• PSF China 1933-36

# **DIVISION OF FAR EASTERN AFFAIRS**

May 3, 1933.

Mr. Secretary:

Herewith a memorandum on China, in connection with the matter of the conversations preliminary to the World Monetary and Economic Conference.

It may be that, after examining this, you would care to send it on to the White House.

SKHambula

SKH: CLS

Studen K. Hornbeck

### DIVISION OF FAR EASTERN AFFAIRS

May 3, 1933.

The memorandum hereunder, relating to China, has been prepared for purposes connected with the conversations which will be held between the President and the Secretary of State on the one hand and the representative of China on the other hand in the course of the conversations preliminary to the Monetary and Economic Conference.

It is realized that by no means all of the topics which are dealt with in this memorandum will be brought up at or need to be vividly in the minds of the participants in the conversations in question. However, the memorandum has been made to comprise information with regard both to matters which should be in the foreground and matters which should be in the background in the minds of the high American officials who hold these conversations with the representative of China. In its entirety it constitutes a sort of "What the President and the Secretary of State may at this moment most need or may most wish to know with regard to China and American-Chinese relations."

It is believed that perusal of this material at this time would be worth the while of the Secretary and the President from point of view

### DIVISION OF FAR EASTERN AFFAIRS

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not only of preparations for the conversations referred to but of their constant interest in and concern with regard to outstanding problems in relations between the United States and China.

FE:SKH:CLS



### DIVISION OF FAR EASTERN AFFAIRS

May 2, 1933.

WORLD MONETARY AND ECONOMIC CONFERENCE PRELIMINARY CONVERSATIONS AT WASHINGTON -

CHINA

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Enclosure: Memorandum containing brief economic review of China with particular reference to foreign trade and the part played therein by the United States.

### PERSONNEL OF CHINESE DELEGATION

T. V. Soong - China's representative and Minister of Finance.

Tsu Yee Pei - Manager of the Bank of China.

W. P. Wei - Counselor of the Ministry of Finance.

Arthur N. Young - Financial Adviser.

Chin Yin Ching - Counselor.

S. D. Wong - Secretary.

Z. S. Tsai - Secretary.

Chang Hung - Servant.

Wong Tsing-ling - Servant.

NOTE: Brief biographical notes with regard to Minister Soong and Messrs. Pei, Wei and Young are attached.

### T. V. SOONG, Minister of Finance.

Mr. Soong is China's Minister of Finance. He has held this position almost continuously since 1928. He also holds other important positions in the Government and in the Kuomintang (the Chinese Nationalist Party which controls the Government). From August 1932 until April 1933 Mr. Soong was Acting Prime Minister (the Chairman of the Executive Branch of the Chinese Government holds a position corresponding approximately to that of a Prime Minister, although there is no such title). As Minister of Finance, Mr. Soong has made strenuous efforts to balance China's budget under peculiarly unfavorable circumstances. The measure of success that he has attained has been remarkable. During 1932, the Republic of China, for the first time during the twenty-one years of its tempestuous career, celebrated the attainment of its majority by balancing its budget. Mr. Soong holds the confidence of the Shanghai bankers and other Chinese financial leaders and his absence from the Government usually results in a financial crisis which brings about his early return. Soong is not only an outstanding financial leader but also has developed shrewdness and astuteness in matters of practical politics. He is probably the outstanding civilian personality in China today. During recent months there have appeared indications

indications that differences have developed between Soong and Chiang Kai-shek, China's outstanding military leader. Soong has appeared to favor the adoption of more aggressive tactics against the further occupation of Chinese territory by Japanese troops, whereas Chiang Kai-shek has seemed to feel that, as China is no match for Japan in a military sense, it would be disastrous for China to oppose Japan so vigorously as to bring about additional and more far-reaching Japanese military operations in China. In general, however, Soong and Chiang Kai-shek (who is Soong's brother-in-law) have cooperated and have been largely responsible for such degree of stability as has been attained by the Chinese Government.

Soong was born in 1891 and is thus only 42 years old. He graduated from Harvard University in 1915 (A.B. in economics). He is the brother of Madame Sun Yat-sen (the widow of China's famous revolutionary leader), of Madame Chiang Kai-shek and of Madame H. H. Kung. (Dr. and Madame H. H. Kung recently visited the United States, Dr. Kung being on a special industrial mission). Soong and the group of leaders related to him by marriage are sometimes referred to as the Soong Dynasty. This group is the most important one in Chinese political circles.

Minister Soong has a fairly good command of the English language. In conversation he is outspoken, direct

and, for an Oriental, frank. He is self-confident, somewhat opinionated and strongly nationalistic.

There is quoted below the text of an interesting statement issued by Soong following the rapid Japanese occupation of Jehol Province.

"When I returned from my visit to Jehol,
I was asked by various military leaders how long
in my opinion the province could be defended. I
replied from a week to ten days. I was received
with polite but incredulous smiles. 'It would
take the Japanese army several weeks to march
through Jehol even if they encountered not a
single shot,' they said. My answer was 'but the
Japanese army is not going to march on foot.'

\*\*\*\*

"But we need not despair. Out of the depth of our defeat, with the unconquerable courage that the nation has been showing in face of frequent disasters there will arise from the anvil of Japanese aggression something strong and pure, for great nations must be forged with blood and tears.

"This time last year the world was hailing the epic of heroism that was the Chinese soldier at Shanghai; today it looks with wondering eyes on the rabble fleeing back to the gates of Peiping. These two came from the same stock; only the one quickened by a spirit of nationalism, and the other corrupted and paralyzed by the taint of archaic and incompetent military professionalism."

### TSU YEE PEI (Mr. Pei), Manager of the Bank of China.

Mr. Tsu Yee Pei was born at Soochow near Shanghai in 1893 and was educated at the Soochow University and at the Tangshan Engineering College. In 1914 he accepted a position with the Bank of China at Peiping and has remained with this bank ever since, as follows: Canton branch 1916; Hong Kong branch 1918; Shanghai branch 1927. Mr. Pei is at present Manager of the Shanghai branch of the Bank of China and one of the leading Chinese bankers in that city. He is also at present one of the six prominent Chinese at Shanghai who are members of a Chinese Advisory Committee to the Municipal Council of the International Settlement. In 1928-30 Mr. Pei was also one of the five Chinese Councillors of the Shanghai Municipal Council.

The Bank of China was established in 1912, since which time it has become the leading semi-Government bank. Its paid-up capital is reported to be approximately \$25,000,000 Chinese currency, of which sum the Government's share is \$5,000,000. The bank, in addition to its head office in Shanghai, maintains branches, sub-offices and agencies throughout China to a number in excess of 130 as well as numerous banking connections abroad. Its balance sheet as of December 31, 1931, is in excess of \$845,000,000.

# W. P. WEI, Counselor of the Ministry of Finance.

Mr. Wen-pin Wei has been an officer of the Chinese Government in various connections. He was a member of the staff of the Chinese Delegation at the Peace Conference in 1918-1919, member of the secretarial staff of the Chinese Delegation at the Washington Conference in 1921-1922, and member of the staff of the Chinese Delegation at the Conference on Chinese Customs Tariff at Peking in 1925-1926. He was educated in the United States, speaks English well and is understood to be friendly toward the United States.

In manner he is somewhat breezy and effusive.

He is energetic but not profound. He is a useful "contact"

man.

### ARTHUR N. YOUNG, Financial Adviser.

Dr. Young is an American citizen. He has had extensive training and experience in the field of public economic and financial questions. Born in 1890, he obtained his Ph.D. from Princeton University in 1914. He has served as instructor in Economics at Princeton University, as research associate at the University of California, as adviser on taxation to the Mexican Government, as a trade expert with the War Trade Board, as Trade Commissioner to investigate financial conditions in Spain for the Department of Commerce, as financial adviser to the Government of Honduras, as financial expert in the Department of State and as Economic Adviser of the Department of State (1922-28). He served as expert during foreign debt negotiations (1924-1927) and as expert attending the World Economic Conference (1927). In 1929 he went to China as a member of the Kemmerer financial mission. Since 1929 he has served as financial adviser to the Chinese Government.

It is understood that Dr. Young is highly regarded by and is much relied upon by Minister Scong.

Dr. Young possesses the advantage of very sound training in economic theory and long experience with governmental problems; he now knows both American and Chinese psychology and the problems and methods of procedure of both governments. He has a keen mind, is alert, is a very



### THE POLITICAL SITUATION IN CHINA

The present Chinese Government is the creation and instrument of the Kuomintang (the National People's Party), the Chinese political party formed in and after 1912 by Sun Yat-sen. The Chinese Nationalists (followers of the Kuomintang) under Sun Yat-sen and later under Chiang Kai-shek made several unsuccessful attempts to extend their authority from the Canton area to all of China, but the effort begun in 1927 under Chiang Kai-shek (Sun Yat-sen died in 1925) was successful, and by the summer of 1928 the Nationalists had obtained control over practically all of China. They then set up a government with capital at Nanking. In 1928 this government, which styles itself the National Government of the Republic of China, was recognized by the American Government; and it is the government which has continued to be recognized as the Government of China by the United States and by the other foreign powers.

Since the present Chinese Government was established at Nanking, it has been forced to spend the major portion of its time and energy in putting down internal opposition and resisting pressure from external sources. It has also been seriously menaced by "communistic" activities in large areas of central China.

At the present time the Chinese Government continues to conduct military operations against the Chinese communists.

Its authority is weakened also by the attitude of the leaders

in the Canton area. These leaders at times have been in open conflict with the Chinese Government; at present their allegiance to the Nanking Government is only nominal; and in practical matters of administration they exercise a large degree of independence. However, the mandate of the Chinese Government extends in many important respects throughout all China exclusive (now) of "Manchukuo". Important governmental administrative services, such as the customs, the salt and the postal services, function efficiently throughout the Republic (south of the Great Wall). The Government has made substantial progress in the field of public finance and in development of communications, and some progress is being made in the field of popular education.

Since September 18, 1931, Japanese military operations have resulted in the separation from Chinese governmental control of Manchuria and of Jehol Province, an area comprising approximately 450,000 square miles, equal approximately to that of France, Germany, Austria and Hungary combined.

Japanese military operations have thus wrested from Chinese control the most important Chinese provinces north of the Great Wall. During recent weeks Japanese military operations have extended south of the Great Wall. These operations have reached a point within fifty miles of Peiping and have thus created anxiety with regard to important American and other foreign interests in the Peiping-Tientsin area. Although it is extremely difficult to predict whether Japanese military

activity will be extended to the Peiping-Tientsin area, the attitude adopted by Japanese military leaders since September 18, 1931, makes such extension seem likely. The situation in the Peiping-Tientsin area may be resolved in one or more of a number of ways, among them the following:

- (a) the establishing in the Peiping-Tientsin area of a so-called independent Chinese "state". Such a "state", it is believed, could be formed only as a result of Japanese instigation and such "state" would presumably recognize "Manchukuo" and declare its independence of the Chinese Government at Nanking. In case such a "state" were set up as a result of Japanese activity, Japan would have struck an almost vital blow to the principle of unity in China;
- (b) the extension of Japanese military authority so as to include in "Manchukuo" the Peiping-Tientsin area;
- (c) the creation by agreement between China and Japan of a neutral zone in the area immediately south of the Great Wall;
- (d) direct negotiations between China and Japan whereby China would "recognize" the so-called "state" of "Manchukuo".

During the past few days relations between Japan and Soviet Russia have been reported as becoming increasingly tense, due to a dispute between Soviet Russia and "Manchukuo" resulting from the removal into Siberia from Manchuria early in April of about three hundred cars and locomotives on the Chinese Eastern Railway. In reply to a demand made by

"Manchukuo" on April 10 that the rolling stock be returned by May 10, the Soviet Government stated that the cars would be returned but not the locomotives. The Chinese Eastern Railway has been administered in recent years by a Russo-Chinese board and since the creation of "Manchukuo" the "Manchukuo" authorities have assumed the place of the Chinese in the administration of the Railway. The Railway is in effect the property of the Russian Government, China possessing certain ultimate reversionary rights.

With regard to the situation in the Tientsin-Peiping area, it may be stated that there is at this moment less tenseness than during recent weeks, less reason for apprehension that hostilities may at an early date extend to Tientsin, but the atmosphere is cloudy and the future obscure.

With regard to the Chinese Eastern Railway imbroglio, there is warrant for an estimate that neither Russia nor Japan will launch an attack and that the dispute will not within the near future lead to "war" between those two countries.

## PROBLEMS

### INTRODUCTORY STATEMENT

In China the question that overshadows all others -economic and political, international and domestic -- is
the situation presented by Japan's military occupation of
a large portion of China's territory. There is of course
a purely economic phase of the separation from China of
Manchuria and Jehol Province in that that separation has
naturally resulted in a substantial loss in trade and of
revenue normally accruing to the Chinese Government. In
view, however, of the dominating character of the Manchuria
question as a whole in China's thought today, it may be
anticipated that some of the subjects presented for
discussion by China's representatives will be related to
the political phases of the Sino-Japanese controversy.

In the following pages an attempt has been made to indicate the subjects which the Chinese representatives may bring up for discussion. These subjects have been divided into three categories, as follows:

- A Subjects primarily economic in character;
- B Subjects with both an economic and a political character; and
- C Subjects primarily political in character.

A memorandum containing a brief economic review of China with particular reference to foreign trade and the part played therein by the United States is attached.

# A. Subjects Primarily Economic in Character.

#### 1. Silver.

China is and has been a silver standard country. The Kemmerer Financial Mission which visited China in 1929 recommended that China ultimately adopt the gold standard and there have been some indications that the Chinese Government has favored working gradually toward that end.

It is assumed that in connection with the conversations which it is understood have already been held with certain foreign representatives in regard to the question of silver, the American experts have prepared data on this subject. Consequently no attempt is made to present detailed information on this subject in this memorandum. As of possible interest, however, reference is made to a paragraph in THE CHINA YEAR BOOK, 1931-1932, page 433, as follows:

"The price of silver in terms of gold has fallen by more than half in the last two years. seriously affecting all those who are involved in foreign trade, as well as creating difficulties for the Government in consequence of decreasing imports and the growing cost of gold commitments. For the bulk of the population, who have little to do with foreign trade, the consequences of the decline in the gold value of silver have fortunately not attained serious proportions, as the purchasing value of silver for commodities produced within the country has not depreciated much. However, should crops prove bad and wholesale importations of foodstuffs from gold-standard countries become necessary, the situation might easily turn critical. At the same time one consequence of this low price of silver is that exports will be greatly stimulated once the corner in the economic depression has been turned."

With regard to the trade of the United States with China, --- in 1931, notwithstanding the low value of silver with a corresponding decrease in the foreign purchasing value of Chinese currency, China was the only country in the world which increased its purchases from the United States over those of 1930. This increase was due primarily to increased shipments to China of low-priced American raw cotton - which shipments both in value and in volume were the greatest in the history of the trade. Also, although in 1932 American trade with China declined sharply as compared with 1931, the United States during 1932 ranked first as a source of supply for China's imports. This is all the more remarkable when it is remembered that American goods are sold on a gold basis in competition with merchandise of other countries quoted in depreciated currencies.

In this connection thought should be given as bearing on the <u>present situation</u> to statements from recent telegrams from the Consuls General at Hankow and at Shanghai, as follows:

"Hankow, April 11, 1933.

"\*\*\*\*\*Since China is essentially a price market it would appear that if European currencies continue much longer to be abnormally depreciated in relation to the American dollar, American exports of competitive products to Central China will almost entirely cease except in the case of special commodities which are protected by price agreements."

"Shanghai, April 28, 1933.

"Importers are finding it increasingly difficult to sell American manufactured goods because of low comparative value of competitors' currency as China is primarily a price market."

### A. Subjects Primarily Economic in Character.

#### 2. Debts.

Although it is understood that any discussion of debts at the Washington conversations is restricted to World War debts, China may raise the question of making some adjustment in its foreign debts. In case China raises this question, it would seem that reply might be made to the effect that the question of foreign debts, aside from the broader phases of the question of World War debts, does not fall within the scope of questions to be discussed here.

