a competitive Gross National Product and its physical economy or manufacturing production has led the world, it still cannot compare with the West in terms of GDP. Politicians and reformers under the spell of Cold War soft power believed it was a problem of an inferior national political system. However, the biggest problem was simply that the Soviet Union had remained in the physical economy phase of industrial capitalism and had not upgraded to monetization (financialization).

In comparison, China kick-started its rapid monetization process in 1992, after learning the lesson from the Soviet Union's disintegration: by increasing the supply of money on a large scale to monetize the country's physical assets, the government could receive an enormous amount of seigniorage in the process. As a result, GDP suddenly grew, so much so that, within a few short years, Western politicians had shifted from a discourse of "China's collapse" to "China's threat." This was precisely because China's monetization had facilitated marketization – if there was no expansion of the money supply to bring other physical factors into

the market economy, it would not have been possible to achieve that miraculous growth.

China started rapidly monetizing its economy in the 1990s and faced an even more serious debt crisis, yet was able to weather it without major harm. This is because the process of rapid monetization generated enormous institutional returns. Given that the national currency was still insulated from foreign countries, China was able to benefit from all the institutional returns of sovereign monetization – such was the historic contribution of the renminbi in the 1990s.

This is also why China still insisted on insulating the renminbi from outside markets, even though it was persistently reprimanded by the United States and other Western countries for manipulating the exchange rates and was under continuous pressure to open the sovereign currency to free exchange. This economic principle was attributable precisely to the significant experience of the 1990s. However, monetization had also led to a major change in China's interest structure – the rise of monopolistic financial-capital blocs. China is a massive continental economy and its demand for credit is equally enormous. Thus, with the acceleration of monetization followed the emergence of a vast banking system. This state-controlled, giant financial bloc accounted for over 70 percent of total capital funds in the nation.

Nevertheless, the early phase of China's monetization had been, to a large extent, dominated by local governments. Looking at the entire experience of the 1990s, local governments had all striven to increase local GDP by making use of their respective capabilities and employing all kinds of tricks. This decade may be referred to as a time when local governments competed among each other like corporations, drawing investments while the central government bore all the risks. In this vicious competition, the advantage of coastal regions soon became obvious. Since the 1950s, the overall industrial layout of the country made it so the physical assets were concentrated mostly in coastal regions. When the physical assets became monetized after 1992, growth was obviously much higher in the coastal regions in comparison to the inland. The inequality in capital and returns on capital quickly widened.

Meanwhile, the disparity between urban and rural regions also expanded rapidly. This was because under the conditions of a dispersed peasant economy, agriculture was generally part of the natural economy, with a very low degree of monetization. The problem of the low-income level of peasants, as compared to urban residents, became sharper. This was not a problem of distribution of the institutional returns of monetization – the state had no plans in this regard, nor institutional

arrangements and policy adjustments. As a result, regional disparity, urban/rural disparity, industrial/agricultural disparity, as well as rich/ poor disparity all grew rapidly during the 1990s. The Gini coefficient also rose sharply during this period. All of this was part of the process the country went through in its transformation from a non-monetized economy to a monetized one.

The Cost of China's Monetization in the 1990s

All institutional returns imply corresponding institutional cost. The cost of this monetization in the early 1990s for China was the three aforementioned major areas of inequality—local governments's dominance over the monetization of local assets and resources, the differences in the scale of industrial capital across regions, and the regional disparity in resource conditions.

An even heavier cost was that, since the central government had to take all the financial risks, local governments, in pursuing investments to drive growth, did not consider the extent to which bad assets would accumulate in a state-controlled, monopolistic financial system. By the late 1990s, the portion of non-performing assets in the state-owned financial system generally exceeded 20 percent, and even 30 percent in certain financial sectors. If it had occurred in countries whose currencies could be exchanged freely and where banking was marketized, such a financial entity could only go bankrupt, such as in the case of Lehman Brothers. In fact, at the time when Lehman Brothers went bankrupt in 2008, its percentage of non-performing assets was not as high as that of China's banking industry in the late 1990s. Yet, Lehman Brothers went bankrupt while the banking industry in China did not. In fact, not only did China's banking sector stay solvent and intact, it even developed to give birth to some of the world's top banks in the twenty-first century.

