Paper Money in Early China

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In 1160 the Chinese Song dynasty began to issue paper currency. Over three dynasties, the Song, the Yuan, and the Ming, paper currency continued to circulate until around the 1430's when a silver based monetary system was adopted. This paper will examine the transition from bronze coin to paper to silver currency, how Chinese economic doctrines led to the use of paper as currency, how this period may have influenced subsequent monetary practices in China, and how this history can contribute to our understanding of money.

What is money, what is its role in the economy, what difference does it really make, and in what ways does it make a difference? There are no easy answers to these questions. Even poets have tried to deal with these issues. In a recent article in the Chronicle of Higher Education (Purini, 2009) a Middlebury English professor proclaimed that “Poetry is money, and money is poetry.” He saw poetry as an attempt to look at the world anew, and he feels that something as important as money should be looked at anew from time to time. Responding to the poet’s task, he wondered about “the wealth of our nation…in gold bars that nobody ever really lifts, cherishes, polishes, or spends”. Money—what is it? Really!

This paper examines an experiment with money that started over 800 years ago when China’s Song Dynasty began the wide-spread use of government-authorized printed paper currency. For almost 300 years paper currency circulated throughout China and even beyond China. A review of the history of this currency may provide us with a better insight into what money is and its role in the economy.

The paper will be organized as follows. We begin with a chronology of role of paper currency in the Song, Yuan, and early Ming dynasties. We will then review of how Chinese scholars viewed money. We will
conclude by glancing at the next issuance of government backed paper currency—over 200 years later, and at a contemporary analysis of the role of money that Chinese monetary theorists of over 2,000 years ago would have endorsed.

**EARLY PAPER CURRENCY IN CHINA: A CHRONOLOGY**

From the beginning of Chinese imperial era (3rd century BC), bronze coin served as the country’s currency. Chinese rulers saw control of the money stock as a way of promoting social harmony and to maintain control. Silver and gold was viewed as a commodity, not money. While used mostly for decorative purposes, it was seen to some degree as a store of value. But at least up to time we are considering, neither metal was used as a medium of exchange or for fulfilling tax obligations. (von Glahn, 1996)

But a monetary system that used bronze coin had a problem. The copper and tin used to make the coins had to be mined and in response to the threat of counterfeiting minted carefully. Particularly during times when the economy was expanding, these constraints led to currency shortages—or to use the Chinese expression, currency famines. Since such shortages could be seen as inhibiting economic growth, there was a call for government intervention.

One response by the government to the currency famines was to limit the use of copper to currency. Moreover, from time to time the government ordered the surrender copper utensils and decorations to the mints. But in spite of these efforts, periodic currency shortages continued to plague China.

With the breakup of the Tang dynasty in 906, the various states that replaced the Tang government competed with each other not only with arms but also with money. Many of the states in southern China hoarded bronze coin and replaced it with lead or iron coin. Merchants in neighboring states were forced to either accept this currency—or barter. These states also tried to keep their bronze coins from flowing elsewhere. This battle over money played an important role in the ascent of the Song dynasty.
THE SONG DYNASTY (960–1279)

When the Song dynasty was established in 960 (and finally taking over the last state in the south in 978), it attempted to unify the currency by establishing a monetary system based on bronze coin. They took measures to inhibit the outflow of currency from their domain, and also increased the production of bronze coin. While non-monetary uses of copper continued to be banned, it remained in short supply, and so the amount of lead in the coins was increased. In spite of all of these efforts to increase the stock of currency, shortages continued to occur.

Another complication for the Song dynasty was that both Japan and Korea used Chinese bronze coin as their currency. Japan stopped minting coins in the 10th century and instead used imported Chinese coin. Korea also used Chinese coin for their currency. The Song government finally in 1199 banned the export of coin to Japan and Korea. Silver was also exported from China to Japan and Korea during this period.

