

The London School of Economics and Political Science

A Comparative Study of Late-Imperial and Early-Republican Private Property Rights
Institutions, as Measured by their Effects on Shanghai's Early Financial Markets

A thesis submitted to the Department of Economic History of the London School of
Economics and Political Science in partial fulfilment of the requirements of the degree
of Doctor of Philosophy

Jamesdaniel Adam Harris

London, 2020

Declaration

I certify that this thesis I have presented for examination for a degree of Doctor of Philosophy from the London School of Economics and Political Science is solely my own work, other than where I have clearly indicated that it is the work of others.

The copyright of this thesis rests with the author. Quotation from it is permitted, provided that full acknowledgement is made. This thesis may not be reproduced without my prior written consent.

I warrant that this authorisation does not, to the best of my belief, infringe the rights of any third party.

Acknowledgements

Writing a dissertation is always a challengingly endeavour, and I was fortunate to have support from many individuals.

First and foremost, I wish to sincerely thank my dissertation advisor, Professor Kent Deng, for his unwavering support and commitment. His deep knowledge of Chinese history and willingness to share resources was extremely helpful. So, too, I want to acknowledge the encouragement from my *viva voce* examiners, Professor Rana Mitter at Oxford, and Professor Dic Lo at SOAS. Their support of my research project was deeply appreciated. I greatly value their willingness to provide advice on both theoretical issues and ways to advantageously present historical financial data.

In regard to data gathering, I very much appreciated the kind assistance in accessing historical materials that staff at the Shanghai Municipal Archives and the Bibliotheca Zi-Ka-Wei of the Shanghai Library, especially from librarian Timmy Zhang. I also want to thank Tokyo University researcher Li Tianyu for providing me access to the university's historical materials collection.

Thanks also is owed to my lab mates, both for helping focus my thinking on abstract theoretical matters relating to the dissertation, as well as provide plenty of appreciated distraction from thinking about the same. Your encouragement and humour were always much valued.

Seminar participants, including students and professors both inside and out of my department, also provided invaluable advice and suggestions that I have attempted to incorporate into the final dissertation product.

Although located overseas, my family nonetheless always found a way to provide kind encouragement and support. Most of all, I wish to express my enduring gratitude to my wife. Her assistance in helping me with the most tedious of data entry tasks deserves my absolute appreciation, but it is her intelligence and insight that proved both inspiring and invaluable in assisting me during the writing process. I could not have completed this project without her constant support and kindness.

Table of Contents

Abstract	v
Part I. Introduction, Theory and Debate	1
Chapter 1. Introduction Shanghai – Institutionally bifurcated, but singularly Chinese	2
Chapter 2. Theoretical Foundations: Institutions and Finance: Smithian and Austrian Approaches	21
Chapter 3. Outlining the Debate in the Literature	40
Part II. China's Late-Imperial and Republican-Era Domestic Institutional Environment	54
Chapter 4. State Capacity: Political and Legal Systems	55
Chapter 5. State Capacity: Bureaucratic Capacity	73
Chapter 6. State Capacity: Monopoly on Internal Coercive Violence	117
Chapter 7. Violence Trap and Related Theories: Economic Consequences	143
Part III. Shanghai's Parallel Institutional Environments	187
Chapter 8. Institutional Quality in Shanghai's Domestic Municipality	188
Chapter 9. Institutional Quality in the Extraterritorial International Settlement	208
Part IV. Financial Markets and Private Property Rights	270
Chapter 10. Both Roving and Stationary Bandits Equity Shareholders and Government Actors: Two Cases	270
Chapter 11. Shanghai's Early National and Municipal Bond Markets	291
Chapter 12. Conclusions: Contemporaneous Perceptions of Historical Institutional Frameworks	338
Bibliography	347

Abstract

This research presents an analysis of Shanghai's two separate, parallel but simultaneously co-existing institutional environments, one operating under control of the Chinese central government, and the other under an extraterritorial system defined by foreign (mainly British, American, and French) political and legal conceptualisations. This institutionally dichotomic condition characterised Shanghai for over one hundred years, from the mid-nineteenth to mid-twentieth centuries, throughout the course of amid tumultuous political upheaval shaping the domestic political landscape. The nature of these parallel institutional environments in large part reflected the period's political events; the era's political turmoil, via their impact on the nature of institutional protections on private property, contract, and investor rights, concomitantly helped determine Shanghai's economic development, including the development of the city's financial markets

While China's broader domestic institutional framework over this period has received considerable attention in the literature, there exists debate regarding the nature of the strength and efficacy of the domestic institutional environment, particularly in regard to issues pertaining to state capacity and protection of private property rights. This debate is reflective of similar debate within Chinese economic history, one that has portrayed China's late-imperial and republican economic growth as signified mostly by failure, yet with recent revisionist work providing intriguing empirical evidence suggesting considerably stronger economic growth to have occurred throughout the period. In a parallel manifestation, a robust revisionist literature has presented an effective challenge to the standard conventional literature has tended to view the domestic institutional environment over the period as inherently weak and ineffective.

In this research project, we utilise Shanghai's unique dualistic institutional setting over this period to help address this debate in the literature. Specifically, we identify how differences between these two institutional frameworks impacted economic actors' behaviour, with a particular emphasis on the revealed preferences displayed by investors acting within Shanghai's early financial markets. To undertake our analysis, we construct an original dataset based on archival records of bond and equity prices that traded on Shanghai's early stock exchanges. The market pricing and trading activity associated with similarly constructed financial instruments, differing primarily in terms of the issuer –whether a domestic or extraterritorial entity– reflect the differing perceptions that contemporaneous investors ascribed to the broader institutional environments.

This economic and financial historical research project therefore utilises analysis of contemporaneous investor perceptions to examine not only Shanghai's early financial markets, but also to draw broader conclusions regarding Shanghai's dual institutional environment from a comparative perspective, as well as providing a new viewpoint on a long-standing debate in the literature regarding the efficacy and strength of China's domestic institutional foundations over the late-imperial and early republican time period.

Part I. Introduction, Theory, and Debate

The introductory material in Part I provide the historical and theoretical framework to be utilised in this research study. Specifically, Chapter One provides a brief introduction to the historical setting that serves as the focus of the study, that being China during the late-imperial and early republican time frame. In particular, some of the unique historical and institutional features of Shanghai, the primary area our research centres upon, are introduced, as are some of the unique features defining the city's early financial markets. Of particular emphasis is how while Shanghai's institutional environments were uniquely dualistic, the city and its population of economic actors were singular in nature. Furthermore, the primary research goals and methodological approach to be employed in this dissertation are presented and explicated.

Chapter Two lays out the overall theoretical background that shapes and drives the analytical approach employed throughout this research study. Focussing on the contributions of the Austrian school of economics that helps to centre our methodological approach and unit of analysis to that of the individual, we seek to emphasise the fundamental role that the incentives, motivations and actions of individuals play in shaping and determining economic outcomes. Building on this foundation, we discuss how private property rights impact the incentives, motivations and actions of individuals, thereby underscoring the importance of institutional constructs that serve to either increase or decrease the security of property rights. Finally, we introduce the Violence Trap and related theoretical concepts that will be employed in our analysis of the domestic and extraterritorial institutional environments that defined the late-imperial and early republican time period.

Finally, Chapter Three provides a general outline of the important debate in the literature regarding the nature of domestic state capacity and the attendant institutional environment that prevailed over the course of the late-Qing through republican time period. In general, this debate highlights two rather differing visions of China's domestic institutional environment over this period, with the conventional literature typically suggesting domestic institutions were persistently weak, and that efforts to construct stronger, more capable institutions were continually sabotaged by historical legacies, cultural shortcomings, and war; whereas conversely, a robust revisionist literature bolstered by new evidences maintains many domestic institutions were in fact much stronger and capable than the traditional mainstream view suggests. It is to this debate that this dissertation attempts to provide a substantial contribution through the employment of a novel new comparative data-driven approach allowing the actions of contemporaneous actors themselves to reveal their perceptions of the domestic institutional environment.

Chapter One.

Introduction: Shanghai as an institutionally bifurcated but singularly Chinese city

"The rise and fall of Shanghai means the birth or death of the whole nation."

– Jiang Jieshi (Chiang Kai-shek), 1937

The focus of this research dissertation centres on analysis of the nature of China's domestic institutional constructs shaping private property and contract rights over the late-imperial and republican period, with particular attention paid to Shanghai's bifurcated institutional environment. The city's unique, dualistic political structure created two separate, parallel but simultaneously co-existing institutional environments, one domestic and one extraterritorial. The dichotomous institutional environment that characterised Shanghai for over one hundred years, from the mid-nineteenth to mid-twentieth centuries, provides a useful construct to conduct a comparative analysis to better understand China's larger institutional environment. Specifically, this research project utilises observation of the behaviour of contemporaneous economic agents acting within and across the Shanghai's unique dualistic institutional structure as indicative of their revealed preferences to draw broader conclusions regarding their perceptions of the relative strength and efficacy of the city's differing institutional environments, providing a new viewpoint on the debate in the literature regarding the strength and efficacy of China's late-imperial and republican domestic institutional environment.

1.1. Late-Imperial to Republican Shanghai: A Divided, but uniquely Chinese, City

While the time and place on which this research dissertation centres its focus is late-imperial and republican Shanghai, to be clear, the beginnings of the city's history are not to be found, as is frequently presented in the literature, with the arrival of Western merchants that occurred in the immediate aftermath of the signing of the Treaty of Nanjing. Yet the city's past is too frequently truncated as such, with the majority of the English language historiography on modern Shanghai frequently opening with a suggestion that Shanghai was nothing but a "sleepy fishing village" prior to the arrival of Europeans in the mid-nineteenth century.

1.1.1. Mischaracterised Historical Antecedents

While the exact origins of this oft-repeated trope are unclear, references to pre-treaty port Shanghai as but a "sleepy fishing village" are replete in much of the early English-language literature regarding the city's history (McFarlane 1881, Wright 1908, Pott 1928, Tawny 1932), with the 1935 edition of the *All about Shanghai and Environs* guidebook continuing to expound the by-then standard image of a Shanghai that barely existed until the Treaty of Nanjing changed its fortunes: "Less than a century ago Shanghai was little more than an anchorage for junks, with a few villages scattered along the low, muddy banks of the river. ...There is nothing of outstanding importance to relate about Shanghai from the dawn of the 17th century down to 1843, when it was opened to foreign trade" (1935: 1-2).

The image of a Shanghai unimportant until the arrival of western traders has persisted through to the present, finding its way into popular conceptualisations of the city's history. Lewis (2001: 21), writing in the financial periodical *Fortune* at the start of the millennium, extolling Shanghai's potential economic growth, begins his piece by noting, "Hong Kong and Shanghai were both sleepy fishing villages until the British took them over in 1842 and turned them into dynamic trading centers." Leading English-language newspapers also continue to propagate this image: "Shanghai was still a sleepy fishing village... until the arrival of large numbers of British soldiers and traders in the 1830s and 1840s—followed by the French and later the Japanese—[after which] the city began to expand" (*LA Times* 27 February 2005). The domestic Chinese press has been equally guilty in the spreading of this trope, as a recent article in the *China Daily*, a newspaper published by China's state-owned Xinhua news agency, illustrates: "Following the end of the First Opium War in 1842 and the signing of the Treaty of Nanking on Aug 29 that year, Shanghai was opened up to British merchants and subsequently those from other Western nations such as France, Germany and the United States. The resulting influx of foreigners provided the city with an infusion of different cultures and had also quickly transformed it from a sleepy fishing village into a hub for maritime trade" (*China Daily* 20 January 2017).

The suggestion in the literature that Shanghai was made "modern" as a result of Western influence in the post-Opium War period is also widespread in both English- and Chinese-language the literature. Wang (1991:39) implies that the foreign influence of the extraterritorial settlements served as a modernising force, while Zhu (1994:20) claims it was European influence that brought about Shanghai's ascent and the arrival of "modernity" into China. Lee (1999) identifies it to have been in Shanghai where "Chinese modernity began." Yan (2015: 1-2) similarly suggests, "The mid-19th century undeniably marks the beginnings of modern China... with the opening of treaty ports following the ratification of the Treaty of Nanjing."

However, actual historical data belie the outdated yet persistent view of Shanghai as of little import prior to its designation as a treaty port. The city was already mentioned in original dynastic records as far back as 249 B.C.E. (上海通史 1999a: 5). Although not located along the main economic thoroughfare dominated by the Grand Canal waterway, by the eleventh century, Shanghai's prominence had grown such that the Song imperial court designated it a market town with an official customs station (Smith 1900: 91). In 1288 under the Yuan, Shanghai officially was designated as 县, or county-tier city (de Jesus 1909: xi). During the Ming, in 1544 Shanghai's status was again raised to that of a "walled city", with a seven-gated city wall seven metres in height and five kilometres in circumference; the wall, originally designed as protection from marauding activities of Japanese pirates, remained standing until the fall of the Qing empire (*HKDP* 1912: 327, *All about Shanghai* 1935: 2).

Shanghai's littoral location, as well as its connection to the Yangzi, played important in its role as an international transportation hub. Significant coastal trade from northern regions subsequently repackaged and sent by smaller boats via inland rivers to Suzhou for further distribution to the interior areas along the Yangzi (上海通史 1999a: 25-27). Already by 1800 Shanghai had become one of China's twenty largest cities (Richardson 1996: 417); by mid-century, the city encompassed an area of approximately two hundred hectares with a population between three to five hundred thousand (de Jesus 1909: xxvii). Feng (2004)'s research based on archival records of property sales within Shanghai during the Qing era indicates a significant increase in the frequency of property transactions and values taking place already in the early nineteenth century, well before the city became a treaty port, in response to the city's economic growth and concurrent inflow of merchants.

Thus, Shanghai had an established historical and economic foundation spanning nearly six hundred years before the Nanjing Treaty. Multiple contemporaneous reports, including those by foreigners visiting the area, conclusively support this view. H. Hamilton Lindsay, for instance, an English merchant and East India Company official, visited Shanghai in June of 1832. According to his published report, the city had "commodious wharves, and large warehouses occupy the banks of the [Huangpu] river... [with] shops filled with wares of every description exhibited in them for sale" (Lindsay 1833: 172). Impressed by the scale of trading activity occurring in the port, Lindsay continues his description, noting "Shanghae [Shanghai] is the seaport of the Yang-tse-keang [Yangzi River], and the principal emporium of eastern Asia, the native trade of it greatly exceeding even that of Canton. On our first day of arrival I was so much struck with the vast quantity of junks entering the river... upwards of 400 junks, varying in size from 100 to 400 tons, passed Woo Sung, and proceeded to Shanghae... Many of these were from Formosa, Canton, the Eastern Archipelago, Cochin China, and Siam" (209-210).

A similar account is provided by Fortune (1845: 101), a British botanist who documented his visit to Shanghai just a few weeks after its designation as an open treaty port on 17 November 1843. He describes a vibrant and dynamic commercial economy: "Shanghae is by far the most important station for foreign trade on the coast of China... No other town with which I am acquainted possesses such advantages: it is the great gate—the principal entrance, in fact—to the Chinese empire. In going up the river towards the town, a forest of masts meets the eye, and shows at once it is a place of vast native trade. Junks come here from all parts of the coast, not only from the southern provinces, but also from Shantung [Shandong] and Peechelee [Beizhili region]: there are also a considerable number annually from Singapore and the Malay Islands. The convenience of inland transit is also unrivalled in any part of the world."

Given the domestic city's continual growth, its twisting network of streets bursting with economic activity became evermore cramped. An early English-language newspaper, the *Shanghai Mercury*, provides a stereotypical western account: "Shanghai City is shunned by the foreigners who have settled here... they find there is nothing attractive in it, but many things repulsive—narrow streets, and dirty stagnant pools and creeks" (McFarlane 1881: 28). Clark (1894: 11-25), who similarly suffers from what Capen (1913: 434) identifies as typical of western attitudes on China that "unconsciously and automatically assumes an attitude of proud superiority to the Chinese", is nonetheless considerably more positive, describing a thriving commercial city, full of vibrant markets, tea shops, temples, and parks, and thus corresponding to earlier, pre-treaty port descriptions such as provided by Fortune (1845).

1.1.2. Extraterritorial Shanghai: A City within a City

As the contemporaneous accounts cited above suggest, the conventional historical narrative becomes more accurate when reversed; that is, rather than the arrival of foreign merchants signifying the origin of commercial activity in Shanghai after its designation as a treaty port, instead, the very reason Shanghai was attractive to the Treaty of Nanjing negotiators was because it was already a dynamic centre of commerce and trade. While the "sleepy village" misconception remains persistent, recent scholarship is beginning to present a more accurate picture of pre-treaty port Shanghai as a significant eighteenth century trading centre—Johnson (1993), using primary sources including county gazetteers and Maritime Customs reports, represents an early contribution. Hayes (2008), Fogel (2010) and Bickers (2012), each utilising slightly different source materials, provide additional support.

The view of Shanghai as economically unimportant prior to the Treaty of Nanjing is rightly criticised. However, recognition that an oversized importance has been ascribed to the influx of western influence and the creation of the city's foreign settlements should not justify a discounting of the import to the economic history of Shanghai of these events. Indeed, our particular focus on the post-Treaty of Nanjing time frame is due to the way in which Shanghai's resultant economic history was fundamentally shaped by the presence of geographically and economically large and politically powerful quasi-sovereign extra-territorial settlements located in the centre of the city.

The presence of extraterritorial settlements implied more than simply physical land area not under the direct control of domestic Chinese governments. Nor does their importance to the city's economic history derive solely from their role facilitating the importation of technology, commercial goods, and foreign direct investment. Instead, the significance of these extraterritorial settlements derived from the fact that within their physical boundaries there existed a separate and distinct institutional system based on imported legal enforcement mechanisms, creating very different private property and contract rights constructs than that which existed throughout domestic Shanghai, whose own institutional regime was determined by the larger political construct of domestic China.

Thus, while much of the interest that Shanghai has attracted in the academic literature has primarily been driven by its role as an economic powerhouse and political flashpoint, our focus is centred on Shanghai because of the unique dualistic nature of its institutional structure. Specifically, Shanghai's setting allows for the juxtaposition between two parallel institutional environments that operated concurrently within the same geographical space, within the same historical time frame. Thus, the Shanghai of this period provides a unique opportunity to consider the impacts of institutional variation on economic outcomes.

1.1.3. Domestic and Extraterritorial Shanghai: A Chinese City

The literature concerning the extraterritorial settlements often depict them as enclaves of western modernity and commercialism (Tai *et al.* 1991, Wang 1991, Zhu 1994, Lee 1999, Thomas 2001), physically separated from the Chinese section of the city by a city wall, and likewise symbolically segregated by the military might of western warships docked along the Huangpu River. Taylor (2002: 128) claims the bund to have signified "essentially a social system of western creation." In certain ways, the settlements did reflect its residents' characterisation of the system as one of *imperium in imperio*—a part of Shanghai within which institutions such as legal systems, government regulations, and property relations between economic actors and the governing body were defined quite differently than those existing within the domestic sections of the city and greater China. From the mid-nineteenth century until the end of 1941, these extraterritorial self-governing municipal governments ran parallel to those on the domestic side, operating under relative autonomy, maintaining their own judicial systems, police protection, postal services, taxation structures, and legislative bodies. Under the settlements' unique institutional frameworks, private property rights relations were organised under western law, defining the underlying legal basis upon which commercial dealings within the extraterritorial settlements took place, affecting the nature of the development of business forms such as modern banks, joint-stock companies and financial markets. Over the course of the same time period, multiple domestic national governments administrated the domestic-controlled sections of the municipality, utilising quite different sets of legal and enforcement mechanisms, and operating under quite different conceptualisations of property rights relations. The differing institutional environments that defined the domestic economic space impacted the way in which parallel domestically-incorporated business forms, including banks, joint-stock companies, and financial markets, operated and were utilised by private economic agents.

Yet, the definitiveness of the division between foreign and domestic Shanghai was far less clear in actuality than the symbolism of old stone city walls and gunboats suggest. As depicted in Figure 1.1a, while early on it was the domestic section of Shanghai—referred to as "Nan-shi", and labelled on the map as "Chinese Town"—that was separated and surrounded by a city wall, the subsequent growth of the domestic city led to it being the extraterritorial-controlled areas of the city that were surrounded, as shown in Figure 1.1b.

Figures 1.1a and 1.1b. Maps of Shanghai, c. 1880 and 1933, respectively



Sources: McCulloch (1880); General Staff No. 3956 U.S. Army War Office 1935

By the start of the twentieth century, the majority of the city walls surrounding the Nan-shi section of the domestic city had been dismantled. The breakdown of physical barriers existing between extraterritorial and domestic Shanghai paralleled symbolic breakdowns in terms of the livelihoods and movement of the city's residents. Despite foreign-constituted legal and political systems, the extraterritorial settlements were neither exclusively "foreign", nor did they exist outside of a broader Chinese Shanghai. The domestic city grew not only to surround the extraterritorial settlements, but to also become incorporated into the fabric of the settlements themselves. Only shortly after their founding, the populations of the extraterritorial settlements came to be comprised predominantly of domestic Chinese residents who chose to settle within their boundaries. Indeed, the settlements' domestic and foreign populations were of vastly different scales. In fact, at no time after the 1880s did the International Settlement's non-Chinese population ever exceed more than four per cent of its Chinese population. For instance, in 1890, the domestic Chinese population residing within the English Settlement totalled 168,129 persons, with the corresponding foreign population at just 3821; similar figures for the International Settlement in 1937 were 1,178,880 and 39,750 persons, respectively (SMC 1895: 20-21; SMC 1937: 118).

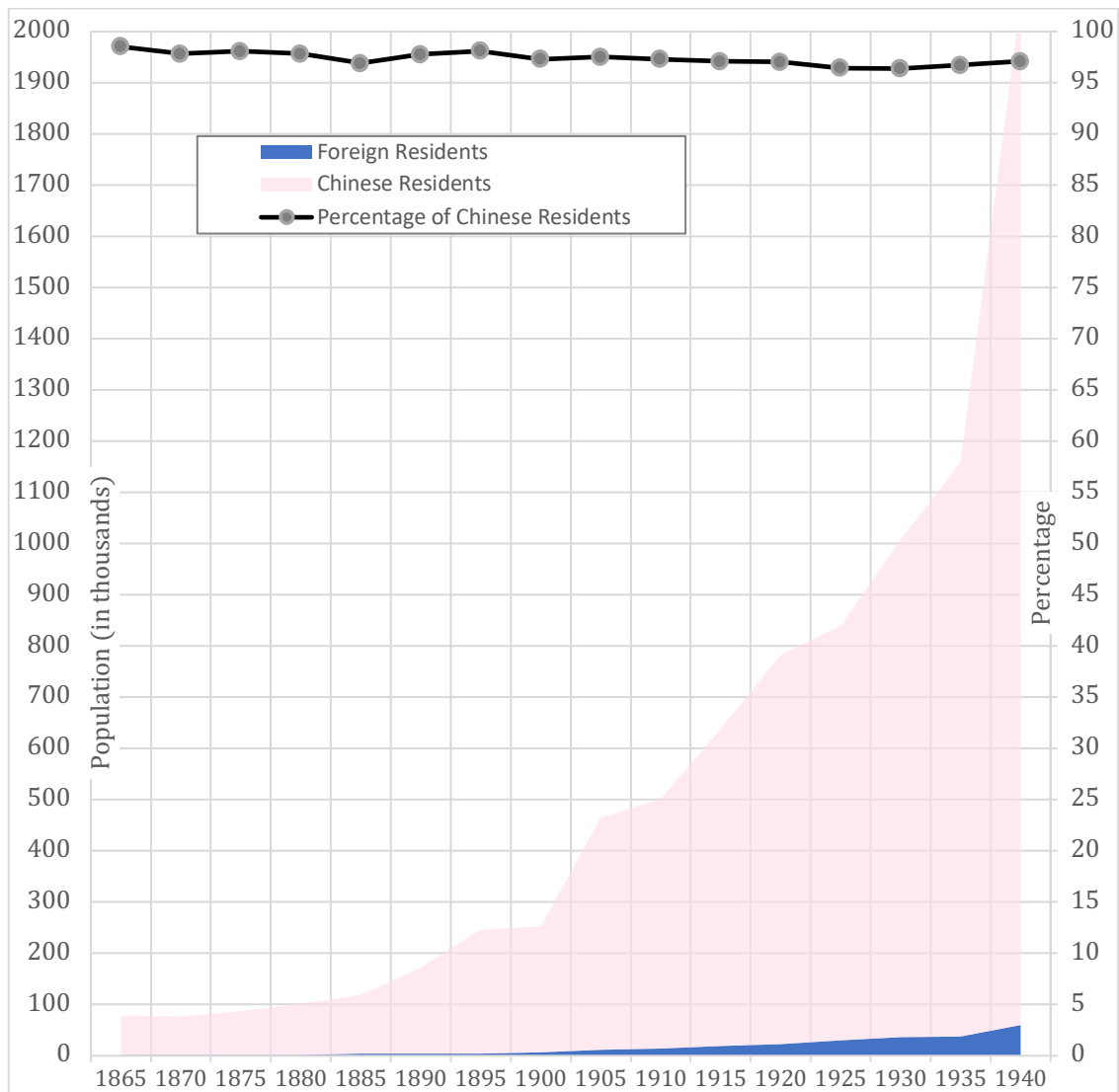
Given the settlements' role as a nexus that drove much of the city's fantastic growth, it is common for the literature on late-imperial and republican China to suggest that Shanghai's growth was a consequence of the glory of "Western capitalism" imposed on China in the wake of the Treaty of Nanjing (Thomas 2001). Yet this tired trope employed in the telling of Shanghai's resultant economic history misses far too much of the true picture. The undeniable importance of the extraterritorial settlements to the economic vitality of Shanghai does not, in turn, support of the triumphalist myth that Shanghai's economic dynamism was primarily due to the arrival of western merchants operating independently in their enclaves of "Western capitalism". Instead, it was domestic Chinese economic agents who were equally responsible for the growth and development of modern capitalism in Shanghai. While domestic and extraterritorial Shanghai were defined by sharply different institutional landscapes, the population of the economic agents inhabiting both institutional environments was primarily Chinese, as per Figure 1.2.

