



## WHO AM I?

Submit assignments to this address.

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- **EDUCATION**
  - Bard College (NY), B.A. Asian Studies
  - University of South Carolina, IMBA Finance
  - studied at Tsinghua University, Corporate Risk Management & China Strategy
  - East China Normal University, Ph.D. Politics (in progress)

### CONSULTANT

Globinvest, PwC, Business Connect China

### WRITER

VICE News, Seeking Alpha contributor, blog at [LowBetaPortfolio.com](http://LowBetaPortfolio.com)

*Myanmar 2014: New Information and Cultural Insights* Entrepreneurs Need to Start a Business in Myanmar, co-author w/ Derek Silvers

## WHY DO I LOVE FINANCE?



1989



2001



2009

## INTERNATIONAL FINANCE AND TRADE (IFT)

### FALL 2015

- **1 session per week**
  - Friday 1:00 – 4:15 (incl. 15-min. break)
  - Room 308, ECNU Physics Building (subject to change)
- **Classes: September 18 – December 18**
- **PLUS TWO (2) MAKE-UP SESSIONS (TBD)**
- **ALL work due by Tuesday, December 22. NO EXCEPTIONS.**

### TEST DATES

- **MID-TERM: November 6**
- **FINAL EXAM: December 18**



華東師範大學

EAST CHINA NORMAL UNIVERSITY

## COURSE READING

**Textbooks** (\*Prof. K will provide digital copies)

- *International Economics: Theory and Policy*. (2012). by Paul Krugman, Maurice Obstfeld, & Mark Melitz.
- *The Offshore Renminbi: The Rise of the Chinese Currency & its Global Future*. (2013). by Kelvin Lau & Robert Minikidn.
- PwC. *Banking and finance In China: The outlook for 2015*.
- Assigned readings (see Syllabus)

### Assignments

- Quantitative homework
- Reading of textbook chapters & various articles as assigned
- Research for mini-presentations, presentations & papers



## COURSE OBJECTIVES

### 1. To provide an overview of:

- Key theories of International finance and trade
- Balance of payments analysis
- International financial institutions
- China's unique financial system & onshore and offshore markets
- Exchange rate regimes and forecasting tools

### 2. Have fun!

## COURSE ASSESSMENT

- |  |     |
|--|-----|
| • Mid-term Exam                                    | 20% |
| • Final Exam                                       | 30% |
| • 2 Journal Article Findings & Presentations       | 15% |
| • 2 Quantitative Homeworks & Case                  | 15% |
| • Class Participation                              | 10% |
| • Class Attendance                                 | 10% |
| ❖ Optional - Presentation (at least 20 minutes)    | 10% |
| • Mid term exam weight will be reduced to 10%      |     |
| ❖ Optional - Research Essay (at least 1,000 words) | 10% |
| • Final exam weight will be reduced to 20%         |     |

\*If you choose to do the optional assignments, you must get your topic approved by Prof. K before you start doing the work. I encourage you to do **at least one** of the optional assignments.

## WHAT IS FINANCE?

Derived from Latin *finis*, which means "boundary, end."

In English, *finance* has been used as a noun since 1739 and as a verb since 1866.

As a verb, *finance* describes the method of getting money to pay for things.

As a noun, *finance* relates to all the various ways that people can manage money:

- personal finance
- corporate finance
- public finance

When *countries* manage money, it is called **international finance**.

The study of finance lies at the confluence of economics, accounting, and math.

Contrary to popular belief, financial math is not that difficult. Only a few applications require high-level algebra and even fewer require an understanding of calculus.

## WHAT IS THE YUAN?

The Chinese call the US dollar *měiyuan* (美元), the American yuan.

The Japanese and Korean names for their currencies, the yen and the won respectively, are derived from the same Chinese yuan character. The Chinese name for the Japanese yen is the “rì yuan” (日元).

Measure word - “kuai” (块), literally “piece”, the word historically used for coins.

• Eg. “10 kuai qian” literally means “10 pieces of money”.