The reason for this is that the state-fiscal and banking sectors were not fully segregated at the time. It was not until 1997, during the East Asian financial crisis, that then-Premier Zhu Rongji started to fully segregate the state fiscal function from the financial industry, to prevent the central fiscal system from being hijacked by rash local governments. Furthermore, then-President Jiang Zemin supported this move and deposed Beijing's municipal head Chen Xitong, who led the opposition against macro regulation. Only then could the central government drive forward the reform on banking commercialization to enable banks to become independent of all levels of local fiscal function.

Obviously, the state-owned financial sector could not completely sever itself from the central government's fiscal system, because large amounts

of bad assets that had been peeled off from the banks required central government funding. To this end, the State Council set up the investment company Central Huijin Investment to convert foreign currency reserve into capital investments in state-owned banks. Before that, the central fiscal budget had also come up with part of the capital funds for the banks. In this way, the financial system in the form of commercial banks was able to function independently.

This financial marketization – commercialization of the state-owned banking system – took about five years, from 1998 to 2003. Although it achieved the centralization of banking power, as well as the severance of banking from the local fiscal system, the banking system was still closely linked to central-fiscal capacity and the central government's foreign exchange reserve (financial sectors under the control of the central government). Consequently, China had a gigantic monopolistic financial sector, in which many banks ranked among the top of the world, that was precisely in line with the overall trend of global financialization, where large monopolistic finance reaped the greatest profit.

Financial Globalization

During the period between 1998 and 2003, China completed its banking commercialization reform, which coincided with financial globalization. The Chinese financial sector then faced the repercussions of the series of global financial disasters of the early twenty-first century: since 1997, after the East Asian financial storm, there were successive financial disasters in Russia, Latin America, New York, Spain, Greece, Ireland, and the rest of Europe. These financial crises took place in the context of financial globalization. Nations in crisis were asked to give up core economic sovereignty, which involves currency credibility based on political authority to monetize a nation's resources and assets. By depriving other nations of their economic sovereignty, powerful countries can monetize resources and physical assets around the world with their strong currencies. The strength of the U.S. dollar has been invincible with the backing of military power, and only a few nations have been unwilling to submit to it. These countries have since become the enemies of financial globalization.

When nations become a part of financial globalization, it amounts to them giving up monetary sovereignty, which is at the core of their economic sovereignty, and, in turn, means giving up their capacity to regulate their macro-economy to respond to crisis. In financial capitalism, a nation must coordinate all of its power to secure currency sovereignty, because the government must rely on political authority to expand credit

on two sides: on the one hand, there is currency credibility, by which money supply can be expanded in large quantities, and, on the other hand, there is debt credibility, which increases national debt by large quantities. In the age of financial globalization, it does not matter if it is the U.S. government or the Chinese government, whatever country succeeds in expanding its credibility is the winner.

Of course, a series of complicated issues remain. One of them is that a large amount of credit creation would have an impact beyond the nation itself. For example, the U.S. dollar is a world currency. The U.S.-dollar reserve makes up 70 percent of the world's foreign exchange reserve. Therefore, the U.S. dollar can proceed with its global expansion.

The astronomical expansion of money supply in the United States has not induced hyperinflation in its economy. Then where does the large amount of additional U.S. dollars go? On top of the increased foreign exchange reserves in various countries, at least 60 percent of those dollars have flowed into the world's futures markets, such as raw materials, energy, staple grains, and so on. As a result, the prices of grains, commodities, and oil fluctuate wildly. With every surge there are hundreds of billions of dollars more, and with every crash hundreds of billions of dollars vanish, as if fed into a monetary incinerator. Hundreds of billions, even trillions, of dollars's worth of electronic symbols are created out of nothing, then disappear into the void, since these currency symbols do not represent real wealth, but are merely symbols of credit conjured by political authority. The virtual value of these symbols could be high or low, and the authority could release the currency or withdraw it. Therefore, every large-scale decline in the financial market serves to consume part of that massive, additional created credit.