The economic dynamism of Shanghai was due in large part to the entrepreneurial activities of domestic Chinese; their successes in turn drew additional foreign and domestic entrepreneurs and investors, creating a virtuous self-enforcing cycle leading to greater economic growth, commercial activity, and attraction of capital. Much of the money, human capital and entrepreneurial drive behind the investment that took place under the umbrella of the private property rights regime of the institutional environment of Shanghai's extraterritorial settlements was provided by domestic Chinese economic actors. Such dynamics began early in the settlements' histories; as reported in the 1895 Shanghai Municipal Council Annual Report, significant amounts of both financial and human capital flowed into the International Settlement from domestic China: "Since the Census was taken a large addition has been made to the Native population, a great many wealthy Chinamen having invested in land and houses and migrated here from different parts along with their wives and families, whilst the numerous filatures and projected cotton mills are attracting numbers of the working classes" (SMC 1895: 21).

The dynamic growth of the city continued to attract domestic migration from all over the country. Given the perception of the extraterritorial settlements as oases of relative peace in a politically turbulent domestic landscape, some came to escape the ravages of civil wars. As a centre of economic dynamism, others came to seek their fortunes. Others desired to take advantage of perceived economic and civil protections offered by the extraterritorial institutional environment. As a popular newspaper expressed at the time: 四方之人趨之若江漢之朝宗, 商賈往來無遠勿屆, or, "People from all corners of the country were drawn to [Shanghai] like rivers flowing to the ocean; merchants make their trips despite the distance" (*ShunPao*

27 October 1883).[§] As a result of these inflows, by the turn of the century, Shanghai had already become the most populous city in China. From a population of less than five hundred thousand in the 1850s, the city had grown to nearly two and a half million by 1919, and by 1937 had become the world's fifth-most populous city, home to over three and a half million residents (SMC 1938:141, SHTS 1999: 16). These immigrants helped mould the city into the economic powerhouse it became, as they interacted with, were transformed by, and helped transform the economic dynamics of the extraterritorial settlements, and the entire city.

Figure 1.2. Population Composition of the International Settlement, 1865–1940



Sources: Shanghai Municipal Council Annual Reports and Census Reports, various years.

[§] Fogel (2010: 318) claims the perceived safety of the settlements helped drive culture into Shanghai: "[Taiping] rebels... attacked the major centers of Chinese culture in the lower Yangzi region—Suzhou, Hangzhou, and Yangzhou. Chinese of cultural prominence... frequently made their way to Shanghai. The presence of ...the foreign concessions... meant that not only did Shanghai's population soar, but as a center of cultural production it rapidly outstripped the rest of the country. Thus, Shanghai was ironically the cultural and intellectual beneficiary of the rest of the lower Yangzi's catastrophe. The native culture it would produce in the aftermath of the Taiping Rebellion was a rich amalgam of regional Chinese cultures, increasingly over time with influence from westerners and Japanese."

1.1.4. Domestic and Extraterritorial Shanghai: Dual Institutional Environments, Dual Financial Markets

Late-imperial and early republican Shanghai is to be rightly described as a uniquely Chinese city. Much of the city's uniqueness, however, was also due to the existence of the foreign-run extraterritorial system that operated with the centre of this thriving Chinese metropolis. As a result, Shanghai was home to a unique, dualistic institutional environment structure—one defined partly by domestic legal and political enforcement mechanisms, and partly by extraterritorial legal and political enforcement mechanisms. Shanghai's two, synchronously co-existing parallel institutional structures, one domestic and one extraterritorial, were created by two sovereign powers differing in governmental form and legal system, with both institutional environments, existing within essentially the same overlapping geographic space, subject to the same economic and demographic forces, across the same exact timeframe. Thus, although separated institutionally, domestic and extraterritorial Shanghai represented the same singular economic entity, with few physical barriers separating these parallel environments, and with a single set of economic actors free to move between and conduct business within and across the different areas, and able to purchase the same set of products and financial instruments priced in the same currencies.

Meanwhile, from an economic and financial standpoint, Shanghai also is unique in the Chinese setting over this period. The great increases in trade both created a demand for and helped attract tremendous amounts of capital into Shanghai, spurring the development of a robust financial economy. The creation of domestic modern banks and domestically-registered joint stock companies, the country's first government bond issuance, its first municipal bond issuance, and the opening of domestic stock markets, all took place during this period, with Shanghai serving as the nation's financial epicentre. The increasing complexity of the domestic financial system saw foreign and extraterritorial-based financial intermediaries, including modern banks and investment and insurance firms, play a vital role in financing the early near-exponential expansion of the city's trade flows. In addition, over time, capital markets developed within the city, although their growth was uneven and sporadic. At differing times, however, there existed active trading in Chinese central government domestic sovereign debt instruments, as well as in extraterritorial and domestic municipal government debt offerings. So, too, was there trading in private debt and equity securities, issued both domestic- and extraterritorial-registered firms.

The dualistic nature of the underlying institutional frameworks that characterised Shanghai was also paralleled by a similar bifurcation of the city's financial markets. To begin with, there existed the domestically-operated markets that traded primarily in domestic-issued debt and equity instruments. In addition, there were extraterritorial-operated markets which traded primarily in the sovereign bond offerings of extraterritorial municipalities, as well as in private bond and equity shares issued by extraterritorial-registered corporations.

Yet although bifurcated, both sets of Shanghai's early financial markets were ultimately uniquely Chinese insofar as they were supported in large part by domestic Chinese investor participation and capital that flowed into the city's financial markets from all parts of the country. This observation is key to our methodological approach in studying Shanghai's early financial markets and deriving implications about the larger institutional environments in which these parallel financial markets operated. Thus, it is a singular set of economic actors—Shanghai's participatory investor class—whose revealed preferences across domestic- and extraterritorial-issued financial instruments we are able to analyse. By holding constant economic, geographic, temporal, and investor idiosyncrasies across the differing financial markets, observed differences in the relative demand for differing instruments can more confidently be attributed to being driven by differences between the institutional environments under which the instruments were issued.

1.2. Research Goals and Rationale

The above discussion has outlined several broad observations. First, that late imperial and early republican Shanghai was home to a unique, dualistic institutional environment structure—one defined partly by domestic legal and political enforcement mechanisms, and partly by extraterritorial legal and political enforcement mechanisms. Second, Shanghai was bifurcated not only in regard to its institutional structure, but also in regard to its financial markets, with parallel bond and equity markets operating concurrently within Shanghai during the time period—a domestic bond market that primarily traded domestic government bonds (including national and municipal government bonds), and an extraterritorial-operated bond market on which extraterritorial municipal government bonds traded. These two sets of bond markets traded securities whose valuations and risk perceptions reflected the differences between the separate institutional systems within which they operated. We utilise these unique features of Shanghai's late-imperial through early-republican institutional environments and financial markets to address our research goals, look to contribute to the literature in several dimensions.

1.2.1. Addressing Important Debates in Chinese Economic History Literature

The main research goal of this study is to address a significant debate within the Chinese economic historical literature involving the overall strength and efficacy of the domestic late-imperial and republican private property rights institutions. The current mainstream view typically advanced in the literature depicts domestic institutions to have been relatively poor and ineffectual at providing economic agents effective protections on private property rights. Such poor institutions are generally attributed to Chinese governments' weak state capacity over this period. For instance, the state's institutional weakness is considered responsible for late-Qing fiscal insolvency (Ma 2013, Johnson & Koyama 2017), Beiyang republican-era political failure (Fairbank *et al.* 1965, Strauss 1997), and the Guomindang government's excessive corruption and economic failures (Paauw 1952, Eastman 1972, Xu 1997). Overall, the common themes emphasised within the literature suggest a domestic institutional private property rights environment that was unaccommodating for economic and financial development.

Evidence indicating a weak domestic institutional framework appears easy to identify. Starting in the late-Qing, the domestic Chinese state proved unable to command an internal monopoly over coercive force, experiencing excessive levels of social strife, including numerous internal rebellions, warlord activities, and external military invasions. Other indicators of China's institutional environment also seem symbolic of weak-capacity states, such as a high degree of corruption, bureaucratic malfeasance, and an inability to manage fiscal matters. Additionally, the country's weak economic performance over this period—especially when viewed in comparison to neighbouring Japan, a country that began at a similar level of development in the mid-nineteenth century only to definitively surpass China by the start of the twentieth century—is also considered important supplemental evidence of China's poor institutional domestic environment. On the surface, therefore, it appears that China lacked the type of effective and complementary institutional framework that could have provided strong protections on private property and contract rights.

Yet for all of the seeming weight of the evidence of a poor domestic institutional environment, there are arguments that support contrarian viewpoints. To begin with, some of the mainstream literature is based upon untenable theoretical assumptions, employing arguments that represent simple extensions of those applied to earlier periods of Chinese economic history contending China's failure to undergo an industrial revolution was the result of a cultural heritage antithetical towards commerce (Weber 1905, Wittfogel 1957).

Further, recent revisionist scholarship also directly challenges the traditional depiction of weak Chinese institutions, arguing instead that many domestic institutions were strong and effective. One branch of this revisionist literature, found particularly in works by Strauss (1998, 2008), Boecking (2011b, 2017), Harris (2012, 2018), and van de Ven (2014), argues that in spite of considerable political strife defining the period, the existence of sufficiently capable bureaucratic institutions allowed state actors to achieve many of their policy goals. These authors focus on specific organisational structures within the broader domestic Chinese state apparatus—such as the Chinese Maritime Customs Service, the Salt Inspectorate, and the Chinese Postal Office—to argue that the domestic state, at least during certain sub-periods of the time frame, was capable of creating and sustaining robust and effective bureaucratic organisations that could define, plan, and realise definitive goals. Similarly, Bian (2005a, 2005b) argues that the scope of late-republican economic planning, leading to an increasing percentage of economic output produced by large state-owned enterprises, implies the existence of an effective and competent economic planning apparatus given the required large-scale organisational capacity necessary to direct economic resources towards employment in state enterprises.

As suggested, therefore, there exists a significant divide in the literature between scholars advocating the traditional view of weak domestic late-imperial and republican era institutional quality, versus those revisionist scholars who point to examples of strong and effective institutions operating throughout the period. The debate is characterised by a definite lack of clarity, as both sides have been able to marshal significant amounts of contemporaneous evidences in support of their respective positions. Given the theoretical importance of the role institutions play in determining economic and political outcomes, this debate regarding the domestic institutional environment is not trivial. Yet what might appear to be a clear-cut question—did China during this important historical period possess weak or strong institutions—remains unresolved in the literature. Therefore, this research project's primary goal is to help resolve the debate in the literature regarding the nature of the strength and capacity of the domestic institutional environment over the late-imperial and republican time period.

Finally, subsumed within this larger debate is a related, similarly-framed theme frequently found within the literature on Shanghai's domestic institutional environment, defined in large part by the broader national environment, contrasted against the city's extraterritorial institutional framework, defined by western legal and political structures. On this issue, the literature an implied assumption that western-based institutions necessarily provide strong protections of private property rights, and hence most discussions that consider the city's dual institutional environments seemingly assume, *parti pris*, that western property rights institutions were more secure and better defined (Kirby 1995, Bowen & Rose 1998, Goetzmann *et al.* 2007). Thus, we look to address this epistemological fallacy by providing a comparative, data-based analysis of Shanghai's extraterritorial institutional environment with that of domestic Shanghai's institutional environment.

In regard to the extraterritorial institutional environment, to our knowledge, while a number of important historical researches have been conducted considering specific extraterritorial institutions (Bickers 1998, 1999; Hershatter 1999, Ruskola 2003; Jackson 2012, 2017; Whewell 2015), the extant literature has yet to produce a detailed examination of the extraterritorial institutional framework from an economic historical or institutional analysis standpoint. Our research, relying on a host of archival and contemporaneous sources to provide a level of detail on the workings of the International Settlement that shaped the institutional environment and resulting economic outcomes, therefore contributes to expanding the depth of analysis available on extraterritorial private property, contract and investor rights institutions.

1.2.1.1. Detailed and Encompassing in Scope Analysis

To begin with, we provide a highly detailed yet encompassing in scope qualitative analysis of China's domestic institutional environment, utilising contemporaneous source documentation and complementary contemporary researches. There have been a multitude of detailed studies on specific aspects of late-imperial and republican institutions. Paauw (1952) conducts an in-depth study of the Guomindang Ministry of Finance, analysing its budgeting and internal control mechanisms, in regard to how efficiently they channelled fiscal resources to areas identified by state actors as most important. Mann (1984) looks at the way the state tax system interacted with business associations, noting a distinctive shift in state actor behaviour occurred with the start of the republican period. Wakeman (1988, 1995a,) analyses the effectiveness and growth of domestic policing institutions during the period, with a particular emphasis on the Guomindang era. van de Ven (1997) considers the organisation and operation of the military under the late-Qing and later republican governments, arguing fiscal pressures led to an increasingly decentralised military power structure, and ultimately brought about the so-called warlord period. Strauss (1998) considers in detail several bureaucratic institutions under the Guomindang, including the Ministry of Finance, the Salt Inspectorate, and the Maritime Customs Service, arguing that each of them displayed a high level of capacity in setting and achieving policy goals, attributing such success to their ability to set their own internal hiring and promotion policies, and to insure an overall degree of bureaucratic insulation; Strauss (2008) reiterates much of these same arguments albeit more singularly focussed on the Salt Inspectorate. Crossley (2010: 47) provides a discussion of the government bureaucratic structures devoted to generating population measures, presenting the rationales that led local officials to either under-estimate or inflate actual population figures. Harris (2012, 2018) studies the operation of the Chinese Post Office (née the Imperial Post Office at its founding under the late-Qing). Harris argues the broad set of services offered by the Post Office, including money orders, life insurance, and postal savings accounts, combined with the ubiquity of its offices throughout rural China, helped serve a broader role as a symbol of state presence and authority. The focus of both van de Ven (2014) and Boecking (2017) is upon the Maritime Customs Service, providing a historical analysis of its myriad of roles as tax collector, tariff enforcer, and guaranteeing collateral for both overseas and internal government bond payments. Thai (2016), and in a more limited study Boecking (2011b), also consider the operation of the Maritime Customs Service, as well as the domestic judicial system, but their focus of these institutions in this regard is solely on the enforcement and prosecution of anti-smuggling directives. A similar set of studies are more specifically centred on the domestic state institutions in regard to regime structure. Much of this work focussing on the specific nature of the Guomindang state structure as it pertained to state-civil relations, most notably those by Eastman (1974, 1979, 1984), Coble (1980), Geisert (1982, 1985), Kubo (1982), Fewsmith (1984), Wright (1991) and Fung (2000).

The works cited represent only some of the numerous quality detailed studies on specific features of the domestic institutional environment. Overall, the findings of these studies reflect the complexity of the domestic institutional environment, with varying offered opinions and conclusions regarding the level of institutional quality as reflected by the specific institution under consideration and evidence assembled. Conversely, however, there also exists a large literature that is much broader in scope. The majority of these researches delivering conclusions about the overall quality of the late-imperial and republican institutional environment make sweeping generalisations absent the detailed historical analysis of contrasting evidences and observations of the inherent complexities (Shiue & Keller 2007, Congleton 2011, Chen *et al.* 2014, Sng 2014, Ma 2016, Johnson & Koyama 2017, Ma & Rubin 2017, Ko *et al.* 2018, Koyama *et al.* 2018). Thus, our provision of a broad overview that is nonetheless highly detailed in its analysis strives to clarify some of the complexities contributing to the debate on domestic institutional quality.

1.2.1.2. Analytic Strategy and Methodology: Application of Theory

Second, we believe an important contribution of our approach comes in our application of a powerful set of theoretical frameworks employed to analyse China's late-imperial and republican domestic institutional environments. The institutional frameworks defining rule of law, or private property, contract and investor rights, are inherently multidimensional concepts (Haggard & Tiede 2011). In this respect, we seek to reframe the debate over whether China's institutional framework was "weak" or "strong" by contesting the validity of the underlying question as overly reductionist. Institutional environments are shaped by a complex web of interrelated social, economic and political forces that are not easily summarised as "strong" or "weak", or "good" or "bad". What we argue for instead is the need to view the broad institutional frameworks defining private property rights as inherently subjective, based on perception. As such, the fundamental issue becomes how economic agents perceive the degree of protections on their property. There exist no objective measures of the level of private property rights, nor are there objectively "good" or "bad" institutional constructs, *per se*; the same constructs might well generate different results in terms of the actual behavioural responses from economic agents depending on how such constructs are perceived by the agents themselves. Thus, what is of relevance in determining the human action of economic agents—and hence determining economic outcomes—is the way in which agents perceive their private property rights environment, and the expected stability of that environment. As such, our focus remains on agents' perceptions of private property rights, as well as what might have led to changes in their perceptions over time. To this end, we continually seek to keep the frame of analysis on the individual—that is, how were the entrepreneurial and investment decisions made by individual economic agents, domestic and foreign, affected by the nature of the private property rights environments within which they acted; and, are we able to identify consistent patterns of behaviour amongst these actors based on observable differences existing between the domestic and extraterritorial institutional environments?

We utilise several specific theoretical concepts to provide a more structured and cogent analysis of these institutional environments and resultant economic and financial outcomes. The concept of state capacity, first advanced by Migdal (1988) and Davidheiser (1992), and summarised recently by Johnson & Koyama (2017), stresses the importance for state bureaucratic structures to be able to successfully implement the policies desired by state actors. Note we do not, as is found in some parts of the state capacity literature (Caplan 2014, 2018), advance the view that state capacity is necessarily positive or negative—self-interested state actors in charge of effective state bureaucratic structures might well be more able to exploit private actors than those in control of states unable to effectively implement extractive policies. However, regardless of questions regarding whether or how state power should be employed, the ability for state actors to utilise state power is nonetheless highly relevant, given their ability to affect agent behaviour and shape economic outcomes. As we do in regard to the concept of property rights, so too do we argue for a multifarious conception of state capacity—China's domestic state administrative capacity to implement policies varied across time, across specific bureaucratic organisations, and across policies themselves, based on the authority possessed over and incentives structures driving the specific private or state actors upon whom successful implementation of policy was dependent.

Additionally, we also rely heavily on the theoretic framework developed by Weingast and his co-authors (North *et al.* 2009, 2013; Weingast 2010, 2017; Cox *et al.* 2017; Levi *et al.* 2017) regarding what they describe as the "violence trap", as well as our extension of a "low credibility trap". Both of these theoretical constructs provide insight on the kinds of behaviours state actors are apt to undertake in environments defined by high levels of civil

strife and warfare, and hence are particularly relevant in understanding much of the actions of the domestic Chinese state behaviour. While operationalisation of measures of state capacity (Hanson & Sigman 2013) and the Violence Trap (Cox *et al.* 2017) is challenging, the exercise nonetheless helps provides structure to the interpretation and analysis of the seemingly conflicting set of evidences regarding the relative strength or weakness of the relevant domestic and extraterritorial institutional environments, that we believe, along with the additional historical patterns uncovered through our analysis, provides important new insights that should advance the debate.

1.2.1.3. Analytic Strategy and Methodology: Utilisation of Shanghai's Unique Institutional Framework

Finally, another important contribution comes from our adoption of a novel methodological approach to addressing the open issue in the literature regarding the relative strength or weakness of the domestic and extraterritorial institutional environments. The conventional approach in historical and economic history research primarily involves scholars looking back at relevant aspects of historical events and conditions, producing analysis based on the weight of such evidences. Certainly, great value comes from the study of original source documents; indeed, we employ this approach ourselves in conducting our detailed qualitative analysis of the national domestic and municipal domestic and extraterritorial institutional environments, recognising the undertaking of this kind of evidentiary-based historical scholarship to be an important part of the exercise of obtaining an understanding of how institutional environments shape economic and financial outcomes.

However, our contention is that any analysis of the historical record is inherently subject to selectivity and interpretational issues, open to confirmation bias on the part of the researcher. Given the complexity of historical realities, conflicting results and explanations are easily obtainable by different researchers considering the same time period, institutional setting, and historical facts, with individual researchers likely able to identify a robust set of evidences to support her or his line of argumentation. This has certainly proven to be the case in the literature on late-imperial and republican era institutional quality, leading to the aforementioned scholarly debate. Our own exercise in employing the more conventional, backwards-looking analysis of the domestic and extraterritorial institutional environments also produces results that, while suggestive, cannot be considered definitive, with support for both positions in the debate identifiable within the historical evidence. Given the multifaceted nature of concepts such as institutional quality and private property rights, it is not surprising that conflicting signals make difficult declarations of domestic or extraterritorial institutions as either definitively weak or strong.

Therefore, we argue for a change in the temporal framework from which much of economic history and historical research is undertaken; that is, rather than rely on the interpretations and opinions of the researcher, located temporally in the current time frame, looking backwards at a given historical time frame, a more appropriate and robust methodology is to attempt to locate the temporal framework to the timeframe of the period under study itself, by relying on techniques to capture the opinions, perceptions and revealed preferences of the actual contemporaneous economic actors who existed, and interacted, and conducted business within that prior time frame.

Hence, to resolve the debate in the literature regarding issues of domestic institutional quality, and differing levels of domestic and extraterritorial institutional efficacy and strength, we attempt to discover the contemporaneous perceptions of the economic agents who operated in those institutional environments. The salient issue obviously becomes how

to accurately identify the opinions, perceptions and revealed preferences of contemporaneous actors. Markets represent a powerful means to capture the individual decision-making of economic agents, as market prices represent the sum of all market participants' individual pricing decisions in the aggregate, with Hayek (1945: 524) highlighting the role of "the price system as... a mechanism for communicating information." We note that recent critiques of Hayekian price theory (Bronk 2013, Bowles *et al.* 2017) arguing price signals can provide "incorrect" information due to systemic biases from informational asymmetries, market power, or other distortions, whether or not valid, do not affect the underlying argument that prices reflect market participants' preferences and expectations. Of course, in practice, as most economic historians will readily attest, much of the economic history research exercise involves the elusive search for data on market prices. Hence the rationale for the expenditure of the great effort that went into the construction of our database of financial indications on Shanghai's early financial markets.

Indeed, much of the reason Shanghai proves so interesting and valuable as a research focus is because its unique, dualistic institutional environment and parallel financial market structure allows exploration of these issues in a novel approach. To begin with, as described above, we are able to take advantage of Shanghai's unique political and institutional bifurcation that allow for the utilisation of analytic techniques that can exploit the informational power of market prices to capture investors' relative perceptions of domestic and extraterritorial institutional quality. Specifically, the parallel institutional frameworks of Shanghai—one domestic Chinese, one extraterritorial—combined with our construction of a dataset of parallel bond prices—both national and municipal domestic and extraterritorial—allow us to conduct a "natural experiment" to calculate comparative yields across different sovereign debt issuers to assess differences in the levels of institutional, sovereign-specific risk assigned by domestic investors.

Shanghai's two, synchronously co-existing parallel institutional structures, one domestic and one extraterritorial, were created by two sovereign powers differing in governmental form and legal system. There are several important advantages from a methodological standpoint that we can exploit in our research study. To begin with, we first make note of the fact that the domestic institutional environment as existed in domestically-controlled Shanghai represents a powerful proxy for the broader domestic Chinese institutional environment about which so much debate exists in the literature. Hence, coming to conclusions about the quality of Shanghai's domestic institutional environment allows us to apply the same general conclusions to the broader domestic Chinese institutional environment.

Second, it proves highly useful that both municipalities, and therefore both institutional environments, existed within essentially the same overlapping geographic space, and were subject to the same economic and demographic forces across the timeframe. Although separated institutionally, domestic and extraterritorial Shanghai represented the same singular economic entity. Few physical barriers separated these parallel environments, with economic actors free to move between and conduct business within and across the different areas. The same commodities and financial instruments were available to the same set of savers and investors, and were priced in the same currencies. In fact, from an economic sense, concepts of "domestic" and "extraterritorial" were frequently blurred—one of the domestic-registered stock exchanges was physically located within the International Settlement, as were the headquarters of some domestic-registered banks; securities of extraterritorial issuers were sometimes sold on domestic-operated exchanges, and conversely some domestic municipal bonds traded on the extraterritorial-operated stock exchange.

Third, however, for all the cointegration of economic activity, and while the same set of investors could purchase and trade the same set of financial instruments available in the market, there did exist one clear, bright-line distinction, that being the institutional environments of the two sections of the city, domestic and extraterritorial. Similarly, therefore, this institutional distinction was represented by separate government bonds issued by domestic and extraterritorial sovereign entities. Bonds issued by differing governmental entities represented property rights to the expected future cash flows promised by the differing governmental entities. Hence, the prices of those bonds contain information on the subjective, interrelated valuations investors placed on such rights, based on the subjective confidence of the strength of institutional constructs that credibly committed these governmental entities to honour their promises to repay.

Analysing differences in the choice behaviour of the same set of individualistic, atomised investors as measured by trading activity and pricing behaviour of these simultaneously-trading bonds issued by municipalities occupying the same space and time, differentiated primarily only by considerably dissimilar institutional environments, allows us to identify economic agents' revealed preferences for the bond issuances of the respective municipalities, and ascribing the observed differentials to differences in contemporaneous investor perceptions of the relative strength and efficacy of private property and contract rights mechanisms defined by the institutional environments defined by the respective domestic and extraterritorial governments.

The advantage of our methodological approach to addressing this debate in the literature via the utilisation of the informational power of market prices is that the results from our analysis can be interpreted as providing a more definitive resolution to the open debate regarding late-imperial and republican era domestic and extraterritorial institutional quality. Admittedly, such results are relativistic and comparative in context—we cannot make claims as to a singular objective measure of domestic and extraterritorial institutional quality, *per se*, only rather describe relative perceptions of these environments, over time and between one another, as indicated by the revealed perceptions of those acting within these institutional constructs.