“Kuai” is colloquial, like “quid” in the UK and “buck” in the US

Measure word - “jiao” (角) and “fen” (分)

• 1 yuan = 10 jiao

• 1 jiao = 10 fen

Colloquially most people use the word “mao” rather than “jiao” instead.

The character is the same as Mao's surname, but used long before he was prominent

## WHAT IS THE RENMINBI?

• Renminbi (RMB, ¥, CNY, 元, 人民币) is the official currency of the People's Republic of China (PRC)

• *Rénmínbì* means “people's currency”.

• Renminbi is legal tender in mainland China, but not in Hong Kong or Macau

• Issued by the People's Bank of China, the monetary authority of the PRC.

• Names: simplified Chinese: 人民币; traditional Chinese: 人民幣; pinyin: *Rénmínbì*

• *Yuan* is the name of a UNIT of the renminbi currency.

• Something may cost 1 yuan or 10 yuan.

• It is incorrect to say that it costs 10 renminbi.

## WHY CHINA?

Market be crazy. That's why!

Down 7%, Up 5.55% = 12.55% swing

\$1 trillion market cap swing in one day on June 30, 2015.

Two days later, by the market close on July 2, the Shanghai market had already closed below the low shown here.

Certainly, China is using some very questionable/innovative techniques with its market, but it's certainly not the first time that China has pushed the envelope in international finance...



## PRE-“CHINA” MONEY

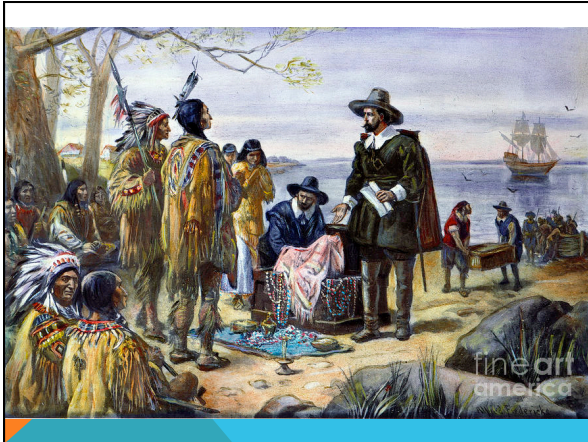
In the Shang (1600 BC ~ 1046 BC) & early Zhou (1046 BC ~ 711 BC) Dynasties, currency was simply cowrie shells brought from Shandong province and the Maldives.

It took the form of jewelry:

- A string of 10 cowries (贝) = 10 peng = 0.25 acres
- 20 peng = 3 mu (亩) = 0.5 acres (1 acre ~ 6 mu)

Not unlike the beads used by the Dutch to purchase Manhattan around 2,000 years later – in 1626.





## BRONZE & COPPER MONEY

Obviously, shells don't make the best currency. With economic development in the later Zhou Dynasty (770 BC ~ 221 BC), the concept of "money measured by weight" began to take root.

In the Warring States Period, coins were different shapes and sizes by region :

- Spade-shaped (Jin: later Zhao, Han, & Wei) from the agricultural heritage of China's heartland.
- Knife-shaped (Qi & Lu) from the fishing heritage of this coastal region.
- Shell-shaped (Chu)



Spade-shaped bronze money.



Shell-shaped copper money.

## KNIFE-SHAPED MONEY (刀)



## QIN & HAN DYNASTIES

Unified China =>  
Unified currency.

Qin Dynasty (221 BC ~ 206 BC) adopts 3-tier system:

- Gold
- Bronze & Copper
- Jewelry, Silver, Tin

Liu Che a.k.a. Emperor Wu of the Han Dynasty (206 BC ~ 220 AD) bans private coinage (with limited success) and begins to mint the five-zhu coin (五铢), which became the ideal for many future Chinese coins.

Wu also instituted 3 forms of **credit**:

1. Disaster relief (government-based lending)
2. Ziqian holders (non-government speculation)
3. Lending by monks & temples





## SUI & TANG DYNASTIES

Yang Jian, who would become Emperor Wen of the Sui Dynasty (581 – 618), issued the order that "the old money used in the marketplace shall be confiscated by the government", solidifying the idea that currency was a function of the state.