The United States excels at playing this game of monetary strategy. Without resorting to military force, and relying simply on soft and smart power, the country has, time after time, provoked inflation in energy, raw materials, and food. Nations importing these commodities on a large scale then have to import inflation at the same time. If these countries rely on general manufacturing of low marginal profitability, their economies are hit hard, resulting in high unemployment, monetary instability, and even political regimes. What follows is then an unimpeded inflow of U.S.-dollar capital, monetizing what remains of those nations, their resource-type assets and production-type assets. The returns of monetization are then swept away, leaving behind economic ruin and political turmoil, what we refer to as the "tyranny of monopoly finance." Nations around the world have lost this game of monetary strategy.

As of now, Russia is trying to break the rules of the game. The Russian president has renationalized the country's largest oil and gas resources, then hitched a ride in the U.S.-manipulated energy-market price upsurge. The premium profit is used to improve people's welfare and fits into Russia's larger strategic play. Of course, this has also led to a geopolitical clash between the United States and Russia. Similar cases include Venezuela, Iran, as well as, formerly, Iraq and Libya. For example, after the launch of the euro, Iraq announced that it would no longer use the U.S. dollar for oil-trade clearance. This implied that tens of billions of U.S. dollars would be sold in the international market, inevitably starting a domino effect. Iraq was then invaded by U.S. military forces and its ruler was brought to the gallows. The former Libyan president not only nationalized its oil resources after coming to power, using the large amount of oil revenues on social welfare (Libya was once known as the Switzerland of the Middle East), but even dared to announce the abandonment of U.S. dollars and the euro for oil trade clearance under the attack of continued financial crises. He envisioned gold as the medium of oil trade clearance. As expected, Libya eventually faced a proxy war. After military defeat and the president's execution without trial, Libya was said to have been liberated and once again reverted to a tribal society. Its oil resources were already carved up by transnational companies of the foreign nations that had joined the war.

Today, the power of currency has already transformed itself into an "alienated power" independent of other spheres. This alienated power, with a direct and intimate link to political power, has become the dominant power of financial globalization and will continue to lead to an extensive and fundamental restructuring of the globe. If this structural change is not properly considered, if we still limit ourselves to the discourse of industrial capitalism and obsolete debates about institutional reform, then we cannot understand twenty-first-century financial globalization – large-scale money-supply credit creation and public-debt expansion. A fundamentally new landscape of competition among nations is taking shape.

China today is still able to stand on relatively firm ground despite fierce international competition. The reason for this is nothing more than what we have persistently emphasized: currency sovereignty is part of the core of economic sovereignty. While Chinese leaders have kept promising to liberalize the renminbi in the future, they have not committed to any fixed schedule. At the same time, China's fiscal policy, financial system, and foreign exchange management are still within its own control. The Chinese government still holds macroeconomic autonomy in the era of financial capitalism.

It is now the key moment of strategic choice: if China is to follow in the footsteps of the West in pursuing financial capitalism, then it is necessary for it to totally liberalize and deregulate its financial-derivative market due to the pressure of excess liquidity, and to enter the competition of global capitalization. Nevertheless, that road has proven unavailing by the large nations that have experienced bubbles and crashes in their virtual economies. If China is to correct the alienation of financial capital, reintegrating itself into industrial capital, then it is necessary to strengthen the hand of the government. Externally, it must prevent cost transfer from financial globalization and, domestically, it must strengthen macro regulation and rebalance its different sectors.