Nonetheless, we find this methodology represents a more satisfying approach to conducting economic history. The results presented from the comparative yield analysis do not represent our opinion, or the viewpoints of traditional mainstream scholarships such as Paauw or Fairbank or Perkins, or of revisionist scholars such as Strauss, van de Ven, or Boecking, gained from looking backwards at historical materials and then rendering judgement from temporally afar. Instead, these results represent the combined opinions of the actual economic actors of the day—captured not from a few selective quotes from a few selected writers of the time, susceptible as those are to reflect political pressures or ulterior motives, but rather—based upon the combined contemporaneous assessments of multitudes of dispersed market participants whose actions generated pricing behaviour reflective of their collective perceptions and expectations of institutional quality.

1.2.1.4. Rationality and the Non-binary Approach to Institutional Forms

Although we actively contrast the two institutional settings, one domestic and one extraterritorial, in accord with the concept of multidimensionality of institutions that inherently defy a simplistic "good" or "bad" characterisation, we are equally actively not presupposing either to be "superior" to the other, *per se*. Indeed, we reject this kind of implicit ordering of institutional environments on several grounds.

To begin with, as Wong (2004: 87-88) notes, this approach comes from "an older scholarship that finds in the European historical developments the pattern according to which to evaluate others and assumes that deviations from European institutions had to lead to different and inferior results." Further, our appreciation is for how institutional environments organically develop over time as an instrument to enable individuals in social arrangements overcome issues such as collective action problems, deal with uncertainty and computational limitations, or resolve market and informational impediments. These are humanistic goals—protection of personage and property, and the ability to provide for oneself—not culturally defined.

There exist many institutional environment arrangements that afford sufficient protections of property rights, and we are clear in avoiding venerating institutional environments that mimic what are perceived to be "western" institutional arrangements designed to protect property rights as an inherent standard at the expense of alternative structures that are more suitable for providing similar protections in different historical and cultural settings. Lu (1999) emphasises the danger of reductionism that comes from falling into what he refers to as "binarism" that focuses on the differences between "Chinese" versus "Western" aspects of Shanghainese life, with his work showing a multi-faceted approach partaken by Shanghai's domestic Chinese residents, encompassing both modern and traditional aspects of native and imported customs, products and social mores. We strive to avoid such trappings. Thus the tired tropes of Asian cultural impediments or European exceptionalism proffered by Marx (1859), Weber (1905), or Clark (2005) are firmly rejected as offering a false dichotomy between "similar to the west" or "not similar to the west (and therefore in need of some reform)."

Yet while human cultural forms impress in their complexity, variety and uniqueness, equally true is a shared universality of common responses and drive for survival and improvement for themselves and their offspring. Rather than looking to impose value judgements from the analysis on the differences in institutional arrangements as structured, our concern is solely to analyse the behaviour responses of investors operating within the contrasting institutional environments, so as to help us understand their contemporaneous perceptions of differentials in institutional quality, especially in regard to private property rights protections. Our contention is that residents of Shanghai made their economic decisions in response to rational economic incentives, incentives that were in large part shaped by a binary institutional environment that impacted economic decision-making on issues such as the valuations of financial contracts, the level of certainty investors could assign to commercial projects, or the ability of lenders to collect on their capital outlays.

Finally, we note that while our conclusions are heavily reliant on analysis of price and volume data of traded securities, the role of theoretical constructs backing these analyses proves equally important. Huang (1998: 188) argues convincingly against purely theorist-based work, as it too readily devolves into "ideologically driven scholarship", that too easily glosses over the complexities and outliers that true empiricism identifies. Our intention is for this work to represent a useful amalgam of both theoretical and empirical techniques; while utilising the epistemological tools of Austrian economic theory—especially the praxeological approach of logical theorising regarding the way in which human actors respond to incentives that are shaped by institutional environments—the focus remains on using empirical data to allow the period's contemporaneous actors themselves to tell their own story, in ways that recognise and explore the complexities and inconsistencies that define human action, and therefore social and economic outcomes.

1.2.2. Describing the Financial History of Shanghai's Early Capital Markets

A secondary research goal of this study is to provide the literature with a more detailed understanding of the dynamics of Shanghai's early financial markets. Although ample studies of early financial markets in early-industrialising economies exist, fewer systematic studies have been undertaken on the experiences of later-industrialising economies, such as China. While certain aspects of Shanghai's pre-war financial system have been considered in the literature, particularly the banking sector (King 1987, Cheng 2003, Ji 2003, Peng 2007), much less financial history research has been done on its early capital markets. That which heretofore has been undertaken typically lacks a comprehensive, detailed data-based approach. This research project seeks to fill that void through analysis utilising our construction of a novel dataset of bond prices, traded volumes, and associated financial indicators on Shanghai's capital markets during the late imperial and republican time frame.

For the vast majority of the period under study, Shanghai clearly served as China's financial centre. A primary reason for this was the amount of capital flowing into the area—by the early twentieth century, nearly half of foreign capital invested into China was done so specifically into Shanghai and the closely surrounding Yangzi Delta region (Remer 1933: 137). While the banking sector was an important component of the city's financial system, increasingly over time so too were its capital markets. Indeed, by the start of the 1940s, Shanghai was home to thriving capital markets, with daily volumes in the millions of locally-issued financial instruments changing hands. These markets were driven not only by local money, but also attracted considerable inflows of capital from other parts of the country seeking the greater security and higher returns that Shanghai's financial markets afforded.

To provide an in-depth analysis of the operation of Shanghai's early multiple capital markets, this project constructs a thorough and extensive novel dataset not previously presented in the existing Chinese financial history literature. Detailed data relating to China's late nineteenth and early twentieth domestic and extraterritorial bond markets are difficult to find, and as of yet no systematically assembled computerised data system exists allowing researchers to easily access and analyse trading records from this early period. Prior studies in the early financial markets of Shanghai have primarily been qualitative in nature; those that have sought to utilise financial data have been much limited in scope, and contained errors in their factual references. This project presents over fifty years of weekly market price and volume traded data on bond issuances of China's domestic national governments.

In addition, for the first time in the literature, we also are able to present a nearly extant set of Shanghai's municipal governments' bond price series; when available, also included are trading activity data on the volumes and values of bonds traded on the city's domestic- and extraterritorial-operated exchanges. Multiple and parallel municipal bond data sets were constructed, one comprising price and volume data of offerings issued by the domestic municipal governments, and one comprised of similar data by the International Settlement extraterritorial municipal government. Accordingly, the scale and scope of the collected time series allows for a deeper and more robust analysis of the performance and activity of Shanghai's early financial markets than previously presented in the literature.

The data and information used in the construction of these novel data sets were hand-collected and manually-entered utilising original archival sources, as well as contemporaneous English- and Chinese-language newspapers and financial publications. Care has been taken to ensure a high level of data quality, with a second set of data entry performed independently, and subsequent data matching analysis performed. Furthermore, a data quality exercise was undertaken to identify and record instances of typographical mistakes entered in the original data sources themselves.

1.3. Structure of the Dissertation

After this introductory chapter, Part I continues with Chapter Two providing the underlying theoretical basis used in the analysis of property rights institutions in subsequent chapters. In particular, we consider the theoretical role the state plays in shaping private property rights protections in the Lockean liberal tradition. A discussion of the ways in which private property, contract and investor rights impact the development of financial markets is provided, using political economics conceptual frameworks provided by the state capacity, credible commitment, and violence trap literatures. Chapter Three follows with the presentation of the robust debate that exists in the literature regarding the nature of domestic institutional state capacity and institutional quality.

In Part II, we look to start to contribute to the debate by providing a detailed and Austrian-based assessment of the domestic institutional framework that defined China's late imperial and republican era. Given that private property rights are multidimensional in nature, their description inherently belie measurement by a single indicator. Analysing private property rights is an inherently different exercise than, for instance, analysing a country's national income. Putting aside the practical measurement problems facing the calculation of Gross Domestic Product—and there admittedly exist many (Oi 1996, Gordon 1999, Coyle 2014)—the idea of capturing a single number that represents the value of all the products and services produce in a given country over a given time appears conceptually satisfying and parsimonious. However, no such parallel indicator exists for the more ethereal concept of "private property rights", or "institutional quality". Measuring the strength of such concepts therefore requires a more diffuse approach. As such, we attempt to develop a broad understanding of the complex matrix of myriad interacting and overlapping institutional constructs that shaped the domestic private property rights regime, including rule of law, legal system efficacy, credible commitment mechanisms, monopoly over coercive force, and other concepts that are themselves often as difficult to measure as are property rights.

We this take a qualitative and historical approach to analyse various aspects of late imperial and republican era domestic state capacity in relation to the broader institutional environment. Chapter Four considers issues related to state structure and legal system, Chapter Five discusses the varying nature of state bureaucratic capacity, and Chapter Six considers the level of perceived effectiveness of state power in the establishment of an internal monopoly on coercive force through the attempted harnessing of bureaucratic, administrative and policing tools designed to protect and defend private individuals from infringements upon their property from nonstate actors. Overall, analysis focusses upon the level of state capacity domestic governments displayed in creating credible commitment mechanisms designed to protect private economic agents' private property from theft or destruction by other nonstate actors, while simultaneously limiting opportunities for the expropriation of private assets by state actors. Chapter Seven presents a summarising analysis by applying the theoretical concepts developed within the Violence Trap literature, as well as our extension of the framework, to help understand the incentives operating on state actors that helped to define the nature of the period's institutional environment.

Part III is centred upon a more focussed description of the unique dualistic institutional environment that defined late-imperial and early republican Shanghai. Chapter Eight provides a brief consideration of domestic Shanghai's private property and contract rights institutional structure, operating as it did under the broader institutional, legal and political structures that defined the national domestic environment. Chapter Nine provides a corresponding comparative qualitative assessment of private property and contract rights and overall institutional quality as concurrently existing in Shanghai's International Settlement, defined as it was by a unique set of extraterritorial political and legal systems.

Next, Part IV seeks to add to the debate in the literature regarding China's domestic institutional late-imperial and early republican environment by providing a new analysis technique not hitherto fore employed in the literature to date. Recognising that the institutional setting of domestically-control sections of Shanghai is reflective of the overall domestic institutional environment of China, we are able to leverage Shanghai's unique dualistic institutional environment, along with the similarly dualistic nature of financial instruments that traded on the city's capital markets, to capture the contemporaneous economic actors' aggregate perceptions of the relative institutional quality of the respective domestic and extraterritorial institutional environments.

Specifically, Chapter Ten presents a review of the experience of domestic shareholders in regard to two of the premier domestically-operated private joint-stock corporations, the Bank of China and the China Merchants Steamship Navigation Company. Particular attention is paid to an analysis of relationship between private shareholders and government involvement in the management and eventual expropriation of these private firms. Chapter Eleven takes a differing approach, providing an in-depth look at the development of the government bond markets in Shanghai, primarily focussing on the trading of domestic national and local municipal bonds. The issuance of bonds by three separate types of sovereign entities—the domestic Chinese national government, the domestic Shanghai municipal authority, and the extraterritorial governments of Shanghai—are analysed. To do so, a comprehensive dataset of bond prices and volumes traded of bond issuances by the relevant sovereign entities is constructed, supplemented with qualitative descriptions to further explicate the general demand dynamics for these bond issuances by market participants. Using a comparative approach, we contrast differences in the development and investor demand for domestic and extraterritorial municipal bonds, as provided by analysis of the separate historiographies and the price and volume traded series that pertain to particular bonds issued by the three sets of sovereign entities. Thus this chapter provides a more quantitative approach to measuring the perception of private property protection held by contemporaneous economic agents that serves to complement the more qualitative analysis presented in Parts II and III.

Part V comprises Chapter Twelve, which summarises the primary themes and conclusions developed in the dissertation, as well as containing the bibliography and several appendices that present the massive equity and bond pricing data sets collected in the course of this research project. Finally, here we will also make a brief note on a formatting issue regarding the use of Chinese words and names, and the associated romanisation thereof. In general, we attempt to eschew the use romanisation where possible, such that many words or phrases are presented simply by their original Chinese characters, as well as translated English meaning. Hence, for instance, we refer to simply the 1904 Qing Company Law (公司法), as opposed to using a romanisation of the phrasing, such as *gongsilü*. However, in regard to individuals' names, or in instances where an exact English translation is difficult, such as with the concept of *quandu shangban* (管都商辦), the modern *pinyin* system of romanisation is employed. Given, however, that the research topic deals with a time frame during which several alternative systems of romanisation were common, reference is made to such earlier spellings where it serves to assist in identification; for instance, such as in reference to the Jiang Jieshi, who is frequently referred to in western literature as Chiang Kai-shek, or with the city of Guangzhou being historically referred to as Canton. For such cases, at the first presentation of the name or place, the *pinyin* spelling is used with the alterative historical Romanisation provided in brackets. Note further that alternative romanised spellings are also used when quoted as such from an original historical document. Similarly, the original published names of sources such as newspapers or periodicals are retained to reflect their spelling as printed at the time of their publication; hence, for example, the Chinese-language newspaper 申報, is transliterated in the manner it was contemporaneously printed on its heading as *Shun Pao*, rather than the more recent rendering in *pinyin* of *Shenbao*.

Chapter Two.

Institutions and Finance: Smithian and Austrian Approaches

2.1. Economic Theory: Smithian and Austrian Approaches

At its core, economics is a study of human behaviour. Early economists such as Adam Smith (1759, 1776) and Carl Menger (1871) emphasise that aggregate economic outcomes are generated by the summation of individual economic agents acting upon their individual preferences. Entities such as states, governments, economies and societies do not themselves undertake actions, only individuals do.[†] As Hashimoto (2003:5) notes in this regard, "whenever anything is desired or has a purpose, it is always in the end an individual, not a group. Something such as the 'purpose of society' does not exist at all. All that exists are the purposes of each individual." That economic outcomes are inherently consequent from individual human behaviour proves fundamental for several reasons.

First, this approach underscores that the unit-of-analysis in economics should be on the individual. The individual as decision-maker implies that the incentives that drive individual decision-making are central to understanding human behaviour and, therefore, economic outcomes. Since individual economic agents respond to incentives, when incentive structures undergo change, so too will human economic behaviour. Thus, economics is not simply the study of, for instance, the amount of accumulated capital; rather, it is the study of the actions of individual actors making investment decisions in response to incentives defined by their economic environment, which determines in the aggregate how capital is accumulated, and the utilisation of that capital.

Second, an equally important implication of economic outcomes deriving from human action comes from the nature of the humans undertaking action. Mises (1949) focuses on what he calls praxeology—purposeful human action—which emphasises the role of economic actors as rational, self-interested individuals who attempt to maximise their overall utility when interacting in economic and social environments. Economic actors can recognise and foresee risks, act in accordance, plan ahead, and most importantly, respond to incentives. However, individuals' preferences shaping their human action are neither homogeneous nor necessarily stable over time. Thus, while incentive structures help shape human behaviour, they do not drive all humans to all act in the same manner. Further, the concept of "rationality" by economic actors does not, in this context, assume perfect knowledge, or perfect capability or foresight. Unlike formal rational choice models requiring economic agents to correctly compute Bayesian probabilities or constrained optimisation over their choice sets, for Mises, human economic agents undertaking decision-making are capable, but imperfect.

Third, that economics is the outcome of human behaviour implies it is therefore inherently related to the concept of methodological subjectivism. There exist no "true" or "objective" qualities of economic value that drive individual decision-making and hence aggregate market behaviour; rather, the subjective perception of those qualities drive behaviour. As Mises (1949:95) remarks, "The ultimate ends of human action are not open to examination from any absolute standard... they are purely subjective, they differ with various people and

[†] Throughout our analysis, we attempt to maintain the focus on the individual and strive to avoid mistakes of hypostatization by assigning actions to abstract entities such as states or governments; however, we occasionally relax this rule to advance perspicuity. Such stylistic choices should not, however, distract from the fact that when referring to, for instance, "the domestic Chinese state", we are in actuality referencing a collective entity comprised of individuals, each acting in accordance with their own subjective and individual interests and abilities to affect policy.

with the same people at various moments in their lives." Kirzner (1992: 64) expands by noting that, "the actions of individuals are to be understood only by reference to the knowledge, beliefs, perception and expectations of these individuals." Thus, the perception of reality drives individual and hence economic behaviour. For instance, as we consider in detail in Part IV, the willingness of domestic Chinese investors to hold bonds issued by various governments during the late-Qing and republican period was determined by these investors' subjective perceptions as to the viability and commitment of the bond issuers to honour the implicit financial contracts defining the nature of repayment responsibilities the bonds represented.

Fourth, while individuals vary in terms of the structure of their preference profiles, there is nonetheless a universality that defines human economic behaviour. Our approach throughout this research is founded on the concept that human behaviour is universal in nature. Fundamentally, all humans, whether they be nineteenth century Shanghai-based merchants, investors, or government officials—or individuals of any other time period or societal group—act to forward their self-interest, and respond to incentives to achieve goals defined by their self-interest. Thus, we find the differing behaviours amongst different sets of economic actors in regard to investment and capital-raising strategies were not due to any particular weaknesses or exceptionalism that defined Shanghai's late-imperial and republican Chinese entrepreneurs and investors, compared to those of their foreign counterparts, but rather the result of individual rational responses to particular incentive structures shaped by the institutional environments within which they operated.

2.2. Institutional Economics: Smithian and Austrian Foundations

This view of the universality of human nature, of human instinct and intelligence, and of the ability to learn and respond to economic incentives, differs, however, with a formulaic Ricardian conceptualisation of an absolutist universality of economic laws that took hold by the nineteenth century—that markets, prices and economic actors behave similarly in all places across all times. Such an approach mistakenly discards Smith's earlier emphasis on institutional setting. While Smith (1776: I,2) indeed argues economics is the analysis of exchange (the "propensity to truck, barter and exchange"), he stresses equal importance to the analysis of the institutions within which exchange takes place. Smith (1776: IV) emphasises European merchants' propensity to conduct trade priced in varying bank or sovereign currencies to be driven by the differing banking and legal regulations practised in Europe and London. In response to this Ricardian oversight, Menger (1871) seeks to reintroduce Smith's approach and move economic analysis away from an institutionally antiseptic theory. Menger stresses that different economic responses and outcomes are obtained under different settings—while economic actors always act to further their self-interest, the same actor when operating within different environments, facing different legal structures or social norms, might well engage in very different behaviours.

Mises' conceptualisation of *homo economicus* as capable but fallible provides rationale for employing an institutional approach to economic analysis. Such an approach is furthered by Simon (1955, 1972)'s research on the limitations of human economic analytic ability, and Talib (2001)'s emphasis that not only is accurately ascertaining uncertainty difficult but often impossible given the existence of unknown (unknowable) factors. That individual decision-makers—albeit operating under the logic of economic reasoning—nonetheless face difficulty dealing with uncertainty and limited information in fact explains why institutions play a role writ large in the economic sphere; that is, institutions are of primary importance for the very reason that they serve to ameliorate, in different ways, the economic impacts of human limitations.

That different institutional environments ameliorate economic agents' limitations in different ways implies differing economic outcomes are to be realised under differing institutional environments. Coase (1937, 1960)'s work on the relevance of transactions costs on economic outcomes emphasises that differing organisational forms lead to differing impacts of transactions costs. Coase stresses that while many institutional forms are designed to overcome specific exchange problems, institutions designed to ameliorate certain limitations can simultaneously serve to generate other forms of limitations.

2.3. Institutional Focus of Modern Economics: "Institutions Matter"

The contributions of Samuelson (1947) has led economic theory to become increasingly reliant on mathematical models that abstract from human fallibility and transactions costs, and assume economic agents possess stable, known (knowable), and transitive preferences that allow formulaic calculations of optimal action over an available choice set. Such calculations allow economists to identify an optimised market equilibrium.

In response, Buchanan (1964) talks purposely about market processes; that is, the market as "becoming". This view accords with the Austrian conceptualisation of the market as continually agitating and in constant flux, as opposed to, resting at the optimised equilibrium point. While under an idealised institutional environment wherein which, to use Kirzner (1992)'s terminology, the underlying factors of preferences, technology and productive assets perfectly align with induced factors of prices, profits, and the structure of the ownership of productive assets, a stable market equilibrium could be achieved, as Mises, Kirzner and Buchanan stress, the underlying conditions are, in fact, constantly changing. Given the instability of individual preferences and the rate of technological change, markets rarely reach equilibrium before changes on both the supply and demand side occur, inducing new entrepreneurial activity. Thus, the neoclassical focus on optimisation is not incorrect, but rather misguided, as optimisation is a static issue, and instead the production and demand side of markets are always in flux.

It is from this standpoint that Buchanan emphasises the importance of moving the discussion away from a focus upon optimisation choice behaviour in equilibrium outcomes, and back to the Smithian and Austrian tradition focussing both upon market processes of economic exchange, and upon the institutions within which economic exchange takes place. If given a specified amount of inputs all markets inexorably all moved to the same equilibrium point, then calculating that equilibrium outcome would be a rote but important task for economists to undertake. But as market processes are continually in flux, and as there is no single equilibrium outcome, markets continually initiate movement towards an equilibrium outcome only to have the process start yet again once the underlying conditions change. Thus, understanding the rules under which market participants can act, and that determine how human capital and physical capital interact, proves more fundamental to understanding dynamic market processes, than calculating an equilibrium outcome that will likely never be achieved as the underlying conditions will change faster than the equilibrium condition can be met.

Subsequently, one of the most important developments in the field of economics over the past half-century has come from economists re-introducing the role of institutions back into economic analysis. Drawing on the earlier work of Smith, Menger, Mises and Coase, Demsetz (1967), North & Thomas (1973), North (1981, 1990) and Williamson (1981) formally incorporate how differing institutional forms determine economic outcomes by shaping the rules under which economic activity occurs, the incentive structures facing individual decision-makers, and in helping to ameliorate problems of exchange owing to transactions costs and human limitations in information acquisition and processing. Thus, as Williamson (1996: 3) famously declares, "institutions matter" at the most fundamental

level to all forms of economic transactions and relationships. By establishing the incentive structures that shape economic exchange, the institutional framework within which economic agents operate delineates the nature of their decision-making.

North (1994: 360) claims, "Institutions are the humanly-devised constraints that structure human interaction. They are made up of formal constraints (e.g., rules, laws, constitutions), informal constraints (e.g., norms of behaviour, conventions, self-imposed codes of conduct), and their enforcement characteristics." North's definition represents just one of many definitions in the literature. As Calvert (1995: 73-74) is correct to note, "[T]here is, strictly speaking, no separate animal that we can identify as an institution. There is only rational behavior, conditioned on expectations about the behavior and reactions of others. When these expectations about others' behavior take on a particularly clear and concrete form across individuals, when they apply to situations that recur over a long period of time, and especially when they involve highly variegated and specific expectations about the different roles of different actors in determining what actions others should take, we often collect these expectations and strategies under the heading *institution*." This concept of institutions implies a large variety of social structures that shape the way in which economic actors behave by both encouraging and discouraging various decisions due to the relative return they impose on such decisions.

As noted in the definition cited by Calvert, our assumption is that economic agents behave "rationally." However, the concept of rationality within economics has become muddled, especially given the emphasis on "perfectly rational" actors who are endowed in formal economic models with perfect foresight, perfect knowledge and stable preferences. To be clear, we eschew such unrealistic assumptions on economic agents, but keep the focus on the individual actors who we view—in the tradition of Mises, supported by Simon—to be rational, but human; that is, while potentially fallible in their abilities, they nonetheless can rationally respond to incentives and anticipate the future actions of other actors.

Thelen (1999) defines this approach as "rational choice institutionalism", where the fundamental methodological foundation rests on how individuals respond to incentive systems. Economic agents, acting rationally to maximise their personal welfare, and utilising the power at their disposal (which is likely to be unequally distributed across society), attempt to create and maintain institutions that benefit themselves; such institutions might or might not be socially efficient. However, once institutions are established, they tend to remain because they typically bestow benefits unequally, and hence serve to replicate the existing power structure. As Acemoglu *et al.* (2005: 427) note, under such a conceptualisation, "equilibrium institutions will not [necessarily] be those that maximize the size of the overall pie, but [rather] the slice of the pie taken by powerful groups." Thus, institutional change typically results only due to a change in the relative power of groups benefiting from an existing institutional framework.

In our he degree to which institutional structures promoting private property rights within late-Qing and republican Shanghai is likewise related to the ways in which various sociopolitical groups were able to control and benefit from the nature of property rights relations over the period. This period was defined by significant social and political transformations, with concomitant economic impacts. An increase in economic access by foreign merchants, for instance, helped bring about changes in the relative power of economic actors in China. The dynamics these changes unleashed help underscore the fact that while it is true that institutions work to constrain and shape individual economic actor behaviour, agents' behaviours can also drive institutional change. The growing power of the merchant class and the "Shanghai capitalists" helped to further momentum for improved protection of private property rights, including those impacting financial contracts and shareholders.

2.4. Private Property Rights

As implied above, institutions encompass a broad range of social structures, affecting behaviours of economic agents in ways that significantly impact economic outcomes. Of the many types of institutions, however, those pertaining to the protection of private property rights are of primary importance in promoting commercial activity. Indeed, for Mises (1927:19), classical liberalism can be condensed into a single axiom: *private property*.

Private property rights fundamentally shape economic activity because they impact how economic agents perceive the threat of expropriation of their private output. Given that costly effort is required to produce economic output, the fundamental production question facing economic agents involves calculating expected return on investment; that is, whether expenditure of costly effort is worthwhile. As investment represents deferment of current period consumption for returns in future periods, agents' current perceptions regarding the potential expropriation of their future returns is central to the decision to engage in costly investment. Relatedly, therefore, to be perceived secure, property rights must be viewed as stable and not easily subject to arbitrary change. In the absence of such stability, calculation of long-term investments becomes difficult, and investment is skewed away from high-return long-run projects towards the short-run (Elster & Slagstad 1988).