### China's National Debt.

(Department of Commerce figures)

| Chinese \$              | U.S.\$  |
|-------------------------|---|
| 73,845,845              | 151,442,000<br>317,524,000  |
| Total                   | 468,966,000   |
| 000 omitted) <u>Yen</u> | Fres. U.S.\$*   |
| 971 45,478              | - 164,113<br>- 80,928<br>100,000 72,483                               |
|                         | Chinese \$ 73,845,845  Total  000 omitted)  Yen 411 42,094 971 45,478 |

American investments in Chinese Government securities and in obligations of the Chinese Government are estimated to be in the neighborhood of \$45,000,000 U.S. currency.

American investments are largely confined to (a) a one-quarter interest in the Hukuang Railway Loan of 1911

which,

<sup>\*</sup> Foreign currencies converted into U.S. at par.

which, as of December 31, 1930, was outstanding in principal in amount of \$5,656,600 and in interest \$1,032,670; (b) the so-called Chicago Bank Loan (Continental Illinois National Bank and Trust Company) of November 1, 1919, which, as of December 31, 1930, was outstanding in principal in amount of U.S.\$5,500,000 and in interest U.S.\$3,355,000; (c) the Pacific Development Loan of November 26, 1919, which, as of December 31, 1930, was outstanding in principal in amount of U.S.\$5,500,000 and in interest U.S.\$3,996,666.

American investments in Chinese Government securities floated outside of the United States are estimated at approximately \$1,000,000.

The only Chinese Government obligations to the

American Government are in respect to (a) the American portion
of the Boxer Indemnity (which is discussed in another section
of this memorandum) and (b) the purchase on credit by China
from the Federal Farm Board of 450,000 tons of wheat at a
cost of \$9,212,828.46, with interest at 4 per cent per annum.

### A. Subjects Primarily Economic in Character.

#### Boxer Indemnity Payments.

It is anticipated that China may raise the question of postponing payment of the American share of China's Boxer Indemnity payments.

As a result of the so-called Boxer troubles in China in 1900 when the foreign legations at Peking were besieged by Chinese forces, China agreed to pay the aggrieved foreign nations a total indemnity of Taels 450,000,000. The American share amounted to \$24,440,778.81, for which amount China gave to the United States a bond dated December 15, 1906. By a Joint Resolution, approved May 25, 1908, Congress authorized the return to China of a portion of the American share of the indemnity, reducing China's bond to \$13,655,492.69. With the money thus remitted. the Chinese Government created a fund for the establishment and upkeep of Tsinghua College, located at Peiping, and for the education of a certain number of Chinese students in colleges and universities in the United States. Subsequently, upon the payment in full by China for damages to American persons and property, the further sum of \$1.175.835.64 was remitted. By Joint Resolution, approved May 21, 1924. Congress authorized, and in pursuance thereof the President, by Executive Order of July 16, 1925, directed the further remission to China of all payments of the Chinese indemnity made subsequent to October 1, 1917, including sums already received and all future payments in respect to the

indemnity. As a result of this second remission the Chinese Government created a board composed of Chinese and American citizens for the custody and control of the remitted funds. This board, which is known as "The Board of Trustees of the China Foundation for the Promotion of Education and Culture", has resolved to devote the funds at its disposal to purposes indicated in its name. In 1929 a change in procedure was effected whereby payments under the 1908 remission were also to be made to this Board, the Chinese Government continuing to use these funds for the upkeep of Tsinghua College and for the support of Chinese students in the United States.

Between December 1, 1917, and November 30, 1922, China's Boxer Indemnity payments to the Allied Powers and to the United States were deferred. In this connection the Department of State, under date September 20, 1917, telegraphed the American Minister at Peiping stating in part as follows:

"The American Government is not disposed to make any objections to the proposed communication to the Chinese Government upon the following understanding:

"With regard to Section One (A) that the Department is unable affirmatively to agree to the postponement of indemnity payments, but will make no objection, provided the Chinese Government will agree to support the Tsinghua College and the educational mission and students in the United States on the present basis".

In February 1932 the Chinese Government requested the postponement for one year of the payment of the American, British and Italian portions of the Boxer Indemnity. In

reply to this request the Department stated that it was not in position to take the initiative or affirmatively to agree to a postponement of the American share of the Boxer Indemnity payments, but that, in case either the British or the Italian Governments agreed to postponement, the Department would not be disposed to raise objection to postponement for one year, under express written assurance by the Chinese Government that the objectives to which American payments are devoted would not be permitted to suffer. These conditions having been met, the payment of the American portion of the Boxer Indemnity was postponed for one year from February 1, 1932.

In February 1933 the Chinese Government requested a further postponement for one year of the American, British and Italian Boxer Indemnity payments. The American, British and Italian Governments were unable to agree to this request for further postponement and so informed the Chinese Government. However, the Chinese Government has not resumed payment and the Department's most recent information on the subject is that Minister Scong will telegraph instructions to China on this subject after his arrival in Washington.

The reasons which prompted the Department's recent refusal to acquiesce in the further postponement of China's payment of the American portion of the Boxer Indemnity are:

(a) the existing situation is not considered as comparable to that which obtained during the World War at the time of the original postponement in 1917 nor to that of 1932 when

China had recently experienced in the Yangtze flood a major natural catastrophe; (b) the Powers, including the United States, have already been more than liberal in making adjustments favorable to China in relation to the Boxer Indemnity and in relation to other matters connected with China's finances. (NOTE: In 1928 the American Government took the lead in concluding with the Chinese Government a tariff treaty in consequence of which, similar treaties having soon been concluded by China with other powers, it became possible for China to make her own tariff schedules -- with the result that China's customs revenues have been very substantially increased): (c) there will probably never be a time when the making of each indemnity payment when due will be altogether convenient to China and, at the present moment, practically all governments are confronted with unusual financial difficulties and all nations are having to meet by their own efforts extraordinary fiscal and economic problems; (d) the Department feels that it would not be justified, except under most extraordinary circumstances, in further modifying in effect the Congressional action which stipulated the terms and conditions under which payments of the American share of the Boxer Indemnity are to be remitted to China.

In case Minister Soong raises the question of the American Government acquiescing in the requested postponement of the American share of the Boxer Indemnity, it is suggested that reply be made along the lines indicated above. As the

American, British and Italian Governments have adopted and expressed similar attitudes on this matter, it would be difficult for the American Government now to reverse its position with regard to it.

In case Minister Soong presses this matter, it is suggested that consideration might be given to the question of proposing a change, by Congressional action, of the terms under which Congress authorized the remission to China of the American portion of the Boxer Indemnity. The American remissions, under present Congressional authorization, are used for educational and cultural purposes. A number of other nations, which have remitted to China their Boxer Indemnity payments, have made stipulations favoring the commerce or finances of their respective countries. The British remissions are to be used primarily for building railroads, the materials for which must be purchased in Great Britain. The funds advanced for railway reconstruction are in the nature of loans, and interest from the general fund is to be used for educational purposes. The French remissions are assigned to provide for the service of an issue of bonds to be used primarily to settle the obligations of the Banque Industrielle de Chine, which failed in 1921. The Dutch remissions are earmarked for certain harbor and reclamation projects. The Italian remissions are to be expended in part on construction enterprises in China, the materials for which must be purchased from Italy. It is believed that no

action directed toward modifying the terms of the present American remissions should be taken unless the Chinese Government takes the initiative and makes a specific request. Favorable consideration might possibly be given to a request from the Chinese Government that a substantial portion, such as one-half or two-thirds, of the American remissions be used henceforth for the purchase of American commodities for use in the internal reconstruction of China. For instance, in 1931 in connection with the disastrous Yangtze Valley flood, the Federal Farm Board sold to China on credit 450,000 short tons of wheat and flour. This wheat and flour was used in China to pay for labor in reconstructing the intricate dike system along the Yangtze River which had been destroyed by the flood waters. It might be practicable to sell to China additional American wheat and flour for use in China in payment of labor to construct dikes or highways. Or, a portion of American Boxer Indemnity funds might be used to purchase American equipment for use on Chinese railroads or for use in industrial establishments or for reconstruction projects. It is repeated that any such proposal should, it is believed. be initiated by the Chinese Government and should be presented in the form of a fairly definite and carefully worked out proposal.

The amounts due annually by China under existing agreements in regard to the American portion of the Boxer Indemnity are as follows:

Annual Payments

1932-40

U.S.\$1,919,967.10

1941-45

539,588.76

NOTE: Under date April 28, 1933, the Department of State received a telegram from one of the American members of "The Board of Trustees of the China Foundation for the Promotion of Education and Culture" stating that "continuance next year China Foundation Chingwa other Chinese schools depends resumption indemnity payments urge immediate action". It is believed that the Department has already taken such steps in that connection as are appropriate.

# A. Subjects Primarily Economic in Character.

#### 4. Loan.

Minister Scong may bring up the question of the Chinese Government obtaining a loan in the United States. In case he brings up this question, the obvious reply presumably would be that the American Government is not now making any loans to foreign countries and that any request on China's part for a loan would have to be addressed to private firms. (NOTE: It is believed that, from the political point of view, any loan from American sources to China at this time would be inadvisable. However, that any loan is likely to be made may well be doubted. American financiers know well that China's credit position is not good and that China has been in default for a number of years in payments on many of her foreign obligations.)

### A. Subjects Primarily Economic in Character.

5. Sale of Additional American Wheat and Flour to China.

Subsequent to the sale in 1931 by the Federal Farm Board of 450.000 short tons of wheat and flour to the Chinese Government in connection with the Yangtze flood. the Chinese Government has been interested in the possibility of purchasing additional wheat and flour from the United States. The Department of State has only meager information in regard to the proposals made by the Chinese Government. The Federal Farm Board, the Grain Stabilization Corporation and the Reconstruction Finance Corporation have, it is believed, more information in regard to these Chinese recent negotiations. Up to the present time it is understood that the negotiations have failed due to the inability of the interested American exporters to comply with certain credit requirements of the law under which the Reconstruction Finance Corporation operates, and that the promoters have wanted to put up as collateral Chinese Government security of a nature which the Reconstruction Finance Corporation has not deemed acceptable.

# B. Subjects with Both an Economic and a Political Character.

1. Loss in Revenue to China Due to Occupation by Japan of Manchuria and of Jehol Province.

The occupation by Japanese military forces of Manchuria and of Jehol Province has resulted not only in the present separation from China of a substantial area of territory (with its attendant loss of valuable trade. particularly export trade) but also in a substantial loss in revenue normally accruing to the Chinese Government from the occupied territory. Because of this loss in revenue, Minister Soong may urge that the United States and other countries render to China financial assistance in some form. The chief losses experienced by the Chinese Government in this respect are in customs revenues. In this connection it may be observed that, whereas the customs receipts of China amounted in 1926 to Taels 80,435,962, these receipts amounted in 1932 to Taels 200, 239,000. Even though the whole amount of the customs revenues collected in Manchuria and in Jehol Province be now withheld from the Chinese Government, the amount of the customs revenue still received by the Chinese Government will be more than double the amount received in 1926. Consequently, while appreciating the embarrassment and difficulty occasioned the Chinese Government in connection with the loss of revenues from Manchuria and Jehol Province, it still appears that the Chinese Government's financial position is better from the

point of view of customs revenue than it was some seven years ago.

In one sense China's economic system is in a better condition than the economic systems of the United States and a number of other Occidental nations. China is very loose knit economically, as politically, and her economic structure is not sensitive to such shocks as throw more intricately organized systems off balance. Over a period of years China's economic order has remained on a fairly even keel, whereas in many Occidental lands the economic order has experienced terrific dislocation. China in this respect is like a machine with a one cylinder engine which is functioning fairly efficiently as compared with some of the western nations in whose mechanism twelve cylinder engines have several cylinders "missing". The accounts which the world is currently given of complete "chaos" in China are for the most part greatly exaggerated -- many of such accounts being products of propaganda; - China's steady economic progress is evidence in point.

### B. Subjects with Both an Economic and a Political Character.

#### 2. Communism in China.

Minister Soong may raise the question of the serious menace presented to China economically.and politically by the communist movement in Central China.

According to the report of the League Commission of Inquiry, communism in China "has become an actual rival of the Government".

Some twelve Provinces in Central and Southern China (Kweichow, Hupei, Honan, Anhwei, Chekiang, Kiangsu, Kwangtung, Kwangsi, Fukien, Kiangsi, Hunan and Szechwan) are affected by communist activities. Practically the whole of one of these provinces (Kiangsi) is under the control of the communists, the other eleven provinces being only partially subject to communistic influence.

The communistic area is estimated at about 300,000 square miles, an area about the size of Texas and Indiana combined.

The normal population of this area is in excess of 50,000,000.

During recent years the Chinese Government has waged a more or less continuous military campaign against the communists. The military campaign has been only partially successful.

Communism in China exists and is made possible primarily by reason of unsatisfactory political and economic conditions. Therefore the most promising measures for preventing its spread and eradicating it must be - just as

they should be in other countries - measures calculated to eliminate the underlying causes which provide soil for it and contribute to its growth. During the past year the Chinese Government, while continuing its military operations, has endeavored also to combat communism at its roots by adopting constructive measures designed to improve the economic welfare of the peasants. Any program for the economic reconstruction of China would assist in stamping out communism in that country but it is not perceived how the American Government alone would be in position to render the necessary assistance to China in this respect. It might be useful, however, for the principally interested nations of the world to endeavor to work out a program for economic reconstruction in China. This idea has seized the Secretariat of the League of Nations and appears also to be favored in British governmental and financial circles (which may be behind the thought of the League in that connection). It is believed that the American Government might to advantage adopt a cooperative attitude toward approaches which may be made to it on the basis of this idea. International Banking Consortium Agreement with regard to loans to China is still in force and an American banking group is a member of the Consortium. Japan's activities and attitude in relation to China problems complicate this matter: but the Japanese explain and excuse their China policy on the ground of "chaos" in China and they would find it difficult to defend an attitude of obstruction on their

part to an international effort to promote progress toward political order in China by common assistance to the Chinese toward economic improvement.

of the American Covernment have been, as he is aware, repositedly sade known and are maintain of public record.

The American Sovernment and people are seriously interested in the principle that interestional disputes shall be settled by none but pasific usany. We also believe in the sensity

#### C. Subjects Primarily Political in Character.

 The Political Aspects of the Sino-Japanese Controversy.

In view of press reports that the Administration has discussed at Washington with British and French representatives the matter of a consultative pact to reenforce existing peace machinery and thereby bring about a more favorable situation in regard to the disarmament program, and in view of China's vital and paramount interest in the situation created by Japan's military occupation of Chinese territory, it will be very difficult for Minister Soong not to interject into the conversations at Washington the political aspects of the Sino-Japanese controversy. As a result of Japanese military operations, China is in a desperate situation. In this situation China may be expected to ask for assistance from the powers principally interested in maintaining the peace machinery of the world.

In case Minister Soong raises this question, it is suggested that he be informed that the policy and attitude of the American Government have been, as he is aware, repeatedly made known and are matters of public record. The American Government and people are seriously interested in the peace movement and are committed by formal treaty to the principle that international disputes shall be settled by none but pacific means. We also believe in the sanctity of treaties. With more specific regard to the present

Sino-Japanese controversy, our position has been that, China having appealed to the League of Nations and the League of Nations having assumed jurisdiction over a controversy between two of its members, the primary responsibility for initiative and for action rests with the League of Nations. The American Government has not by itself the power to shape the course of events entirely in conformity with the principles to which it adheres and the objectives to which it is committed. It desires that treaty obligations be respected and the rights and interests of all concerned be shown due regard, and it directs its efforts toward those ends. At the same time it is opposed to resort to force as an instrument of national policy in international relations. It realizes that there has occurred in the Far East a serious breach of the peace which is of rightful concern to the whole world. It realizes that the peace machinery has not proven adequate either to prevent this breach or to take care, as yet, of the situation and problems presented in connection therewith. It still hopes that the problems inherent in the present situation will be resolved in accordance with the spirit and the provisions of treaties to which the disputant powers along with others are parties. It has exerted its influence and will continue to do so on behalf of peace and justice.