Furthermore, what practical function should the renminbi be perceived to play in its next step toward internationalism? Would Chinese leaders proactively learn the lesson from the West's appeasement policy in the 1940s when industrial capitalism turned fascist? How should China use the renminbi to facilitate securing a proactive, competitive position amid financial globalization? These are urgent questions for China in its construction of a new currency strategy.

Internationalization of the Renminbi

China's development mode of the past thirty years has come to a dead end. The profitability of general manufacturing has been declining, even approaching zero. Meanwhile, an enormous amount of liquidity has accumulated in the capital market. Interest blocs in the financial sector have become increasingly influential, pushing for deeper financialization and internationalization of the renminbi.

In effect, the intent to internationalize the renminbi is driven by the need to export excess financial capital.

With China accounting for an increasing share of the global economy and with Asia becoming the region with the highest development potential, it would best suit Asia's long-term interest for China, Japan, Korea, and the ASEAN countries to integrate into an equal and complementary free trade zone, as well as to form an Asian currency alliance. This would mean an inevitable decline of the U.S. dollar's domination in Asia and, in turn, a negative impact on the core geo-currency strategy of the United States. To protect the dollar's hegemony, the United States has, in recent years, reverted to influencing Asia through its high-profile Asia-Pacific Rebalance strategy. Moreover, before Trump came to power, the United States had actively pushed for the Trans-Pacific Partnership, which excluded China. These efforts mean to ensure the future of the United States and the maintenance of the enormous dollar pool in Asia-Pacific. As a

response, China's Belt and Road Initiative and the Asian Infrastructure Investment Bank (AIIB) are intended to break through the containment of the United States-Pacific Alliance, using the nation's vast continental depth and long continental-oceanic frontiers to create a renminbi pool on the Eurasian-African megacontinent.¹⁴

Dual Orientation in the Internationalization of the Renminbi

In comparison, the predicament of the renminbi in its rise is almost identical to that of the euro. For any rising regional currency to go a step further and become a global currency, it would inevitably, intentionally or unintentionally, challenge the position of the U.S. dollar. Yet, while still in the emerging process, the currency in question would not have the advantage of the dollar, which is the ability to profit from the entire world. All it could do is accelerate the deepening of domestic financialization to support the profitability of financial capital through internal squeezing in order to, in turn, secure the value of financial assets based on that currency. Hence, the more the financial interests are internationalized, the more the national economy is financialized.

In a nutshell, there are two different sets of goals and interests in the internationalization of the renminbi.

First, part of the fundamental strategic goal of the Belt and Road Initiative is to find an outlet for China's excessive production capacity. To facilitate this, there must be regional institutional arrangements in finance and currency exchange. This is like the establishment of the Bretton Woods system after the Second World War, which facilitated the U.S. export of goods around the world. The AIIB, the Silk Road Fund, the New Development Bank of the BRICS countries, and so on, that have been set up with the lead of China, are transnational institutional arrangements for this strategic goal. At the same time, there is a need to coordinate such arrangements with the establishment of exchange agreements between the renminbi and other regional currencies, which would form a non-U.S.-dollar trade-clearing system. The first step in internationalizing the renminbi is regional rather than global. It relies on China's multi-lateral strategic partnerships, as well as the forging of a regional renminbi pool.

Second, it is inevitable that the internationalization of the renminbi would have further implications. Financial blocs in China expect to expand their interests and power. Large-scale infrastructure projects and international trading would, in any case, require complex financial services such as credit creation, financing, and clearing. The risk is that the enormous profits generated from the internationalization of the renminbi may drive financial groups to overexpand in attempts to forge quality

renminbi-based financial assets. Overexpansion of the financial sector may compromise the real economy. Unprecedented financial crises may be looming on the horizon, like the subprime bubble in the United States and the European debt crisis.

In brief, making use of financial tools to push forward the national strategy of the Belt and Road Initiative, while at the same time effectively preventing the overambition of financial interest blocs is a formidable challenge.