However, this idea was not fully realized until the venerable Tang Dynasty (618 – 907) Emperor Taizong issued the *kaiyuan tongbao* to "inaugurate the reign".

Chinese numismatists now refer to these coins as *tong qian* (通钱).

*Tongbao* (通宝 meaning "treasure in circulation") were the first coins that

- relied on the "full faith and credit" of a government. Unlike previous coinage, they did not rely on weight for their value. In later years, this privilege would be abused.
- There were never enough in circulation, i.e. the **money supply** inadvertently affected prices.



## FEIQIAN (飞钱) "MONEY ON THE FLY"

Due to the severe money supply problems, the concept of credit was strengthened by *feiqian*, the equivalent of a money order that prevented the troublesome conveyance of actual physical money to and from hometowns and business centers.

Not yet official "paper money" just yet but is a step on the way to it.

Coin money was submitted either to a

- "memorial submission office" to ease the payment of taxes (at the time the capital was 长安 (Chang'an which is modern day 西安 Xi'an) OR
- Money shop**, essentially a safety deposit box at a local inn. But when these shops began to offer mortgages on the assets held at the shop they became de-facto banks.

These institutions allowed for corruption, as government-ordained tax collectors would lend money against their future cash flows at high interest rates and then would use their status as government officials to enforce and collect payment. This practice was called "yeomen money" and originally was intended to provide work for these officials in-between tax times... but they would eventually just be called "money snatchers".

## SONG DYNASTY COINS (宋代钱)

Here we can see why the coins had holes in them. Basically, the currency continued the jewelry tradition from the cowrie shell days. And it also made it easier to count, carry, and store.



## SONG DYNASTY PAPER MONEY

**Jiaozi, "voucher for exchange"**

- First paper money in human history, issued in Northern Song Dynasty (960 – 1127)
- Backed by the reputation of 16 secret wealthy merchants
- Only truly accepted in and around the capital Bianjing 汴京 (near modern day Kaifeng), hence "Shaanxi jiaozi".

**Huizi**

- Accepted form of currency during the Southern Song Dynasty (1127 – 1279)
- Capital during this era was Lin'an (modern day Hangzhou)



Jiaozi paper currency

### HUIZI (会子)



### WANG ANSHI'S REFORM (1068)

The Northern Song needed a way to pay for tribute to the cultures to the north. They sought to collect the money from the entire realm rather than just the borderlands.

Two main tenets that brought assets into the Song treasury:

#### 1. Green Seedling Act

Lending to collective farms against their future crops (a kind of Keynesian sharecropping) facilitated increased yields but ensured that peasants would remain peasants.

#### 2. Market Transaction Law

The first financial occurrence of an official reserve. 87% of the assets received by the treasury would be used to control market prices i.e. control inflation.

### SIGNIFICANCE OF PAPER MONEY

Negotiable paper for salt transactions, a "paying voucher". Government had monopolies on salt, iron, tea, etc. After paying for these goods you would receive a receipt. However, instead of collecting the goods, many people would just use these receipts as de facto currency because they had an accepted, established value.

#### CONCEPT CHECK

At the same time, Europe traded with gold coins, primarily the *florin* of Florence. Why couldn't they use paper money? What did the widespread use of paper money in China during the Song and later Yuan Dynasties say about their relative economies?



### YUAN DYNASTY (1279 – 1368)

The Mongols, led by Genghis Khan and later his grandson Kublai Khan (known to Chinese as Hubille (忽必烈)), were the most powerful of the northern cultures that kept pushing the Song to the south.

They were accustomed to using silver as their currency. Thus, the concept of *yuanbao* (元宝) became ingrained in Chinese psyche to indicate vast wealth.

Historically, this is where the first usage of 元 to indicate money originates.



### ZHONGTONG-REIGN CURRENCY

Due to the enormous success of the Yuan Dynasty (it controlled 20% of the world's inhabited land), a currency based on the gold and silver standard emerged. These certificates (*jiaochao*) were representative of shares in Kublai Khan's treasury. Thus, the concept of a **central bank** is Mongolian.