For any given investment opportunity, associated expected variance of return, and agent risk profile, positive expected returns make economic agents more likely to undertake the costly investment necessary to engage in productive activities. Potential expropriation of realised output affects the calculus of the investment decision by adding an additional layer of risk to expected return. The greater the perceived threat of expropriation, the lower are expected returns on a given investment, and hence the less likely is an agent to undertake costly investment activity. When societal institutional arrangements are such that economic agents perceive output as likely to be expropriated, expected returns of many possible investments can turn negative, implying costly investment is less likely to be undertaken. Note this effect is considerably more pronounced in a dynamic setting, since total returns are dependent upon the reinvestment of capital earned from the initial investment. Given this compounding effect, a weak property rights environment, under which potential output faces a perceived high threat of expropriation, economic output over the long term can be significantly impacted. Numerous studies have attempted to empirically link the level of property rights protections with levels of long-term economic growth (Kaufman *et al.* 1999, Johnson *et al.* 2002, Acemoglu *et al.* 2005).

2.5. Private Property Rights: Enforcement Mechanisms

Given that private property rights are so fundamental to economic activity, how are societies structured so as to ensure the protection of secure property rights? How can private agents protect their property, both in the current and future periods, if other private agents, unbound by constraint, can employ force to take the property of others? As Alchian & Demsetz (1973) make clear, fear of expropriation by private concerns is an important factor in agents' investment decisions, helping drive individuals to band together to create institutions that will allow protection from others arbitrarily taking property by brute force. In general, the state has been viewed as the primary institutional structure that can create secure property rights. In particular, as the complexity and size of society increases, issues of scale and scope imply government institutions to be the most appropriate instruments (North & Thomas 1973).

2.5.1. The State as Protector of Private Property Rights

For Hobbes (1651), the absence of a strong state (i.e., anarchy, or the "State of Nature") was defined by a "war of all against all," with private actors using force and violence to take what they wanted from others, and where life was "solitary, poor, nasty, brutish and short." Given the severity of the State of Nature under which agents lack the ability to have any protection of property or life, the state is necessary as the solution.

In a slightly different vein, for Olson (1993) anarchy is defined by the prevalence of "roving bandits," his analogy for private actors unbound by law who take what they want from others by force. Such conditions obviously greatly dis-incentivises agents from expending costly effort, since investment returns are likely be expropriated by such roving bandits who might appear at any moment. Therefore, a formal state apparatus is necessary to afford protection to individual actors from predation by roving bandits. For Hobbes and Olson, therefore, the brutality of the State of Nature justifies any political rule that can institute order and vanquish roving banditry.

Locke (1690) arrives at the necessity of the state to secure property rights from a different approach. His *Second Treatise on Government* provides the theoretical rationale for the origin, and the limiting extent, of legitimate political power. Locke explicitly rejects the Hobbesian view that to escape the conditions of the State of Nature we must accept forms of political rule based on the application of violence. Instead, Locke bases his argument on the underlying classical liberal concept of humans as free and equal by nature, claiming that it is the application of the free will of humans to accept and recognise the application of political authority over them as legitimate; that is, citizens have the right to actively chose and accept—in Locke's terminology, to consent—to political authority that can govern and limit their behaviour.

For Locke, the only reason that humans who are free and equal by nature would agree to be constrained by political authority is if that authority serves to protect and secure their freedom. Thus, at its core, the very reason for government is to secure and protect individuals' freedom from others seeking to impose their will through the use or threat of violence. Consequent to this reasoning is that a primary role of political authority is to prevent the taking of individuals' private property.

Adam Smith (1776: V,3), further underscores the justification for the application of state power to secure private property rights, for without it, neither commerce nor economic growth can occur." Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government."

Thus, the power of the state—through the application of institutions such as the police, the military, the legislative and judicial systems, the regulatory bureaucracy—serves a vital role in terms of the protection of private property rights by preventing other private actors (i.e., roving bandits) from trespass against the holders of private property.

2.5.2. The State as a Threat to Private Property Rights

The fundamental necessity of the state in order to ensure protection of private property from unjust taking by private actors would seem, therefore, to be unequivocal. However, a paradox arises—a state strong enough to protect agents' private property rights from non-state forces is also itself strong enough to violate those same agents' property rights. Olson (1993) continues his use of analogy by describing governments as potential "stationary bandits." While government can provide protection from roving bandits, it can easily in turn act as a stationary bandit, equally adept at expropriation of private property. In this sense, in the terminology of Frye & Shleifer (1997), the state can use its power to act as a "grabbing hand." Smith (1776: II) recognises this much earlier, noting "where men are continually afraid of the violence of their superiors, they frequently bury and conceal a great part of their stock, in order to have it always at hand to carry with them to some place of safety, in case of their being threatened with any of those disasters to which they consider themselves as at all times exposed."

Expropriation undertaken by the government, via outright seizure or excessive taxation, leads to higher transactions costs, lower incentives to invest, and hence lower levels of potential economic output. Thus, it becomes equally clear that the state itself can serve as an equally dangerous threat to private property rights as can private agents. Or, to use Olson's analogy, banditry (the undesired taking of private individuals' property) can be of either the roving or stationary kind; i.e, citizens must be protected by the state, and yet also from the state.

Yet Hobbes and Olson argue that government-as-stationary-bandit is nevertheless preferable to the presence of roving bandits, given that stationarity implies political leaders possess long-term interests in promoting long-term growth. Rational leaders can recognise that taking a non-absolute proportion of economic output encourages future economic output, hence creating a continual stream of income. Roving bandits, conversely, operating under a more immediate time horizon, are thus apt to simply take everything of value and leave, having destroyed future economic productivity.

Locke (1690: II,3,222), however, provides particularly strong counsel that the abuse of power by the state through stationary banditry implies invalidation of the very reason for the existence of government itself: "The Reason why Men enter into Society, is the preservation of their Property; and the end why they chuse and authorize a Legislative, is, that there may be Laws made, and Rules set as Guards and Fences to the Properties of all the Members of the Society, to limit the Power, and moderate the Dominion of every Part and Member of the Society. For since it can never be supposed to be the Will of the Society, that the Legislative should have a Power to destroy that, which every one designs to secure, by entering into Society, and for which the People submitted themselves to the Legislators of their own making; whenever the *Legislators endeavour to take away, and destroy the Property of the People*, or to reduce them to Slavery under Arbitrary Power, they put themselves into a state of War with the People." In a similar vein, Higgs (2002:361) strongly renounces the position that violence potentially perpetrated by private agents under anarchy is by definition inherently worse or greater in scale than violence potentially perpetrated upon citizens at the hands of their own governments.

It is from this reasoning that the classical liberal perspective continually emphasises the dangers of government over-reach, and hence its advocacy for a minimalist state. Further, Buchanan & Tullock (1962), articulating the contribution of the public choice approach, demonstrate that the danger of governmental over-reach is not accidental, but inherent in

the structure of government itself. As government is populated by human actors who, like all human actors, are motivated by personal interest, state actors are subject to the flaws, vices, desires and weaknesses that define all human actors. Thus, just as private actors seek to increase their access to wealth, prestige, and power, so too do government actors, who given their position are able to use the levers of the authority of the state to do so. Thus comes Madison (1788)'s observation in *Federalist Paper Number 48* that "power is of an encroaching nature."

2.5.3. State Power and Credible Commitment

That state actors, with the access and control over the levers of state authority, are particularly well-suited to engage in behaviours that violate individuals' private property rights, suggests expropriatory behaviour towards private property, in line with Olson's stationary bandits or Frye & Shleifer's grabbing hand conceptualisations, to be the norm rather than the exception. Indeed, this has been the defining characteristic of the application of state power throughout the course of history, with state authority employed primarily as an extractive tool of private wealth. That such conditions saw little in terms of sustained expansive economic growth is in line with Smith's observations that citizens must enjoy "confidence in the justice of government" if commerce is to flourish. Economic agents, recognising the power of the state to easily violate their property rights and expropriate their *ex-post* output, *ex-ante* under-invest in costly effort, leading to the underproduction of economic output.

Given the government's ability to expropriate private property, an inherent problem facing state actors is how to create amongst citizens confidence in the security of private property rights so as to spur investment and hence economic growth. The solution lies in creating observable effective constraints on expropriatory behaviours of state agents. Doing so, however, is difficult—even if the state leadership makes *ex-ante* promises not to expropriate private agents' property, given both the incentive structure of state actors, and the state's control over the coercive power of force enabling those in control to easily break promises *ex-post*, rational agents have little reason to place trust in such stated promises. As a result, the state must fashion effective credible commitment mechanisms that can help bind itself to honour the promise not to violate agents' private property rights. Credible commitment refers to actions taken by state actors that increase the costs of breaking their promise, thus decreasing the potential gains of not honouring the promise, and thereby increasing private economic agents' confidence in the reliability of the promise (Schelling 1960, North & Weingast 1989, Elster 2008, Boettke 2009).

Written constitutions that proscribe limits on government power and forbid the use of the military by political elites to maintain power can serve as important signalling devices, but functionally, constitutions themselves are no more than words on a piece of paper. In certain settings, therefore, such as authoritarian regimes, constitutions can be interpreted as documents "without any function other than to give the illusion of legitimacy to the regime" (Ginsburg & Simpser 2014:1). Effective institutional constraints on the unchecked and arbitrary employment of power are required in order to create genuine credible legitimacy as to the limits on governmental power delineated in written constitutions. In practice, however, given it is difficult to effectively constrain the power of the state, multiple institutional constraints are necessary, as the costs facing state actors wishing to break *ex-ante* promises to protect private property rights increase as do the number of existing overlapping credible commitment mechanisms.

Perhaps the most significant credible commitment device comes from a representative government structure. Under representative government structures, the behaviours of state actors are limited given that if they implement unpopular policies, or are viewed to be violating accepted protections on private property rights, such state actors can be peacefully removed from power via an agreed electoral process. In a well-known example highlighted by North & Weingast (1989), the British crown transferred the power of taxation from itself to Parliament, and faced costly consequences were it to try to revoke such power. In extraterritorial Shanghai, a governing representative council was held accountable for its fiscal decision-making by taxpayers who elected the council members. Representative government based on the ability of citizens to remove representatives from power contrast significantly with autocratic government forms. As Olson (2000: 27) notes, "the promises of an autocrat are never completely credible." With the full power of state authority at their disposal, and limited ability for non-state actors to effect change on those in power, it is typically less costly for authoritarian regimes to backtrack on promises to protect private property rights.

In general, the greater dispersal of constraining power throughout society, the greater are the costs to state actors attempting to violate private property rights, and therefore the more credible are the commitments to uphold such rights. Open societies where free associations of civic groups are possible serve as an additional safeguard against the potential for arbitrary expropriations by state actors (Weingast 1997, Raiser 1999). The ability for such groups to pressure the behaviour of state actors, either via lobbying efforts or organised political action, helps align public will with government policies, and increase the accountability of state actors who might otherwise seek to violate property rights. †

Another important institutional credible commitment mechanism is by way of the creation of an independent judicial system. Independent courts serve not only to protect private property by settling property disagreements between private agents (civil law) or enforcing limit of trespass by agents to others' property (criminal law), but equally important, they can serve to affect limits on state actors. Note that both the limits and potency of credible commitment mechanisms are exemplified in the case of an independent judiciary. Ultimately, a powerful executive, with control over internal military force, can disregard court rulings. Yet, ignoring the rulings of the judicial system imposes costs on the executive, as such actions are likely to be viewed to be a breaking of the social contract, and increase the risk of disobedience by the military, anger of civil society groups, and even possible overthrow from power. Conversely, in those states that lack independent judiciaries, including authoritarian regimes, state actors are less constrained to adhere to the rule of law, undermining much of the value of holding private property. Milton Friedman, in assessing the failure of mass privatisation programmes in post-communist Russia, remarks, "the rule of law is probably more basic than privatization. Privatization is meaningless if you don't have the rule of law. What does it mean to privatize if you do not have security of property, if you can't use your property as you want to?" (Friedman 2002: 18).

† A caveat here is necessary. Public participation in the political process can create both positive and negative consequences for the protection of private property rights. Concern is raised by those regarding the dangers of a "tyranny of a majority" which advocates implementation of redistributive policies at the expense of the property rights of those holding significant amounts of capital (Becker 1983). However, the reasoning behind this argumentation is potentially problematic, as it denies the ability of strategic foresight by those in the majority, implying they would non-rationally back policies that capture a larger piece of a smaller pie in the immediate period, at the expense of retaining commitment to policies protecting property rights that generate significantly larger pies in future periods. The argument is admittedly complicated, however, by Fernandez & Rodrik (1991)'s contention that uncertainty as to accrual of gains to any particular individual under policies that lead to greater overall growth can work to limit support for such policies.

2.5.4. State Capacity and the Violence Trap

Epstein (1994, 2000) presents a challenge to the classical liberal idea that limited governance structures and economic freedom are sufficient for modern sustained growth. Epstein's thesis is that while Smithian growth and market integration are indeed fundamental to long-term economic growth, this growth process can be choked off when states lack the capacity to implement policies that will promote market development and integration. As Epstein (1994: 7) writes, "although an autocratic government... will be unable to provide the necessary commitment to existing property rights, and will therefore tend more or less deliberately to stifle opportunities for growth, it by no means follows that free (in the sense of Liberal democratic) institutions will produce an efficient or indeed superior degree of commitment." Specifically, representative government structures also face potential inability to implement credible commitment mechanisms, as self-interested interest groups who can capture the reins of state authority might renege on past promises, much as might a self-interested autocratic ruler (1994: 13).

The key for Epstein is the underlying strength of the state institutional structure—weak states are those easily captured by particular interests, whereas strong states can withstand the pressures applied by self-interested groups, maintaining the underlying institutional framework that defines the rules of the game. Epstein argues there is a minimum level of state power necessary to overcome fragmentation of authority that can otherwise lead to sub-sovereign state actors able to extract rents and privileges from the central state in return for their support, with associated barriers to trade effectively disrupting free entry and the integration of markets necessary for sustained growth: "Prisoner's dilemmas caused by decentralised rent-seeking, and co-ordination failures caused by jurisdictional fragmentation, posed the most significant constraint on pre-modern growth" (2000: 169). Thus, "[effective, capable] State formation was a major cause—possibly *the* major driving force—of market integration and Smithian growth before the nineteenth century" (2000: 52).

Subsequent research has further developed the "state capacity" literature (Migdal 1988, Davidheiser 1992, Acemoglu 2005, Besley & Persson 2009, Acemoglu *et al.* 2016), with Johnson & Koyama (2017:2) defining state capacity as "the *ability* of a state to collect taxes, enforce law and order, and provide public goods." Much of the literature has focussed on state capacity as comprising two components: fiscal capacity, defined by the ability to raise tax revenues, and legal capacity, the ability to enforce its legal authority across the entirety of its territory. While such an approach to state capacity is certainly useful given that fiscal capacity and legal capacity are vital abilities necessary for a state structure to effectively function, a broader conception of state capacity is appropriate. Beyond the ability to effectively raise tax revenue and impose legal authority, state capacity relates to issues of institutional efficacy—whether the state possesses effective institutional and bureaucratic structures to formulate and implement policies. This certainly includes sufficient funding mechanisms, but also an appropriate bureaucratic framework and decision-making structure appropriately robust so as to be able to formulate and implement the desired policies of state actors, as well as sufficiently insulated so as not to fall capture to actors intent on warping the system to primarily serve their interests at the expense of pre-existing commitments to protection of private property. Designing efficient bureaucracies as opposed to simply large ones is not easily accomplished. Given the incentives of state actors, there is continual pressure to expand resources flowing to government. Further, the larger the state apparatus, the more opportunity and ability for state actors to utilise state power to extract resources from the private economy for personal gain.

2.5.4.1. Monopoly on Violence

Given its role in providing protection of private property rights, and hence even liberty itself, state capacity in regard to the ability to impose and maintain a monopoly on violence within its territory is fundamental. Under either Hobbesian or Lockean conceptualisations of the state, the ability to eliminate the presence of Olson's "roving bandits" to create a safe atmosphere for private agents to conduct business and own property is paramount. To do so, as Migdal (1988: 18) notes, sovereigns must "hold a monopoly over the principal means of coercion in their societies by maintaining firm control over standing armies and police forces while eliminating nonstate controlled armies militias and gangs." A state that cannot keep out externally-waged war, that cannot provide for the absence of civil war, and that allows non-state actors to arbitrarily impose violence within state borders, fails in this primary function.

As recently highlighted in Weingast (2017), the primary importance of state capacity in creating security was well-recognised by the earliest economic philosophers, with Smith (1776)'s *Book Three* emphasising that early modern growth in Europe could only occur once sovereign monarchs grew powerful enough to limit the ability of sub-sovereign nobility from using the threat of waging violence to extract rents, hence stifling growth (thus, Epstein's thesis represents a partial extension of Smith's earlier observations). More recent work by Barry Weingast and his co-authors (North *et al.* 2009, 2013; Weingast 2010, 2017; Cox *et al.* 2015; Levi *et al.* 2017) explicitly argues that modern economics has under-accounted for the importance of violence as fundamental to the ability for countries to undertake policies necessary for sustained economic growth. Their work finds political violence to be endemic to poor countries, observing that from 1840 through 2004, on average, violent regime change occurred every seven years for the bottom fifty per cent of countries ranked by gross domestic product, compared to only every sixty years for the top decile of countries.

Thus, for most states, the actuality of serious, existential political violence is the norm, not the exception. Creating the sufficient level of state capacity sufficient to maintain an internal monopoly on the ability to conduct violence, and limit the dispersion of the ability to commit violence amongst multiple actors within the state, in practise proves to be extremely difficult for most state institutional structures.

The impact of such frequent and endemic episodes of internal violence is severe. To begin with, for states with weak state capacity unable to prevent the destructive actions of "roving bandits" represented by corrupt state police or military forces, internal rebels and militarist leaders, thieves and organised crime members, or foreign military forces, levels of domestic investment and entrepreneurial activity are considerably circumscribed. Given that realised output achieved by costly investment undertaken by private domestic entrepreneurs face either expropriation by force from non-state actors, or destruction from military actions, implies the inclination to invest capital is severely depressed. Furthermore, potential investors who might consider financing domestic entrepreneurs must likewise factor in the expected probability not only of the potential economic success or failure of an entrepreneurial venture, but also the expected probability that the gains of an entrepreneurial venture could be expropriated or destroyed by such "roving banditry" or in the process of state military response. Thus, in states with high levels of expected violence, such additional risk can serve to drive the expected return of many potential economic investment opportunities negative, thus depressing realised economic output.

Given the immense negative economic and political consequences owing to violence, Cox *et al.* (2015) describe a vicious cycle, or violence trap, that limits policy options of political leaders in states incapable of imposing a monopoly on coercive force. Political leaders, wishing to maintain their rule, recognise the possibility of overthrow given that competitors possess significant access to coercive force. As negative impacts of sustained political violence are severe, leaders seek strategies to ameliorate outbreaks of violence. Such strategies centre on creating rents that can be distributed to potential competitors to induce support for the leadership and remaining invested in the current order. These rents-creation strategies, while potentially reducing the incidence of violence within society, are in general antithetical to economic growth. Yet abandoning these rent-creation strategies would weaken the (already limited) support for the regime and increase the likelihood of political violence. Hence, leaders of states with weak capacity to enforce a monopoly on coercive force can find themselves "trapped" into maintaining policies leading to poor economic outcomes.

2.5.4.2. Violence, Existential Threats and Credible Commitment

Our previous discussions highlighted the importance of sovereign entities creating institutional credible commitment mechanisms which bind state behaviour into honouring *ex-ante* promises to protect private property and contract rights. The key is in the perceptions of private economic agents—it is essential for agents to believe that property and contract rights institutions are effective and that commitment devices locking state behaviour into honouring private property and contract rights protections are credible. Under such conditions, it becomes rational for agents to undertake costly investment efforts necessary to produce economic surplus, as well as for investors to hold financial instruments, fostering capital market development.

Here we advance a slight extension of the violence trap thesis of Weingast and his co-authors. Specifically, we contend that states characterised by such weak state capacity so as to be unable to prevent systematic and episodic internal and external violence, and thus facing existential threats of regime change by force, are severely constrained in their ability to implement credible commitment mechanisms to honour prior claims on private property rights protections. The reason for such constraints is simple—*ex-ante* promises made by states facing existential threats are inherently not credible.

Similar to the violence trap argument made by Weingast and his co-authors, the situation for states facing serious existential threats place state decision-makers in a "catch-22" position in regard to honouring protections on private property rights. To begin with, states facing existential threats force state actors to consider a wider range of behaviours in order to prevent loss of power. State actors are more willing to undertake drastic actions to prevent overthrow of the state, such as the declaration of military law, the suspension of civil liberties, or engaging in onerous taxation or outright expropriation of private economic output in support of military efforts. The immediacy of the existential threat means state actors place less weight on policy choices that would contribute to the long-term development of the broader economy or financial markets—such as maintaining strong commitment to protection of private property and contract rights—and more weight on gaining access in the immediate to resources to prevent the overthrow of the regime. State actors are more willing to undertake drastic actions in violation of previous credible commitments to honour private property rights because even if costs to violating credible commitments are large, costs for state actors to the fall of the state are likely to be even greater.

Second, no matter what actions undertaken by the state, however extreme or limited they may be, rational private agents are likely to view existing institutional commitments to protect private property rights as relatively hollow. Private agents, aware of the existential threats facing the state, recognise that under a situation of duress, state actors are more willing to undertake drastic actions to increase the chance of state survival, including actions that violate previously credible commitments in order to accomplish the short-term goal of staying in power; hence, private actors are more likely to discount attempts at credible commitment. Thus, even governments whose leadership authentically holds the intention of protecting private property rights in general will, in the face of otherwise collapse of the regime, be perceived as likely to engage in expropriation in order to secure emergency funds necessary to pay for defence of the regime.

For governments to make credible their commitments to protect private property rights, they need to be seen as justifiably not willing to suffer costs associated with breaking the commitments they have made; under such conditions, however, rational actors perceive state actors as willing to suffer such costs. For instance, while the sovereign has the ability to default on its bond payments, recognition by state actors that such action will lead to future increased borrowing costs serves as a deterrent to default; it is the widespread recognition of that deterrent helps make the sovereign's commitment to repay more credible. However, if the state is faced with existential threats, the power of the deterrent is marginalised—the priority of state actors is first and foremost to remain in power; only after that immediate and primary goal is secured will subordinated goals, such as attaining favourable cost of capital in the future, be considered, given that were the state to fall, future concerns such as borrowing funds in the future are by definition made moot.

A third fundamental problem preventing states of such weak capacity as to be under continual existential threat of violent regime change to effectively implement credible commitment mechanisms is that the very existence of an existential threat implies rational private actors will be inclined to discount credible commitment attempts by the state—no matter the actual set of actions state actors undertake. Whatever commitments the state apparatus creates to honour protections on private property rights, a serious existential threat implies the existing state apparatus might well become incapacitated or removed altogether. Thus, even if the state actors, in the face of an existential threat, were able to guarantee that state policies would never violate commitments to protect private property rights, and even if private actors perceived the state's credible commitment mechanisms as incontrovertible and remained confident that state actors would not violate any prior-committed promises to uphold private property rights, rational private actors would still be inclined to discount the state's attempts at credible commitment under circumstances where the current state apparatus is facing a high probability of violent loss of power, given that the regime that might replace the current regime may well not be committed in same way to protect private property rights as the ousted regime. (For instance, however well or poorly the Guomindang regime provided protections on private property rights, the incoming communist regime in 1949 provided considerably less such protections).

Further, for the class of weak-capacity states described, any actions undertaken by the state that violate prior commitments, no matter whether circumscribed or extreme, serves to validate the perception amongst private actors that state actors are willing to accept the costs of breaking commitments, as those costs are lower than the cost of loss of power were the existential threat to be realised. Therefore, the ability to generate functional commitment mechanisms to be perceived as credible by private economic agents is further limited. Not only do exigent circumstances help propel state actors to undertake actions likely to include violations of prior commitments to protect private property rights, but forward-looking rational agents will anticipate such violations, making attempts by the state to commit to protect private property rights as unable to be perceived as credible.

This condition, too, exists no matter what actions the state takes in actualisation—it is the recognition of the likely potential that the state will undertake such violations that drive private actors' perceptions, not simply the realised actions of the state. Further, given that private actors anticipate the state will violate commitments to honour private property rights, state actors in turn anticipate such anticipation by private actors. As a result, a vicious circle, or "low credibility trap", is created that locks the state into an action set that severely undermines its ability to credibly commit to protect private property rights. The dynamics of the trap are self-reinforcing: facing serious existential threats, incentives on state actors to honour prior commitments to protect private property rights are considerably reduced, given that private actors will react similarly whether state actions uphold or violate commitments. This condition therefore increases the likelihood that the state will in fact violate its prior commitments. Recognition by private actors that state actors are more likely to violate prior commitments under such conditions creates secondary effects that further strengthen the overall dynamics of this trap.

Finally, the simultaneous consideration by private actors that loss of power by the current regime might well lead to the repudiation of existing prior commitments only serves to reinforce both the perceptions of private actors that state commitments are not credible, and the respondent incentives on state actors to violate prior commitments. This reinforces the structure of the trap that limits the ability of a weak capacity state incapable of enforcing a monopoly on internal violence to credibly commit, and likewise increases the likelihood of expropriation of private assets.

2.6. Contract Rights

Contract rights represent an important subset of private property rights protections. The structure of institutions providing the protection of private property and contract rights are fundamental to the operation of markets. North (1990: 54) argues the specific mechanisms that impact the enforceability of contracts are essential to commercial activity. Indeed, he goes so far as to claim that "[the lack of] effective, low-cost enforcement of contracts is the most important source of both historical and contemporary under-development in developing economies."