Joining the Special Drawing Right

The renminbi exchange-rate reform that shook the world on August 11, 2015, has been regarded as the move toward a more market-oriented Chinese economy. Later that year, in November, the International Monetary Fund (IMF) announced the inclusion of the renminbi in the currency basket of the Special Drawing Right (SDR), effective October 2016. The weight of the renminbi ranks in third place (10.92 percent of the SDR basket), behind the U.S. dollar (41.73 percent) and the euro (30.93 percent). However, the IMF emphasized that China should complete its marketization of the exchange-rate mechanism within three years.

The SDR is the IMF's unit of international currency. It originates from John Maynard Keynes's proposal at the Bretton Woods conference for an international currency. Ideally, its weighting would reflect the respective situations of the participant countries in international trade. Keynes's idea was to build a stable international currency to prevent dominance by any single currency, and to prevent long-term structural imbalance in international trade. However, the United States was against the idea as a matter of course, and aimed to build up its dollar's hegemony through the Bretton Woods system. After the Second World War, the U.S. dollar became the unchallenged international reserve currency and clearing currency. Since the end of the Bretton Woods system, the U.S. dollar's exchange rate has fluctuated to serve the geo-currency strategy of the United States, according to its domestic economic situations. The international monetary system has entered a chaotic era.

Ideally, the SDR currency basket should have replaced the single dominant currency and developed into a stable international currency, becoming the clearing unit for international trade and reserve currency among central banks. Yet, with the United States unwilling to give up its dollar's hegemony, the SDR at present does not serve any real purpose and, perhaps, could not even be regarded as a form of currency. Although the IMF has allocated SDRs to member nations several times, up until January 2015 the SDR only accounted for less than 4 percent of total global-currency reserve. Since its inclusion in the SDR, which was widely regarded

as the first time the renminbi's international position was acknowledged, there has been no significant increase in renminbi demand as a reserve currency. For China in the short term, it is of symbolic significance rather than real benefit. Interestingly, while the United States has in recent years censured and even suppressed China in international affairs, it was supportive of including the renminbi in the SDR. It is widely known that China has defended its currency sovereignty all along, and withstood pressure to appreciate the renminbi to avoid depressing the export sector and, in case of a large influx of speculative funds, to reap profits by hedge trading on the exchange rate.

The inclusion of the renminbi in the SDR is a double-edged sword for China. Compared to the long-term benefit, the short-term issue of how to maintain full currency sovereignty is even bigger. Including the renminbi in the SDR implies accelerating the opening of China's capital account, such that international capital will be free to flow in and out of China to take advantage of financial-market volatility. This would be in line with the strategic interest of transnational financial capital, seeking quick kills around the globe.

Given that China's domestic financial capital also has interests in capital account deregulation, there would appear to be a complicated multilateral scenario. Among the three interest groups—domestic industrial sectors, domestic financial sectors, and transnational financial capital—what kind of relationships would form? Now, on the one hand, the renminbi accounts for only 1.1 percent of the global reserve.¹⁵ Renminbi assets would have to grow by 330 billion U.S. dollars before it could reach the level of the Japanese yen. On the other hand, China's export trade, which clears in the renminbi, has already reached 26 percent. Furthermore, with the increasing renminbi deposits around the world, the demand on renminbi financial products are also rising. Some estimate that by 2030, the Asia-Pacific region will account for 40 percent of global GDP and two-thirds of the global middle class, with China's middle class growing from three hundred million to six hundred million. China, and the entire Asia-Pacific region, would have the biggest consumer market for goods. By then, will the renminbi have become the major trading and clearing currency in the region? If so, how will the conflict between Chinese and U.S. strategic goals be resolved? This will probably be the most crucial question for Pacific Asia, and even the world, over the next decade.

On the road to financialization and currency internationalization, where crises lurk at every turn, will China be fortunate enough to be spared?

Notes

1. The renminbi, which means "the people's currency," has been the official currency of the People's Republic of China since its establishment by the Chinese Communist Party in 1949.