It might further be said that one great difficulty in relations with China and in connection with any effort to assist China is found in the fact that China's leaders,

both political and military, frequently give evidence of having arrived at no position of solidarity or unity of objective among themselves. This statement of fact does not imply or impute blame: everyone who intelligently observes and studies Far Eastern affairs must realize that China is passing through a period of internal upheaval in the nature of what is frequently referred to as a "five-fold" revolution and it stands to reason that there must be differences of opinion among her leaders and people and be internal political contests over a considerable period of time. These are, however, facts and the Chinese as well as the rest of the world must take cognizance of them and face them. It is particularly unfortunate, in view of China's problems in the field of foreign relations, that such are the facts. It is highly desirable, toward the strengthening of China's position in international relations, that China's leaders "get together" and develop some method of expressing themselves unitedly on questions of foreign relations. It is exceedingly difficult for other countries to assist a nation which talks, in its foreign relations, through a multiplicity of mouths; and still more difficult to exert effective influence in connection with a controversy between that nation and some other country. The world views with regret and abhorrence the military activities which are going on in North China, but, under existing circumstances, the world can hardly be expected to take a firm stand with regard to the problems presented while the Chinese leaders and people show no sign of firmness by manifesting singleness

of purpose and centralization of authority and responsibility on their own part.

#### C. Subjects Primarily Political in Character.

2. The Question of an Arms Embargo.

In connection with the present controversy between China and Japan, Minister Scong may bring up the question of the American Government's attitude toward an arms embargo.

There is now pending in Congress legislation empowering the Executive in his discretion, after consultation with such other nations as he might deem necessary, to impose an embargo on the export of arms and munitions of war to any nation or nations which he might designate, in case there was reason to believe that such articles exported from the United States would be used in international conflict.

Irrespective of whether Congress may or may not have passed the legislation now pending, it is believed that, if Minister Scong raises the question of an arms embargo, he should be discouraged from expectation that the American Government will be likely to favor the use of an arms embargo in connection with the present controversy between China and Japan. (NOTE: The Department of State has already informed the British Ambassador here that it does not believe that any useful purpose is to be served by the imposing of an embargo on export of arms in and under the circumstances which now prevail in the relations of China and Japan to each other and to the world at large). The imposition of an embargo upon exports both to China and to Japan would in effect operate to the practical disadvantage of only one of the two countries,

namely. China. - for Japan has accumulated huge supplies of essential raw materials and is able to supply domestically such arms and munitions of war as she may need in her contest with China. Japan's essential imports in respect to war supplies are raw cotton, machine tools and nitrates, which do not fall within the category of articles usually considered in connection with an arms embargo. China. on the other hand, is largely dependent upon foreign importations for its supply of arms and munitions. An imposition of an arms embargo upon China alone would appear to be inconsistent with the findings and conclusions of the Assembly of the League of Nations and of the United States with regard to responsibility for the present Sino-Japanese controversy. An imposition of an embargo upon Japan alone would not act as a practical deterrent to Japan; and if such embargo were imposed it is a foregone conclusion that Japan would not permit delivery to China ports of arms and munitions shipped from foreign countries.

Enclosure:

Memorandum containing
brief economic review of
China with particular
reference to foreign trade
and the part played therein
by the United States.

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# DEPARTMENT OF STATE OFFICE OF THE SECRETARY WASHINGTON

May 8, 1933.

Dear Mr. Howe:

The Secretary thinks that the attached memorandum regarding China, prepared in connection with the forth coming conversations with Mr. Soong, is well worth the President's reading.

Sincerely yours,

Hugh S. Coming . f.

Honorable Louis McH. Howe,

Secretary to the President,

The White House.

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### THE UNDER SECRETARY OF STATE WASHINGTON

May 9, 1933.

Dear Mr. President:

It occurs to us that, before you have a talk with Mr. Soong on political matters, that you would be interested to see the accompanying confidential memorandum prepared by Doctor Hornbeck.

You will note that Hornbeck has
already been approached by Mr. Sze, the Chinese
Minister, on the subject of possible action by
the powers in relation to the hostilities in
North China. The memorandum attached gives
an account of the conversation and proceeds
with comments in support of the view that the
American Government should not let itself be
drawn

The President

The White House.

drawn into the matter in advance of an initiative by other interested powers.

Milliam Rully

### DEPARTMENT OF STATE

#### DIVISION OF FAR EASTERN AFFAIRS

May 9, 1933.

#### MANCHURIA SITUATION

#### Tientsin-Peiping Area

#### China's Tentative Appeal to the Powers

I.

I called on the Chinese Minister at his request last evening. The Minister stated that Mr. T. V. Soong had received a telegram from Wang Ching-wei (China's Premier) in which the Premier, after referring to the state of hostilities in China south of the Wall, instructed Soong to inquire whether the powers could not take some step, in the nature of mediation, to bring the hostilities to an end. It had been arranged between Soong and Sze that the latter should inform me of this and discuss the matter with me. There followed a conversation lasting an hour. In the course of the conversation I gained the impression that the Chinese Government had not formulated any project for the course which it would pursue if the powers were to offer "mediation"; also, that they entertain the hope that the President of the United States might become seized of the idea of an offer on his part to assume the role of mediator or of taking the lead in organizing a movement

among the major governments either toward united action calling upon Japan to halt or toward calling upon the disputants to call an armistice and proceed to negotiations.

I made it a point throughout the discussion to make it clear that in what I said I would be expressing merely personal and unofficial opinions. I reminded the Minister of the statement which I had made to him on several previous occasions to the effect that the logic of the situation calls for the taking of the initiative, if to be taken, by the League of Nations or by powers members thereof. I said that in the immediate situation the material interests most acutely menaced in China (at Tientsin) are those of Great Britain and France. I then spoke of the risks which always confront governments which contemplate taking action in the nature of intervention or toward mediation. And I reminded him of various of the special difficulties inherent in any attempt of the powers to inject their views or wishes in connection with the present Sino-Japanese dispute. I referred to statements which I had made in our last previous lengthy conversation to the effect that it is difficult

for any foreign government to act as a go-between on China's behalf for the reason that China speaks not through one but through several mouths. At this point the Minister said that Mr. T. V. Soong is authorized to speak with authority for China. I then referred to the efforts which the League and the American Government severally and collectively have made since September 18, 1931, and I said that it seemed to me logical and fit that any new effort which it might be possible now to make should be discussed first at Geneva or at capitals of states members of the League and that the United States was on record to the effect that if and when the League decided upon measures which its members were prepared to take the United States would be predisposed favorably toward cooperation. I said that I see no reason calling for or which would seem to warrant a departure by the United States from that position.

There followed a discussion of various possible courses which events may take in China.

(See memorandum of comment attached).

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II.

Referring to my memorandum giving account of conversation with the Chinese Minister,

It is my belief and that of other officers of this Division that the American Government should avoid taking any initiative, for the present at least, along the line apparently sought by the Chinese Premier. Were we to take such an initiative, the first effect would be to re-invigorate Japanese animus against this country. If, notwithstanding that, our effort proved successful, one of the ultimate results would be a lasting "soreness" on the part both of the Japanese and of the Chinese (in general) toward us. In all probability, the effort, being led by us, would fail by virtue of refusal on the part of the Japanese to desist from the military operations in which they are engaged. If, however, they yielded, there would begin the negotiations between Japan and China which the Japanese have long been demanding. Those negotiations could have but one successful issue, a capitulation on the part of China in terms of recognition of the new status quo in Manchuria and a pledge to refrain from any further efforts to upset that status quo.

The consummation of such an agreement between Japan and China would mean stultification to the position taken by and the efforts of the League and the American Government in relation to the Chino-Japanese conflict during the past two years. It would mean military and diplomatic victory for Japan. It would enable the Japanese to consolidate their position on the Continent and prepare for their next move (either further coercion of China or conflict with Russia or conflict with the United States). It is not to the interest of the United States or of China or of the world that such an agreement, under such circumstances, be concluded. Better that the situation between Japan and China remain fluid, even though it mean further suffering for the time being for the Chinese and a continuation of uncertainty and apprehension by and on behalf of foreign nationals in China and foreign powers in general. In some of the major foreign countries neither the governments nor the people appear as yet to have grasped the full significance of the movements which have been and which are being made by the Japanese military machine. Events at Shanghai a year ago almost (but not quite) made the thing clear

to the British. Probably impending events, if the thing be not checked now and prematurely, in North China should serve to make it clearer to them. Likewise, the French. Enlightenment with regard to this matter comes slowly. Some people learn by observation, reasoning, and the use of the imagination. Others learn only by experience. It can no longer be contended by the Japanese with any approximation to appearance of reality that the movements in which their army is engaged on Chinese soil are in "defense" of the lives and property of their nationals. They are now engaged in movements the objective of which is to compel the Chinese to sign an agreement the substance of which would be China's assent to the amputation of Manchuria and the ultimate purpose of which would be dismemberment of China. They are making "war" in fact (though not in name) an instrument of national policy. This is a clear violation of the Kellogg Pact. The conclusion of the agreement which they have in contemplation would be in violation, on the part both of Japan and of China, of provisions of the Nine-Power Treaty. The whole transaction has been and is in violation of the Covenant of the League. Such being the case, the American Government should by no means

become

become the original sponsor of the idea that such a course be pursued. We should be one of the last, rather than the first, of the foreign powers to take up with that idea. The initiative, if from any quarter, should come from one or more of the major countries members of the League. It might best come to us from the League; next best, from the British and the French Governments. If and when it thus comes, there would be warrant for our giving it serious consideration.

It should be kept in mind that approaches have already been made to our Minister and to the British
Minister and probably to the French Minister in Peiping,
by Chinese in certain different capacities, and by officials of Japan, in this connection. The British Minister explored the problem and finally decided that there was nothing further that it seemed wise to do. The potential go-between would find himself in the impossible position of trying to bring together two parties neither of whom could be relied upon in relation to the transaction contemplated. We gave our Minister instruction that he was to take no initiative but was to keep in close contact with his colleagues and if he were approached with a definite, practicable, constructive proposal by the

British and the French he should receive it in a cooperative attitude. We suggested to him various of the
hazards of the situation and told him that he might discuss the whole matter with his British colleague. He
informed us that the British Minister had received instructions indicating that the British Government's
attitude was similar to ours. There the matter stands.
Any change can best be worked out by the Ministers of
the powers at Peiping who are in close contact with
events and men on the spot. If and as the hostilities
bring the contending armies into close proximity to
Peiping and Tientsin, British, French, Italian, Belgian
and to some extent German anxiety will increase. We
can afford to wait and watch.

As Japanese armed forces advance into China proper, the whole problem for Japan becomes greater, more complicated and increasingly unsusceptible of an early and satisfactory solution. At the same time, the strength of Chinese nationalism should be increased and some of the problems of the Nanking Government be diminished.

Occupation by Japan of the whole Peiping-Tientsin area would tend to increase the amount of apprehension with which the situation is viewed by Great Britain and by Russia.

Russia. Those two countries in particular stand to lose as Japan gains. The United States has not much to lose. The principles of our Far Eastern policy and our ideals with regard to world peace may be further scratched and dented (they have been considerably so already in this connection); and our trade prospects may be somewhat further impaired; but from the point of view of material interests there is nothing there that is vital to us. In the long run, our interests would be best served by a complete exposure of Japan's program, her strength and/or weakness, and as complete as possible involvement of herself in the situation which she has created and is developing there: given time, the flood tide of her invasion will reach its height and the ebb will follow. For that reason, among others, we should avoid pressing, so far as we are concerned, for an early, premature and inconclusive "peace". Let those whose interests would be better served by such a development take the initiative toward its consummation.

It is realized that the above is not a humanitarian view. It also is realized that a continuation of military reverses to the Chinese armies, and possible loss of Peiping

Peiping and Tientsin, may result in serious political repercussions adversely affecting the stability of the Nanking Government. That Government, however, is between the devil and the deep sea: the devil being the prospect of further military adversities and the deep sea being the potential conclusion of a disastrous "peace". Its security will not be ensured by the acceptance of either of these hazards.

PSF: China THE UNDER SECRETARY OF STATE WASHINGTON August 2, 1933 CONFIDENTIAL Dear Mr. President: The Department has not been informed with regard to the subjects which the Chinese Minister of Finance (Mr. Soong) hopes to discuss with you; nor, apparently, has the Chinese Legation been informed. However, it is the Department's surmise that the Minister will wish to discuss questions relating to financial and other assistance, of allegedly non-political import, to China. On that assumption, the Division of Far Eastern Affairs, feeling that you should have in connection with those questions certain information, has prepared several brief data memoranda, which memoranda I send you herewith.

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The President,

The White House.

It is my understanding that the Chinese Minister of Finance talked recently with the Secretary of State, in London, with special reference to the assistance which the League of Nations is rendering to China in the form of supplying technical experts in several fields, conspicuously finance and public health. As you know, the League has been intimating that it desires to have our approval of and perhaps cooperation in its efforts along that line. There have appeared recently indications that Japan views with apprehension and is inclined to object to these activities of the League in relation to China. It may be assumed that the Chinese, especially the Minister of Finance, will endeavor to enlist American support. It is felt in the Department that we should assume a favorable attitude in principle toward the League's effort, but that, in connection with the actual giving of any encouragement to the Chinese to expect assistance from the American Government in that connection or independently, we should take advantage of the opportunity which is afforded by the fact that China is actively seeking such aid — an opportunity to invoke the principle and practice of "reciprocity" in demonstration of international good will — to ask of the Chinese somewhat pointedly that they give more effective attention than they have been doing during the past decade to various outstanding obligations of the Chinese Government to the United States and American nationals.

Would you care, during Secretary Hull's visit, to go over these papers with him? In any event, you may desire to glance through the contents of the memoranda before your conversation (on August 7 or 8) with the Chinese Minister of Finance.

Faithfully yours,

Man Huley of

Enclosures:

Three memoranda.

August 2, 1933.

#### Fifty Million Dollar Credit to China.

The recently concluded credit to the Chinese Government of \$50,000,000 by the Reconstruction Finance Corporation for the purpose of financing sales of American cotton and wheat has been made the subject of some adverse criticism in certain quarters throughout the world.

In this connection, Sir Charles Addis, (of the Hong Kong and Shanghai Banking Corporation) acting on behalf of the British Group of the China Consortium, has informed the American, French and Japanese Group members that, although the credit under reference does not infringe the Consortium Agreement, as no public issue of bonds is contemplated, the Groups assembled in New York in 1920, assured of the complete support of their respective governments, did not contemplate encountering competition in the business of Chinese loans from any of such governments. In concurring with these views the Japanese Group has offered additional comments to the effect, inter alia, that the transaction under reference would create in China surplus stocks of cotton and wheat, tending to paralyze the Chinese market, and would render probable the imposition of new and higher customs

customs duties. They also expressed the fear that a large proportion of the proceeds of the loan would be used for the purchase of arms and munitions of war, thus fostering further political strife in China.

The credit under reference has also been made the subject of sharp criticism by the semi-independent political faction of south China (which sent direct telegraphic protests to the Department of State and the Reconstruction Finance Corporation) and by numerous individuals, both foreign and Chinese, who apparently feel that the transaction is a violation of the spirit if not of the letter of the Consortium Agreement and that it will prove a costly step for China in view of the fact that, in order to move the large stocks of cotton and wheat so obtained, the latter will be forced to sell such commodities at prices far below the level of laid-down costs in China.

There have occurred in connection with the credit under reference additional unfortunate developments, in that the concerned representatives of the American and Chinese Governments have failed to arrive at a prompt agreement in regard to the mechanics of the transaction, with the result that to date not a single shipment of either cotton or wheat has gone forward. Furthermore,

much of the moral credit which should have accrued to the American Government in consequence of this very tangible evidence of its desire to be of assistance to China, may have been lost in consequence of the fact that, while minor differences of opinion in regard to the terms of the contract have occasioned much discussion, the market prices of cotton and wheat have materially increased - to the obvious disadvantage of the Chinese Government.

JONETHIMPITE

August 2, 1933.

#### Boxer Indemnity Payments.

It will be recalled that in February, 1933, the Chinese Government requested a repetition of postponement. for another year, of the American, British and Italian portions of the Boxer Indemnity payments, and that in reply the American, British and Italian Governments informed the Chinese Government of their unwillingness to grant this request. However, the Chinese Government allowed the payments due on the American portion to go into default, and not until the Department and the Legation at Peiping had on numerous occasions brought the matter to the attention of high officials of the Chinese Government did the Chinese Government resume, in part, payments on the American portion of the Indemnity. March and April instalments were not effected until two months after due dates, with attendant and gratuitously injected difficulties in regard to differences in rates of exchange; and payments are now in arrears for the months of May, June and July -- a situation which is causing considerable inconvenience to the American authorities concerned, including the Department, and which would appear to be unwarranted in view of the fact that in regard to the Italian portion of the Indemnity the Chinese Government is effecting payments regularly and on due dates.