In 1060 the Song government issued a set of “New Laws” that attempted to reform the economic system. The state established a loan program promote increased farm productivity. Taxes which were paid with service were now to be paid with cash. But the most radical reform, one which was widely criticized at the time, was to eliminate the requirement, established during the Tang dynasty, that all copper output was reserved for the minting of coin. Lifting this prohibition encouraged copper mining, and contrary to the expectations of many, it led to an increase in copper mined and amount of bronze coins actually produced.

In the 1120s, the Song dynasty lost northern China to the Jin. While most of the copper mines were in territory still controlled by the Song, nevertheless coin production dropped as copper output declined and costs of minting coins increased. The government once again ordered the surrender of copper objects to the mints and the coins themselves were further debased. In spite of all these efforts, the production of bronze coins continued to decrease.

Finally in 1160, the Song dynasty needing to finance their war against the Jin introduced paper money. This was not the first use of paper
money in China. In the 1020s paper currency was introduced in the iron-
currency section of the Sichuan province. Also, bills of exchange were
being used in private commerce to transfer funds between distant com-
cmercial centers. Both of these forms of paper currency were readily con-
vertible to hard currency. The dynasty had also issued paper currency in
1135, but this issue was quickly abandoned as both merchants and state
officials protested against it because it was not convertible to metallic
currency.

The new paper currency, called *huizi*, was initially also not well
received, but the government by buying up of “surplus” paper currency
with bronze coin, created confidence in the notes. From 1160 to around
1190, the currency circulated at or near its face value.

The success of the *huizi* currency was such that the government had
to establish a number of large paper manufacturing plants whose output
was exclusively used for currency. The number of people employed by
these factories numbered in the thousands. Other large paper manufactur-
ing plants specialized in paper for use by the government as well as for
books, artists, and ceremonial uses. (Needham, 1985)

At the same time, the Jin dynasty to the north was unable to mint their
own coins and relied on the Song and Liao coins as their medium of
exchange. The Song tried to prevent the outflow of bronze coin, and both
regimes set up special currency zones along their common border. The
Song used iron coins and a special paper currency on their side of the bor-
der while the Jin introduced a paper currency for exclusive use on their
side. In spite of all these efforts, at least initially, coin continued to flow
from the Song area to the Jin area.

In 1190, war broke out between the Song and the province of Sichuan.
Essentially a civil war, this led to another war with the Jin from 1206 to
1208. During this period, the Mongols were also attacking the Jin. The
cost of these hostilities generated a fiscal crisis for both the Song and the
Jin which led to issuing more paper money. This led to a rapid decline in
the value of the paper currencies of both countries. But since the value of
the Jin currency declined more, coin now began to flow from the Jin area
to the Song area.
The Song attempted to maintain the value of *huizi* paper money by backing it with silver. As a result, silver began to take on some of the characteristics of money. This led to a concern about its export, and so its export was restricted. Silver began to be used as a substitute for currency and as a store of value. Near the end of Song dynasty, particularly after 1264, paper money began to be replaced by silver and even silk yarn as a measure of value.

**Yuan Dynasty (1271–1368)**

In 1234 the Mongol’s took control over the northern China from the Jin. This was a significant step in the creation of the Yuan dynasty. The local leaders in the Mongol controlled areas were relatively autonomous and each issued his own currency. With no single widely accepted currency, trade was conducted mainly through barter.

Then in 1260 Khubilai Khan, newly elected the grand khan, founded the Yuan dynasty. One of his first acts was to reform the Mongol financial system. He introduced a new paper currency called *Zhongtong chao*. The new currency was an attempt to acquire the gold, silver, and bronze coin held by the local people, and replace it with paper currency. Being aware of the inflation of the Jin paper currency, they backed the bronze denominated paper currency with silver. Such backing, it was felt, would make the currency more readily accepted. Moreover, they mandated that taxes be paid with the newly issued paper currency. Metallic money was banned in trade although the paper currency was fully convertible into silver through exchange bureaus set up in major cities. During the first decade of the new currency, convertibility was maintained and the printing of the notes was limited.