All forms of commercial exchange are inherently imbued with transactions costs, with the most significant owing to asymmetries present in the information sets each side brings to the exchange. Particular institutional exchange forms and information mechanisms (for instance, well-functioning markets with publically known prices) can work to mitigate such asymmetries, thus shaping the nature of exchange (Aron 2000).

Contracts are designed to overcome transactions costs in regard to incentive problems caused by informational asymmetries, particularly in regard to principal-agent problems. Incentive problems occur when a rights-controlling agent (the principal) seeks to delegate a task to another agent. However, once control has been given to the agent, the agent can gain access to information not available to the principal (for instance, the manager of a firm will have significantly more information on the operation and resource allocation of the firm than will outsiders, including the principal). Effective contracts can help overcome some of the problems associated with asymmetric information, depending on the efficacy of enforcement frameworks that bind agents to the terms of the contract. Hence, the institutional framework determines the nature and efficacy of contract enforcement mechanisms, and helps to determine the effectiveness of these mechanisms in overcoming problems of hidden and asymmetric information. Jensen & Meckling (1976: 311) emphasise the importance of these mechanisms when noting, "The police powers of

the state are used to enforce performance of contracts or to enforce the collection of damages for non-performance. The courts adjudicate contracts between contracting parties and establish precedents... All of these government activities affect both the kinds of contracts executed and the extent to which contracting is relied upon."

Problems relating to differing principal-agent incentives and informational asymmetry are particularly relevant in regard to corporate governance issues, where the principal is the owner of a company (i.e., a shareholder), and the agent is a manager of the firm. Under institutional settings defined by weak contract enforcement, it becomes more difficult to overcome the agency problems inherent in the principal-agent relationship and, hence, less efficient for companies to utilise joint-stock corporate forms, or for investors to enter into contractual relationships via shareholding. Agency costs also increase the cost of debt issuance, as bondholders wish to impose costly restrictions on firms when significant concerns over agency problems exist (Jensen & Meckling 1976). The impact of such agency costs will be underscored throughout our examination of Shanghai's early debt markets, especially in regard to their payout structures.

Many forms of potential exchange are characterised by a lack of simultaneous exchange. In such instances, the potential risks of one side of the exchange reneging on previously agreed-to exchange conditions are high. In response, economic actors will attempt to reduce risk via various institutional arrangements to increase profitable exchange opportunities. Economic historians have identified many situations where economic agents designed uniquely appropriate institutional arrangements to overcome high transactions costs so as to facilitate trade outside of formalised, government-enforced private property rights and contract enforcement. Greif (1993, 2011) for instance shows that even in the absence of government-enforced contract protection, nomadic Jewish Maghribi traders were able to construct effective self-enforcing relationships that allowed trade to take place over time and distance.

However, for markets to be able to deepen and exchange to take place amongst individuals who are not related to one another by communal relationships—which by nature are bounded in size—non-simultaneous exchange requires parties to be able to ensure that agents are likely to honour future commitments. Whether formally or informally, such commitments can be conceptualised as contracts. Settings requiring contracts imply transactions costs, such as identifying reputable agents, to be high. Hence, institutional arrangements that encourage agents to uphold their contractual commitments reduce transactions costs for exchange, increasing the degree and scope of commercial activity. Such arrangements are particularly important for financial transactions that can allow for agents to undertake the sort of long-term, higher-return investment projects modelled by Bencivenga & Smith (1995).

2.6.1. Contract Rights and Financial Instruments

The importance of private property rights protection and contract enforcement is particularly relevant in relation to the development and use of financial instruments. Financial instruments are in fact contracts—they represent an agreement between two parties, whether principal and agent, as in equity shares, or claimant and recipient, as with bondholder and issuer. The economic value of financial instruments is derived not simply from the expected cash flows designated within the terms of the contract; of equal importance are the rights these contracts afford their holders. As La Porta *et al.* (1998:1114) note, "Shareholders receive dividends *because* they can vote out the directors who do not pay them, and creditors are paid *because* they have the power to repossess collateral. Without these rights, investors would not be able to get paid."

However, a financial contract—a share of stock, or a bond—is represented by nothing more than words written on a piece of paper. Ultimately, any economic value assigned to the stock or bond comes only from the ability of the owner of that piece of paper to actually enforce the contract it represents. Hence, the nature and efficacy of contract enforcement mechanisms is fundamental to the perceived value of financial instruments, and thus to the overall development and functioning of financial markets.

Recent research in financial contracting focuses on the ways in which such contracts are inherently incomplete; that is, they are unable to define many decisions that need to be made in future periods, as these decisions are inherently unknowable or indeterminate at the time of contracting. Therefore, financial contracts serve as tools that shape the methodology determining how these decisions will be made. Relevant literature has thus focussed on the nature of the decision rights endowed under varying financial contracting formulations (Aghion & Bolton 1992; Hart 1995, 2001).

As with all economic exchange, each side in financial contracting faces trade-offs (Grossman & Hart 1986, Bolton 2014). Financial contracts require wealth-constrained entrepreneurs to give up control and decision rights in return for access to financing. The form of financing, equity or debt, reflect different sets of decision rights. Equity shareholders typically have voting rights and can demand changes to management practices and make-up, and can attempt to extract profits out of the firm through influence over dividend decisions. Bondholders, conversely, do not initially gain decision rights; as long as scheduled payments are made, bondholders have no control over management decision-making. From the entrepreneur's standpoint, therefore, she prefers debt financing, given she receives capital while retaining full decision rights. Greater debt obligations, however, increases the risk of default; once a default takes place, firm management lose all decision-making control and assets can be seized by creditors. Hence, debt and equity pose different sets of risks and trade-offs for either side in both forms of contracting relationships. The efficacy of contract enforcement determines the relative and absolute costs and benefits of equity or debt financing (Jensen & Meckling 1976). Differing property rights regimes can generate higher or lower absolute levels and forms of financial contracting.

In instances where a government is the bond issuer, the contract that governs the borrower-lender relationship similarly defines both parties' rights; however, the nature of government power limits lenders from exercising certain decision rights, even in the case of default. While bondholders can turn to the courts to enforce repayment, their position is disadvantaged given the court system is a government institution and judges are technically government officials, underscoring the importance of the strength of credible commitment institutional mechanisms relating to judicial independence, as such independence helps determine the actualisation of the potential conflict of interest between the courts and the broader state apparatus.

The importance of additional enforcement mechanisms is therefore important to fostering repayment. Such mechanisms are typically centred around reputational concerns, and the implied threat of withholding future lending—if the sovereign reneges on the current bond contract, lenders are less likely to enter into a similar contract in the future (Gulati & Triantis 2007:984). The efficacy of such enforcement mechanisms is therefore dependent on the sovereign possessing a long-term outlook under the anticipation of necessitating future borrowing.

Thus, when governments face existential threats such that their outlook skews to the short-term, or in cases where the state is able to force lenders to supply funds, the ability of reputation to serve as an effective enforcement mechanism is weakened. As later

discussed, domestic Chinese governments frequently faced existential threats, and at times possessed sufficient power to require private agents to purchase government bonds; further, the formal court system was far from independent. As such, both legal and reputational enforcement mechanisms were sufficiently weak to allow for recurrent incidences of government default on bond obligations.

2.6.2. Contract Rights and Financial Instruments: Empirical Support

Weak enforcement mechanisms of the contracts representing financial instruments, or poor institutional protections allowing a predatory state or private actor to expropriate or destroy productive assets to which financial instruments give claim, will theoretically lead an economy to under-produce financial instruments. North & Weingast (1989) describe how the power-sharing arrangement emerging out of Britain's Glorious Revolution created an institutional framework incentivising the monarchy to respect the private property rights of the commercial class. Prior to the Revolution, the crown consistently imposed onerous taxes and had the power to compel members of the commercial class to purchase government debt, on which the crown would consistently default. Lacking an independent judiciary, the poor contract rights environment implied the commercial class were unwilling holders of government debt, as evidenced by the state using coercive power to force the purchase of its debentures. The lack of inherent investor demand, however, meant secondary bond markets were essentially absent, as there was little in the way of secondary trading of perceived high-risk, low-return government debt instruments.

After the Glorious Revolution, the power dynamics between the state and investors changed—the creation of a more powerful parliament, which had authority over the crown's taxation, revenue and spending decisions, served as a powerful credible commitment mechanism on the crown to protect the rights of bondholders. The key to the efficacy of the credible commitment mechanism was its self-enforcing nature. On the one hand, in line with Olson (1993)'s stationary bandits argument, the monarchy now had positive incentives to respect private property rights, as it received benefits by way of increased and stable tax revenues from policies encouraging economic activity. Simultaneously, the monarchy faced serious negative consequences were it to not honour its promise to protect private property rights—given that the regime had recently been overthrown by an increasingly powerful commercial class, the threat of subsequent overthrow was all the more credible, hence providing an effective check on the crown's behaviour to honour its commitments.

North & Weingast cite two main pieces of evidence. The first was the fall in cost of capital to the British government once the credible commitment mechanism was created—interest rates paid by the crown fell post-1688, and trended lower over the next several decades. The second was the monarchy's improved ability to obtain financing, evidenced by the concomitant massive increases in government borrowing. Hence, the government's ability to credibly commit to protect property rights led to improvement in public finances.

Numerous subsequent studies have followed North & Weingast's methodological framework. Fratianni & Spinelli (2006: 262) find commitment mechanisms similar to those operating in post-Glorious Revolution Britain to be in place in the Italian city-states of Florence, Genoa and Venice in the fourteenth century: "republican political institutions and the rule of law... gave [the cities] legitimacy and credibility to issue large amounts of long-term and marketable debt." Fratianni & Spinelli's research indicates that the different institutional arrangements operating in the three city-states led to different commitment mechanisms, generating differing levels of protection of property rights, as well as differences in the resultant credit available to the borrowing governments.

Stasavage (2002) presents an important possible critique of North & Weingast, finding that while interest rates fell immediately after the Glorious Revolution, they exhibited much volatility thereafter. His analysis shows the fluctuations appear to be strongly correlated with the political party in power. Importantly, however, his data confirm that although there was variability in interest rates paid by the British crown following the Glorious Revolution, the overall trend was consistently downward. Hence, while other factors are undoubtedly salient in respect to impacts on sovereign borrowing costs, improvement in credible commitment mechanisms regarding the protection of property rights seems to provide an unequivocal positive effect.

Saiegh (2013), utilising data from nineteenth century Argentina, complements Stasavage in his finding that credible commitment is most readily derived when property owners have some control over political power institutions. Thus, the property holders who gained power over the monarchy in late seventeenth century Britain, or those who took control of the post-colonial government nineteenth century Argentina, effectively imposed limits on state authorities' abilities and incentives to violate expressed commitments to protect the property rights of property holders.

Sussman & Yafeh (2006) utilise sovereign borrowing costs to critique North & Weingast's findings, focussing on the role played by market participants' perceptions of the credibility of private property rights protection mechanisms. Using a VAR analysis to study interest rates in Britain after the Glorious Revolution, their results indicate that while interest rates on British sovereign debt fell immediately, differentials between Britain and Holland did not fall appreciably until the late 1720s. They argue that the slower process to reduce the difference in interest rates between Holland and Britain indicated that foreign investors were less convinced that the new credible-commitment arrangement in place in Britain implied the risk of default had fallen substantially. British interest rates were impacted not only by "the perception of property rights by local investors, but also the perception of Britain's creditworthiness by foreign investors" (908). However, while presenting their analysis as a critique, Sussman & Yafeh's findings do not undermine the underlying North & Weingast argument that *within* Britain, the post-Glorious Revolution institutional framework generated a property rights environment that saw a fall in sovereign capital costs.

Overall, the theoretical arguments advanced by North & Weingast (1989) are compelling. As described throughout this chapter, the argument that stronger institutional protections on private property, contract and investor rights should incentivise private economic agents to more readily be willing to hold and trade financial instruments is based on an older, well-constructed set of Austrian and institutional theoretical supports. This research dissertation similarly considers the relationship between institutional quality shaping private property, contract and investor rights, and the willingness of economic actors to hold financial instruments.

The empirical testing methodology of North & Weingast, as well as the research that has followed in their path, is based on observing differences in investor behaviour prior to and after the introduction of an event viewed as changing the private property rights environment of the setting under study; if investor behaviour is positively (negatively) affected due to a strengthening (weakening) of the property rights environment, support for the underlying theory is bolstered. However, as some of the critiques of North & Weingast suggest, other factors might have also occurred over the time frame under consideration, and hence observed changes in investor behaviours can also be ascribed to these alternative political or economic factors.

Our research project seeks to alleviate this methodological issue facing studies that utilise the approach taken by North & Weingast, by taking advantage of late-imperial and republican Shanghai's unique dualistic institutional framework. The city's parallel institutional environments and financial markets existed concurrently, in the same geographical location, affected by the same economic trends, using the same set of currencies, with financial markets that traded similar sets of financial instruments that the same underlying set of investors could choose between to place their capital—yet, these issuances fell into two major classes based on the issuer entity, whether domestic or extraterritorial. The differing issuing entities operated under the differing institutional environments, shaped by differences in the degree of exhibited state capacity of the sovereign political structures, domestic and extraterritorial, defining the respective institutional environments to create effective legal systems, protections on property and contract rights, and enforce a monopoly on internal violence, allowing for the effective functioning of market processes, including the development of financial markets. Thus, Shanghai during this period affords the opportunity to simultaneously consider the way in which institutional differences work to impact the decision-making of investors and the functioning of financial markets, allowing for simultaneous comparison of investor behaviour across stronger and weaker institutional environments.

Finally, similar to the research approach undertaken by Sussman & Yafeh (2006), we too focus on the investment choice behaviour of contemporaneous market participants to elucidate their contemporaneous perceptions of the credibility of private property rights protection mechanisms that existed at the time. Given that contemporaneous investors could choose to hold financial instruments of either domestic or extraterritorial issuers, observing their revealed preferences between these instruments helps shed light on their perceptions as to the underlying private property and contract rights institutional frameworks that implicitly defined the differing values of holding financial instruments of the differing issuers.

Chapter Three.

Outlining the Debate in the Literature

3.1 Debate Regarding the Late-Qing and Republican Domestic Institutional Environment: Conventional Wisdom and Revisionist Critiques

An important goal of this study is to help resolve a significant debate that exists within the Chinese economic history literature regarding views on the overall strength and efficacy of the domestic late-Qing and republican state capacity and its institutional environment. Given the importance that employing an institutional approach to economic history analysis has gained over the past several decades, the literature on this time period has begun to more explicitly consider the economic impacts that the institutional environment had upon the economic dynamics shaping this turbulent period of Chinese economic history.

3.1.1. Debating Late-Qing and Early-Republican Economic Growth

Much of the origins of the debate on domestic state capacity and institutional efficacy stem in part from a larger, older debate regarding the nature of China's economic growth path during the century that followed the First Opium War. That Chinese economic growth over this time period was sub-optimal appears on the surface obvious, especially when compared in relation to that of its neighbour Japan; whereas both of these East Asian countries began the mid-nineteenth century at approximately similar stages of economic development, over the course of a century, Japan significantly outpaced China both economically and militarily, pulling even in many regards to the western powers, while China remained mired in economic, political and military chaos.

Given such *prima facie* evidence, it was long-assumed that Chinese economic growth over this period was best characterised in terms of wasted potential, one in which economic stagnation predominated, with levels of agricultural productivity growth unable to overcome rising population growth (Ou 1946, 1947; Liu & Yeh 1965, Skinner 1965, Perkins 1975, Ash 1976), and minimal industrialisation (Paauw 1952, Yeh 1977). However, revisionist scholarship has argued voraciously that, at least over part of the time period and in certain regions, measures suggest Chinese pre-war economic growth should rather be characterised as robust, with substantial economic growth occurring in the rural economy (Brandt 1989, Rawski 1989), the manufacturing and transportation sectors (Rawski 1989, Ma 2008, Shi *et al.* 2014), the banking and credit markets sectors (Ji 2003, Ma 2016, Chen *et al.* 2018). Both Brandt and Rawski, for instance, find agricultural productivity outpaced population growth over the first four decades of the twentieth century.

Responses to these interpretations have been mixed, with critiques suggesting the revisionist growth figures are overly optimistic and dependent on compounding heroic assumptions and mischaracterisations of the degree of market efficiency the Chinese economy exhibited over this period (Huang 1990, Esherick 1991, Li 1991, Sicular 1991, Bramall 1992, Eng 1992, Little 1992, Wong 1992, Ma 2004, Du & Li 2011, Du 2013). Wong (1992: 602) criticises Brandt's reliance on "mutually reinforcing assumptions," claiming "undocumented assumptions [are used] to support claims tautologically derived from the assumption"; Little (1992: 427) and Esherick (1991: 502) provide nearly identical criticisms of Brandt's data assumptions. Regarding market efficiency, mixed evidence has been produced, usually using co-integration analysis on rice price data. Shiue & Keller (2007) and Cheung (2008) show regional rice markets to be relatively integrated during the late-Qing, while Li (2007:196)'s data conversely suggest interregional market integration fell substantially beginning at the start of the nineteenth century.

Pre-war Chinese economic growth remains a complex and contested topic in the literature, with Brandt (1997: 286) noting that there is more consensus regarding the economic growth trajectory and institutional fabric of the state apparatus for nearly the entirety of the Qing period compared to that on the four decades following the Sino-Japanese War of 1895. Ma (2008) attempts to address such differing views by returning to Skinner (1985)'s regionalism argument by suggesting that starkly different economic realities existed between the modernising littoral centres of the Lower-Yangzi delta, and the agricultural-based economy characterising the rest of China. Utilising provincial-based survey data collected in the 1930s, Ma estimates economic output for the Lower-Yangzi region. His results show a dichotomous development experience in China over this time frame, with the Lower-Yangzi region exhibiting national income per capita levels over one and a half times the national average for China, and economic growth rates double.

3.1.2. Domestic Institutional Environment: Weak State Capacity, Weak Institutions

The debate regarding China's economic growth over this time frame has spurred a parallel debate in the literature in regard to the overall efficacy and strength of the domestic institutional environment during the same period. In general, the mainstream view of the domestic Chinese institutional and private property rights environment over this time frame has been that it was relatively poor. The late-Qing has been consistently characterised in the literature as exemplifying a "weak state" (Fairbank *et al.* 1960, Miller 2000, Ma 2013, Johnson & Koyama 2017), as have its republican successors throughout its iterations of the Beiyang (Sheridan 1975, Strauss 1997) and the Guomindang (Pauw 1952, Eastman 1992, Myers 2000). Yet similar to the debate regarding the era's economic growth, so too has a revisionist literature put forth a sharply differing image of domestic state institutions as considerably more capable and effective than the traditional mainstream approach suggests. Whilst this revisionist challenge has produced more prolifically in recent years, debate in the literature regarding the extent and quality of state-building efforts, particularly during the Guomindang period, go back to Eastman (1974)'s "autonomy model" of the Guomindang state as an authoritarian institution beholden to few powerful decision-makers. While subsequent research by Coble (1980) and Fung (2000) add support to Eastman's arguments, Fewsmith (1984, 1985) challenges such conceptualisations of the Guomindang state by envisioning a more ostensibly corporatist state structure. Geisert (1982, 1984, 1986) regards Guomindang Party as becoming increasingly beholden to conservative elements within the Party structure, and thus less inclined to undertake radical policy manoeuvres that could upset landed elites. Overall, the complexity of the institutional landscape during various domestic governments, and use of different conceptualisations and measures of domestic institutional strength and state capacity, have prevented the formation of meaningful consensus in the literature regarding the nature of the domestic institutional environment over this important time frame.

3.1.2.1. Domestic Institutional Environment: Perceptions on the Early and Mid-Qing

While an important debate exists regarding late-imperial and republican period institutional quality, the literature has generally painted the early- and mid-Qing state as fundamentally different in terms of institutional and state capacity. For instance, the early and middle period Qing state is typically described as at worst benign, playing only a classic *laissez-faire* role of a limited state apparatus that did not impose too many obstructions on commercial activities. The *laissez-faire* governments of the Ming and early Qing, defined by low levels of taxation and concomitant small fiscal expenditures, exhibited little direct active role in the economy (Wang 1973: 79-83, Deng 2003, Zhang 2014: 182), with Miller (2000: 23) noting that "Taxes on commerce were insignificant until the institution of the *lijin* (likin) in the mid-nineteenth-century."

An older western scholarship views Confucianism's dominance over classical Chinese culture as preventing social change and economic development. Specifically, Weber (1905 [1930])'s glorification of western culture and "European exceptionalism"—along with his implicit assumption viewing non-European social forms as thereby inherently flawed—identifies Confucianism's negative attitude towards the merchant class as a sufficient impediment to successful economic development, and an important driver of Chinese state policy that was antithetical towards commerce. If Rowe (1993)'s documentation of explicitly market-oriented policies implemented by Qing officials did not manage to sweep away such outdated Weberian tropes, certainly changes in the current economic landscape serve to refute these long-held views: "Successful development in East Asia, especially in places under the influence of Chinese culture, such as Hong Kong, Singapore, and Taiwan, surprised many observers. During the 1950s and 1960s, development experts were pessimistic about the economic future of these areas; sociologists, under Weber's influence, expected development to occur only with the import of Western 'Protestant' values and the removal of 'traditional' cultural obstructions to development; and sinologists continued to discuss Confucianism as a factor in China's failure to change and modernize in recent centuries" (Jochim 1992:137). Nonetheless, the Weberian viewpoint remains, as does the antiquated but still influential "oriental despot" concept advanced by Weber and Wittfogel (1957), or Fairbank (1969)'s more-recent "foreign impact, Chinese reaction" thesis driving an image of a static Chinese society and economy that was only spurred into (muted, unsuccessful) dynamism after its interaction with western powers.

Chang (1962)'s study on landed elites, however, indicates economic interests trumped some of Confucianism's anti-merchant themes, given that landlords during the Ming and Qing earned up to twenty per cent of income from commercial activities, signifying a declining antagonism towards commerce than might have previously existed. Metzger (1966) also stresses the early Qing government was not particularly "anti-commerce" in its policies. His study of archival Qing records show officials were clearly aware that promotion of commercial activity was important, as it generated tax revenue: "[T]here was frequent official concern about retaining a margin of profit for the merchants (indeed there was an old principle that a 10% profit was moral). This concern must have been particularly alive in the lower Yangtze, where, as the remarks of Hsu Kuangch'i, Pao Shih-ch'en, and others show, it was widely recognized that commerce was the basis of the tax-paying capacities of prefectures such as Soochow and Sungkiang. If cotton and silk cloth could not be successfully marketed there, both the *ti-ting* and the grain tribute were endangered. In the salt monopoly also, although policy varied from zone to zone, there was widespread official recognition of the dependence on merchant capital, which on the whole could most definitely not be coercively enlisted. The pervasive worry was that '*shangjen pu ch'ien* (merchants would not come forward).' If salt officials brought about this unfortunate situation, they were to be fined a year's salary when the cause was their inefficiency and demoted by one *chi* (sub-grade) and transferred to another post when the cause was their oppressing and squeezing of the salt merchants. ...Besides solicitude over Yangtze commerce and salt investments, many officials realized that customs revenue depended partly on their not harassing merchants and laid particular stress on the smooth maintenance of the grain trade" (Metzger 1966: 4).

This theme painting many of the institutions of the early and mid-Qing as capable and effective appears frequently in the literature. For instance, in regard to the role of the administrative and bureaucratic capacity, Wang & Adams (2011) argue that the Qing rulers, as foreign rulers of a nomadic Manchu tribal origin viewed as distinct from the majority of ethnic Chinese, relied on differing sets of complex bureaucratic strategies to maintain control over the vast Chinese empire. These strategies depended on the installation of a powerful administrative state apparatus, quite different in nature from the more

decentralised power structure the Manchus had traditionally employed during their prior periods of nomadic self-rule. Such strategies included using multiple layers of officials with differing interests to collect and monitor tax the taxation of salt monopolies and textile commerce and otherwise attempt to overcome inherent principal-agent problems between the ruling Manchu elite and the more entrenched Chinese local level bureaucracy. Thus, imply Wang & Adams, at least early in its rule, from the standpoint of bureaucratic and administrative capacity, the Qing exhibited characteristics of a strong and sophisticated state capacity.

The same is suggested of early- through mid-Qing military capabilities. Miller (2000: 22-23) notes that at the height of Qing rule, the state possessed military power indicative of classic monopoly on coercive force. The government controlled a standing army of over 200,000 elite troops and an additional 600,000 soldiers, forces sufficient to not only quickly quell any rebellions but also to expand Qing territory to the south by the pacification of Tibet as a vassal state, as well as soundly push back military incursions from the northern Mongolian empire. Overall, the Qing state is depicted as functioning quite effectively and efficiently, with small tax receipts apparently not an impediment. Wang (1973), based on archival imperial records, gives a detailed account of the system of land taxation that provided the great majority of incoming revenues, supplemented by taxes on state-monopolised commodities (primarily salt, alcohol and tobacco), that proved sufficient to support the expenditure needs of the Qing state apparatus up through the mid-nineteenth century.

3.1.2.2. Domestic Institutional Environment: Declining Quality Starting in Late-Qing

Quite conversely, however, areas of institutional strength of the Qing state at earlier periods are identified in the traditional mainstream literature as areas of weakness starting in the late-Qing. Indeed, the mainstream view identifies a variety of ways in which the domestic state displayed weak state capacity starting with late-Qing, with a multitude of causes given for this weakness. To begin with, the late Qing state is characterised as being too small in scale and having access over too little fiscal resources. Kiser & Tong (1992:310-312) focus on the weak fiscal base of the Qing—as a percentage of aggregate agricultural output, they find tax receipts fell from approximately ten per cent under the Ming, to only two per cent by the end of the Qing, with total output remaining more or less stable. Thus, it is argued, the Qing state lacked fiscal resources to conduct much of the basic, fundamental roles of effective governing, including maintaining sufficient military defence of the country from internal and external threats. Kuhn (1970) provides a description of the beginning of the weakening of the military capacity of the Qing state with the success of the White Lotus Rebellion forced the empire in the early nineteenth century to turn to support from local elites to raise sufficient monies and militia support to finally quell the uprising. The Qing state's lack of capacity to deal with military issues was further proved in relation to subsequent interactions with western powers, as losses to the British and French in the 1840s soon proved. This was then followed by the inability of the Qing to put down the Taiping Rebellion, furthering the need for the central state to cede more power to the local elites in return for resources to fight the uprisings, leading to a weakened central state (Kuhn 1986). As local elites gain in power, they were able to effectively capture more tax revenues, leading to a cycle of continuing underfunding of the central state that became ever more reliant on the local powers.