CONFIDENTIAL

August 2, 1933.

#### Outstanding Claims against the Chinese Government.

There are now in existence outstanding American claims against the Chinese Government totaling many millions of dollars, a large proportion of which are of a contractual nature, covering loans made, materials supplied and services rendered.

In the opinion of the Department there has existed for many years a lamentable lack of effectively earnest desire on the part of the Chinese Government to liquidate or even to consider with appropriate seriousness its acknowledged debts and obligations to American claimants, in consequence of which the matter has now become one of urgency not only because of the inherent rights of the American interests concerned but also because the Chinese Government is constantly hypothecating for new purposes revenues which might be, and which should be, devoted to the service of obligations to American (along with other) creditors, and because with the passage of time it becomes increasingly more difficult to meet the demands of procedure with regard to certain types of such obligations.

Of the large number of contractual claims of the nature indicated above which have been filed with the Department during the past ten or twelve years, none, it

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is believed, has been paid; and in only three instances, all of which have occurred during the past month and which have involved only comparatively small sums, (and after special pressure by the Department of State), have the Chinese made arrangements for the ultimate liquidation of claims.

(NOTE: The attitude of the Chinese Government, as briefly reflected above, appears to be in distinct contrast to that displayed by the present régime in Manchuria which, according to recent communications received by the Department from various sources, are evidencing a greater solicitude with regard to the meeting of past and current obligations to American creditors than was shown by the former authorities in Manchuria or is shown by the Chinese Government.)

Under date January 30, 1933, the American Legation at Peiping, acting under instructions from the Department, presented to the Chinese Government a proposal for the establishment of a Sino-American Claims Commission to examine and determine, with a view to ultimate liquidation, the claims presented by the citizens of one country to the government of the other. This proposal apparently met with the approval of certain of the ranking officials of the Chinese Government, including the Minister for Foreign Affairs

Affairs and the Minister of Finance, Mr. T. V. Soong. The latter, however, caused to be brought to the attention of the Department, subsequent to his arrival at London to attend the Monetary and Economic Conference, information to the effect that disagreement had arisen among various departments of the Chinese Government in regard to the proposed commission, in consequence of which he (Mr. Soong) felt that it would be to the interests of both the United States and China if the former would refrain from pressing the matter until Mr. Soong shall have returned to China. As a matter of practical expediency, the Department deemed it advisable to comply with Mr. Soong's suggestion, and at that point the matter now rests. It is, however, the opinion of the Department that there should be impressed upon the Chinese Government and particularly upon Mr. Soong, as its Minister of Finance, the importance which the American Government attaches to the proposed Claims Commission as the simplest and most efficacious means of arriving at a satisfactory settlement of just claims long overdue.

It might also be urged upon the Minister that the quickest and surest way for China to rehabilitate her credit abroad -- especially in the United States -- will be by demonstration by the Chinese Government that it is definitely

definitely and in a practical manner concerned with the problem of meeting the overdue and just claims of China's foreign creditors.

#### PARAPHRASE

A telegram dated August 3, 1933, from the American Minister at Peiping reads substantially as follows:

#### Confidential.

There is current in Shanghai, according to the American Chamber of Commerce at that place, the rumor that an attempt may be made by certain interested Chinese officials to use part of the proceeds of the \$50,000,000.00 American wheat and cotton loan for the purchase in Germany or Great Britain of materials to carry out plans for the construction of a modern munitions factory, arsenal and steel plant. Reference is made in this connection to a report from the Consul General at Nanking discussing a proposed German steel plant which, due to a change of administration in Germany and difficulty experienced in obtaining necessary credits, is understood to be suffering. The Legation has also received a communication from the American firm of Andersen, Meyer and Company urging that the proceeds of the American wheat and cotton loan be utilized for the purpose of refunding the claims against Chinese railways on the part of American material creditors. The Minister asks whether the Department desires to give him any instructions in case it should appear that the Chinese intend to use for the purchase of supplies in Europe the proceeds of the American loan. The Minister states that the Legation would also welcome an expression of the Department's views with regard to the attitude the Legation

Legation should adopt in reference to any proposal that the proceeds of the American loan be utilized to refund the claims of American material creditors.

## THE UNDER SECRETARY OF STATE WASHINGTON

August 4, 1933.

#### CONFIDENTIAL

Dear Mr. President:

Referring to the letter which I wrote you on August 2, enclosing three memoranda, on the subject of the impending call of the Chinese Minister of Finance and financial obligations of the Chinese Government, I feel that you would wish to see the contents of a telegram which has just reached the Department under date August 3 from the American Minister at Peiping. I enclose a paraphrase.

Ordinarily we do not give ourselves great concern with regard to "rumors" and we do not spend much time formulating in anticipation replies to requests for instruction with regard

to

The President,

The White House.

to contingencies which may or may not develop. In this case, however, there is reason to believe that the reported rumor may have some basis in fact, and our Minister in Peiping evidently believes, as does the Department, that, we should consider both means of prevention and means for meeting the needs of the situation if and as they arise. Pending the preparation of an instruction to the Minister. and feeling that it might be much to our advantage were the Chinese Minister of Finance to have directly from you some expression of this Government's thought and attitude with regard to the course which should be pursued by the Chinese Government if that Government hopes to retain our confidence and to continue to receive assistance from this country, it occurs to me to suggest that in your conversation with Mr. Soong you might take occasion to give him

some indication of your thought on that subject.

The so-called "loan" which the Reconstruction Finance Corporation has made to China is in fact a credit, for the purchase by the Chinese Government of cotton and wheat in the United States. It is realized that, on the cotton and wheat so purchased, the Chinese Government may be able to base further credit or cash transactions. In case it should do so and should plan to apply the proceeds thereof to purchases of materials abroad, it would seem reasonable for us to expect that it should apply them for purposes and in manners most to China's advantage; but, other things being equal, China ought to give first consideration to American trade, keeping in mind both American firms which have in the past sold it goods on credit and firms which are prepared to sell to it. Especially, the Chinese Government should avoid

any discrimination, either in fact or in appearance, against American trade. That principle should apply in relation both to past and to future transactions. If, in consequence of the credit which the American Government has recently extended to the Chinese Government, any funds become available to the latter which it may choose to apply either to the paying of claims to foreign creditors or to new purchases, the Chinese Government, in its use of those funds, should give scrupulously equitable treatment to American claimants and should give amply fair opportunity to American firms that are prepared to supply such materials as it requires. We regard as very important the question of rehabilitation of China's credit. We do not ask for or expect special favoring of American interests but we would look with emphatic disapproval upon any discrimination against American interests.

You may wish to have all of these matters in mind when talking with the Chinese Minister of Finance.

Faithfully yours,

Enclosure:

Paraphrase of telegram from Peiping.

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## THE UNDER SECRETARY OF STATE WASHINGTON

COMPIDENTIAL

August 5, 1933.

Dear Mr. President:

Referring further to my letters to you of August 2 and August 4 on the subject of the impending call of the Chinese Minister of Finance, I send you herewith a paraphrase of a telegram which has reached the Department this morning under date August 4 from the American Minister at Peiping; also a memorandum containing the comment, which of necessity has been hastily prepared, by the Division of Far Eastern Affairs.

Faithfully yours,

Enclosures:
Paraphrase
of telegram;
Memorandum.

The President,

The White House.

#### PARAPHRASE

A telegram dated August 4, 1933, from the American Minister at Peiping reads substantially as follows:

The American Minister proposes that, upon the return to the United States of T. V. Soong to complete details of the American cotton and wheat loan, the Department suggest to Soong that a part of the proceeds of that loan be segregated for use in rehabilitating the Peiping-Suiyuan and the Peiping-Hankow Railways under a plan that probably would involve the consolidation of the two lines for the purpose of purchasing new equipment in the United States for rehabilitation and for the purpose of safeguarding sums due American material creditors amounting to approximately gold eighteen million dollars for the two lines. Under this plan there would be earmarked approximately gold four million dollars of the proceeds of the American loan for rehabilitation of the Peiping-Hankow line and approximately gold three million five hundred thousand dollars for rehabilitation of the Peiping-Suiyuan line, and the additional earmarking of funds sufficient to pay interest on old debts of American material creditors of the Peiping-Hankow Railway to the amount of gold two hundred fifty thousand dollars a year and on old/American material creditors of the Peiping-Suiyuan line to the amount of gold five hundred thousand dollars per year. The Chinese Legislative Yuan, according to announcement made publicly in China, approved the American

loan on condition that it be used for purposes which would be non-military and constructive. The suggestions current in Shanghai and Nanking that a portion of the proceeds of the loan will be used to carry out proposals involving purchases in Europe are causing serious concern to American material creditors. The American Minister is of the opinion that such a result would be extremely regrettable, especially when the proceeds of the loan could be profitably used (a) to place American material creditors - who represent 90% of the material creditors of those lines - in a position where they may obtain a return upon their claims, and (b) to furnish needed employment in American industries involving several thousand jobs. The equipment supplied by American industries and still unpaid for is the chief reason why both the railways are able to operate today.

Subject: Comment on Peiping's telegram 655, August 4, 6 p.m.

Johnson evidently envisages the sale by the Chinese Government of the cotton and wheat purchased by it from the United States. The proceeds from that transaction will be available to the Chinese Government for its own purposes. The contract between the Chinese Government and the Reconstruction Finance Corporation imposes no restrictions: it makes no provision for application of these proceeds either in whole or in part to settlement of American claims or purchases in the United States.

In approving the loan, the Legislative Yuan of China prescribed, for Chinese administrative purposes, two conditions, the second of which reads:

- "2. The entire proceeds of the Loan shall be used only for the following productive purposes, and under no circumstances shall be used for the prosecution of any internal military campaigns or for other unproductive purposes:
- (a) Creation or development of basic industries.
- (b) Revival of rural economy.
  (c) Enforcement of water conservancy measures.
  - (d) Development of principal communication enterprises.

"The Committee for the Administration of the Loan shall fix, through the prescribed legal procedure, the proportion of funds to be allocated for each of the four purposes mentioned above (Kuo Min News Agency, June 17)."

It would appear that there is no way by which we can at this stage lay down stipulations prescribing uses to be made of any portion of these "proceeds".

The most that we could do would be to make suggestions.

It is the understanding of the Department that the Chinese have recently given British material creditors some special new assurance based on arrangements with regard to the Tientsin-Pukow Railway.

American material creditors have been complaining that this is preferential in favor of the British; and the Chinese have intimated that they will consider giving American material creditors some similar new assurance.

In principle, if the Chinese choose to place material creditors in a preferred class as compared with other creditors, it should certainly be expected, and if necessary be demanded, of them, that, in the treatment which they accord such a preferred class, American creditors should obtain not less favorable treatment than that accorded to any others the most favored.

Throughout this whole matter, we have three problems: first, that of obtaining solicitous consideration and American creditors in particular; second, that of ensuring that there be given to American creditors treatment not less favorable than that given to creditors of any other nation; and third, that of promoting American trade against the background of and in connection with the making available to China by the American Government of funds.

The recommendation which Johnson makes would appear reasonable in principle. Whether it is the most practicable recommendation, as to details, that might be made would be a question requiring some amount of examination and discussion. Certain political factors would need to be taken into consideration in connection with the Peiping-Hankow and Peiping-Suiyuan Railways: the Peiping-Hankow Railway has involved Belgian, French and British interests; the Peiping-Suiyuan Railway was built by the Chinese themselves but it lies in an area to which the Japanese have recently been giving special attention. It is true that American firms have in recent years supplied materials which have contributed to the operation of these lines, as implied in the specifications which Johnson suggests.

The recommendation which Johnson makes is not one which can be adopted and be put forward as a "take it or leave it" suggestion, request or demand. It calls for treatment as an entirely tentative subject for discussion between representatives of the two Governments concerned who are prepared and who could take the time to exchange views and upon the basis of an exchange of views, work out together what would be a practicable plan acceptable to both sides.

#### SMITHSONIAN INSTITUTION FREER GALLERY OF ART WASHINGTON, D. C.

chipse

January 6th, 1934.

NOTE ON THE INSCRIPTION WOVEN INTO A CHINESE RUG SUBMITTED TO THE NATIONAL MUSEUM BY THE PRESIDENT.

The three characters, reading from right to left, are Chien Ching Kung, and mean Palace of Heavenly Purity. In this Palace was the Council Chamber, into which the Emperor went in the morning and gave audience until eight o'clock, to transact business with his ministers, and to see those who had been appointed to office. It is one of the most important and most magnificent of all the palaces.

J. E. Lodge, Curator. phone

chura (s) (s)

## THE UNDER SECRETARY OF STATE WASHINGTON

December 10, 1934

Dear Mr. President:

I believe that you will be interested to have before you a copy of a cablegram from Dr. H. H. Kung, Minister of Finance, which the Chinese Minister has just handed to me and which relates to our silver purchases. I have already sent a copy of this communication to Secretary Morgenthau. In this connection I am also sending you a message dated the seventh instant which we have received from the American Consul General in Shanghai, in which the statement is made that American business and prestige are suffering because of the fact that the Chinese are asserting that present distressing financial conditions are due to America's silver

The President,

The White House.

policy and purchases.

In addition to the foregoing, the Treasury
has sent to us a copy of a cable to the Chase
Bank from its representative in Shanghai in
which the following sentence occurs:

"Anti-American feeling growing. If Chinese Government cannot stop outflow Shanghai silver stock not sufficient to meet requirements and Chinese currency may be forced off silver. Confidential report Japanese Government will make loan China and Chinese currency will be managed in line with Japanese yen."

In view of the situation which appears to be rapidly developing, I am wondering whether you would care to consider any modification of our present policy.

Faithfully yours,

Enclosures:

From Shanghai, No. 582, December 7, 3 p.m.; Copy of cablegram from Dr. H. H. Kung. CHINESE LEGATION
WASHINGTON.

CABLEGRAM FROM
Dr. H. H. Kung, Minister of Finance,
Received December 9, 1934.

The American Government's communication of October 12 expressed a desire to conduct its silver purchases so as to avoid disturbing China's economy and expressed its willingness to discuss the problem involved. In this spirit and having in mind America's traditional interest in China's welfare and the President's special friendship, the Chinese Government frankly lays before the American Government the present difficulties resulting from the rise of silver and requests American cooperation. Notwithstanding the silver export restrictions of October 15, China is now involved in a dilemma: - If the present disparity persists there will be continued silver drain through legal and illegal export and hoarding which create fear and consequent capital flight. If, however, the Government endeavors to raise the exchange toward a foreign parity this would

only

only cause further severe deflation and necessitate further heavy silver export and create again a situation similar to that before October 15. The adoption of a gold basis involves transition difficulties and risks which the Government is reluctant to take up unless supported by substantial foreign credit. Regardless of which alternative chosen as to the silver policy drain and hoarding would continue threatening metallic basis. China, therefore, wishes to inquire whether the American Government would cooperate by announcing it would not . pay over say 45 cents per ounce except American domestic silver. If the American Government wishes to be in a position to do whatever is desired about silver without hurting China an alternative would be some form of cooperation to facilitate currency reorganization. Chinese Government would appreciate the views of the American Government concerning the subject entirely.

Gray

Shanghai (N.R.)

Dated December 7, 1934

Rec'd 2:30 p.m. 8th

Secretary of State,

Washington.

582, December 7, 3 p.m.

Referring My No. 579, and in continuation of same.

One. I reached conclusion from conversations with number of Chinese directly and indirectly that American business and prestige are suffering because the Chinese are asserting that present distressing financial conditions are due to America's silver policy and purchases. I therefore consulted three well informed Americans whose names are given in penultimate paragraph to ascertain their views regarding the present silver situation and the cause of the failure leading thereto. Excerpts from replies follow.

Two. "You have asked one to give you a short outline of Shanghai's present financial troubles. Boiled down, it is a shortage of (?) species. You might also add mal-distribution of the remaining stocks held. Immediately after the United Kingdom silver purchasing policy was announced shipments of

silver from this port started to flow out to London and the United States."

