



## REVIEW

Last week we learned that China was a **monetary pioneer** because of its cultural innovations with regard to:

- String money
- Money measured by weight
- Minted coins
- Credit
- Currency as a function of the state
- Monetary value backed solely by "full faith and credit"
- Paper money
- Banks (in the form of money shops)
- Agricultural subsidies
- Official reserves
- Central bank



## SILVER AND THE OPIUM WARS

Spence provides some data points about the annual flow of silver into China during Qianlong's reign (1735-1799), in taels of silver (1 tael = 50 grams).

- 1760s – 3.0 million
- 1770s – 7.5 million
- 1780s – 16.0 million

From 1650 to about 1820, which was the year the opium trade really began to accelerate, it is estimated that China received a surplus of nearly 28 million kilograms of silver from European traders. The Brits, on the gold standard during this time, had to obtain the silver from the Spanish colonies.

Jonathan Spence in his book *The Search for Modern China* sums up the issue:

"Over the previous century, the growing demand in Europe and America for Chinese teas, porcelain, silk, and decorative goods had not been matched by any growth in Chinese demand for Western exports such as cotton and woolen goods, furs, clocks and other mechanical curiosities, tin, and lead. The result was a serious balance-of-payments problem for the West. Westerners had to pay for Chinese goods mainly in silver, and this steady flow of silver into China—one of the causes of the general prosperity in Qianlong's reign—became a source of alarm to the British government."

## HOW DID THE OPIUM WARS START?

1834 – The British East India Company lost its royal charter on monopoly Asian trade, opening up the opium trade to thousands of private entrepreneurs. Americans joined in on the fun with cheaper Turkish opium. Opium prices fell. Opium use soared.

1839 – Emperor Daoguang gets scholar Lin Zexu to write a letter directly to Queen Victoria, asking her to stop the unseemly trade. Of course, the British merchants, who despite competition are selling 1400 tons of opium per year, want money.

1839 – 20,000 chests (estimates range from 1.1 million kg to 3 million pounds of opium) were destroyed by Lin's people as a condition for resuming drug-free trade. The Brits demanded reparation for the destroyed product, refused to cease dealing drugs and started the Opium Wars in order to gain even more concessions.

Much like the South used "state's rights" to justify the Civil War, the West (including many in the US) used "free trade" to justify the Opium Wars.

First Opium War: 1839 – 1842 (aka Anglo-Chinese War)

## WHAT CAUSED THE OPIUM WARS?

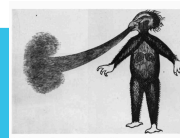
### Broader causes:

- the social dislocations that began to appear in the Qing world,
- the spread of addiction,
- the growth of a hard-line mentality toward foreigners,
- foreign refusal to accept Chinese legal norms,
- changes in international trade structures, and
- the ending of Western intellectuals' admiration for China.

### Specific causes:

- oversupply due to stockpiling in order to bet on potential legalization,
- the superintendent of trade had recently changed from being a British East India Company official with to a government rep (*the Chinese just saw another "barbarian"*)
- the traders wanted compensation for the seized (and subsequently destroyed) opium

"An old hairy one"  
– a Chinese sketch of an English sailor, 1839



## ESCALATION OF OPIUM TRADE

### BRITISH SALES OF OPIUM TO CHINA<sup>6</sup>

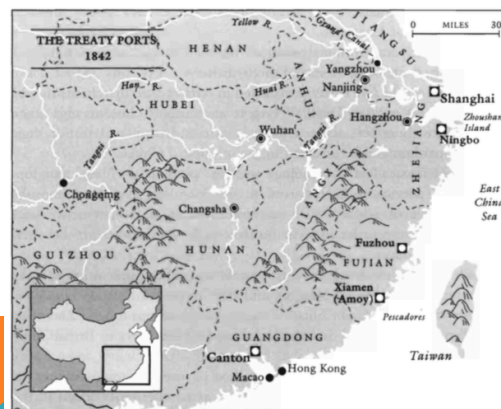
Year	Number of chests
1729	200
1750	600 (est.)
1773	1,000
1790	4,054
1800	4,570
1810	4,968
1816	5,106
1823	7,082
1828	13,131
1832	23,570

Spence also gives us two other data points not included in this chart:

1835 – 30,000  
1840 – 40,000

Also, he states that "by 1800, the East India Company was buying over 23 million pounds of China tea at a cost of £3.6 million."

Approximately how much opium was needed to be traded each year just to balance the tea trade? How much to begin to recoup some of the surplus silver?



### TREATY PORT SYSTEM

As part of the Treaty of Nanking (1842), which ended the First Opium War, Britain forced China to open up 5 of its port cities to free trade and habitation by foreign nationals - Canton (Guangzhou), Amoy (Xiamen), Fuzhou, Ningbo, Shanghai.

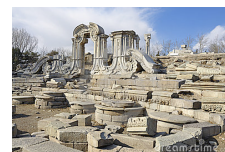
Previously, under the "Canton System" this trade had been restricted to a small part of Canton and had been subject to strict regulation by the *Cohong* (公行) trade group. This group of between 5 and 26 merchants essentially bribed the Qing emperors into allowing them to hold a monopoly over the lucrative Chinese export trade in the 18<sup>th</sup> and early 19<sup>th</sup> centuries.