Further, areas of administrative capacity cited as a strength of the early-Qing state—for example, China's traditional civil service examination system and attendant official appointment methodology, that, while imperfect, was designed to limit corruption and promote qualified candidates to officialdom—is frequently identified under the late-Qing as symbolic of an ineffective state. With increasing needs for revenue, it is claimed, the Qing

government turned away from a meritocratic based appointment system and towards the sale of official titles. Moreover, the civil service bureaucracy during this period is viewed as hopelessly anachronistic, unable to respond to changes occurring within society as well as the pressures imposed from external contact and threats from western powers, as the focus of the exams on Confucian thought and ancient literature seemed ever-more abstracted from the realities of modern global political expediencies (Elman 2000, 2013).

3.1.2.3. Domestic Institutional Environment: Chaos under the Beiyang

The traditional literature presents a similarly bleak view on the institutional capabilities of the early republican Beiyang government. Issues with fiscal capacity are seen to continue from the end of the Qing into the start of the republic. Strauss (1997) notes that problems plaguing the late-Qing state in capturing tax revenues collected locally worsen during the Beiyang period, with provinces only beginning to remit local tax receipts to the central government in 1914, three years after the fall of the Qing government. However, the death of President Yuan Shikai saw an end to tax receipts submitted to the capital, becoming completely dependent on the small excess of salt and customs revenues owed to foreign creditors, as well as additional substantial debt financing, to continue its existence. Strauss cites the inability of the Beiyang regime to induce provincial officials to remit taxes to the central government as indicative of low state capacity and weak institutions. Similarly, van de Ven (1997) argues that the development of the so-called warlord era is directly due to the fact that the Beiyang central government had fewer financial resources than many of the provincial governments whose leadership was controlled by local military leaders.

The overall state structure, of an authoritarian, non-representative military-controlled government, is also viewed as contributing to the weak institutional environment, especially in regard to protection of private property rights on private actors. After the overthrow of the Qing, for a brief moment the country was ruled by an elected representative government structure under the moniker the Republic of China; while the moniker remained, and hence the term "republican China" utilised to distinguish the change from authoritarian imperial rule, the subsequent seizure of the presidency by Yuan Shikai in late 1911, and successive dissolution of the National Assembly and provincial assemblies created once again an authoritarian state structure. After Yuan's death, the National Assembly was reconstituted in the 1920s, but its membership was primarily determined by the relative power of differing factions of local military leaders, or warlords, with multiple constitutions continuously drafted designed to legitimise their rule (Ch'ien 1950: 69-75).

Perhaps the most significant and defining feature of the Beiyang period identified in much of the literature as an emblematic and contributing factor of the period's low state capacity and overall poor institutional environment was the high degree of social disorder, symbolised by the state's lack of ability to maintain a monopoly on violence. Works by Sheridan (1966, 1975), Ch'en (1968), and Ch'i (1976) in particular provide extensive detail on the warlord era. In the context of early republican China, warlords were competing local military leaders who used their armies to secure control over geographic areas that could be as large as provinces. Most of the period was characterised by military skirmishes between these leaders as they each sought to expand their power bases. The scale of the fighting was considerable; as Ch'en (1968: 563) relays, "In a period of merely 16 years (1912-28), over 1300 warlords had fought more than 140 provincial and interprovincial wars." Most of the literature sees the activities of these warlords and associated civil strife as contributing to poor economic growth, with Li (1991:97) noting that an optimistic view of republican-era economic growth "is difficult to reconcile with the record of warlordism, banditry, famine, and migration" that dominated the era.

Further, the chaos created by political and social strife is generally viewed as undermining attempts to construct a more effective bureaucratic structure. While the state apparatus grew substantially in size and new bureaucratic departments designed to facilitate the state building process were created, most lacked sufficient efficacy to implement policy goals. Strauss (1997:333) argues that under late-Qing and Republican governments, "central state capacity was extremely limited with respect to the key issues of taxation and personnel, and the project of building civilian institutions was consistently undercut by the twin phenomenon of internal division and external military pressure." Strauss also specifically cites an inability of the early republican state to replace the older civil service system based on traditional Confucian-thought with a modern and effective civil service: "Although all Republican regimes repeatedly professed their desire to recruit talent through the institution of modern civil service examinations to create a technically competent and proactive government, the short-term pressures to provide patronage and buy off recalcitrant subordinates and would-be allies repeatedly stymied the re-institutionalization of norms of objectivity and impartiality, however attractive they remained in principle" (334).

3.1.2.4. Domestic Institutional Environment: Guomintang—Increasing Authoritarianism

The ascension of the Guomintang did not substantially alter many of the institutional and state capacity characteristics from the Beiyang era. To begin with, the structure of the state remained that of an authoritarian military dictatorship. Eastman (1974), Coble (1980), and Fung (2000), for instance, advance the concept of a relatively autonomous authoritarian domestic state that could unilaterally take actions to progress the interests of powerful state actors, frequently at the expense of private actors, even those possessing considerable economic import. In this regard, Coble systematically outlines a plethora of examples to support his argument that urban commercial elites proved unable to prevent the domestic state from consistently violating their interests and private property rights, let alone effectively shape government policy-making processes. As Fung states, "A dictatorship tolerates no opposition, guarantees no rights, curbs civil liberties, silences its critics, and relies on coercion to impose its will on the populace. The GMD dictatorship was no exception" (43). Wakeman (1997), following upon earlier, similar depictions of the Guomintang state as exemplifying fascist tendencies (Tien 1972; Eastman 1974, 1984b), characterises the Guomintang as embodying a kind of "Confucian Fascism." His research describes the operations of several fascist-style organisations, including the Lixingshe Society, the Fuxingshe Society and the Lanyishe Society, all designed to enforce the power of the Guomintang Party and intimidate those outside the party structure who sought to oppose its single-party rule. Contemporaneous critiques depict the military's dominance over the political system, with an editorial in the *Jen Min Jih Pao* (1931: 21) opining, "in all civilised countries the military in active service are subordinate to the civilian authorities. No military officer may interfere with politics lest the Army should become a menace instead of a support to the State. China again seems to be the only exception to the rule. It is now the most militaristic country in the world. It is the only country where the democratic forces are without any protection, are subject to arbitrary persecution. One of the first essentials is therefore the separation of military power from political authority. Our generals must choose whether to remain plain military commanders or plain Mr. So-and-so. Any general on accepting political office must relinquish his military affiliations."

Beyond issues of state structure, much of the mainstream assessment consistently presents the bureaucratic capacity of the Guomintang republican state as relatively weak. Similar to the previous two regimes of the late-Qing and the Beiyang, the Guomintang government's continual fiscal shortfalls were viewed as debilitating. Paauw (1952) chronicles the Guomintang's continual budgetary issues, as continual fiscal shortfalls were forced to be covered by huge flotations of high interest rate government debt issuances. The majority of

government spending was devoted to military expenditures (Paauw 1952, Young 1971, Feuerwerker 1983). As under the Beiyang period, the Guomintang central government had but *de facto* control over but a fraction of the entire country, exercising weak authority outside of a small area close to the capital, exhibiting sustained difficulty to exercise a monopoly on force—characteristics exemplifying those of the classic weak-capacity state. Nonstate actors such as local warlords, Communist rebels, and Japanese military forces all controlled parts of the country, with the government unable to prevent military battles and destruction from taking place by these nonstate forces. The impact of this continuing civil strife is also viewed as affecting effective implementation of desired policies by the Guomintang state, such as policies that would have helped entrepreneurs; according to Wright (1991: 670), "Within China, residual warlordism and Japanese aggression prevented the government extending its sovereignty across the whole country, while its weak hold over the rural sector forced it into dependence on revenues from modern industry and trade. The government wanted to help the capitalists, but in the end did not have the power to do so." Social strife also included large increases in organised criminal activity, especially given that the weakness of the Guomintang state led the party to frequently enlisted these criminal organisations to assist the party in defeating its political or military enemies, such as communists or the Japanese. Within the city of Shanghai, for instance, the level of social strife was high, evidenced by numerous incidences of murders, extortions and corruption (Martin 1989, 1991, 1995; Arbor 1995; Hershatter 1999; Wakeman 1995a).

Paauw (1952: 8) is particularly critical of the Ministry of Finance under the Guomintang for its inability to act independently from Party dictates: "funds appropriated for one purpose were, at the volition of the Ministry of Finance, used for other purposes. This type of tight Party control of expenditures was symptomatic of the general domination of political and economic life by the small clique of Kuomintang elite." Eastman (1984a: 225), in his study of the government during the Second Sino-Japanese War, is equally critical of the Guomintang administrative state, emphasising the prevalence of fractionalisation, "corruption and ineffectiveness... and pervasive incompetence" that characterised state institutions. Eastman (1991: 130-131) later finds that even modest successes such as the migration of physical capital out of the Yangzi into the interior after the start the Japanese offensive on Shanghai in August 1937 was defined by incompetence and corruption; ultimately, "instead of standing as a monument to Chinese patriotism, the industrial migration betrayed a distressing degree of self-serving," as it was conducted to benefit a few well-connected industrialists at the expense of the majority of private industrialists, who chose instead the shelter provided by the International Settlement when they were able. Myers (2000: 60) recognises the increasing state planning structures instituted by the Guomintang, but finds them lacking competency, calling, for instance, the major economic planning apparatus created in 1935, the National Resources Commission, "a bureaucratic monstrosity of planners and technicians who wasted vast resources building inefficient state-owned and state-managed factories." For Sheehan (2010: 197), China's weak bureaucratic capacity was reflected in its inability to utilise tariffs as an effective nonviolent strategy against Japanese aggression, with "poor implementation and enforcement" leading to social dissatisfaction at the weakness of government response.

Overall, the general depiction in the literature suggest an institutional weakness reflected by the degree of an overall lack of respect for protection on private property rights by the government, combined with interference in the economy. Hou.(1965), in compiling detailed statistics regarding the level, composition and determinants of foreign direct investment in late-19th century China, argues that the observed inconsistent levels of foreign investment into China was partly attributable to a poor government policy environment that was inimical to private business, as well as overall institutional weaknesses, especially in regard to government interference in the economic and outright corruption, that led much of foreign borrowing to be funnelled into non-productive assets (30, 227-228).

Feurerwerker (1958) describes the ways in which government officials under the late-Qing and early republican era utilised the *guandu shangban* system to attempt to control private enterprise activities in ways that benefited state actors at the expense of merchants and private investors. Mann (1984: 615; 630) is particularly critical of the state's role in suppressing entrepreneurial activity during both the Beiyang and Guomindang periods, arguing that "Republican state policy imposed new critical constraints on the entrepreneurial activities... Beginning as early as 1914 with the Yuan Shikai regime in Beijing, and continuing through the Nanjing government of Jiang Jieshi, the state raised the cost of brokerage licenses, stiffened procedures for checking and renewing licenses, and allowed local governments to increase revenues from brokerage taxes by farming out the tax quotas at auction. These programs to tax and regulate imposed significant new limits on the brokers' abilities to engage in entrepreneurial activities. County-level magistrates eager for revenue invoked state policies to fill their treasuries and also to line their pockets."

Bian (2005b: 101-102) makes note of the extreme regulation to which private and state-owned firms were subject, citing for example detailed directives to ordinance enterprises regarding intricate accounting methodologies produced by the Bureau of Ordnance, a division under the Ministry of Military Administration. Outright nationalisation of many private businesses also occurred, including major domestic banks and some of the largest manufacturing concerns. Private ventures that did not become nationalised were coerced into holding government debt or providing compulsory donations, such as in the case of Rong Zongjing, who in 1927 was forced in his role as head of the Chinese Cotton Mill Owners Association to buy 500,000 yuan of unwanted government bonds. The contemporaneous observation by Issacs (1938: 209) is indicative of the impact that the intrusive state played in affecting business activity: "The plight of the Chinese merchant in and about Shanghai is pitiable. At the mercy of General Chiang Kai-Shek's dictatorship, the merchants do not know what the next day will bring—confiscations, compulsory loans, exile, or possible execution." Both Eastman (1974: 239-243) and Coble (1980: 32-35; 268-269) echo this sentiment of the Guomindang state as an active and destructively expropriative force on the private property rights of the business community.

3.1.3. Domestic Institutional Environment: Revisionist Views

While much of the literature paints a domestic institutional environment defined by weak state capacity, generating a poor institutional environment, with weak protections on private property rights, an important set of contributions by revisionist scholars offers a more nuanced—and sometimes starkly differing—view of the domestic institutional landscape. While much of this revisionist scholarship focuses on issues pertaining to bureaucratic state capacity, some considers more fundamental issues regarding state structure and its impact on the nature of state-private relations, with much of the attention skewed towards the Guomindang period. Chang (1979, 1985) pushes back against the some of the mainstream depictions of the Guomindang regime as being ostensibly fascist in nature, as argues Eastman (1974) later Wakeman (1997). Viewing such depictions as problematically Marxist in origin and employed too readily as an "attempt to impart meaning to the obscure sequence of events by exploiting project terms: consigning the sequence to some familiar category." In this regard, referring to the Guomindang state as "fascist" obscures more than it illuminates: "Thus a fragmentary collection of behaviors and events seems to take on substance... Such categories are familiar, and serve as mnemonic and didactic aids. They are conceptual boxes into which otherwise disjointed sequences can be stored for recall and interpretive conveniences. These mnemonic and didactic conveniences often fail, however, to provide credible explanatory yield and theoretic purchase on events. They merely give the illusion of understanding" (Chang 1985: 6).

Fewsmith (1984, 1985) represents an early challenge to the mainstream view of an authoritarian Guomintang state that monolithically dominated civil society unchallenged, typically advanced by scholars such as Eastman (1974, 1984b), Coble (1980), and Fung (2000). Alternatively, Fewsmith argues a more accurate interpretation of the domestic state's relationship with private economic actors occurred along corporatist lines, as certain privileged commercial elites were granted limited access to policy decision-making in return for their support of the political regime. Although presenting a compelling theoretical argument, Fewsmith's evidence of the 1930 reorganisation of the Shanghai Chamber of Commerce has been criticised for both its longitudinal and temporal paucity (Eastman 1984b). Another critique of the mainstream Eastman and Coble depiction is provided by Geisert (1982, 1984, 1986), who characterises the authoritarian regime as possessing considerably less autonomy in terms of control over societal groups, suggesting instead a more "pluralistic" model of state-civil relations, where numerous private actor interest groups were able to exert influence on state decision-making authority and policy construction in ways to advance their private interests. Thus, argues Geisert, albeit lacking consistent access and influence over state policy-making, economically powerful or coordinated nonstate actors could occasionally influence state actor behaviour and enforce limited accountability upon state actors. Kubo (1981) Similarly, in his study of cotton producers and textile manufacturers, Bush (1982) cites instances of powerful producers utilising personal relationships to affect official policy decisions in their favour, which he also claims supports a more pluralistic conception of the Guomintang state. In response, Eastman (1974) stresses in arguing that the power dynamics of the Guomintang authoritarian state can be thought of as one characterised by autonomy does not require a total lack of influences exerted on state decision-makers by nonstate actors; importantly, however, as generally Geisert (1984) concedes, such influences were of a personalised, individualistic and irregular nature, implying "those influences were insufficient to impose accountability upon the regime or to prevent those within the regime from ruling with the primary intent of enhancing their power, prestige, and wealth."

Other significant areas of revisionist scholarship focus on domestic state bureaucratic capacity, claiming the mainstream literature's depictions of an ineffectual and corrupt state bureaucracy seriously mischaracterise its nature. To begin with, the size of the domestic state apparatus grew considerably over the course of the time period, a signal for many indicative of increasing state capacity (Bian 2005a). However, whether such increases in the size of government implied increasing capacity, potential for greater bureaucratic inefficiency, or an ability for state actors to expropriate private economic gains, remains an open question in the literature. For many, however, the increase in the state bureaucracy was accompanied by an increase in the effectiveness of domestic government bureaucratic capacity, at least for part of the time frame. Li (2007) concentrates on the Qing government's ability to respond to food crises, with a sophisticated famine relief avoidance planning and food distribution system, that existed well through the end its imperial rule.

Breard (2006) focusses on the impacts of the Self-Strengthening Movement, which the literature has traditionally viewed as a failure given the fact that the Qing state failed to industrialise or militarise as effectively as its neighbour Japan. For Breard, however, the movement succeeded in increasing the degree of human capital within the government bureaucratic apparatus via its programmes sending researchers to study abroad, delivering long-term effects. In contrast to Strauss (1997), Breard also sees significant improvements in organised bureaucratic capability during the Qing. For instance, she emphasises the depth of institutional reform that took place in the government in regard to improving the collection, record-keeping, and utilisation of statistical data. New bureaucratic organisations within the government were created that, she argues, improved the ability of the state to analyse data and then formulate policy based on these data, as well as monitor

the success of implemented policies and adjust accordingly: "The Statistical Bureau was created in August 1907, followed two months later by the establishment of Statistical Offices at all the Ministries in the capital, and Information Bureaus at the provincial level. The *Commission to Draw up Regulations*, in a memorial to the throne, described the mission of the Statistical Bureau, responsible for centralizing statistical information communicated by the statistical offices of the Ministries and the provincial bureaus: As to statistics, they are a method with which to examine our fiscal administration and fathom our national strength so that comparisons can be made and appropriate policies developed. Therefore, the state of the Empire has to be analysed internally, and the competition of the world has to be observed externally. The Boards and Ministries at the Capital and the provinces shall establish detailed tables on their domain of activity and submit these regularly for consultation. Our office will synthesize all the tables for the purpose of estimation of the actual state of the Empire" (Breard 2006: 7).

A domestic state considerably more bureaucratically capable than typically portrayed in the mainstream literature is also suggested by numerous other scholars. Recent research produced by Chang (2013), van de Ven (2014), and Boecking (2017) on the Imperial Maritime Customs Service (which after the fall of the Qing was subsequently renamed the Chinese Maritime Customs Service), are representative of some of the more enthusiastic efforts in the revisionist literature. Certainly, by seeming all measures and descriptions, the Maritime Customs Service consistently displayed a relatively high level of competence in regard to its primary roles in assessing, collecting and allocating customs revenue, and was able to do so within the constructs of highly chaotic political environments, while mostly successfully deflecting pressures applied by competing government factions seeking control over customs receipts. Su & Barber (1936: 115) reflect this view when stating, "The customs service has been one of the few stable factors in a land retarded by foreign interference, administrative changes, and chaotic military rule. Reaching into all 21 provinces, the customs have provided a dependable source of revenue for many foreign loans and indemnity obligations secured on these returns and left a substantial surplus for the ordinary necessities of government." Chang focuses on the Customs Service from the framework of the late Qing state, arguing that Qing Court officials purposely delegated authority from the centre to indirectly-controlled governor-generals, viewing the Maritime Customs as a form of a governor-general decentralised power structure (12). For Chang, the autonomy of the Maritime Customs, rather than a sign of weakness of the central state, was reflective of a conscious attempt by the those within the Court to create decentralised and flexible structures such as governor-generals and the Maritime Customs that could undertake modernisation strategies outside of, and thereby preserving, the traditional state bureaucracy. The success of the Maritime Customs under the late-Qing, therefore, should be viewed as a success of Qing administrative capacity.

For van de Ven, the Customs Service exemplifies an effective, capable and efficient domestic state bureaucratic organisation, and one that played a particularly positive role in regard to the fiscal health of the state, providing a steady stream of revenue to various central domestic governments from the late 1860s through the end of 1941. van de Ven finds the Customs Service to have exhibited its most sweeping role in this regard during the Beiyang period, when it assumed responsibility over not only revenue collection but also general oversight of all central government bond issuances. While such direct control was circumscribed with the ascendancy of the Guomindang after 1927, the import of the Service remained, given it provided over half of government revenues. Boecking's focus is on the narrower time frame of the Customs Service administration under the Guomindang government, during which the domestic government reclaimed much of the control over the Service, reducing in part its former bureaucratic autonomy it exercised during the late-Qing and Beiyang periods. Overall, however, Boecking arrives at similar conclusions to those of van de Ven, viewing the Service's provision of vital revenue via tariff collection as

indicative of strong domestic bureaucratic state capacity. To begin with, he characterises the Guomintang's successful negotiations with foreign treaty powers in restoring the power to set tariff rates as "the Nationalist government's first major foreign-policy achievement" (62). It is in this regard that Boecking's approach is clearly revisionist, arguing in his introduction that his work "analyzes the relationship between the Maritime Customs and the Guomintang only to the extent that it is relevant to a revisionist argument about the success of Nationalist tariff policy in terms of revenue extraction and midterm sustainability" (19). In particular, Boecking actively seeks to challenge the mainstream view that blames the Guomintang's loss to Communist rebels in the Chinese Civil War on bureaucratic corruption and incompetence, arguing instead that it was only due to the fall of the Nanjing government to the Japanese military in 1937, with the resultant loss of access to Maritime Customs tariff revenues, that forced the later Guomintang government to turn to the kind of "rapacious" tax extraction policies so heavily criticised by Paauw (1952), Eastman (1974), Coble (1980), and others.

The arguments by Chang, van de Ven, Boecking, and others, including Strauss (1998) cited below, claiming the Maritime Customs Service provides convincing evidence of strong domestic state capacity is somewhat circumscribed, however, by the fact that albeit technically a domestic government organisation under the purview of the Chinese authorities, the Customs Service was thoroughly unique in that it operated with a large degree of autonomy from direct control by domestic state officials, with the Customs Service senior management headed primarily by western diplomats and personnel throughout its existence (up until its seizure by the Japanese military in 1941). While Chang provides an important refocus of research on the Customs Service onto the role of the organisation's Chinese staff, and the essential and significant ways in which they helped to shape the direction of the Service, especially in its later years, that the leadership of the Customs Service remained in foreign control through the end of its effective organisational independence in 1941 attests to its unique bureaucratic position as at most only a quasi-domestic Chinese state organisation.

Beyond these specific studies on the Maritime Customs Service, other research similarly paints a considerably more positive picture on the fiscal condition of the domestic Guomintang state. Young (1971) and Boecking (2011b, 2017) describe the efforts of the domestic state in greatly expanding its fiscal capacity, especially under the Guomintang, as well as in terms of the creation of new departments dedicated to raising capital for the central government by way of issuing of domestic government bonds. While not ostensibly revisionist in nature, similar descriptions of previous government efforts under the Qing and Beiyang period by Qian (1955) and Pan (2007, 2008) emphasise the considerable bureaucratic machinery created that supported this new source of revenue that proved vital to the fiscal health of domestic central governments. Much of the growth of domestic government bond issuance machinery was accompanied by growth in the financial system that supported the bonds and associated bond markets, and part of the revisionist literature focuses on the growth of this sector as indicative of the domestic state's institutional health. Ma (2012:15) for instance claims that "The success of the [Guomintang Ministry of Finance-directed] 1935 monetary reform... was a powerful testimonial to the remarkable progress achieved in the Chinese monetary and banking system in during the 1920s and 1930s."

Strauss (1998), while in previous work critical of the bureaucratic capacity of the late-Qing and Beiyang governments, also provides a strongly revisionist presentation of Guomintang-period state capacity. While conceding that important aspects of domestic state capacity under the Guomintang were poor, Strauss identifies in particular three national-level Guomintang administrative units—the Sino-Foreign Salt Inspectorate (which similar to the Maritime Customs Service, operated under foreign management), the Ministry of Finance, and the Ministry of Foreign Affairs—as exhibiting relatively high

degrees of state capacity, as evidenced by their effectiveness in implementing policy goals, doing so by engaging in administrative strategies such as a focus on impersonal norms, objective goal orientation, and organisational insulation. In support of Strauss' claims regarding the Ministry of Foreign Affairs, work by Thai (2015:26-28) finds that by the 1930s the Ministry was able to effectively utilise the organs of international law to present sophisticated legal reasoning to substantiate China's assertions of maritime territorial rights, with such efforts achieving at least partial success in obliging the acceptance from various nations, including the United States, of Chinese claims of sovereign rights within a twelve-mile zone from its coastline.

Other revisionist research focuses directly on the role of the state in the economic sphere, suggesting that the state in this regard acted with much greater capability and caused much less damage than often suggested within the mainstream literature. Myers (1982: 280) describes policies under the Qing that supported the deepening of market processes: "households increasingly contracted with each other to exchange resources of all kinds of procedures based on what I have termed customary law, [and] the imperial state looked upon this activity with approval—even consenting to adjudicate violations of contracts between private parties—these private contracts served as an effective device for greatly reducing transactions costs." Bush (1982) finds the claims made by Coble (1980) and others citing examples of expropriatory behaviours on the part of Guomintang state actors, such as coercive techniques to force private agents to undertake bond purchases, as "greatly exaggerated" in terms of their frequency or consequence. Chui (2008), meanwhile, argues the government programs such as the broker entitlement system (官牙制), or some of the limitations placed on the price control system, provide evidence that the government was not completely disinterested in protecting merchants' property rights. Especially during the Guomintang era, entire governmental ministries devoted to economic planning focussed on implementing economic growth policies, such as encouraging industrial innovation, were created and expanded. Bian (2005a: 37) claims that a sophisticated bureaucracy devoted to centralised economic planning developed under the Guomintang government, especially after the start of the 1937 phase of the Second Sino-Japanese War. Ma (2016: 12-13) argues that the development of domestic bond markets during the Guomintang was due to significant improvements in institutional commitment mechanisms that helped convince investors the safety of government bonds, and leading to a sea change in terms of the ability of the state to raise capital from financial markets: "This marked perhaps the first time in Chinese history that the Chinese government could tap into the wealth of Chinese elites or even average people for borrowing without the usual coercion and predation."