Continuing, "the Chinese Government and banking authorities naturally became quite alarmed as these shipments continued to grow and in an effort to protect their remaining reserves the Government on October 14th put into effect the export tax and equalization fee. This made it comparatively unprofitable for foreign banks to ship but it created another situation which we consider even more dangerous to China, namely, that the Chinese themselves lost confidence and proceeded to hoard and convert their local balances into foreign currency as quickly as possible. Added to this the large profit which could be made in getting harbored silver into open markets, such as London, encouraged smugglers to operate extensively and it is estimated a great percentage of the silver now going out from Shanghai up country and to out ports is being smuggled and hoarded. The export tax therefore, while having almost completely stopped legitimate shipments by (?) banks has failed to prevent silver leaving Shanghai for the purposes mentioned of smuggling and hoarding".

Continuing, "as a result it has been necessary for many banks to call loans and dump securities on an already weak market. As the situation stands to-day business cannot go on except at usurious rates. The Chinese Government officials and bankers are desperate and are again seeking a remedy in an endeavor to correct the situation. Whether this will result in a complete embargo no one knows but sooner or later some drastic step must be taken which will work a great hardship on Chinese and foreigners alike. The situation is so delicate that unless outside help is received we can only see a complete collapse."

Continuing, "the cause in our opinion can be directly traced to America's silver purchasing policy."

Continuing, "rightly or wrongly the Chinese believe that all their present troubles are directly attributable to America's silver purchasing policy with the result that the feeling towards America and American business houses in China has grown very bad. We know from authoritative sources that negotiations are at present under way with the British for a loan to China for the purpose of enabling them to defend their currency with further attacks. If these nego-

tiations are completed it will mean a further strengthening of the Sino-British ties and a further cleavage in Chinese-American friendship."

Three. The person quoted in this paragraph does not subscribe fully to the theory that the silver purchasing policy of the United States is entirely responsible for the present situation though "there is a growing feeling amongst the majority of the more important Chinese bankers and many government officials that the silver purchasing policy of our Government is the direct cause of the steadily advancing silver price on all world markets particularly London but also in the widespread conviction among speculators that further advances in price are inevitable and as a result of that policy China is being drained of her necessary monetary silver reserves and subjected to all the undesirable effects of deflation".

Continuing, speaking of the export duty and equalization tax he said: "whilst succeeding to an appreciable extent in checking the outflow to foreign countries they have created another situation even more dangerous to China. As a result of the above measures Chinese are losing confidence in both bank deposits and note issues and shipments of silver are

now going up country and to out ports at an alarming rate. It is admitted that a great percentage of this silver is being hoarded and smuggled. A continuation of the present trend for another three to six months would mean practical expropriating of Shanghai's silver reserves and the almost inevitable failure of some of the Chinese banks and possibly a complete economic collapse. Already bank loans are being called. securities are being liquidated on weakening markets, and business operations are being contracted through the difficulty of obtaining credit. The situation is/serious that I understand that the Chinese banking group and prominent government officials are conducting negotiations with British banking interests for the extension of a substantial sterling credit for currency stabilization purposes; details of the credit are not known nor can I ascertain whether or not negotiations are progressing satisfactorily but I do regard rather seriously the attitude of many Chinese bankers and government officials that the American Government, because of its silver purchasing policy, is responsible for the present critical situation and in many quarters it is noticeable that American

prestige

chinese confess: "I feel that the growing antagonism in responsible Chinese quarters against the
American Government and its silver buying program
is so serious that it should be brought to your attention and that if almost immediate outside assistance
is not forthcoming there is a possibility of a complete collapse of the local banking situation with
resultant irreparable damage to American trade with
China."

Four. The next person quoted calls attention to the fact that the stock of silver in Shanghai in June 1934 was estimated to be approximately 570,000,000 Shanghai dollars including sycee, silver dollars Chinese mint bars and commercial bar silver. The stock today is 350,000,000 Shanghai dollars. He states that "due to the reduced stock of silver in Chine at present we are already experiencing a serious situation due to the stringency of cash and the resultant higher interest rates which is already beginning to interfere with Shanghai business. If the outflow of silver from Shanghai continues we may see a very serious situation here."

Continuing, "even if the export duty on silver . were removed and the foreign exchange value of Chinese dollars be again on a parity with world silver prices it is doubtful whether this condition of parity would be maintained in the face of higher prices of silver in world markets. As long as the foreign exchange value of Chinese currency is below parity with silver prices abroad silver will continue to flow out of Shanghai and should a complete export embargo be promulgated we may see increased hoarding and increased smuggling of silver out of the country. If the out flow of silver from Shanghai continues the Chinese Government may be forced to take its currency off silver with a result that may be very serious for Chinese and foreign trade. I have heard that anti-American feeling is growing among Chinese as they blame the American Government's silver purchasing program for China's heavy loss of silver. Should the American Government find it possible to modify its silver purchasing program so that there is no further inducement for speculators to force silver prices higher the local situation may work itself out although it may be necessary for the Chinese Government in order to restore confidence in currency and to bring the

foreign

foreign exchange value of its currency up to silver parity to obtain a sufficiently large loan from foreign sources."

This person calls attention to the fact that commercial hoarding of silver dollars has been practiced since October 14.

Five. The quotations in paragraph two are by National James A. Mackay, Assistant Vice President of the City Bank; those in paragraph three are from J. E. Swandien and Fritz and those in paragraph four are from A. E. Shumacher of the Chase Bank. Each of these speaks personally and not for or on behalf of the institution which he represents. I am led to believe that each would consider seriously any contribution which they might care to make concerning the silver situation if presented in case of Mackay and Schumacher through their principal officers.

Six. Representatives of important American firms exporting from the United States to Shanghai have expressed the view that trade was stopping because of an apparent feeling against the United States due to the silver purchasing program. I intend to make inquiries of some American business concerns in regard

FS 9-No. 582, December 7, From Shanghai

to the possible existence of a feeling that Chinese bankers and business men are unsympathetic to American trade.

CUNNINGHAM

HPD:CSB

(\*) omission

#### DEPARTMENT OF STATE

#### ASSISTANT SECRETARY

2/1/35.

Dear Miss Le Hand:

This is to apologize for the forged initial on the attached note.

I am being flooded with telegrams from American business men addressed to W.C.B. asking what hope is left for business with the Soviets now that our negotiations have collapsed, to say nothing of a couple of dozen long distance telephone calls from various people asking appointments to discuss with W.C.B. the present state of Soviet-

### DEPARTMENT OF STATE

ASSISTANS SECRETARY

American relations. I am quite used to turning them down but what with W.C.B. on his way to Philadelphia, I am sure he must feel that he is going off like Madame Pompadour. Was it not she who coined that famous statement, "après nous la déluge"? It's quite all right but I'm not keen about the deluge when I'm at the wrong end.

Sincerely,

the or sent state of Soviet-

Offer

ADDRESS OFFICIAL COMMUNICATIONS TO THE SECRETARY OF STATE WASHINGTON, D. C.



# DEPARTMENT OF STATE WASHINGTON

February 1, 1935.

Personal.

Your Ladyship:

I am asking Office to bring to you this morning a telegram which Jean Monnet has just delivered to me. Monnet has also informed me that Doctor Sze has received the definite proposal of the Chinese Government and will presumably present it to the Department of State today or tomorrow.

Do remind the President, if he has not already
put those poor devils out of their misery, that he is
going to let the Department of State have the two hundred
thousand dollars which will be saved by dismissing
Foreign Service Officers for the purpose of promotions
in grade of younger men and the injection of new blood
into the Service; that he is going to ask for an extra
hundred thousand dollars to establish a courier service
in the Far East, to provide travel expenses for officers
he may wish to summon for consultation, and to keep the
field

Miss Marguerite Le Hand, The White House. field informed by telegraph of important diplomatic developments in Washington; that he is <u>not</u> going to order the dismissal of any more clerks in the Foreign Service, twenty percent of whom have already been dismissed since 1932.

I will be at the University of Pennsylvania Hospital in Philadelphia.

Good luck.

1. c. o.

Enclosure: Telegram as stated above. Personal message from T.V. Soong to Ambassador W. C. Bullitt

Shanghai, January 31st, 1935.

Am taking a hand in currency and financial problems because of the extreme gravity situation. Considered opinion myself is that inevitably
economic and especially currency situation heading towards crisis, possibly
in March, probably in April certainly before June. When it comes banking
system will be smashed, country forced to irredeemable paper money and government finances entirely disrupted, with disastrous effect on Central Government
authority.

In other countries and under other circumstances currency collapse while unfortunate need not be so disastrous, but with country not yet well organized and with Japan now pressing for show down (which fact must be well known to you) in order to dominate China, Government would then have to choose between accepting a Japanese loan under onerous political and economic conditions or facing the emergence of provincial governments with different currencies virtually under Japanese protection. Had I not seen this eventuality I confess I would view approaching crisis with comparative calm.

In view of the impending danger to China and world, hopeful that proposal (which is being transmitted by Minister Sze) for an American loan to Znable China to firstly link her currency with U.S. dollar and avert coming crisis, secondly spare a part of her silver stocks for American requirements, will be viewed with great sympathy as far more is involved than the fate of the present Chinese Government or even her economic well being.

DEPARTMENT OF STATE

DIVISION OF FAR EASTERN AFFAIRS

February 2, 1935.

To:

Colonel Howe.

From: Mr. Hornbeck.

The attached copy of a note under date February 1, 1935, from the Chinese Minister, with enclosure, in regard to the silver situation in China, is transmitted for the information of the President.

GILL

CHINESE LEGATION WASHINGTON

February 1, 1935

My dear Mr. Secretary:

I beg to inform you that I have received from Dr. M. H. Kung, Minister of Finance at Manking, for delivery to you a memorandum summarizing, supplementing and bringing up to date the data on the silver question, a copy of which is herewith enclosed for your consideration.

I beg leave to point out that the opinions expressed in the report of the Ministry of Industries Commission referred to in the memorandum do not necessarily represent the views of the Chinese Government.

I am, my dear Mr. Secretary, Very mincerely yours,

SAO-KE ALFRED SZE

Enclosure: Wasorandum as ubove.

Honorable Gordell Hull, Secretary of State.

## DATED JANUARY 30, 1935

The Chinese Government had thought the situation here was made clear but in view of the inquiry of January 26 desires to summarize, supplement, and bring up to date the data furnished heretofore.

The Chinese Government was greatly disturbed for the past year over the effects of the American Silver Program on the Chinese connection with the ratification of the London Silver Agreement for Stabilizing Silver the Chinese Covernment through the American Consulate General at Shanghai informally communicated the following views:

"China entirely sympathizes with the purpose of the London silver agreement on the stabilization of silver prices and Minister Kung has personally urged ratification which is now sending. Since China's currency is silver, China is of dourse vitally interested in measures affecting its value and international exchange but of course has no desire to intrude upon questions of purely American internal concern. In view of reports here, it may be observed that any action resulting in a rise of China's currency out of relation to other currencies and especially out of relation to world commodities would have deflationary effects in China, further decrease her already reduced exports and so impair her ability to purchase goods from abroad. It would also probably increase the present serious tendency towards heavy silver exports as necesmary means of settling large adverse balance. In view therefore of China's vital interest, it is hoped that the Government of China will be consulted in advance if measures concerning silver that might materially affect China's currency and exchange are in fact being contenplated."

Again immediately after the American nationalization of allver in August the Chinese Covernment made the following further communication:

"The London Silver Agreement of July 1933 received the signature of China's representatives and has more recently been ratified by the National Government of the Republic of China with the understanding that its major purpose was to secure the stability of the price of silver which was thought menaced by the large surplus stocks held by the Governments of India and Spain. The preamble of the agreement states in part that 'it is to the advantage of China that sales from monetary stocks of silver be offset by purchases as herein provided, with a view to its effective stabilization."

"It now appears that under the Silver Purchase Act of 1934 the stability of the price of silver and the interests of China are as much menaced as by the previous situation of potential sellers. China would therefore appreciate an indication of the probably policy of America in the future purchase of silver in order that China may properly safeguard her currency, which has recently been flowing out of the country to a degree that is potentially alarming".

These views were substantiated by results as detailed in a memorandum communicated to the American Minister on October 5. Moreover full information furnished Professor Regers here and subsequently concurrently furnished the American Treasury representative, the Commercial Attache and the Consulate in both Shanghai is presumably available/to the State and the Treasury Department. Mevertheless the following further statement is submitted:

- 1. Net silver export in 1934 not including amuggling was 257 million dollars of which five sixths in less than four months from the adoption of the Silver Purchase Act to October 15 when China was obliged to enforce restriction to protect the currency reserve from this extraordinary drain. In 1934, the silver export was five times the previous high record in 1907.
- 2. The Shanghai silver stock declined from 544 million dollars at the end of June 1934 to 312 million dollars now. Also the stock of other leading centers declined proportionately.

- 3. Till July last money was easy and financing plentiful but accompanying the silver drain money became extraordinarily tight. Since the first half of 1934 interest rose from the equivalent of six percent per annum charged by native banks to customers to 26 percent about January 1. Since arranging the financing of new year settlement lower rates have been nominally quoted at the instance of the Government but this does not represent real improvement since it is practically impossible to borrow at any rate regardless of security. As a consequence tightness of money led to the sale of foreign exchange for cash at a premium over forward delivery worked out to be 27.4 percent per annum yesterday for one month loan.
- 4. Notwithstanding the tendency to world wide recovery deterioration of China's situation increased alarmingly the last six months and the condition now is at the lowest point since depression began. total foreign trade for the second half of 1934 is thirteen percent below the first half and sixteen percent below the second half of 1933. Although the adverse merchandise balance has declined the drain of both gold and silver the last three years makes the situation here precerious unless the conditions causing the adverse balance of payment are counteracted. Sime July last Covernment and industrial bonds declined by ten percent; property of the Center District of Shanghai declined about fifteen percent; industrial stocks declined seven percent. There are widespread business failures in all regions including numerous important indus-

trial and mercantile betablishments. Recently Covernment-supporting banks and enterprises through the Central Bank of China, Bank of China and Bank of Communications try to prevent further increase of unemployment and wholesale collapse. New year settlement is only about fifty percent of the normal as banks fear pressure would precipitate numerous bankruptoies which at this time would cause general collapse. As a consequence notwithstanding their own difficulties banks feel obliged to grant loan extensions even to practically insolvent concerns. In order to ease money and sustain confidence during new year settlement the Government is obliged to bring back silver from Hongkong at 19 percent loss in the small driblets which the financial situation permits but the present impaired credit structure and the inordinate interest rate due to the silver drain are destroying trade.

- finance is making practically impossible further financing by banks. The reserve, particularly that of the customs is seriously threatened by the present tendency. Peconstruction activities are checked; for example the loan for the important project of bridging connecting railways near Hang-chow and extending the railway to Hingpo cannot be floated though already contracted for.
- 6. All evidences confirmed the rising of currency value which has proved disastrous to China because involving parallel deflation. For detailed discussion supported by statistics see a recent report

of the Ministry of Industries Commission of which Professor Buck has preliminary copy which however contains figures only to early 1934. Since then the conditions have become greatly aggravated.

Chinese Legation,

Washington, February 1,1935.

DEPARTMENT OF STATE
WASHINGTON
February 7, 1935

My dear Mr. President:

I enclose for your information and consideration copies of communications which I have sent to the Secretary of the Treasury, under dates February 6 and February 7, in regard to and in connection with the question of effects in China of the silver policy of the United States.

Faithfully yours,

Correlfue

Enclosures:

Copy of letter to Treasury, dated February 6, 1935, with enclosures; Copy of letter to Treasury, dated February 7, 1935.

The President,

The White House.

### Department of State

ENCLOSURE

TO

Letter drafted

ADDRESSED TO

The President.

In reply refer to

February 6, 1935.

My dear Mr. Secretary:

Referring to previous communications in regard to and in connection with the effects in China of the silver policy of the United States, I enclose for your consideration copies of papers as follows: a note dated February 1, with enclosure, from the Chinese Minister in Washington; and a note dated February 5 from the Chinese Minister in Washington.

I would appreciate receiving at your early convenience an indication of your views in regard to the "plan" outlined by the Chinese Minister of Finance, the text of which is communicated in the note of February 5 from the Chinese Minister in Washington.

Sincerely yours,

Inclosures:

From Chinese Legation, February 1, with enclosure; From Chinese Legation, February 5.

Cordell Hall

The Honorable

Henry Morgenthau, jr.,

Secretary of the Treasury.