### MING DYNASTY (1368 – 1644)

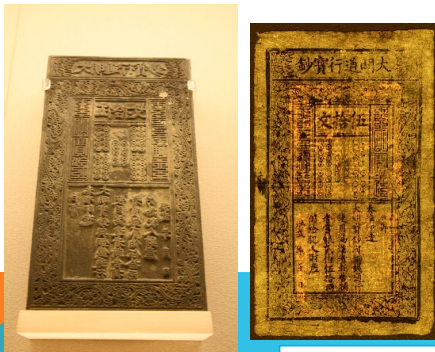
- Emperor Hongwu (1368 – 1398), was the first Ming emperor.
- He continued the Yuan Dynasty practice of issuing silver-based paper money, basically maintaining a **silver standard**, which his successors maintained.
- These notes were made from mulberry tree paper recycled from waste paper from government ministries and Civil Service examination papers.
- **Corvée (statute labor)**, Unpaid work imposed on the poor and other classes of people that lacked the means to pay their taxes. Widespread system used all over the world, especially medieval Europe.
- P.M. Zhang Juzheng (1525 – 1582) abolishes corvée and requires that taxation be paid in silver, stimulating the economy.

Why?



"The embryo of **capitalism** was already emerging by the mid-Ming dynasty."

### CURRENCY OF THE HONGWU REIGN



A 50 kwan note (right) and the block used to print it (left)

### MING PORCELAIN

A rare Ming Dynasty vase (called a "moonflask") that had been used as a doorstop in a Long Island (NY) home that sold for \$1.3 million at a Sotheby's auction in 2012.



### WHY IS SILVER SO IMPORTANT TO CHINA?

**Yuan** is an older term than *renminbi*. It is the Chinese word for dollar, which is historically the name for a silver coin while a gold coin is called a *florin*, *guilder*, or similar forms.

Silver coins were mostly minted in the Spanish empire (from their Mexican & South American colonies), used by foreign merchants in China for some four centuries.

- The "piece of eight" (or "real de a ocho") beloved of pirates and their parrots, worth eight reals and known as a peso in Spanish and a dollar in English.
- The European merchants arrived in China in the early 16th Century to buy silk and porcelain.
- Chinese partners wanted silver, preferably these large European-style silver coins.
- China, as a result, was the destination of much of the silver coming from the mines of Spanish-America, a process which accelerated as the Philippines integrated into the Spanish system.

The dollar of choice among Chinese businessmen was for a long time the Spanish Colonial Mexican dollar. Later it was the so-called Eagle Dollar produced by independent Mexico.

In the second half of the 19th Century major trading nations started producing their own "trade dollars". The UK produced a trade dollar, and so did the US, as discerning Chinese traders demanded higher-quality silver than the metal used in regular US dollars.

The Chinese name for bank is "yín hang" (銀行) - "silver firm"

### QING DYNASTY (1644 – 1911)

1646 – Emperor Shunzhi regulated the type of silver to be used as coin (93% purity).

1681 – Emperor Kangxi lifts ban on maritime trade. Because the West wants Chinese items (raw materials like tea & silk, but also items made from the "small-peasant economy" like porcelain, lacquerware, etc.) and the Chinese have no basis to demand Western items, the Qing begins to amass a larger and larger balance of trade. This trade imbalance, of course, brings more foreign currency into circulation.

1823 – Private money shops start issuing loans and starting their own chains (becoming essentially a hybrid between basic bank and currency exchange) due to their brisk business in casting silver fragments into coins. The Rishengchang Exchange Shop and Five-Shop Chain of Pingyao started this trend.

1890 – China's first domestically produced machine-struck dollar coin, or *yuan*, was minted in Guangdong province in 1890.

Pingyao



**NEXT WEEK:  
FROM THE OPIUM WARS TO  
THE BRETTON WOODS SYSTEM**  
PROF. K. @ EAST CHINA NORMAL UNIVERSITY

Homework  
Read Chapters 6&7 in this book...