Finally, while the majority of the literature finds the domestic state's inability to maintain a monopoly on coercive force within its borders serves as an indictment on the level of domestic state capacity, and evidence of a poor institutional environment, some argue the social strife facing the state provided several benefits that ultimately improved state capacity and institutional strength. These arguments follow from the strain within the state capacity literature that views the role of externally-imposed violence in the form of war as one of the primary drivers of more efficient resource mobilisation leading to an increase in state capacity. Thus, the development of Self-Strengthening Movement projects such as the Jiangnan Arsenal are frequently traced to early defeats to foreign powers, and further in providing inducements for state actors to increase industrialisation efforts, as well as the state's bureaucratic and fiscal capacity (van de Ven 1996, 1997). Others cite the importance of the constant military hostilities defining the republican period as vital in contributing to improvements in military capacity, as well as leading to state ownership of arms and munitions enterprises which further contributed to levels of industrialisation (Waldron 1991, 1993; Bian 2005b).

3.1.4. Domestic Institutional Environment: Contested Viewpoints

As the foregoing discussion has demonstrated, differing viewpoints and sources of evidence can be found throughout the literature regarding the nature of the late-Qing and republican domestic state capacity and institutional environments, with some indicating definitive strength, or undergoing a strengthening process, while other developments were concomitantly taking place that suggest a contrasting story.

While objective measures make clear the growth of the domestic state, with creation of new governmental departments, whether these factors led to positive outcomes in regard to stronger private property, contract or investor rights in ways that could encourage economic activity is contested. Researches by Paauw (1952), Eastman (1974, 1984a, 1991), Coble (1980), Feuerwerker (1983), and Myers (2000), amongst others, present convincing arguments indicating a weak domestic state institutional environment, lacking in state capacity with poor tax-raising ability and a deteriorating fiscal situation. Strauss (1998), Ma (2012), van de Ven (2014), and Boecking (2017), meanwhile, attempt to highlight examples of positive state capacity and effective institutions capable of implementing policy goals. Meanwhile, works such as Kubo (1981), Fewsmith (1985), Bian (2005a, 2005b) and Ma (2016) provide arguments supportive of both viewpoints—a strengthening of bureaucratic capacity that in turn is seemingly utilised by the state to engage in a greater degree of expropriation and ultimate state control of private civil space.

Given such differing views of the domestic state presented in the literature, it is logical to ask, therefore, which viewpoint is correct—do the analyses by pessimists or by optimists more accurately reflect the domestic institutional environment? Confusingly, there appears to exist strong evidences supportive of both viewpoints. Yet this seeming inconsistency underscores the fact that concepts such as "institutional quality" and "private property rights institutions" are inherently complex and multidimensional. Thus, different scholars have been able to identify different evidences that support particular viewpoints as to the nature of China's pre-war domestic institutional environment as one of strength or weakness, leading to significantly differing portrayals within the literature. For instance, at the same time that we observe the expanding role of the domestic state across society and within the economic sphere, and a growing scope and capacity of some state bureaucratic systems and formal legal institutions—all of which could in theory help to strengthen some important features of private property rights mechanisms—we can also observe examples of the state use its power to extract economic assets from private economic actors, as well as find other forms of state capacity disintegrating, especially those designed to enforce the internal monopoly over coercive force, thus unable to prevent nonstate internal and external agents from expropriating or destroying private economic agents' property.

Understanding such complexity, therefore, allows us to rationalise the seeming inconsistency between competing viewpoints of domestic private property rights institutions, both over time and within the same time frame, as multiple indicators of property rights protections—for example, the application of rule of law, expanded funding for the formal court system, effective administration of customs duties, private companies forcibly taken over by the state, private banks forced to purchase government bonds, destruction of economic assets by internal and external military clashes—simultaneously suggested differing and conflicting conclusions as to the overall nature of the domestic institutional environment.

Problematically, however, for all of the recent explicit focus in the literature on the impacts that the domestic Chinese institutional environment had on the period's realised economic outcomes, there still remains a relative lack of detailed analysis of the institutional environment as perceived by the relevant contemporaneous economic actors themselves. Further, and similarly problematic, while there exists an important debate regarding the strength of the domestic institutional environment over the late-Qing and republican time frame, nonetheless much of the related literature on differing aspects of the period's economic history far too readily ignores much of the complexity and nuances that drive this debate. Instead, it is frequently the case that this related literature simply begins the analysis based on a general implicit assumption, typically that suggested by the dominant viewpoint, of a late-imperial and republican China that was defined by weak domestic state capacity and a poor institutional environment with relatively poor private property rights protections. Subsequent analysis of economic outcomes or corporate and financial behaviours—such as the inability of republican China to exhibit sustained industrialisation, the inability to successfully incorporate foreign technology, or the scarcity of joint-stock enterprises—is then based upon such implicit and prior assumptions.

This is particularly true of the literature referring to the nature of corporate governance of Chinese firms (Kirby 1995, Bowen & Rose 1998, Koll 2000, Goetzmann & Koll 2005, Goetzmann *et al.* 2007, Liu 2010, Wang 2013), or the literature seeking to explain the economic impact of the domestic state's weak capacity (Congleton 2011, Ma 2013, Johnson & Koyama 2017, Koyama *et al.* 2018). Each of the latter papers, for instance, openly starts with the explicit supposition that the late-Qing state possessed weak state capacity and institutions, followed the exposition of a model that seeks to explain why states such as the late Qing might find it optimal to exhibit certain characteristics, as well as a discussion of the attendant problems resulting from such weakness in state capacity and poor institutions. However, serious epistemological dangers result from ascribing economic outcomes to institutional features, when much of those institutional features are themselves based on assumptions.

We seek to overcome these two problematic features of the literature. First, in looking to address the debate in the literature regarding the relative strength or weakness of the domestic institutional environment, we recognise from the onset that the reason the debate exists is an outcome of the inherent multidimensionality of institutional constructs that allow for conflicting and contrasting signals regarding their efficacy and ability to protect private property rights. Given that neither institutional quality nor private property rights are binary variables—neither simply "weak" or "strong"—we take an explicitly relativist approach in our analysis. As noted, Shanghai's unique institutional environment is particularly useful in this regard given that there were two simultaneously-operating parallel institutional environments, one domestic and one extraterritorial, that we can utilise in conducting a comparative analysis.

Second, in looking to establish a general understanding regarding the overall nature of domestic and extraterritorial institutional quality, we do so expressly from the perspective of the contemporaneous economic agents who acted within these institutional environments. Our argument is that given the complexity of the institutional environment, attempts to discern its overall strength is likely difficult if relying solely on present-day interpretations of historical evidences, such as trying to judge the severity and importance of policies that might be expected to either increase or violate protections on private property rights. Rather, it becomes more appropriate to attempt to identify the way in which contemporaneous economic actors perceived the strength and quality of institutional protections on private property rights. Conclusions as to the impacts of differing private property rights environments could then be drawn after establishing the contemporaneous perceived quality of these environments.

Part II.

China's Late-Imperial and Republican-Era Domestic Institutional Environment

Chapter Two emphasised the importance of state power in preventing Olson (1993)'s "roving bandits" from appropriating or destroying economic agents' private property. Yet, as Smith (1776) notes, a paradox arises—a state strong enough to protect economic agents' private property rights from non-state forces is also strong enough to itself violate those same agents' property rights; or, using the terminology of Frye & Shleifer (1997), to act as a "grabbing hand." Economic agents, recognising the power of the state to violate property rights and expropriate their ex-post output, under-invest in ex-ante costly efforts. This leads to the underproduction of economic output, and underdeveloped financial markets. However, the state can overcome this paradox by creating effective credible commitment mechanisms by binding itself to honour promises not to violate agents' private property rights.

In Part II, we attempt to move from the theoretical to the specific by taking a detailed economic historical analysis of domestic state actions that contributed to the formation of economic agents' perceptions of institutional protections on property and contract rights as effective and commitment devices credible, which defined the state-private agent relationship in ways that either allowed private economic activity to flourish, or to be constricted by government action.

Specifically, the material comprising Part II is designed to present a detailed qualitative analysis of the domestic institutional environment, based on contemporaneous documents, and supplemented by the rich assemblage from the economic history literature that helps shape the on-going debate on late-imperial and republican domestic institutions. Chapters Four, Five and Six, in successive order, discuss the primary facets of state capacity in regard to creating credible commitment mechanisms and institutional protections on private property and contracts, that comprise (i) the nature of effective political, legal, and judicial systems which impact the state's "reaching hand" and prevent government expropriation of individual private property; (ii) the efficacy of state bureaucratic capacity that defines the ability of state actors to enforce their desired policies, focussing in particular on the design and implementation of fiscal policies; and (iii) the ability of the state to enforce a monopoly on internal violence, and the related impacts that prevalent and persistent social violence has on the ability of the domestic state to create credible commitment mechanisms to empower private economic actors.

In this regard, the theoretic concepts presented in Chapter Two associated with the Violence Trap (Cox et al. 2017) and our "low credibility trap" extension prove useful in analysing much of domestic Chinese state actors' behaviour. The analysis presented in Chapter Seven looks to synthesis the implications of these theoretical concepts and apply them to develop an understanding of the incentives and motivations behind the actions of private and state actors throughout the time period.

As domestic state capacity to deal with political strife and warfare fluctuated, and as the immediacy of existential threats fluctuated, the domestic state's actions signalling commitment to property rights protection—versus "grabbing hand" behaviour—also fluctuated. Moreover, the multidimensionality of institutional constructs means state policies affecting economic agents' perceptions of private property rights protections were frequently conflicting. Contradictory state actions that included economic policies such as taxation, regulations, or even expropriation of private assets, as well as policies shaping the openness of civil society such as educational policy, media censorship, shaped the complex nature of the determinants of domestic institutional quality.

Chapter Four.

State Capacity: Protecting Private Property and Contract Rights via Effective Institutions — Political and Legal Systems

The political economics concept of "state capacity" refers to the ability for state actors to set and accomplish policy goals, including the creation and maintenance of measures that serve as credible commitment mechanisms that in large part determine the nature of the institutional environment which in turn accords private property and contract rights protections. The following chapter presents a qualitative consideration of the late-imperial and republican domestic institutional quality, using a state capacity approach, focussing on the way in which the state structure and legal systems operated to impact contemporaneous actors' perceptions of the strength of the domestic institutional environment.

4.1. Credible Commitment Mechanisms: State Structure

As presented in Chapter Two, because the power of the state apparatus is such so as to allow state actors to renege on prior promises to not violate private property rights, credible commitment mechanisms that bind governments in ways that raise the costs of renegeing are important because they serve to increase the perception amongst private economic actors as to the security of their property rights, thus incentivising costly private investment and economic production. Concrete examples of credible commitment mechanisms can take on many forms, from written constitutions defining specific limits—which by themselves can prove relatively weak, given they are but words on pieces of paper—to ceding power to other bodies that would require force or other costly measures to retake such power, an example of which was discussed by North & Weingast (1989), when in the aftermath of the Glorious Revolution the monarchy in Britain ceded fiscal authority solely to the Parliament.

Representative government structures that provide property owners with a voice in the governance process can help lead to greater protections on property (although tyranny of a privileged, propertied minority remains a danger), especially when representatives' authority is sufficient to check executive power. Representative governance that is supported by free and open elections can make it costly for state actors to deviate from prior-agreed to protections on property rights, given the electorate can hold them accountable (although tyranny of the majority at the expense of property holders remains a danger), thus helping to make state actors' commitments more credible.

Overall, we argue that consideration of the late-Qing and republican period provides little in the way of evidence of effective credible commitment mechanisms employed in terms of state structure. Throughout the entirety of the period, notwithstanding the "republican" epithet employed in the post-imperial era, the domestic state structure remained an authoritarian regime. At no time were spending and revenue functions effectively separated from the executive power, except, as to be discussed, in limited instances such as by way of the Chinese Maritime Customs, a foreign-administered institution over which the domestic state executive branch continually sought to retake control. While at various times legislative bodies existed, their role was much more "advisory" than providing property owners or electors with an actual role in the decision-making process or its oversight on the implementation of taxation and other commercial policies. Further, while the formal structure of the legal system continually developed over the course of the period, at no time did the judiciary provide actual independent authority over executive state power, therefore lacking ability to provide limits on potentially expropriative or extra-legal behaviour of state actors. In sum, therefore, it appears difficult to identify the existence of many credible commitment institutional devices provided by the state's political structure.

Discussions of state capacity and state actors admittedly represent a gross oversimplification of the complexity of actual governance situations; this is particularly true in a country as large as China. The "state" of late-imperial and republican China was by no means a monolithic structure; comprised of many thousands of individual actors, each was imbued by the system with varying degrees of autonomy over their action choice sets. The conditions defining these actors and their choice sets changed considerably over time; that was true not only as differing regimes came to power, but even within the same general regime, as different power dynamics emerged. Further, concepts of state capacity can falsely imply a monolithic degree of capacity, whereas in reality there can exist considerable variation amongst aspects of state capacity, such as tax collection, economic policy formation, or enforcing a monopoly of violence. Additionally, as Perry (1994) and Remick (2002) emphasise, regional variation matters, as state capacity and state-society relations are neither constant nor uniform within states at the national level. The degree to which regional variation in state capacity differed is particularly important given the lack of centralisation of political authority possessed by Chinese national governments throughout our period of study.

Historiography of the Domestic Chinese State Structure

Administratively, the Qing state applied a four level hierarchy under the central government over the eighteen provinces comprising China proper: the provincial level *sheng* (省), followed by the circuit level *dao* (道), the prefecture level *fu* (府), and the county level *xian* (縣). At the *dao* level sat the *daotai* (道臺), and below them were the local magistrates in charge of *xian*. Throughout the Qing period, Shanghai was at the lowest administrative level and was a county reporting to *Songjiang fu* (松江府), *Susong Tai Dao* (蘇松太道), which in turn reported to Jiangsu Province. The local magistrate was the direct government interface with the public, serving as the local executive head, responsible for the maintenance of peace and order, also acting as the local judge, the prosecutor, and responsible for delegating authority of the collection of tax revenue (Wang 1890). Appointed by the emperor, the local magistrate was expected to serve for no more than three years before being transferred to other posts. In Shanghai, where the office of the *dao* was located, the *daotai* was in effect in direct control of the local magistrate, and was often referred to as the "Shanghai *daotai*" (Leung 1991).

The success of the Wuchang Uprising and subsequent Xinhai Revolution of 1911 brought about an end to the nearly three hundred-year reign of the Qing, and two thousand years of an imperial system of government for China. The seventeen provinces under control of supporters of the rebellion centred their new republican government in Nanjing, with legislative powers enshrined in a new constitution given to an indirectly-elected national body, and the executive branch led by a president, inaugurated to be Sun Zhongshan (Sun Yatsen). Early effectual weakness and inability to force complete capitulation on the part of the remaining provinces still loyal to the Qing Court led the new government to turn to Yuan Shikai, the Qing Prime Minister and military commander, to assume the country's presidency contingent upon a peaceful abdication by the Qing monarchy, which occurred in early 1912. Before transfer of power to a Yuan presidency, however, the provisional government ratified the Provisional Constitution in March of 1912, changing the government structure to a parliamentary form—its electorate still comprised of provincial legislatures or leadership—with executive control centred mostly with a prime-minister, and the president's role mostly titular. With Sun's Guomindang Party winning a majority in the first election in early 1913, it selected Song Jiaoren (宋教仁) Prime Minister-elect, and drafted a new constitution which was to further weaken the power of the president by making the prime minister responsible to parliament alone, and not the president.

Yuan's response to the parliament's actions was swift. With his power base comprised primarily of military commanders centred in the north of the country, Yuan moved the capital back to Beijing, leading to the formation of the so-called Beiyang government (北洋政府). The transference of power from Nanjing to Beijing also led to a substantial weakening of the power of the legislature. In March of 1913, Prime Minister-elect Song was assassinated, with most observers at the time understanding it to have been sanctioned, if not ordered, by Yuan (Spence 1990: 281). With little patience for dealing with attempted negotiations with other branches of government—as McNair (1930: 214) contends, "Yuan was the proponent of a centralized government with a powerful executive and a weak, or no, parliament"—Yuan demanded parliament change the new constitutional draft to give the president greater powers. After refusal on the part of the legislature, in November of 1913, with the backing of loyal military supporters, Yuan outlawed the Guomindang Party, had its members arrested, and ordered a restructuring of the legislature. Beholden to Yuan, a newly-constituted parliament ratified in 1914 the Constitutional Compact, which gave Yuan his desired power, with a weak legislature whose actions could be vetoed by the president; or as Hu (1917) describes, little more than a rubber stamp institution. However, Yuan ignored even this constitution and issued rulings in the absence of a parliament; by the next year, he advocated the "monarchical movement" that brought an end to the republic and Yuan declaring himself emperor, an experiment that ended quickly once Yuan died in office in 1916.

While Reid (1916:25) and others appear quick to absolve Yuan of responsibility for his assumption of the role of emperor, finding it was "in the misdeeds of his friends, who cast liberty to the winds, and grasped at glory, but [Yuan] has been made to suffer", it is clear the first years after the end of the authoritarian rule of the Qing monarchy brought about an authoritarian version of a so-called republican government. Whether emperor in name or not, Yuan used his control over the military to exert dictatorial power over the state apparatus. His reign was defined by an acute lack of rule of law, including political assassinations of opponents, such as Song, or Chen Qimei (陳其美) who had controlled Shanghai after the 1911 Xinhai Revolution (Chang & Chang 2010: 197); the execution of political enemies without trial; the removal of the elected governor of Hefei without due process; and entering into the 100 million *yuan* Reorganization Loan without the participation or approval of the legislature (Sheridan 1975: 49). Thus, the first attempts at republican governance were simply an extension of the lack of democratic accountability of the Qing rule. An authoritarian executive, with military power dominant to political control, are characteristics of "limited access" governments (North *et al.* 2009, Weingast 2010, Cox *et al.* 2017), and characteristics of the governance structure that repeated itself throughout the rest of the republican era.

The death of Yuan brought forth a series of new ascendants to the presidency, each with similar autocratic powers, but none strong enough to maintain control, as the country fell into the political disarray of the so-called warlord period, as local military commanders vied for power. The eventual end of the Beiyang regime was accomplished by violent overthrow by way of the Northern Expedition, a military campaign led by General Jiang Jieshi (Chang Kaishek). Jiang subsequently moved the country's capital back to Nanjing and instituted a new era of nominal republican rule, yet one under single-party rule of the Guomindang. Jiang, in power throughout the period, wielded near-dictatorial powers as supreme "generalissimo", as the legislative body, the Legislative Yuan, provided no actual check on the power of Jiang and the executive branch. Jiang, like Yuan Shikai, justified this concentration of power in his office as necessary due to political expediencies owing to civil war with communists and warlords, as well as external threats represented by Japan and the Soviet Union.

Jiang also cited the need for authoritarian power as part of the plan laid out by Sun Zhongshan, promoted by the Party as the philosophical leader of the 1911 Revolution. In *Fundamentals of National Reconstruction for the Guomindang Government*, written in 1924, Sun proposed a Leninist conceptualisation of successive stages of governance to take place as the Chinese populace became "ready" for such implementations. Sun laid out a three-stage transformation of governance: military (軍政), tutelage (訓政), and eventually constitutional (憲政). Sun argued that after the Guomindang used military force to achieve unification of the country, the country would enter a tutelage period, during which the central government was to "educate" citizens in understanding democracy, and assist provinces to achieve self-governance. According to Sun, after a "sufficient" amount of time, and constitutional governments were instituted in half the provinces, the promulgation of a true constitution could take place, with a national republican government based on indirect election of representatives from provincial legislatures. As such, Jiang's government frequently referenced their rule as part of a necessary "tutelage period", sometimes more generously translated as the "educative period". In either reading, the terminology was symbolic of a patronising, self-serving approach to governance that reflected the incentives of those in power to formulate a rationale for remaining in power indefinitely. Mises (1944:44) refers to such conceptualisations of the state's role as one of 'etatism', noting "Etatism assigns to the state the task of guiding the citizens and of holding them in tutelage. It aims at restricting the individual's freedom to act." It is telling that over the entirety of the prewar period, only a few provinces, including Hunan and Guangdong in 1922, managed to ratify formal provincial constitutions (Jiang & Zhu 2010, To 2016). Thus, there appeared little desire on the part of the Jiang government to support moves that threatened its absolutist control of the so-called tutelage stage.

The general incentive for state actors in control of the state to seek to increase their power is typically only deterred by the need to create credible commitment mechanisms to induce private actors to engage in productive activities and for investors to provide capital resources to the state. As discussed in Chapter Two, serious existential threats can change the calculus, making credible commitment unlikely. The inability of the domestic state under the Guomindang to maintain a monopoly on violence and reduce the severity of the existential threats from internal and external military forces decreased incentives to undertake the steps necessary for the creation of credible commitment, with state leadership under Jiang focussing instead on using authoritarian power to marshal resources in support of the military.

State structure remained authoritarian in form, operating under one-party rule. Under the Leninist approach outlined by Sun, the Guomindang Party would rule the country under the guiding principle that the Party had the best interest of the country (以黨治國). The judiciary pointedly lacked independence from the Guomindang Party. Likewise lacking any actual authority, the Legislative Yuan served, using Sun's terminology, as a "consultative body", primarily providing a rubber stamp of the executive branch's orders. As T'ang (1931: 9) observes, "[The Legislative Yuan's] purpose is to let the Government know what the people think," and nothing more. Paauw (1952: 7-8) underscores the titular nature of legislative authority over government expenditures, noting "When budgets were actually passed before the deadline, they were openly defied by the Executive branch of the government... The Ministry of Finance, which was directly under the authority of the Executive Yuan, did not follow the dictates of the promulgated budget in its employment of revenues for specific purposes... This type of tight Party control of expenditures was symptomatic of the general domination of political and economic life by the small clique of Kuomintang elite." In the few instances that legislators sought to defy Jiang, such as did Legislature President Hu Hanmin in 1931, Jiang had them arrested and removed from power. The solidifying of authoritarian state political structure coincided with a continually expanded role of state control over an ever-widening set of private economic and social behaviours.

4.2. Credible Commitment Mechanisms: Legal and Judicial System

Legal systems serve as important institutional constructs that help provide the framework for overall protection of private property rights by enforcing limits on and providing punishments to violations of individual property rights by other private actors from behaviours such as theft or personal violence, and promoting trust in commercial dealings via the enforcement of contracts and other matters of commercial law. Further, effective and independent legal systems can also serve to protect private property rights by enforcing limits on the ability of state actors to violate previously-agreed to limits on state actions; i.e., to serve as credible commitment mechanisms.

Throughout the late-imperial to early-republican era, China's legal system exhibited at best a chequered record in serving as an effectual credible commitment mechanism. To begin with, at no time was the judiciary ever effectively independent; instead, it was beholden to and served to reinforce the authoritarian state structure described in Section 3.1. Therefore, rather than serving as a limit on the state to violate property rights, it simply served to validate such violations. Further, the role of the legal system in promoting commercial relations is a contested concept in the literature, with some viewing the legal system of the middle and late imperial periods as able to facilitate commercial activity, while others—including many contemporaneous actors—finding the lack of formal codified commercial and civil law structures an inherent obstacle to the development of more impersonal and complex commercial behaviours. The republican period, however, saw continual development of more formalistic representations of commercial law, as well as greater judicial and associated legal system skeletal structure, improving the potential for greater use of impersonal commercial structures, such as financial contracts, between private economic actors.

4.2.1. Historical Antecedents of China's Commercial Legal Environment

By the time of the Qing rule, China had already developed an extensive and formally codified legal system over the course of many centuries, with the Great Qing Legal Code (大清律例) representing an extension and refinement of earlier dynastical codes. Made up of thirty-one books divided into seven divisions, the Qing Code sought to be comprehensive in its scope of application, but its focus was primarily on military and criminal laws. When property rights were explicitly addressed in the Code, they primarily focussed on state, as opposed to private, property rights protection, with specified rules and punishments designed to prevent misappropriation of government property rights. When lay citizenry were accused of violations against state authority, they were brought before local government officials known as magistrates, who utilised their authority as an enforcement mechanism, ensuring the laws were upheld, the accused judged, and punishments enacted. Recent scholarship utilising archival Qing legal documents has detailed the extensive case record regarding the administration and prosecution of the criminal laws designed to enforce and prevent infringement on state authority, such as by forgery of official seals or impersonation of government administrators (Edwards 2003, Wang 2005, McNicholas 2008, Zhang 2009).

On the surface, such codification of state property rights appears to stand in contrast to a lack of attention to private property rights. Chinese law as a whole had little apparent explicitly codified civil law until as late as the enactment of the Civil Code in the 1930s. Given the Qing Legal Code's near-exclusive focus on criminal matters, Chinese economic and legal historians have traditionally viewed China's lack of codified civil law to be indicative of a legal environment providing poor protection of private property rights and un conducive to contract enforcement (Jones 1983: 135, Fairbank 1992: 185-186, Kirby 1995: 44, Chan 2012: 324), with Jones, for instance, specifically claiming the Qing Code failed to

substantively address issues pertinent to corporate regulation or dispute resolution. Fa (1980: 27) notes the "most civil matters were regulated by ethical custom rather than formal law, the scarcity of civil provisions and a near absence of commercial law in the traditional codes made Chinese law incompatible with [commercial] needs." Overall, the dominant view in the mainstream literature has been straightforward—China had only criminal law but no civil law traditions.