#### CHINESE LEGATION WASHINGTON

February 1, 1935

My dear Mr. Secretary:

I beg to inform you that I have received from Dr. H. H. Kung, Minister of Finance at Nanking, for delivery to you a memorandum summarizing, supplementing and bringing up to date the data on the silver question, a copy of which is herewith enclosed for your consideration.

I beg leave to point out that the opinions expressed in the report of the Ministry of Industries Commission referred to in the memorandum do not necessarily represent the views of the Chinese Covernment.

I am, my dear Mr. Secretary,

Very sincerely yours,

SAO-KE ALFRED SZE

Enclosure: Memorandum as above.

Honorable Cordell Hull, Secretary of State.

### DR. H. H. KUNG, MINISTER OF FINANCE AT MANKING DATED JANUARY 30, 1935

The Chinese Government had thought the situation here was made clear but in view of the inquiry of January 26 desires to summarize, supplement, and bring up to date the data furnished heretofore.

The Chinese Government was greatly disturbed for the past year over the effects of the American Silver Program on the Chinese economic and financial situation. On February 16 in connection with the ratification of the London Silver Agreement for Stabilizing Silver the Chinese Government through the American Consulate General at Shanghai informally communicated the following views:

"China entirely sympathizes with the purpose of the London silver agreement on the stabilization of silver prices and Minister Kung has personally urged ratification which is now pending. Since China's currency is silver, China is of course vitally interested in measures affecting its value and international exchange but of course has no desire to intrude upon questions of purely American internal concern. In view of reports here, it may be observed that any action resulting in a rise of China's currency out of relation to other currencies and especially out of relation to world commodities would have deflationary effects in China, further decrease her already reduced exports and so impair her ability to purchase goods from abroad. It would also probably increase the present serious tendency towards heavy silver exports as necessary means of settling large adverse balance. In view therefore of China's vital interest, it is hoped that the Government of China will be consulted in advance if measures concerning silver that might

materially affect China's currency and exchange are in fact being contemplated."

Again immediately after the American nationalization of silver in August the Chinese Government made the following further communication:

"The London Silver Agreement of July 1953 received the signature of China's representatives and has more recently been ratified by the National Government of the Republic of China with the understanding that its major purpose was to secure the stability of the price of silver which was thought menaced by the large surplus stocks held by the Governments of India and Spain. The preamble of the agreement states in part that 'it is to the advantage of China that sales from monetary stocks of silver be offset by purchases as herein provided, with a view to its effective stabilization'.

"It now appears that under the Silver Purchase Act of 1934 the stability of the price of silver and the interests of China are as much menaced as by the previous situation of potential sellers. China would therefore appreciate an indication of the probably policy of America in the future purchase of silver in order that China may properly safeguard her currency, which has recently been flowing out of the country to a degree that is potentially alarming".

These views were substantiated by results as detailed in a memorandum communicated to the American Minister on October 5. Moreover full information furnished Professor Rogers here and subsequently concurrently furnished the American Treasury representative, the Commercial Attache and the Consulate in Shanghai is presumably available both to the State and the Treasury Department. Nevertheless the following further statement is submitted:

- 1. Net silver export in 1934 not including smuggling was 257 million dollars of which five sixths in less than four months from the adoption of the Silver Purchase Act to October 15 when China was obliged to enforce restriction to protect the currency reserve from this extraordinary drain. In 1934, the silver export was five times the previous high record in 1907.
- 2. The Shanghai silver stock declined from 544 million dollars at the end of June 1954 to 312 million dollars now. Also the stock of other leading centers declined proportionately.
- plentiful but accompanying the silver drain money became extraordinarily tight. Since the first half of 1934 interest rose from the equivalent of six percent per annum charged by native banks to customers to 26 percent about January 1. Since arranging the financing of new year settlement lower rates have been nominally quoted at the instance of the Government but this does not represent real improvement since it is practically impossible to borrow at any rate regardless of security. As a consequence tightness of money led to the sale of foreign exchange for cash at a

premium over forward delivery worked out to be 27.4 per cent per annum yesterday for one month loan.

4. Notwithstanding the tendency to world wide recovery deterioration of China's situation increased alarmingly the last six months and the condition now is at the lowest point since depression began. The total foreign trade for the second half of 1934 is thirteen percent below the first half and sixteen percent below the second half of 1953. Although the adverse merchandise balance has declined the drain of both gold and silver the last three years makes the situation here precarious unless the conditions causing the adverse balance of payment are counteracted. Since July last Government and industrial bonds declined by ten percent; property of the Center District of Shanghai declined about fifteen percent; industrial stocks declined seven percent. There are widespread business failures in all regions including numerous important industrial and mercantile establishments. Recently Government-supporting banks and enterprises through the Central Bank of China, Bank of China and Bank of Communications try to prevent further increase of unemployment and wholesale collapse. New year

settlement is only about fifty percent of the normal as banks fear pressure would precipitate numerous bankruptcies which at this time would cause general collapse. As a consequence notwithstanding their own difficulties banks feel obliged to grant loan extensions even to practically insolvent concerns. In order to ease money and sustain confidence during new year settlement the Government is obliged to bring back silver from Hongkong at 19 percent loss in the small driblets which the financial situation permits but the present impaired credit structure and the inordinate interest rate due to the silver drain are destroying trade.

- finance is making practically impossible further financing by banks. The reserve particularly that of the customs is seriously threatened by the present tendency. Reconstruction activities are checked; for example the loan for the important project of bridging connecting railways near Hangchow and extending the railway to Ningpo cannot be floated though already contracted for.
- 6. All evidences confirmed the rising of currency value which has proved disastrous to China because

involving

involving parallel deflation. For detailed discussion supported by statistics see a recent report of the Ministry of Industries Commission of which Professor Buck has preliminary copy which however contains figures only to early 1934. Since then the conditions have become greatly aggravated.

Chinese Legation,

Washington, February 1, 1935.

#### CHINESE LEGATION WASHINGTON

The Chinese Minister presents his compliments to the Secretary of State and has the honor to transmit the following text of a cablegram which has been received from Dr. H. H. Kung, Minister of Finance at Manking:

China greatly appreciates the American Government's consideration for China's difficulty in connection with the execution of the silver purchase program. However the Chinese Government feels that under existing conditions the present or higher price in any open silver market inevitably involves the loss of an essential part of China's monetary reserve through legal and/or illegal exportation with resulting monetary chaos and social and political complications international in scope. China however cannot raise the exchange to the foreign silver parity and at the same time prevent disastrous deflation and conserve the silver reserve on the present basis. Lack of confidence in and present doubt about China's currency resulting from uncertainty about the silver price and about the extent of the drain on China's silver under the influence of American buying are ruinous to foreign and internal trade and seriously impair the Government's revenue when the Government is making strenuous efforts to stamp out the communist threat in a western province and consolidate its position throughout the nation. China has therefore considered how it might adjust its monetary and financial policy and program to the American policy and program and harmonize the interests of both countries and has decided it has no choice but to seek feasible means to abandon the exclusive silver basis maintained by it alone and adopt a new currency system by using both silver and gold with a view to linking its currency to that of the United States and to freeing its exchange from uncertainty attached to the silver basis under present conditions.

American cooperation is essential to that end if China is to escape from the present impossible situation and pass safely through the trying transition to a new monetary system without a period possibly prolonged of inconvertible paper money accompanied with grave risks to internal if not external stability. The Chinese Government hopes the American Government will be able to act along the line indicated by the memorandum of January 21 pending an arrangement whereby China would supply the American silver requirement in an endeavor to assist the American Government and would obtain American support in currency reorganization. To this end China outlines the following plan:

Section 1. Under existing circumstances China would prefer to supply the requirement under the Bilver Purchase Act provided the extent thereof, the period of years for their fulfilment, and the sale price of silver supplied are mutually agreeable. Given time and facilities to get together sufficient silver in the hand of the Covernment China could provide for the entire requirement out of the country's holdings. It is suggested that in the first year China sell 200 million fine ounces with tolerance to China of fifty million fine. Subsequent delivery is to be arranged as soon as the American Government indicates its requirement. The price is to be determined either on a gradually rising scale or at a flat valuation above the present price depending on how rapidly and to what valuation the American Government desires the silver price to be raised.

Section 2. In changing the currency of the entire country in a brief time from silver to a currency linked with the United States of America dollar China would require immediate resources so as to establish confidence during the transition and provide a sound basis for the new currency which would require protection against temporary adverse balance of payment consequent upon China's silver exchange being out of line with the level of the world's commodities and leading foreign currencies. Such resources further would tend to assist in repairing the serious damage to China's economy resulting from the loss last year of 260 million silver dollars vital reserve plus the amount smuggled and consequent extreme tightness of the financial market.

Gurrency experts estimate that the minimum resources required would be a loan or long term fund amounting to United States of America dollars 100 million. In addition to this a credit of like amount against future delivery of silver to be drawn upon if and when required is desired so as to ensure beyond question the soundness of this currency reform. It is hoped that this credit would not be drawn upon at all because the reform based upon American cooperation and a settlement of the silver difficulty would itself command general confidence.

proposal is conditioned upon a final agreement on a feasible currency program. The Chinese Government earnestly hopes that the foregoing will receive favorable consideration with a view to promoting a solution of the silver difficulty and encouraging trade development.

Chinese Legation,

Washington, February 5, 1935.

In reply refer to FE 893.515/402

February 7, 1935.

My dear Mr. Secretary:

Referring to my letter to you of February 6 transmitting copies of communications of February 1 and February 5 from the Chinese Minister in Washington, I wish to add that, in connection with the note of February 5 in which appears the "plan" outlined by the Chinese Minister of Finance, the Chinese Minister in Washington gave me a separate note in which he states that, in reference to the communication from the Chinese Minister of Finance, he "desires to make the following observation:

"By making all purchases from China desired quantities could be obtained more expeditiously and advantageously and with less inducement to speculation than by buying from many sources and the Chinese Government can thus obtain necessary supplies without the risk of smuggling to take advantage of a higher price abroad. American buying at London or other open markets at a price above the value in China necessarily invites smuggling. For these reasons the assurance of American purchases made in China only from the Central Bank of China is no great assistance against smuggling. Moreover an exclusive arrangement would facilitate the government in obtaining desired quantities from the Chinese public."

Sincerely yours,

Cordel Hell

The Honorable

Henry Morgenthau, jr.,

Secretary of the Treasury.

DEPARTMENT OF STATE
WASHINGTON
February 20, 1935

My dear Mr. President:

Referring to my letter to you of this morning on the subject of the suggested reply to the Chinese Minister's notes of February 5, I hasten to send you herewith a copy of a letter which I have just received from the Secretary of the Treasury in which Mr. Morgenthau states that he has no objection to the giving of a reply as proposed although he doubts whether it will "get us any farther than our previous reply."

If you approve of our making reply as proposed,
I shall, before formally communicating the reply, first
discuss the matter informally with the Chinese Minister.

Faithfully yours,

Enclosure:

From Treasury Department, dated February 15, 1935. ordere Stuce

The President,

The White House.

## Department of State

ENCLOSURE

TO

Letter drafted

ADDRESSED TO

The President.

# THE SECRETARY OF THE TREASURY WASHINGTON

February 15, 1935.

My dear Mr. Secretary:

I beg to acknowledge receipt of your letter of February 6th with enclosed copy of cablegram from Dr. H. H. Kung and a suggested draft of the reply to the same.

I have no objection to the forwarding of this reply, but doubt if it will get us any farther than our previous reply.

Yours sincerely,

H. MORGENTHAU JR.

The Honorable

Cordell Hull

Secretary of State

DEPARTMENT OF STATE
WASHINGTON

March 2, 1935

My dear Mr. President:

Developments of importance in regard to relations with China during the week February 25 to March 2 have been as follows:

On Monday, February 25, the British Ambassador called on me and stated that the Japanese had recently asked for information with regard to the attitude of the British Government toward the financial situation in China; and that the Foreign Office had thereupon decided that this was an opportunity to explain the British Government's views to the three other Governments principally concerned, namely, China, the United States and Japan. The Ambassador continued to the effect that the British had followed the situation in China, and especially proposals involving loans or credits, with close attention; and that they had had to discourage such loans or credits. He then handed me a copy of a confidential memorandum giving "reasons for which His Majesty's Government believe that foreign loans or credits for China would not offer any real or lasting remedy." He said that the views expressed in that memorandum

had

The President,

The White House.

had been communicated to the Chinese and to the Japanese Governments. However, he said, the British had been careful to indicate that the situation was one with regard to which they felt grave concern and they have emphasized their desire to help China, in cooperation with the other governments principally concerned. Their general policy in the Far East was influenced by their desire for cordial relations between China and Japan, based on a friendly settlement of outstanding difficulties. This they regarded as the only possible basis for a general relaxation of tension in the Far East which they considered of supreme importance and without which they felt that there could be no satisfactory solution of any of the particular problems. They felt that any plan to help China needs a sound basis and must be carried out with friendly agreements with the other powers and of China herself. They would value an expression of the views of the Chinese Government as to how this might be done. If China responded favorably to their communication, the British Government would welcome the cooperation of the United States in any useful steps.

The Ambassador concluded his remarks by asking whether we could give any indication of how we view the problem as a whole. He said that he had purposely refrained from alluding to the American silver purchasing policy and that he would say, on his own initiative, that an easing of the

tension in the Far East would have a very real effect upon naval negotiations.

On the next day, February 26, we gave the Chinese Minister the reply, which had been decided upon before the British Ambassador's call, to his notes of February 5 inquiring about the possibility of a loan or a credit from the United States to China. In this we said:

". . . the American Government deems it not practicable for the United States to embark upon an undertaking such as is envisaged in this outline and ventures to inquire whether the Chinese Government has given thought to the possibility of presenting this outline or an outline similar in essential features simultaneously to the governments of those foreign powers -- of which the United States is one -- which have in the past manifested interest in projects relating to Chinese financial problems and especially in projects for Chinese currency reform."

From the above it will be seen that the positions taken by the British Government and by the American Government were identical in regard to two points of major importance: each of the two replied unfavorably to China's solicitation from it of a loan or a credit; each indicated its thought that such assistance as might be rendered to China in that connection should be on a basis of cooperation among several of the powers most concerned. The British Government, however, went further than did we: they affirmed their desire to be of assistance to China, they intimated that China should come to an agreement with Japan (which intimation on Great Britain's part would be highly gratifying

to the Japanese, but probably not so to the Chinese), and they volunteered an initiative toward canvassing with the interested powers possibilities in relation to the question of bringing about an easing of tension and affording to China some form of assistance.

On February 28 the Chinese Minister came to us and gave us information which showed that the British Government had expressed itself to the Chinese Government in terms similar to those in which it had expressed itself, through the British Ambassador here, to us.

When, on February 26, we made our reply to the Chinese notes to us, we told the Chinese Minister that we expected to inform the British Government of the exchange of communications between the Chinese and us.

On Friday, March 1, the British Ambassador called, and I informed him that we had considered with gratification the information which he had given us on the 25th. I told him of the approach which the Chinese had made to us on the subject of a loan and a credit and I informed him of the substance of our reply. I then stated that this Government wishes, as does the British Government, to be of assistance to China and that we believe, as do they, that the giving of assistance, if any, to China should be by way of cooperative action by and among the principally interested powers with, of course, the assent and collaboration of China. I pointed out that, to that extent, our views

were apparently identical. I made it clear that in speaking of assistance I was not in the slightest degree committing this Government to any line of action whatsoever. I then said that we were not convinced that the rendering of such assistance should be made conditional upon there first being achieved a relaxation of tension in the Far East; that in our view it is conceivable that the according of collective assistance to China in her present moment of great need might contribute toward preventing further deterioration in the situation in China and toward making possible a more satisfactory resolving of some of the questions there than can possibly be brought about under existing conditions. I said that we would like to know whether the British Government was disposed to take the lead in trying to work this matter out among the powers which had in the past shown the most interest in projects for Chinese currency reform and in Chinese financial problems; and that we would view with gratification its doing so.