2. At the end of the Qing Dynasty, China was forced to pay an estimated 950 million taels of silver in war reparations due to military defeats, including in the Boxer Rebellion (450 million taels), the First Singaporeans War (200 million taels), and the two Opium Wars.

3. Liu Yunzhong, "Impact and Implications on the Chinese Economy of the US 'Silver Purchase Act' in 1934," *Research Report 200* (2005), People's Republic of China's State Council Development Research Center.

4. China had to purchase military equipment with precious metals, as a global form of hard money. Using China's fiat money to purchase armory would not have been possible.

5. In the invasion, over 40 percent of the bullets and cannonballs fired on China by the Japanese were from the United States. Tao Xingzhi, a famous educator, was studying in the United States and upon leaving claimed that 46 percent of Japanese armory was supplied by the United States and the United Kingdom.

6. Under the Bretton Woods system, only the U.S. dollar was pegged to gold and thus became the world's reserve currency.

7. It was widely known that after the Bretton Woods Agreement was dissolved, the dominant currencies were backed more by political power than by gold. In the early 1950s, China still backed its currency with precious metal reserves to some extent.

8. At that time, the monthly inflation rate reached over 30 percent, a rate much more severe than that of today.

9. At the beginning of the new republic, the banks guaranteed the value of a deposit by anchoring it to a basket of "white rice, white flour, and white cloth" of a certain quantity. This does not mean that people would bring rice, flour, and cloth to banks for deposit. Rather, the banks made the commitment to people, regardless of the severity of inflation, that they would honor the deposits and pay them back in cash in the amount equivalent to their purchasing power when deposited.

10. In 1953, the Korean War ended. Well before the end of the war, the USSR and China formed a strategic alliance, based on which the USSR committed to support China in building industrial infrastructure by exporting its armory-production lines. Of course, over 70 percent of Soviet aid was for the production of military armory and facilities.

11. At the time, China only had a small set of skilled personnel in urban industries. It was thus impossible not to

completely employ Soviet experts to help China establish its schools, government, administration, and all enterprise units. Chinese factories had Soviet heads, Soviet chief engineers, and Soviet technicians. China had to provide relatively high salaries to Soviet management and technical personnel.

12. At the time, Elementary Cooperatives were already established. They were introduced by Mao to help Chen Yun resolve the problem of unified purchase and sale. The early cooperatives were for carrying out the country's unified purchase and sale, appropriating agricultural surplus, and facilitate market exchange.

13. In Western economic theory, this is referred to as reduction of transaction costs. The central government proposed agriculture modernization in 1956. The objective was to achieve agricultural mechanization through collectivization, in response to the need to create an outlet for urban industrial goods.

14. Sit Tsui, Erebus Wong, Lau Kin Chi, and Wen Tiejun, "One Belt, One Road: China's Strategy for a New Global Financial Order" *Monthly Review* 68, no. 8 (January 2017): 36-45.

15. Wolf Richter, "US Dollar Refuses to Die as Top Global Reserve Currency," *Wolf Street*, January 1, 2018, <http://wolfstreet.com>.

MONTHLY REVIEW *Fifty Years Ago*

The economic dependency of the underdeveloped countries as the suppliers of food and raw materials to the developed countries results in financial dependency as well. And this financial dependency serves to cement the economic dependency. This process usually follows the following lines: Fluctuations in the demand for and hence the price of the primary products exported by the underdeveloped countries creates frequent deficits. The deficits are financed by borrowing from the creditor countries. Servicing the debt – payment of interest and amortization – requires that a portion of future exports be devoted to this purpose instead of buying needed imports. Hence, further borrowing is induced to pay for their regular imports. This cycle of economic-financial dependency becomes even more pronounced, paradoxically, as a country tries to advance via the established capitalist path. For then the country imports capital goods from the same creditor nations and goes even further into debt: the capital goods are bought on credit and have to be paid for in the currency of the supplying country.

– HARRY MAGDOFF, "The Age of Imperialism, Part Three,"
Monthly Review, November 1968.

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