Britain's successful treaty negotiations led to other Western powers negotiating their own treaty, including the American's Treaty of Wanghia (1844) that expressly forbade the trading of opium. Together, all of these treaties are known as the "unequal treaties".

Further treaty ports were negotiated after the Second Opium War.

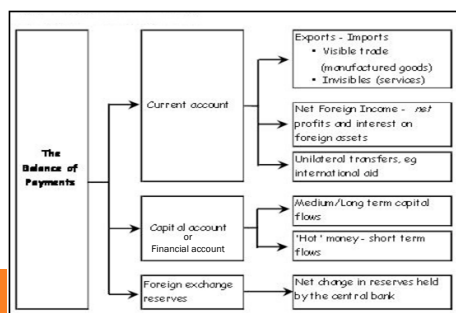
The treaty port system would essentially last until World War II.

### YUANMINGYUAN RUINS



Second Opium War: 1856 - 1860 (Arrow War)

### BALANCE OF PAYMENTS (BOP)



### NOTES ON BOP

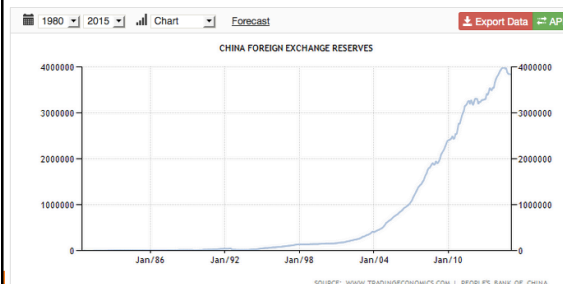
- Tracks all financial flows that cross a country's borders in a given period.
- **Capital Account ~ Financial Account**
  - Direct investments made by companies
  - Portfolio investments in equity, bonds, & other securities
  - Other short-term investments & liabilities ("hot money")
- Some texts (like the CFA) distinguish the capital account (KA) as something between the current account (CA) and the financial account (FA). In their definition, KA is a very small account for aid, debt forgiveness, and expropriation losses.
- **By accounting definition, the sum of all BoP MUST BE ZERO!!!**
  - Formula:  $CA + K/FA + OR = 0$
- In other words, the OR is a plug to the equation that represents the overall balance.

### EXAMPLE: US BOP (2004)

EXHIBIT 2 U.S. Balance of Payments for 2004

Current Account (CA, in Billions of Dollars)		Capital Account (KA, in Billions of Dollars)	
Goods	—\$665	Net capital transfers	—\$2
Services	+ \$48	Financial Account (FA)	
Net income	+ \$30	Net foreign direct investment	—\$145
Current transfers	—\$81	Net portfolio investment	+ \$660
<b>Total</b>	<b>—\$668</b>	Net banking and other flows	+ \$67
		Net statistical discrepancies	+ \$85
		<b>Official Reserves</b>	
		Net change in official reserve assets	+ \$3
		<b>Total</b>	<b>+ \$668</b>

### CHINA FX RESERVES (OR), 1980-2015



### REPUBLIC OF CHINA (1911 – ???)

1912 – Yuan Shikai, who is simultaneously the first president of the ROC and also proclaimed himself the first emperor in a new dynasty (1915-1916), unified the currency using his “big-headed Yuan” silver coin.

1933 – Shanghai, already firmly China’s monetary center, abolishes the various silver coins and regional currency in favor of the dollar.

1937 – *Fabi* (法币) became the standard paper currency, essentially pegged to both the pound sterling and the American dollar. The “silver standard” was effectively abandoned by exchanging Chinese silver deposits for U.S. dollar deposits.

1948 – *Fabi* replaced by the gold yuan banknote, which lasted for 9 months until the “resolution” of the Chinese Civil War.

### BIG-HEADED YUAN



Also called the “Fat Man” or “Big Head” Chinese Silver Dollar.

### THE SHORT-LIVED CHINESE DOLLAR



### FABI (法币)



### NEW CURRENCY FOR A NEW CHINA 新中国

On December 1, 1948, three banks merged to form the People's Bank of China (PBOC):

- North China Bank
- Beihai Bank
- Northwestern Peasants' Bank

PRC currency, since even before the founding of the country, has always been "totally disassociated from gold."

As always, China was a monetary system pioneer by developing a currency that was solely "backed by government tax revenues and state-owned commodities and materials."

Thus, the RMB is an early form of *flat money*.



First series RMB.  
第一套人民币

### WHAT IS FIAT MONEY?

*Fiat* is defined as "a command or act of will that creates something without or as if without further effort." Its closest synonyms are *dictate* or *decree*. It is derived from the same Latin word as *fate*.

*Fiat money* implies paper currency that cannot be converted into another commodity or asset (gold/silver or even exchange reserves) of equivalent value.

Both its value and its supply is determined by government order and is thereby made a legal instrument for financial transaction purposes.

It is the basis of the ENTIRE modern monetary system.

Its real value is determined SOLELY by market forces of supply and demand.