Late on the evening of March 1 there came in a telegram from London in which Atherton gives an account of a conversation with Craigie, now an Assistant Under Secretary in the British Foreign Office. Craigie, stating that these were his own strictly confidential views, said that in the recent British proposals for an Anglo-Japanese-American-French-Chinese discussion of the economic situation in the Far East and especially China, the first reactions of the

Tokyo Foreign Office had apparently been favorable. -- This is indicative of something more specific and more comprehensive than anything that the British Ambassador had said to us. Also, I may remark in passing, the press reports this morning give ground for doubt whether the reaction of the Tokyo Foreign Office has been in fact favorable. --Craigie thought that if the price of silver could be kept from going above its present level and if the international conversations to which he had referred were to lead to some sort of an international loan to China, the result might be an easing of the Far Eastern tension and the economic conversations thus successful might be followed by political conversations affording hope that China and Japan might evolve a modus vivendi on the Manchuria question. Craigie felt that any Far Eastern action in which Japan was not included would be to the disadvantage of Anglo-American objectives in the Far East. He said that the objective of British policy at this time was to ease the tension in the Far East and bring Japan into some naval agreement that could be accepted by Great Britain and the United States. He said that the British Foreign Office understood that Hirota desires a naval conversation at an early date, but that he, Craigie, did not feel that it could be held before the end of September.

In the meantime, press stories appeared last evening and this morning spreading reports to the effect that consideration

consideration is being given internationally to the question of possible financial assistance to China. The Japanese Ambassador and the Chinese Minister, noting these stories. have made informal inquiries. To these we have as yet made no reply. An important press story has come from London this morning to the effect that it has been given out there that the British Foreign Office has approached a number of powers on the subject, including France.

In the light of all of the above, it is our view in the Department that we should let the most possible be made of the fact that the British Government has taken the initiative in regard to this question; that, in brief, we should, with gratification, let them play the part of broker in an endeavor to explore the possibility of bringing the powers into line for the considering and the possible carrying out of a plan for improving the situation in the Far East, in which plan there may be involved the affording cooperatively of some financial assistance to China. On our part, we shall have to decide, tentatively but as definitely as possible, how far we may be willing to go by way of encouraging the British Government and giving assurance of support, in principle, in the effort upon which that Government is embarked. It is my belief that the effort has constructive possibilities and that we should give it Faithfully yours, William Hulliful encouragement.

DEPARTMENT OF STATE WASHINGTON April 30, 1935 My dear Mr. President: May I suggest that at your convenience you glance at the attached memorandum of a conversation which took place on April 25 between the Chinese Minister, Mr. Sao-Ke Alfred Sze, and myself, in regard to the effects on China of the silver policy of the United States. I am also sending a copy of my memorandum to Mr. Morgenthau. Faithfully yours, Enclosure: Memorandum of conversation, April 25, 1935. The President, The White House.

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#### DEPARTMENT OF STATE

#### THE SECRETARY

COMPIDENTIAL

April 25, 1935.

MEMORANDUM OF CONVERSATION BETWEEN SECRETARY HULL AND THE CHINESE MINISTER, MR. SAO-KE ALFRED SZE.

Silver.

The Chinese Minister called and stated that he had received a communication from his government, following the recent increase in the price of silver by this government, in which he was requested to see me and express the concern of his government about the increased silver price and its effect upon the Chinese economic and financial situation. He added that of course his government had not then learned of the latest increase in the price of silver by Presidential proclamation last evening. He stated also that his government desired to remind this government of its statement, made in a communication to the Chinese Government during last October, to the effect that in administering our silver Act we would keep in mind the Chinese financial situation and proceed with a view to causing the minimum of unsatisfactory reactions upon Chinese financial, fiscal, and general economic affairs.

I repeated to him our deep interest in the welfare of the people of China and our disposition to cooperate

in every feasible way that might be mutually helpful, and stated that the minimum of inconvenience to the people of China would be contemplated by any and every governmental policy or measure of ours.

### THE SECRETARY OF THE TREASURY WASHINGTON

June 14, 1935.

My dear Mr. President:

I feel sure that you will be interested in seeing a resume made in this office of an extremely confidential report transmitted to me by one of our Treasury Attaches abroad.

With all good wishes,

Faithfully yours,

Myn law

The President,

The White House.

Enclosure.

Copy for The President
The Secretary of State
The Secretary of the Navy

June 8, 1935

To Secretary Morgenthau

From Mr. Haas

Subject: Summary of Report by the Treasury Agent at Nanking, China, on a Plan to Develop the Communications in the Southwestern Provinces of China

- 1. The Southwestern Provinces of China, Yunnan, Szechuen, Sikong, and Kweichow, are rich in natural resources such as copper, tin, coal, iron, lead, gold, silver, oil, wool, leather, and opium. Owing to the lack of modern means of communication these rich resources, all commodities of international importance, have been undeveloped. It is proposed to build a rail-way connecting these provinces. On account of the vastness of this plan, the cooperation of these provinces and of foreign capital, especially British, will be necessary.
- 2. For the past eight months, the Chinese and British authorities have been working on a proposed railway development in the Southwestern Provinces. The general outline provides for linking Canton and Chengtu through the Southwestern Provinces. There will be connections with existing railways to Hankow and Peiping and possibly through to Burma.
- 3. It is believed the project is directed against the possible further aggression by the Japanese. It is expected that in case of another Sino-Japanese Conflict, which is deemed unavoidable, the Japanese will take all the coastal provinces. This railway is the only way to preserve China from falling into pieces, and by its means China may receive British assistance in war equipment.
- 4. The proposed railway development scheme under joint Sino-British auspices was at first met with the opposition of the French, but later an understanding was reached by the British with the French to connect the Haiphong-Yunnan railway with the scheme.
- 5. Mr. P. K. Lan, one of the important proposers of the railway development, has presented the following summary of the plan:

- (a) The proposed line will run from Canton to Chengtu, about 1,000 miles.
- (b) It is estimated that the total cost will be \$150,000,000.
- (c) The expenses may be generally classified into two kinds: (1) Materials costing about \$100,000,000, and (2) engineering expenses of about \$50,000,000. The British authorities have given definite assurance through the Hongkong Government that they will make loans in railway materials to be refunded in ten years. The engineering expenses are to be raised from Shanghai bankers or by issuing special bonds.
- (d) Construction will require five years and when it is completed the oil resources at Szechuen and Kweichow are to be developed.
- (e) It is estimated that the present oil consumption of China amounts to \$180,000,000 per year, most of which is now imported.
- (f) The completion of this railway may also help the Government to eradicate the communist troubles, which have been centered in the Southwestern Provinces.
- (g) The railway will be a great contribution to national defense and industrial development.
- (h) This development will benefit the British Colony at Hongkong.

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## THE WHITE HOUSE WASHINGTON

MISSY:

For my confidential file.

F.D.R.

## NAVAL MESSAGE

RECEIVED AT NAVY DEPARTMENT

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Peiping, January 17, 1936.

My dear Mr. President:

I want to thank you for your very cordial and very much appreciated letter of November 27th in which you sent a word of appreciation to myself and family, and to the staff here in China. I naturally lost no time in bringing this to the attention of all under the jurisdiction of this Embassy.

The year that has passed has been an interesting and, in some respects, a trying one in this part of the world, but I am sure, from conversations which I have had with representatives of our Government in this field, that all have felt inspired by the part that our Government has played.

They would all wish to join me in expressing to you the hope that the New Year will be a happy one for you.

Faithfully yours,

Helen Truly Theron

The President, The White House, Washington.

Chiva - 1936

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## PARAPHRASE OF CABLE RECEIVED FROM PROFESSOR BUCK

Shanghai, China, March 14, 1936

Chen left last night, March 13, on SS President Pierce.

Kung's attitude is one of hearty cooperation with the United States Treasury. Apparent policy is that of continuation of managed currency with the use of silver and partly gold metal reserve and currency redeemable in foreign exchange, although not to be linked to the currency of any other country. Some silver in token coins may possibly be used. Resolved not to return to silver standard. Now that China has left silver standard favors a higher price for the metal and also desires price not to fall below parity. Still desires to sell some silver in order to increase balance of foreign exchange or to have some other guarantee of assistance should an emergency arise requiring additional foreign exchange.

Note: The parity price for silver, figured on China's new currency, would be 40¢ per ounce.

PSF: Claira

# THE SECRETARY OF THE TREASURY WASHINGTON

Arpusal

May 12, 1936.

My dear Mr. President:

Enclosed herewith is a draft of the proposed agreement furnished us by the Chinese. I hope that you will find time to read it and advise me whether there is anything in this proposed agreement that you feel is not in the best interests of the United States government.

Faithfully yours,

AM youthan /

The President,

The White House.

### MEMORANDUM ON INCREASING THE USE OF SILVER IN CHINA

I

The conversations on Chinese currency now being held between the Chinese Monetary Delegation and the United States Treasury have been found most useful in bringing to light China's present urgent needs and the steps she should pursue in strengthening her currency position.

As China's note issue is covered to the extent of more than 65% by a cash reserve composed mainly of silver and to a lesser extent of gold and foreign exchange, it is most essential for her to achieve two objectives in order that the confidence of the public in the new currency may be maintained and further increased. First, the value of the white metal should be stabilized at around either the present or a higher level; secondly, the amount of gold and foreign exchange held in the cash reserve against note issue should be sufficiently increased so that there shall be no doubt in the minds of the public as to China's ability to hold her currency at the prevailing level of exchange. While the methods of achieving the second objective will be the content of another paper, in the present memorandum the Chinese Delegation will offer, on behalf of their Government, the ways and means of achieving the first objective which has been the policy of the United States Government during the past three years.

II

With a view to stabilizing the value of silver, China agrees with the United States that the use of the white metal should be widened. In this connection China is prepared to undertake the following three steps: First, to lift the present limitation on the use of silver in arts and industry in China; secondly, to commence in the immediate future the coinage and circulation of new silver coins, of the denominations of half yuan and one yuan Chinese currency; and, thirdly, to announce formally the maintenance of a definite reserve in silver, along with gold, foreign exchange, and other collaterals, against note issue.

#### III

The use of silver in arts and industry in China has been an old and established custom and Chinese silverwares have always enjoyed a reputation and prestige for their artistic value. Since the adoption of the monetary reform, the Chinese Government has issued an order restricting the fineness of silver used in arts and industry to 30%, in order to prevent hoarding of silver coins and to insure the success of the nationalization programme. With the world price remaining stable at the present level China is no longer afraid of hoarding and smuggling of silver. The Chinese Government is ready, in order to prove its intention of using more silver in China, to rescind the restriction order on the fineness of silver used in arts and industry. It is certain that this action will result in an increased consumption of the white metal in China.

#### IV

The Chinese Government has given orders to the United States Government Mint in Philadelphia to make several sets of dies for the coinage of two silver coins: the half yuan and the 1 yuan piece. The Chinese Delegation have received definite instructions from their Government to

state that the Chinese 1 yuan piece shall contain at least 138.24 grains of pure silver, and the half yuan piece, at least 69.12 grains of pure silver. As soon as technical preparations allow, the half yuan piece will first be coined and put into circulation, to be followed later by the 1 yuan piece. These coins have a monetary value for silver at US\$1.04 per ounce of silver.

The present capacity of the Central Mint at Shanghai is about 40 million pieces monthly including the necessary amount of subsidiary copper and nickel coinage. The Ministry of Finance is making plans for the reconditioning of the mints at Hankow and Chungking. When reconditioned these mints will take over from the Central Mint the task of making copper coins, leaving the latter to bear the sole responsibility of making silver and nickel subsidiary coins.

The Chinese Government hopes that by issuing 200,000,000 pieces of each kind of coin during the period of inception, to be followed each year by say 50,000,000 pieces of the 1 yuan coin and 100,000,000 pieces of the half yuan coin, 86,000,000 ounces of silver will be required for the initial period and 30,000,000 ounces for each succeeding year. That the Chinese people in normal times can absorb great amounts of silver currency can be substantiated by the following facts: During the ten years 1922 to 1931 there were imported into China 750,000,000 ounces of silver the greater portion of which went into the interior in the forms of coins. When economic depression came to China no less than 300,000,000 pieces of silver yuan flowed back from the interior to the Shanghai financial market during the years 1931-35. Since the order for the nationalization of silver was issued on November 4, 1935, old silver

yuan at the rate of 6,000,000 pieces each week have flowed into the vaults of the government banks. A tremendous potential requirement of hard coins must have been slowly built up during the last five years, intensified still more by the recent nationalization programme. On top of the potential demand must be added the requirement from the contemplated move on the part of the Government to substitute the new coins for the 1 yuan notes issued by the banks in China. The amount of this kind of money now in circulation is approximately Yuan 130,000,000.

It is evident from the above mentioned facts that the amount of the new silver coins can be increased very much before a saturation point is reached and no more silver needed. The Chinese Government, however, prefers to proceed with the new coinage programme in a cautious manner, realizing that public acceptance is usually hesitant at the beginning, and also that counterfeiting is a serious problem that warrants more than ordinary attention when the new coins are first issued.

V

The practice of maintaining silver as a part of the monetary reserve of the nation was adopted by the United States in 1934. As an evidence that China is in agreement with the United States in this matter, she has decided and will announce, as soon as complete accord is reached in the Washington conversations, the formal adoption of maintaining at least 25% reserve in silver against notes outstanding, using for this purpose the old silver yuan - which has a bullion value 10% above its monetary value - until such a time when the change in circumstances warrants the use of another method of valuation. As

there are now issued by the three government banks legal tender notes to the amount of Yuan 780,000,000, a minimum amount of Yuan 195,000,000 in silver would be kept in China's monetary reserve. This announcement when made will afford conclusive proof of the contention of the Chinese Delegation that China does not want to dispose of all her stock of silver. It will also give strength to the price structure of silver, because, aside from allaying the fear of dumping from China, additional silver will be required by her as monetary reserve for the future expansion of her note issue. Such being the case, this action of the Chinese Government will prove to be an important factor toward the stabilization of the white metal.

Jule December 17, 1936. Memo to Pres. From Sec. of Treas. attached-two memoranda on Chinese situation-one prepared by Mr. Haas and the other prepared for H. M. Jr. by Captain Puleston. Sec. says to would appreciate return of memo from Puleston for obvious reasons. Two memoranda not attached. SEE--Henry Morgenthau-(S) Drawer 1--1936

PSF; China - 1936

#### DEPARTMENT OF STATE

# DIVISION OF FAR EASTERN AFFAIRS

December 22, 1936.

## THE CHINA SITUATION

I. The important figures on the China stage at this moment in connection with the Sian situation are: General Chiang Kai-shek, Generalissimo of the Armies of China and President of the Executive Yuan, who has been seized and is held at Sian;

General Chang Hsueh-liang, the "Young Marshal", who is "Commander of Bandit Suppression Forces in the Northwest" and who is nominally responsible for the seizure and detention of Chiang Kai-shek;

General Yang Hu-cheng, who is "Pacification Commissioner, Shensi Province", and who is believed to be in position to dictate to General Chang Hsueh-liang. General Yang is reputed to be a stronger and more ruthless man than Chang Hsueh-liang and to be a very positive proponent of the idea that the Nanking Government should cease its military operations against communists and that China as a whole should make war on Japan.

T. V. Soong, leading male member of the Soong family, China's leading financial expert, formerly Minister of Finance, principal adviser to the present Minister

of Finance, president or chairman of several of China's leading banks and miscellaneous business enterprises. Soong has three sisters, one of whom is the widow of Sun Yat Sen, another the wife of Generalissimo Chiang Kai-shek, and a third the wife of the present Minister of Finance, H. H. Kung.

H. H. Kung, Minister of Finance and Vice President of the Executive Yuan (now its acting head). Kung is a direct lineal descendant of Confucius (in the 76th generation). Before becoming an official, he was a banker and business man. His wife is one of the Scong sisters, and he is greatly influenced and helped by T. V. Soong.

General Yen Hsi-shan, for many years governor of the "model province", Shansi (which province is directly adjoining and east of Shensi province in which latter Sian is located). General Yen commands a considerable body of troops, is loyal to the Nanking Government, has no known personal or political feuds with the military leaders in Shensi, is in position to function as a gobetween, and would stand to profit by the release of Chiang Kai-shek and a disciplining of the generals who are holding Chiang.

Mr. W. H. Donald, a British national of Australian origin, who came to China thirty years ago, who has been actively associated with several of China's outstanding

leaders

leaders and has had personal contacts with nearly all of China's outstanding men during the past three decades, who stands well both with Nanking officialdom and with Chang Hsueh-liang, who is in good repute both in British and in American official and business circles in China, who is well known to all press correspondents in China and to the staffs of the LONDON TIMES and the NEW YORK HERALD-TRIBUNE, who is very effective in dealing with Chinese officials, and who has twice visited Sian and had contact with Chiang and Chang since Chiang's capture.