The Mongols intended that the paper currency would be used throughout the Mongol empire. It was easy to transport and it established a common unit of value. As the archaeological evidence reveals, this actually happened to some degree throughout Mongol occupied areas.

By this time, the Yuan dynasty increased the amount of paper currency in circulation and backed off from the full convertibility of the
Zhongtong chao. They did this in part to finance their conquest of southern China and also to the construction of a new capital in what is now Beijing. As a result, once again the value of the paper currency depreciated.

In 1287, remaining committed to paper currency, the government officially devalued the existing paper currency by 80 percent, and introduced a new paper currency which from its inception was not convertible. Both currencies continued to circulate although the new non-convertible currency depreciated more than the older currency.

Another attempt at reform was made in 1309. Small denomination coins were minted and made legal. They also introduced a new paper currency. Within two years, the government stopped issuing the new currency and also stopped minting coins. The new currency was devalued and the coins were hoarded and not widely used as currency. And conducting trade in silver was made legal. But in spite of all the problems associated with paper currency, most trade continued to be done with paper currency.

But after 1350, with the further depreciation of paper currency and the resumption of the minting of bronze coins and the growing circulation of coins from earlier dynasties, the use of paper currency in China ceased. But, as we will see, not for the last time.

**MING DYNASTY (1368–1644)**

In the mid-14th century, a new dynasty replaced the Yuan. Money played a role. In 1361 Zhu Yuanhang, the eventual founder of the Ming dynasty, as part of his campaign form a new dynasty issued his own bronze currency from his base in Nanjing. Like his predecessors, he lacked a source of raw copper, and so he resorted to melting down copper utensils and old coins for his new currency. He also permitted the circulation of old coins.

In 1368 Zhu Yuanhang officially established the Ming dynasty. He marked the new dynasty by minting a new bronze currency, but the mints were unable to supply sufficient coin. Therefore, in 1375, a new paper currency, call *Da Ming Tongxing Baochao*, was put into circulation. The new notes were not convertible, and coins continued to circulate.
The government tried to make paper currency the primary medium of exchange. But they vacillated between coin and paper. The printing of paper currency was halted in 1384, resumed in 1389, halted again in 1391. And the mints were closed in 1375, reopened in 1377, closed in 1387, and reopened in 1389. All during this period, the value of the paper currency continued to decline, and the flight to silver continued unabated.

Governmental outflows out-paced its revenues and the difference was made up by using the printing presses. Convertibility could have slowed down the depreciation, but for political reasons the government was reluctant to weaken their control over the money supply.

In an attempt to increase their control over the amount of currency in circulation, the government in 1394 decreed that even the bronze currency they had issued could not be used in trade, and all coins in circulation were to be traded in to the government in exchange for paper currency. But paper currency continued to depreciate, and in 1397 the government, once again, banned the use of silver as money.

In spite of the efforts by the government to have a monetary system based on a paper currency, this was not to be. The emperor, for example, banned the use of silver as money in edicts issued in 1403, 1404, 1419, and 1425. Paper currency was to be used to pay new taxes imposed by the government. But with military campaigns and the relocation of the capitol to Beijing being financed through the use of the printing press, by the mid-1430s silver had become the de facto form of money in China. Paper currency ceased to circulate.

**THE CHINESE APPROACH TOWARDS MONETARY POLICY**

How did the Chinese of this period view money? For them, what was it and how did it function? What was their “theory of money”?

Money in the western world is usually seen as a response to the demands of trade. Money facilitates trade. This can be seen as a bottom up approach where individuals can be seen agreeing to use money as a way to make it easier to exchange goods between each other.
On the other hand, the Chinese commentators on money focused on the role of the ruler who had the responsibility for the general well-being of his subjects. Money is an artifact that helps promote harmony among the ruler’s subjects, and it is used by the ruler to establish an equitable distribution of goods through his land.