Madame Chiang Kai-shek, who is the wife of General-issimo Chiang, sister of T. V. Soong and Mrs. H. H. Kung, and who has been active in the political councils of the Nanking Government for several years. She is a woman of bourgeois descent (the father of the present Soong generation is understood to have been a Chinese Christian pastor of comparatively humble origin); she is intelligent, liberally minded, self-assertive, magnetic, reasonably good looking, intense, somewhat impulsive, determined, devoted to her husband and to China. She was educated in the United States. It is reported that she has flown with her brother, T. V. Soong, to Sian with a view to helping effect the release of Chiang Kai-shek.

Lin Sen, is the nominal head of the Chinese Government, occupying the substantive position of "Chairman of the National Government of China"; but he is not outstandof South the

ingly active in political matters and his name has not appeared in connection with the present Sian situation.

There is ample ground for assuming that Chiang Kai-shek is still alive. There is warrant for an expectation that an arrangement will be effected which will result in his release. We should not be misled by the accounts which state that Shensi province has "revolted" against Nanking: Generals Chang and Yang have perpetrated an act of treachery, but they have not as yet engaged in any military operations against or in defiance of Nanking. Nor should we attach great importance to the reports which state that Kansu province has "revolted": Kansu is on the extreme western frontier, has in its population a large Mohammedan element, plays no great rôle in the political and military affairs of China and is usually passive or "anti" in attitude toward and relations with the Central Government. It will be difficult to effect an arrangement which will induce his captors to release Chiang Kai-shek, for by seizing and holding him they have acted disloyally and have jeopardized their own futures. It will probably take some time to negotiate an arrangement, and before the matter is settled it will probably be necessary to raise and place in their hands considerable sums of money. The fact that public opinion has condemned the seizure, this being true both of public opinion abroad and of public opinion

opinion in China, together with the fact that other military leaders in China have almost universally declared their loyalty to Chiang Kai-shek, renders it very unlikely that Generals Chang and Yang will venture to do any violence to Generalissimo Chiang. Their problem now is that of extricating themselves, with some possible advantages to themselves and assurance that their own lives will not be taken, from the "hole" in which they have placed themselves.

Thus far, the affair has been to the advantage of China as a whole. Although governmental processes have been disrupted and China's reputation has been damaged (probably temporarily only), the Sian affair has evoked an extraordinarily widespread protestation by Chinese officialdom, both civil and military, and the Chinese public in general, of loyalty to Chiang Kai-shek and the Central Government. It has intensified the interest of the whole world in China and the situation and events in the Far East. It has given pause to the Governments both of Japan and of the Soviet Union as regards their thought and action in relation to China. If Chiang comes out of Sian alive his prestige in China will be greater than ever and the cause of the unification of China will probably have been substantially advanced; it should be less difficult than before for Chiang to resist the importunities and threats of those elements in China which have been demanding the making of war on Japan. III.



III. When the news first reached the Department on December 14 that Generalissimo Chiang had been seized at Sian, the Department telegraphed the American Ambassador at Nanking to observe events carefully, to keep in touch with the Chinese officialdom and with his diplomatic colleagues, to report fully, and to consider constantly and carefully what action, if any, might helpfully and appropriately be taken by his Government. On December 18 the British Embassy in Washington, on behalf of the British Foreign Office, inquired whether this Government might be willing to cooperate with the British and other Governments in an offer, if opportunity should arise, to assist in effecting a safe conduct for General Chang Hsueh-liang out of China. On that evening, this Government instructed our Ambassador to confer with the British Ambassador in China with regard to this suggestion, making no commitment, and to report. On the afternoon of December 19, the Department received a report from our Ambassador; and at midnight, December 19-20, this Government authorized our Ambassador at Nanking, enjoining caution upon him, to collaborate with his British colleague in informing H. H. Kung of our willingness in cooperation with the British and other Governments, if any, to attempt to effect a safe conduct of Generals Chang and Yang from a Chinese port to some point outside of China, our responsibility to cease if and when such safe conduct should have been completed.

There

There is warrant for doubt whether this authorization will need to be acted upon. There is warrant for confidence that our Ambassador will proceed discreetly and dependably and altogether within the limits of the authorization. Mr. Johnson understands the attitude and policy of the present Administration and the thought and methods of the Department; he knows China thoroughly and is well acquainted with all the principal actors now before the footlights on the China stage. He is senior in experience and in time at his post to most of his important diplomatic colleagues. He is naturally conservative and he prefers, if erring, to err on the side of caution. He is supported by able and experienced officers at our diplomatic and consular posts in China.

It is believed that we need not at this moment be apprehensive with regard to the China situation.

It is believed that this Government should be prepared to make gestures which may be possible indicative
of willingness to cooperate with other governments in
action, within appropriate limitations, which might
contribute toward preventing the calamitous consequences
which would be likely to ensue upon removal by death of
Chiang Kai-shek from the position of authority which he
has held in China; and that, when making such gestures,
we should be prepared to act in accordance therewith should
the need for so doing develop. The situation in China

and the problems which arise therefrom differ in numerous respects from those with which we have to deal in any other part of the world. Having, as we should and do, policies which it is our purpose to adhere to impartially in relations with all regions and countries, it nevertheless is a fact that, because situations and problems presented differ, the methods which we can most effectively employ and which we should employ in different parts of the world and at different times cannot always be the same.

IV. Our Ambassador and our consular officers in China have been and are taking all possible steps toward ensuring the safety of American nationals (mostly missionaries) in Shensi and Kansu provinces. Those nationals have been asked to withdraw. Thus far there has been no report of any of them being in imminent peril. Special and appropriate representations have been made to Chinese official-dom on their behalf. Communications are difficult. We are solicitous but need not be apprehensive with regard to their safety.

V. Our latest incoming telegrams, received this afternoon, are here attached, with important features marked.



PLAIN

Nanking via N.R. Dated December 22, 1936

Rec'd 10:22 a.m.

Secretary of State

Washington

373, December 22, 3 p.m.

Following is based on press releases at Nanking:

T. V. Soong reported in conferences with the Generalissimo,

Chang Hsueh-liang and Yang Hu Cheng but no details are

available. He returned by plane to Sian this morning with

Mme. Chiang Kai-shek and Donald.

Government forces have captured Hauhsien and are advancing towards Sian. Rebel troops are massing near Sian and Lintung.

Sent to the Department, by mail to Peiping. Filed five p.m.

JOHNSON

CSB

GRAY & SPECIAL GRAY

Shanghai via N. R.

Dated December 22, 1936

Rec'd 2:45 p.m.

Secretary of State
Washington

664, December 22, 3 p.m.

T. V. Soong and Donald returned to Nanking yesterday afternoon and are reported to have left again this morning by plane for Sian accompanied by wife of Generalissimo.

Two. Donald is reported to have told New York TIMES correspondent at Nanking last night that Young Marshal has only small force at or near Sian and that Pacification commander Yang Hu-cheng and his rabble troops are actually in control at Sian and are feared to be anti-foreign in their attitude.

Three. Chinese press reports state that Central Government troops proceeding west from Tungkuan yesterday reached Chihshui and are advancing along north bank of Wei River without meeting resistance.

Four. It seems likely that present negotiations conducted by Soong are for purpose of buying off Yang Hu Cheng following which revolt would probably collapse.

Five. Shanghai quiet. Repeated to Hankow. By mail to Nanking, by air mail to Poiping. Filed with Naval Radio Docembor 22,5 p.m.

CSB

1193671

MEMORANDUM ON INCREASING THE LIQUIDITY OF THE CASH RESERVE AGAINST NOTE ISSUES OF THE CHINESE GOVERNMENT BANKS

In another paper that is being submitted by the Chinese Monetary

Delegation the statement is made that the amount of gold and foreign exchange

now held by the Chinese Government banks against notes in circulation is

relatively small as compared to the amount of silver held in the same

reserve against notes. It is also pointed out that if the amount of gold

and foreign exchange could be increased the confidence of the public in the

ability of government banks to hold China's currency at the prevailing level

of exchange would be enhanced.

The Chinese Monetary Delegation have been gratified by the fact that in several of their conferences with the Secretary of the Treasury he has indicated two possible ways of helping China to solve this monetary difficulty: One of them is for the United States Treasury to buy silver on monthly instalments from China, giving in exchange U. S. funds in New York to help strengthen China's currency reserve; the other is for the Chinese Government banks to ship silver to San Francisco and New York, to be taken in custody of by the Federal Reserve banks there, and arrange for credit facilities against the silver thus shipped.

Pursuant to the request of the Secretary of the Treasury, the Chinese Monetary Delegation are submitting two memoranda signifying the intention of their Government to enlarge the use of silver in China as well as to maintain an independent policy for the Chinese currency, in order to furnish the basis for discussing the two possible courses of action suggested by the Secretary of the Treasury. Believing that the content of the two memoranda

will meet the approval of the Secretary of the Treasury, the Chinese Monetary Delegation, on behalf of their Government, beg to submit the following proposals for his sympathetic consideration:

First, the Chinese Government, through the Central Bank of China, offers for outright sale to the United States Treasury the amount of 75,000,000 ounces of silver, being part of the cash reserves of the government banks of note issue. The time of delivery, the price, as well as the method of payment shall be fixed by mutual agreement. The proceeds from this sale will be deposited by the Central Bank of China at the Federal Reserve Bank of New York, to be used for the expressed purpose of stabilizing China's currency.

Secondly, with a view to providing an additional guarantee against unexpected emergencies, and in order to be able to show in the published statements of the government banks a good increase in the holding of gold and foreign exchange, which the above arrangement for the sale of silver will not be able to reflect because the payments of the proceeds will probably be made on an instalment basis, the Chinese Government wishes that the Central Bank of China, as the representative of the government banks of issue, be allowed to negotiate for credit facilities at the Federal Reserve Bank of New York, or the Federal Reserve Bank of San Francisco - whichever is designated by the U. S. Treasury - with silver as collateral security up to 50,000,000 ounces. This silver will be shipped over in the form of unrefined coins to the United States. On the question of legal technicality China hopes to be advised by the U. S. Treasury as to whether a re-export license needs to be applied for before the shipment of the whole lot of 50,000,000 can be made.

The sums involved in the above proposals are calculated to be sufficient to meet China's present requirements of external funds for monetary purposes. That the amount offered for sale is not too great can be seen by the following calculations:

At present, the three government banks in China hold about Yuan 395,000,000 of silver against their note issue which has recently reached about Yuan 780,000,000. The nationalization programme is proceeding at the rate of Yuan 6,000,000 each week, notes being issued against silver coins taken in. Taking 25% of the present note issue as the amount of silver to be kept in reserve, and allowing the new coinage programme to absorb nationalized silver in the future, there is left free and available for disposal Yuan 200,000,000 of silver equivalent roughly to 150,000,000 ounces. This quantity is twice the amount China offers to sell. It is also larger than the combined amount of the white metal China offers for sale and as collateral against credit facilities.

# MEMORANDUM ON THE QUESTION OF THE INDEPENDENCE OF THE CHINESE CURRENCY

In the course of the conversations on the Chinese currency between the Chinese Monetary Delegation and the United States Treasury the point has been raised that while the official declarations have claimed that the Chinese currency has an independent status, yet in all appearance the Chinese Yuan has maintained a fixed relationship with the British pound sterling since the inception on November 4, 1935, of the new monetary policy in China. The advice was also given to the Chinese Delegation that China could pursue to great advantage the policy now adopted by the Canadian Government of making alternative changes in the Canadian exchange rates on London and New York, each change being dictated by Canada's own needs thus showing unreservedly the independent nature of the Canadian dollar.

The Chinese Delegation have since transmitted the above views to their Government and asked to be informed of the conditions under which the rate of exchange on London as posted by the Central Bank of China would be changed. The following reply and undertaking has been received from the Chinese Government.

When the Chinese Government decreed, on November 4, 1935, that the three government banks should so act as to hold the exchange value of the Chinese Yuan at the then prevailing level, the rate on New York was fixed at 29-3/4 (I.E. US\$29.75 equals Yuan 100.) and the rate on London, at 1/2-1/2 (i.e. yuan 1 equals

14.5 pence). These two rates were fixed to correspond to a London New York cross rate of 4.92 prevailing on the same date. They remained the same for almost two months when the London New York cross rate fluctuated within a small range. However, towards the end of January 1936 the London New York cross rate went up to above 5.00 and the Chinese Government banks were faced with an embarrassing situation. As long as the official exchange rates on both London and New York remained unchanged, the speculators doing exchange arbitrage operations could demand the right to sell American dollars to the government banks against simultaneous demand for the right to buy English pound sterling from the banks, at the respective buying rate for American dollars and selling rate for pound sterling posted by the Central Bank of China. Either the rate on London or that on New York would have to be revised if the government banks were to avoid losses resulting from arbitrage operations of the speculators. As the Government was then chiefly concerned with preserving the value of the Chinese currency and was unwilling to give the public the impression that the Chinese yuan would show a downward revision of value each time the London New York cross rate changed, the rate on London was not reduced but the rate on New York was revised upward early in February this year. Since February 13 these two rates have remained unchanged at 30 for the American dollar and 1/2-1/2 for the pound sterling, while the London New York cross rate has fluctuated between 5.00 and 4.932.

As long as the London New York cross rate fluctuates within the above limits China's exchange rates on both London and New York will remain the same as at present. Should the London New York cross rate

go down to 4.92, which was the rate prevailing on November 4, 1935, when China adopted her currency reform, then the Central Bank of China would restore the rate on New York back to 29-3/4, the rate fixed on November 4, 1935.

If, after the rate on America is restored to 29-3/4, the London New York cross rate should go down further reaching say 4.88, then the Central Bank of China would make a revision of the official rate on London from 1/2-1/2 to say 1/2-5/8, leaving the rate on New York unchanged.

To sum up, the position chosen by the Chinese Government with respect to the exchange rate policy is as follows:

As long as the London New York cross rate fluctuates around 4.92, the rate prevailing on November 4, 1935, then China will keep her exchange rate on London at 1/2-1/2 and that on New York at 29-3/4, both being the original rates ruling on the first day of the currency reform.

When the cross rate goes above 4.92 to such an extent that operators in arbitrage could profit at the expense of the Covernment banks, then the rate on New York would be revised while that on London would remain unchanged at 1/2-1/2. On the other hand, should the cross rate fall below 4.92, reaching 4.88 or even lower, then the rate on London would be changed while that on New York would remain unchanged at 29-3/4.

To change the rate on London now, while the cross rate stands above 4.92 and the rate on New York at 30, would lead to appreciation of the Chinese currency in terms of both the English and American currencies above the level ruling on November 4, 1935. Such an action would be open to objection by the Chinese public. By the same reasoning, to alter the

rate on New York downward to below 29-3/4 and not that on London, when the cross rate goes below 4.92, would lead to suspicion on the part of the public that the Chinese Covernment might further depreciate her currency. For the sake of upholding public confidence the Chinese Government has adhered to the policy, after bringing the value of the Chinese yuan down to the level ruling on November 4, 1935, of following either the English or the American currency whichever is comparatively dearer in value in their daily fluctuations above or below the ratio of 4.92. This policy is merely a modus operandi calculated to uphold public confidence in the Chinese currency for the time being. It is altogether different from the policy of linking a currency to another one, irrespective of whether the latter appreciates or depreciates in regard to other currencies. The Chinese Government is at full liberty to make revision of rates when conditions warrant it. In substance, the Chinese and the Canadian policies are essentially in agreement.

As pointed out above, the policy of always showing to the public either one of the two original rates fixed on November 4, 1935 (i.e. 1/2-1/2 on London and 29-3/4 on New York), is calculated to uphold public confidence. Should the confidence in the Chinese currency become unequivocably strong, then the present policy may give way to a new one whereby China's rates on both London and New York may be different from either of the two original ones ruling on November 4, 1935. Such a step is considered to be in-opportune at the present moment. At any rate, the intention of the Chinese Government is quite clear. The Chinese yuan is to remain independent

in terms of other currencies and is subject to change as circumstances demand. At the conclusion of the present conversations here in Washington another declaration will be made by China to reiterate her old stand.