This doctrine comes from the *Guanzi*, a collection of essays on political economy published in the 3rd or 4th century BC. (Rickett, 1998) While the essays were written by a variety of authors, nevertheless they presented a consistent view of the world and the *Guanzi* was considered to be a canonical text throughout the imperial era.

The *Guanzi* authors promoted in a quantity theory money. They maintained that since the value of money and the value of goods (as measured by prices) are related, prices could controlled by the ruler through his control of the quantity of money in circulation. Unlike the West at that time with its concern about “just price”, the writers of *Guanzi* were concerned about the equitable distribution of goods and wealth in society. They did believe that money was a store of value, but they were not concerned about it being a measure of value.

The Chinese commentators felt that money, while it was a form of wealth, had no intrinsic value and by itself it did not satisfy any wants or needs. Unlike other goods, it could not be produced by the people, but only through the ruler. He controlled the supply of money, and therefore he had the power to determine its value.

From this we can see why a paper currency could be seen as being feasible. Money was what the emperor wanted it to be—both the quantity produced and form it took. Since money had no intrinsic value, the emperor’s declaration of that something was money did, in fact, make it money. Even as paper currency lost value, this loss could be explained by appealing to the *Guanzi*. The *Guanzi* authors recognized that during times of high government expenditure the temptation for the government to print of too much paper currency was very tempting. That temptation it turned out emperors found difficult to resist.

The replacement of paper with silver presented its own problems. Since most silver in China had to be imported, using it as money resulted
in a loss of control by the emperor of the economy. This was seen as a matter of concern by the rulers of the country since it appeared to violate the principles outlined in the *Guanzi*. The use of silver was seen reducing the state’s sovereignty over the livelihood of its subject.

**Paper Currency, a Failure?**

For a period of almost 200 years the primary currency in one of the world’s largest nations was paper. And this was during a time when paper was just beginning to be made and used in the West. Then it disappeared from circulation. While this disappearance as an indication that paper currency failed, it may be worthwhile to look carefully on what happened over that 200 year period.

Paper currency could be seen as a reasonable response to the problem confronting the Song dynasty. Economic activity in China was expanding rapidly, but this increase called for an increase in the money supply. Currency shortages would have an adverse effect on the economic well-being of the Chinese community. The government did significantly increase the amount bronze coin minted, but in spite of their best efforts they were unable to keep up with the demand for currency. Paper money was seen as a reasonable response to this problem.

There was widespread belief that money was in fact a token, and that its intrinsic value was independent of it possible monetary value. Early on merchants would issue script in lieu of money and a paper currency was commonly used along the borders of some Chinese provinces. The Song dynasty, facing a nation-wide shortage of currency, was taking advantage of this belief and introduced paper currency to the entire country.

The Song introduced paper money slowly and carefully. For the first 20 years of its existence, paper currency held its value. One factor that contributed to this was its convertibility. Only when faced with need to finance military activities and the output of paper currency was increased did its value begin to decrease. Increasing the amount of currency in circulation as a way of financing government expenditure was a problem that kept reoccurring.
The creators of the initial paper currency were concerned about the problem to issuing too much. Not only did they insist on the convertibility of the currency into some form of a metallic currency, but it also insisted that paper currency have a finite life. They realized that paper currency was a government liability.

The acceptance of paper currency by the general public was also shown by the initial failure of the Yuan dynasty when it attempted to reintroduce a bronze coin currency as a response in the decline in value of the paper currency then in circulation. In spite of its depreciated value, paper currency remained the currency of choice. Only when the depreciation became particularly severe did silver replace paper.

The Chinese monetary authorities certainly realized that financing by speeding up the printing presses would decrease the value of the currency. But we may want to ask if the end result was much different than the financing that Western countries engaged in when faced with similar demands on the state treasury.

**Banks and Other Credit Institutions**

When we talk about money in the Western world, banks play an important role in the story. But we haven’t mentioned banks in our story. And the reason is simple. Banks as we know them simply did not exist.

What kinds of financial institutions did exist over this period? There was what we would call pawnshops in China during that period. Initially most were owned by Buddhist monasteries (because of tax advantages), but as the importance of Buddhism declined over time, they became privately held. They accepted a wide range of goods—and clientele. But they did not function as banks as we know them. (Yang, 1952)

During this period, mutual financing associations also existed. They provided joint saving by its members and so had funds to make loans to its members for weddings, funerals, travel, or businesses. But again, they were not banks.

There are records of shops could be seen as precursors of banks. The first stored precious metals for a fee. They did not make loans or otherwise
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attempt to profit from having control of the deposited asset but they did permit their depositors to write what we would consider to be checks against their holdings.

The second type of shop issued certificates against deposits, and these certificates circulated. Since these certificates circulated before the Song began to issue paper currency, they can be seen as precursors of the Song’s paper currency.

What we would call commercial banks did not exist in China until the mid 1800s. In the late 1840s, the first foreign banks (initially British) opened in China. They were neither subject to Chinese law nor, for their Chinese branches, the laws of their home country. They issued their own notes which continued to circulate until the 20th century when the Chinese government began to issue currency.

Another late development was draft banks. Began in the early 1800s in order to transmit money from place to place, they eventually had offices throughout China. Even the government relied on them to collect revenues and make expenditures. They were for the most part family owned and under-capitalized. With the end of the Qing Dynasty in 1912, they soon ceased to exist. (New York Times, 2009)

**The US Experience**

Paper money disappeared—at least for a while. Then in 1690, the Massachusetts Bay Colony issued promissory notes to help pay for an unsuccessful invasion of Canada. While the notes were not convertible into the currency of day, they could be used to pay taxes, and they did function as money. By 1711 all the colonies north of Maryland except for Pennsylvania were using such notes initially to help pay for their role in the battles between the Britain, France, and Spain, and then as a means to promote trade and commerce. (Engerman and Gallman, 1996, 243–244)

The issuing of paper money could be seen as contributing to the colonies becoming independent of Britain. While one way in which Britain maintained control of the colonies was by appointing what we would now call the head of the executive branch, the colonial legislators were
residents of the colonies. They promoted the interests of the colonists rather than that of the mother country. And it was the legislatures that were responsible for the issuance of paper currency thereby giving the colonies an economic power that was relatively independent of England.

By the time of the Revolutionary War, the use of paper currency was commonplace. While the value of the paper issued by the national government during the war did in fact lose most of its value, the fact that it maintained its value as long as it did particularly in light of the inability of the national government to levy taxes is remarkable.

The role of money, its form, and its control was a subject of much debate in the new republic. Ultimately until the Civil War it was left in the hands of the states, and they in turn relied on the banks to create money. Money was not seen as a creature of the state. Rather it depended on the supply of metals such as gold and silver and the willingness of banks to engage in the fractional reserve banking. It has been maintained that many Americans in the early and mid-1800’s did not see much difference between bank-issued currency and counterfeit currency—both supplied the currency needed to promote trade and commerce. (Mihm, 2007)

It has been recently asked if we shouldn’t once again view money as the creature of the state, and see it as independent of the intrinsic value of some good such as gold. Money is not a natural medium that arose through the banking system as a way to deal with the needs of trade and commerce. Money, rather, can be seen as an implicit contract deliberately created that reflects the economic, social, and political relationships of society. It calls for our careful study and examination. (Desan, 2005) The early Chinese commentators on money would have been very comfortable with this approach.

A Final Word

The paper currency introduced by the Song Dynasty as an attempt to deal with their currency problems was not an aberration. Rather it was a response that fit in well with their understanding of how money functioned and what it was supposed to do. The claim can be made that it
functioned relatively well given the circumstances of the Mongol invasion and the difficulties of holding together a large and diverse kingdom. The difficulties that we are having today dealing with the role of money would suggest that it may be worthwhile to look at the implementation of monetary policy in the Song, Yuan, and early Ming dynasties. Their view of money to be a creature of the state that is used to promote the well-being of society is a useful perspective for us to view current monetary.
REFERENCES