More recent scholarship has presented a strong revisionist challenge regarding early Chinese legal thought vis-à-vis commercial law and private property rights. Scholars such as Huang (1996, 2010), Osborne (2004), Chui (2008), and Ng (2015) emphasise that China did in fact possess a legal tradition of commercial law, albeit one constructed differently than that found in western legal traditions. These scholars argue that much of the traditional scholarship has been conducted from a Eurocentric standpoint, overly concerned with an application of western legal terminology and rigid labelling of "criminal" versus "civil" concepts that do not apply to traditional Chinese law. Having undertaken detailed reviews of Ming and Qing legal records, these scholars have identified transcribed records by government officials that describe a legal tradition actively used by the Chinese merchant class and citizenry that provided the enforcement mechanisms supporting the widespread use of commercial contracts.

The revisionist literature partly argues that although rules involving contracts were not always codified, the concept that rules have to be written down to exist is incorrect, given that customs, traditions and other forms exist that can create contract enforcement mechanisms (Hadfield & Weingast 2012). Local guilds and merchant associations also exerted their own power and enforced protection of contract terms or standardised business practises, much like the way Greif (1989) noted for Maghribi traders. Huang (2010) contends that a kind of "private law" and enforcement system existed that was promulgated via local customs. In areas such as marriage agreements, familial successions, and land sales, this organically developed private law was abided by common citizens and administered by community leaders and local magistrates. Writing in 1844 (2000), Wang Youhuai (王又槐), a legal scholar on the Qing Code, provides support to these modern interpretations in his reliance on contracts and accepted custom in analysing the correctness of magisterial rulings.

The state legal apparatus, in general, was not utilised above the local level. As Huang (1996: 6) notes, civil matters—including disputes over land, debt, inheritance, and marriage—were considered "minor issues" (*xishi*) in early Qing. Such minor issues were "supposed to be dealt with mainly by society [and not the government] itself" (105-106). The central government typically assumed a "centralised minimalist" approach and left civil disputes to local communities. Disputes regarding commercial matters were mainly and firstly addressed via community or kinship-based mediation, with the participation of local authorities operating as society mediation where necessary (Huang 2010: 63). The formal state was largely uninvolved in the process.

Jenigan (1904:270), writing in the late Qing, also stresses the way in which commercial interests were protected not so much by codified laws but by customs and practises that were self-enforcing: "The essentially democratic nature of the Chinese state is chiefly evident in the operation of its commercial institutions which sometimes transcend, or rather, usurp the law-making functions of the government. The power of their guilds and associations is often sufficient to set the imperial authority at defiance... The sanctity of a Chinese merchant's word is already pretty well known abroad, but it is interesting to observe that this business probity is due to no lofty morality but the firm conviction that transactions can never be profitable in the long run unless credit is kept inviolable; and credit is of course based on honest dealing."

Ng (2015) further stresses the importance of custom as an effective tool in creating an implicit legal structure supporting commercial development. His research critically examines early archival documents relating to British 1864 Bankruptcy Ordinance and finds that its introduction, along with other aspects of British legal framework, was not, as typically conceived, purely beneficial to the development of the colony's legal foundation, as there had existed a robust set of established business mores that had facilitated economic activity prior to the imposition of a British colonial legal system.

Scholars such as Huang (1996, 2010), Allee (2004) and Chui (2008) argue further that the Chinese legal system did possess more formal mechanisms for dispute resolution when contract disputes could not be resolved via guild rules and local customs alone, citing primarily examples of commercial lawsuits recorded in the archival Ming and Qing legal records. Allee, for instance, considers contracts from Taiwan involving land sales, finding that the government magistrates took contracts seriously in their decisions, while also considering the believability of the produced contract that a litigant put forward to support their case. One such case Allee (2004: 163) cites involved a magistrate who performed a detailed physical inspection of a contract and determined it to be a forgery because, although the litigants in question claimed the contract was a century old, "the ink was still fresh and clear; the seal has all its lines."

Overall, the revisionist literature concerning the degree of commercial law contained within Chinese legal traditions hinges on the point of emphasis, and the importance of codification of rules in enforcing contracts, versus the efficacy of custom and moral suasion. To begin with, while litigants could access the legal system to attempt to protect their property rights, there appears to have been a lack of associated enforcement to provide more effective protection to property holders. Alford (1995:16) notes an instance where a group of Shanghai silk producers in 1856 turned to local magistrates to afford protection from imitators, citing evidence in the historical record of the magistrates finding in favour of the producers and ordering the imitators to cease their counterfeit production activities: "There appears to have been massive counterfeiting of well-known brand names and marks, as well as extensive attempts to imitate secret manufacturing processes... Help was sought from local officials, not on the basis of any code provision specifically outlawing such imitating, but instead by imploring these 'father-mother' figures to prevent unfairness and deception... Such appeals, however, do not appear to have been large in number, even taking account of the anecdotal nature of the evidence available." More important is his finding that such appeals by merchants for commercial issues such as trademark provision proved relatively fruitless: "Nor do they appear often to have been successful in bringing the objectionable activity to an end", hence suggesting a reason perhaps for his previous observation of their paucity in the record. Indeed, the offending parties continued to produce counterfeit goods, being sued multiple times by the owner of the trademark and repeatedly being ordered to stop the infringement each time, but apparently to no avail, suggesting a lack of enforcement mechanisms accompanying commercial law.

Second, it is noteworthy that magistrates' rulings were based on their own judgements; that is, with few relevant codified legal regulations to enforce, magistrates were obliged to act out of their own sense of ensuring fairness. Certainly, tradition is the foundation upon which all law rests (Hadfield & Weingast 2012). Accordingly, Ocko & Gilmartin (2009:58-63) argue that well-established societal moralistic norms, based in large part on Confucian values, helped to constrain the application of the law and by definition create an implicit rule of law as exercised by "moral men" under the Qing. Ocko & Gilmartin's position, however, rests upon the argument that such applied "rule of law" depended upon "the personal assertion of imperial authority" by the emperor himself (62). That ultimate decision-making

authority rested upon one man's personal views, even constrained by tradition though it may be, as opposed to a canon of established law stretches to a good extent the classic framing of what constitutes rule of law. As Fa (1980:10) argues, imperial law was based on the rule of (wise and ethical) men, rather than rule of law. Hence, contend Shiga (1988) and Bourgon (2002), dispute resolution for civil matters relied more on the individual moral decisions of local magistrates, thereby lacking consistency. For Zhang (2009), civil litigation as conducted under the Qing was conflicting. While admittedly allowing for multiple interpretations and instances where private property rights were indeed addressed, as identified in the existence of examples cited by revisionist scholars, the lack of formal codified legal structures protecting private property rights implies the legal system lacked an overall degree of decision-making consistency that could sufficiently decrease uncertainty for economic actors when constructing contracts, thus limiting the development of more complex contract forms, especially those defining financial instruments, which were conspicuously absent in the Chinese economic landscape until the late-imperial period. Nonetheless, the legal institutional framework that did exist was sufficient to support the development proto-joint-stock corporate forms with dispersed ownership structures run by managers who were not direct owners of the firm, as explicated in research on merchant groups in Furong, Hunan (Zelin 1988) and Zizong, Sichuan (Zelin 2005a), and Shanxi bankers who paid managers partly with non-voting ownership shares as an early form of stock option compensation structure to help overcome the principal-agent problem and increase interest alignment between bank management and ownership (Morck & Yang 2011).

In general, the revisionist scholarship contributes important evidence pertinent to constructing a more complete and nuanced view of the development of institutions providing protections on private property and contract rights, such as guild- and magistrate-mediated dispute resolution forums, in the period prior to the late Qing. While actual levels of contract protection and commercial law application remains open to debate, it is clear that commercial instruments such as contracts and systems for business dispute resolution were not "foreign" concepts to Chinese merchants and officials that were introduced or had to be "imposed" by the arrival of westerners. Rather, the legal reforms that took place in the late Qing and early republican period built upon foundations of a legal tradition that had already developed by way of nascent organic processes that supported contract enforcement mechanisms, while albeit somewhat limited in terms of their ability to handle impersonal business relations, provided a basis for relatively robust commercial activity.

The existence of such strong institutional foundations in the period prior to the late-Qing and early republican time frame are important to note, especially in light of subsequent failures we describe below that define the later period's legal institutional framework in the area of providing effective legal protection mechanisms for private property and contract rights and commercial activity. Such failures therefore cannot simply be ascribed to a lack of legal traditions, as has frequently been done in the traditional literature (Wang 1993, Chen 1997: 8-15, Yang 2003: 133, Wu 2011: 553-554). Instead, the causes lie with the successive administration of the legal system by a state apparatus that was preoccupied with its own survival amidst civil and external strife, and thus continually undertook actions that undermined the intent of those legal reforms designed to create effective legal protections on private property and provide for contract enforcement. Most notably, lack of judiciary independence undermined any ability of the judiciary machinery from providing realistic or effective limits on state power, thus failing in their role to serve as credible commitment mechanisms.

4.2.2. China's Domestic Legal Framework: Private Property Rights Protections and Contract Enforcement Mechanisms, 1853–1941

The main focus of our discussion of the development of China's legal system over this time period is on the those features most relating to the creation and maintenance of a framework enabling overall protections of private property and contract rights. In particular, we note how the evolutions of the system impacted the legal system's ability to allow economic agents to enforce contracts and provide protections for contract forms relating to financial instruments. We are primarily concerned with the efficiency of the legal system in its application; while chronicling changes in the codification of laws pertaining to the protection of property rights can be useful in indicating a potential baseline on which formulistic and standardised legal reasoning can occur, of far greater salience is a consideration of the efficacy of mechanisms designed to allow for the actual enforcement of such codified rules and regulations.

4.2.2.1. Legal Development under the Qing

The defeat in the Opium War brought about in large part by the British Navy's use of advanced warships and weaponry prompted the realisation amongst some Qing officials that China must achieve technological equivalence with the western powers in order to meet the unprecedented threat their militaries represented. It was not a coincidence that Shanghai became the centre of the early industrialisation movement led by a few government reformers, known as the "Self-Strengthening movement." The three most prominent Qing official patrons of the movement, Zeng Guofan, Li Hongzhang, and Zuo Zhongtang all counted Shanghai within their jurisdiction at one time or another. Zeng and Zuo both served stints as the Viceroy of *Liangjiang* (兩江總督) covering Jiangxi, Anhui and Jiangsu Provinces, while Li was the Governor (巡撫) of Jiangsu, with his role in quelling of Taiping Rebellion in Shanghai contributing greatly to the high regard the Court held him and his attendant rise through the imperial bureaucracy.

The government-led industrialisation movement, however, was not intended to implement significant institutional changes or cause fundamental change in the state-business relationship. Instead the stated goal was to use the foreign skills to strengthen the state's power via the use of Western technology—in other words, to institute an industrial revolution without instituting concomitant substantial changes in existing institutional structures. Yet many of the country's merchants and reformers argued that technological transfer alone was insufficient to unleash the kind of economic growth that could allow China to compete with the foreign powers and its swiftly-industrialising neighbour Japan, and began calling for more explicit and codified protections on property and contracts. Reformers included Qing officials such as Xue Fucheng, who in his 1893 essay "On the Lack of Competence of China's Companies" partly ascribed poor corporate governance to a lack of legal structure that could allow investors to enforce better governance practises within companies (Xue 1893: 480-481). Zheng Guanying, a well-known comprador in Shanghai, who was later appointed to be a director of China Merchants' Steam Navigation Company by Li Hongzhang, was particularly strident in his call for legal reform and the need for the development of civil and commercial law provisions: "[without a commercial code], businessmen cannot obtain effective dispute resolution. Local officials may act arbitrarily and fail to provide justice. Without a commercial code... business cannot prosper" (Zheng 1894: 607, *translated*).

Partly in response to such calls for more substantive institutional changes, efforts were taken by the Qing Court to institute legal reforms. In May 1903, as part of the New Systems Reform, the Qing court appointed a Law Codification Commission (法律編纂官) to carry forward legal reform. The reform took a two-pronged approach: First, revision of the old Great Qing Legal Code to respond to western criticism regarding the cruelty of certain punishment provisions; and second, enacting new codes in line with western legal mores in the area of civil and commercial law. As part of the first effort, between 1902 to 1907, police and prison reforms were carried out, and by 1910, the new "Current Criminal Code" was issued, supplanting that part of old Qing Code with respect to criminal laws. In regard to the second effort, three prominent legal scholars were selected by the Imperial government to begin drafting a new Commercial Code (欽定大清商律) (Tang 1937:1). In 1904, a nine-article Customs and Usages of Merchants (商人通例) and Company Code (公司律) was published, mostly adapting those as found in the codes of Japan and Germany (Hung 1932: 10-11). Subsequent additions and revisions were enacted to laws in the area of commercial matters, including Temporary Regulations for Trademark Registration (商標註冊暫擬章程) and Bankruptcy laws (破產法) which were promulgated by 1906 (Hung 1932:11). Regulations for specific industries or organizations, such as mining, railways, and trade associations, were also enacted. Drafts of codes on criminal and civil procedural laws, civil laws, as well as a new criminal code were completed between 1910-1912, and a draft for a full civil code was under work although it was never promulgated due to strong conservative resistance (Chen 1999: 19-21). Treat (1911: 156-157) suggests that much of this resistance came from local officials whose interests were threatened by proposed changes in the way things were traditionally handled or decided, which tended to be more discretionary and therefore increased their power by giving them veto rights unless appeased by some form of payment or other tribute. The fact that promulgation and implementation of central government legislation could be deterred by the resistance of local officials also underscores the relatively weak position of the central government compared to sub-national level powers.

While on paper significant reforms were instituted, many merchants remained unhappy with the reforms, which Zhu (1993: 107) partly owing to a lack of mechanisms to implement and enforce the paper laws. Specifically, while there were specific efforts and regulations made at the national level that looked to encourage private economic activity, in practice, these were constantly undermined at the local level by government officials intent on using their access to state power to extract wealth from private actors. Zhu quotes a Hubei-based merchant who discussed the difficulties he experienced in dealing with local-level officials: "government officials at the prefecture-level, county-level and town-level—and even sometimes their associates and relatives— would trouble my business activities by asking for money or favours. If I do not satisfy their requests, then they use their political power to block my access to bidding for government contracts, or to receive permission to undertake a new business activity, or they will ignore their responsibilities as objective arbitrators in regard to my relations with other private businesses" (107, *translated*).

It was in the enforcement of laws ostensibly designed to protect private property rights where the weakness of the reform effort became most apparent, as the lack of an independent judiciary prevented placing tangible limits state actors who violated private property rights. While numerous judicial reformers, notably Shen Jiaben, argued for the necessity of the "abolition of the traditional practice in which administrative officials exercise judicial powers... [lacking] non-interference from other government authorities" (cited in Xu 1997: 3). Whatever the limited protection the existing judicial framework did offer was further circumscribed by the lack of capacity to deal with an increasingly complex commercial landscape that accompanied the development of industrial enterprise. As Hsiao (1967), Crossley (2010: 46), Bouye (2014), To (2016: 37) and others relate, the supporting judicial framework proved increasing inadequate, having failed to expand in line with substantial population growth experienced under the Qing; Zelin (2005b) estimates there could be as high as only one magistrate per every 300,000 citizens.

Moreover, the structure of the Qing legal system itself presented limits on the ability of the judicial system to provide independent credible commitment mechanisms on the exercise of executive power. Although serving as arbitrators of the law, magistrates fundamentally served as part of the executive role of the government. As Fa (1980: 21) notes, magistrates were government officials concerned with administrative matters that reached far beyond the interpretation of legal doctrines. "As the judicial system was not separated from the executive branch of government in traditional China, the magistrates had to perform a variety of administrative functions in addition to the administration of justice. Those included tax collection, maintenance of social order, education, social welfare, granaries, and supervision of local public work. Hence, magistrates were not primarily legal officers, but administrative officers of the government." Fa continues by noting that given the type of knowledge required to pass the civil service examination system, magistrates "lacked the necessary legal knowledge and training."

The lack of judicial independence and legal bureaucratic capacity implied weak credible commitment mechanisms to limit the power of an authoritative state, which negatively impacted the development path of private enterprise during the late Qing period. For instance, the successful profitability of a private venture frequently led to government takeover of the company as a way to capture its profits. The lack of an independent court system meant such abuses of government power could occur unchecked. Numerous examples abound. In 1905, after the completion of an official government field report on mining production in Guangdong showed that the privately-owned Qujiang Baochang Coalmine Company was generating large profits, state officials issued orders that brought it under government management several years later (Gong 1999: 262).

Zhu (1993) cites multiple similar examples of government expropriation that took place in various provinces, including an instance where Hunan officials dispensed with the standard rationalisations of "national industrial development" and openly admitted their behaviour was purely financially motivated, stating their decision to nationalise private mining companies was undertaken "to improve the future outlook of the financial difficulties facing the province" (107); that is, to capture privately-generated wealth to address spending deficits created by public officials. Such blatant instances of violations of the recently-promulgated commercial laws led merchants to perceive the laws as ultimately ineffective given the lack of associated mechanisms, such as effective judicial safeguards, that would have been able to provide a shield from the leviathan nature of the expropriatory state. Zhu finds expressions of such perceptions in his research of Hubei's archival resources, relaying the sentiments of a leading prominent Hankow merchant who complained that "without sufficient enforcement mechanisms behind commercial law to prevent government interference in private matters, successful industrialisation will never take place" (Zhu 1993: 103).

Thus, despite a multitude of legislative efforts centred on formal codification of legal precepts, Qing legal reforms largely failed to bring about significant improvements in the nature of private property rights; as per Huang (2001:29), there was "little actually accomplished in civil and judicial reform." Adherence to new reforms was weakened and sometimes counteracted by state actors' behaviour, with few credible commitment mechanisms supporting codified laws. With both government officials and private actors suppressing private information as a strategy to tie the grabbing hands of an absolutist state (Ma 2014), the ability of officials to gain information needed to formulate effective protections on private property rights was limited (Sng 2014).

4.2.2.2. Legal Development under the Beiyang Government

With the fall of the Qing and following the short-lived Transitional Guomindang regime, the Beiyang government came to power with an absence of an established legal code of its own, and hence Qing laws continued to be applied. However, legal reform was a stated priority for the new republican government—aside from providing a new legal framework for China, having a developed modern legal system was viewed as a way to persuade the foreign powers to relinquish their rights of extraterritoriality and for the government to reclaim sovereignty, and more importantly, gain legitimacy in the eyes of the public.

From 1912 to 1927, dozens of codified laws and ordinances were issued, including an amended criminal code, litigation procedure laws, civil dispute arbitration laws, security and police laws, and a press law. Attention was devoted to the development of commercial laws, designed to decrease ambiguity within the code and increase specificity, with new codes enacted to cover areas including trade, mining, finance, agriculture, commercial societies and utilisation of foreign funds. For example, while the Qing reform period produced a *Shangren tongli* (Customs and Usages of Merchants) law that had contained nine clauses, the subsequent Beiyang legal reform expanded the law to include seventy-three clauses. Likewise, the late-Qing Code contained a total of 121 clauses related to company regulations; these were combined and modified to produce the Beiyang government's *Gongsi Tiaoli* (Company Regulations), whose 251 clauses laid out rules regarding corporate credit and investors' rights. By July 1914, the Company Registration Rules and Commercial Registration Rules laid out a formalised corporate registration system.

Laws dealing with specific industries were also issued; for instance, new mining rules in 1914 provided specific provisions on ownership of mining rights, reduced mining taxes, and regulated the size of mining areas. New laws were promulgated governing chambers of commerce and commercial associations, as well as a whole series of financial regulations, such as the December 1914 Securities Exchange Law (證券交易所法) allowing the formation of private securities exchanges to trade government bonds and private securities. Following these laws, the Beijing Stock Exchange was formed in 1918, with the Shanghai Security and Goods Exchange and the China Merchants Securities Exchange opening in Shanghai in 1920 and 1921, respectively. The 1914 Company Regulations also contained clauses designed to create a standardised national set of accounting rules (Peng & Brown 2017: 179).

Overall, the Beiyang government's legislative efforts represented a more extensive legal reform process than that undertaken during the Qing. The degree to which they increased or decreased protections on private property rights, however, is at best mixed; as discussed in Chapter Seven, the application of security and police laws was used to suppress free expression and justify the expropriation of private property and constrain citizen freedoms. Other laws impacted commercial behaviour. For example, the new Company Code was associated with an increase of industrial corporations formed under the new process. According to the government registry, from 1903 to 1908, two hundred sixty-five industrial companies were registered; an additional seven hundred ninety-four were registered from 1912 to 1921 (Feurerwerker 1958:4; Li & Li 2011: 338). Nonetheless, many areas of commercial matters remained unaddressed by the new legal codes, prompting the Supreme Court to issue a ruling that judges should, in the absence of express legal provisions, rely upon "custom, and principles of reason and right" (Wu 1928: 239).

While the breadth of legal reform was aggressive, political instability and an attendant lack of bureaucratic capacity begat mixed success in regard to implementation of the new laws. Of those laws implemented, however, many reflected the trend of an increasing role of the state in private agents' daily lives, and in regard to economic matters in particular. The state became more actively involved in monitoring and controlling what had previously been

considered private matters, or at the least, not the concern of the national government. The enactment of the Chamber of Commerce Law, for instance, explicitly required Chinese merchants in all major cities to form business associations (*shanghui*), and specified their organisational structure, the leadership of which was intended to not only help inform the business community about new government laws, but also help to enforce their compliance.

In addition, business associations were required to collect information about the local business community and pass such information along to local government officials. The role of such legislation, therefore, served far more as a potential threat to the maintenance of private property rights, than as potential enhancement, in that it indicates an example of a top-down approach from central bureaucrats seemingly less interested in simply providing a secure set of rules to the business community, and more interested in generating tools of control. Note that as these regulations mandating registration of business activities took place in an environment defined by instances of government expropriation of profitable companies, as described above. Hence, private business owners and investors might have well been apt to see many of these attempts at information gathering and monitoring by the state as potentially leading to infringements on property rights.

In 1921, the government undertook an internationally-coordinated attempt to negotiate a revocation of extraterritoriality, with negotiations taking place in Washington D.C. at the so-called Washington Conference. The ultimately unsuccessful Chinese delegation's efforts were considerably weakened by the fact that the country was in the midst of civil war. The meeting did produce, however, an agreement by Western powers, led by the U.S., to form a commission to evaluate China's judicial system and the methods of juridical administration to "assist and further the efforts of the Chinese Government to effect such legislation and judicial reforms as would warrant the several Powers in relinquishing, either progressively or otherwise, their respective rights of extraterritoriality" (Resolution of Washington Conference 1921). The start of work by the commission was delayed for over two year, however, by the continuance of large-scale civil war, causing the Beijing-based government to repeatedly request delays to the arrival of the commission (Mah 1924: 676).

The Commission conducted extensive investigations, and by 1926, a final Report of the Commission on Extraterritoriality in China [RCEC] was produced. The Commission's findings were not all negative. As Tang (1937: 2-3) notes, the Report commended the quality of commercial law produced by the Law Codification Commission (法律編纂官) of the late Qing and Republican era. However, as the report made clear, it was not the laws produced as much as the lack of consistency of their enforcement, as well as the lack of adherence to the appropriate enactment process of the laws, that was troubling.

First, it was noted that since the establishment of the Republic in 1912, three constitutions (the Provisional Constitution of 1912, Constitutional Compact of 1914, and Constitution of 1923) had been declared to be in force, and then yet then quickly disregarded by political actors. Further, few of the new laws had been actually confirmed by the legislative body in the method prescribed in the constitutions; instead, laws were typically simply directly mandated by orders of the President or the Ministry of Justice, neither of which had any legal or constitutional authority to enact law. The parliament, ostensibly the legislative branch of the government, was "ephemeral in nature and having contributed but little to the legislation of the country" (RCEC 1926: 62). Further, the Commission found that laws "have been declared to be law by the Central Government at Peking but such laws are not universally applied in all parts of China," attributing this to two causes: "the open refusal of certain parts of China to recognize the Central Government, and the promulgation of subsidiary legislation by provincial and other power authorities without constitutional authority". In general, "the reins of government have fallen into the hands of the military leaders who, by virtue of their powerful position, can assume at will administrative, legislative and judicial functions, thus tending to obliterate the line of demarcation between the executive, legislative, and judicial branches of the government" (RCEC 1926: 97-98).

Moreover, the Report found that the Treasury had been depleted to such an extent that the government had trouble making salary payments to the judicial and police officials, which increased the chance of corruption, and it was ""interference with the departments of civil government by the military leaders" that the Report identified as one of "the chief factors preventing the effective administration of justice" (RCEC 1926: 90-91). The Report cited eleven specific examples that took place around the time of the investigation to illustrate the lack of due process and enforcement of law. These included actions such as the arrest and summary execution without trial of the chief justice of the high court of Shandong on the order of the military governor based on the charge being in communication with an opposing military faction; execution of an editor of the Beijing-based Chinese newspaper *Chingpao* by military authorities on account of editorial writings alleged to be propaganda against the military; the arrest and shooting of a local official in charge of salt tax collection in Chengdu for reason that he had incurred the governor's displeasure in connection with the handling of the salt tax funds; a military-issued order to "behead" anyone who speculated in an issue of military notes in circulation in Beijing; and the execution of five men at Mukden without trial in the presence of a large crowd after being accused of speculating in the paper-note issue of the Fengtian authorities (RCEC 1926: 90-96).

The instances cited in the report were reflective of a legal system unable to enforce the rule of law through its enforcement mechanisms, given the disconnect between codified law and actual enforcement. Executions without trial and political assassinations were prohibited under the existing Beiyang legal system, as were takings of private property by government actors. The persistence and frequency of such extra-legal incidents were indicative of the nature of the authoritarian Beiyang state. So, too, was the lack of an independent judiciary that could serve to properly enforce codified law or serve as an effective check on arbitrary exercise of executive power. As contemporaneous legal analyses by Tyau (1912: 143-145) and Mah (1924: 692-694) note, the extensive number of new courts established failed to be accompanied by impartial and effectual judges who could administer the law. This was symbolic of the lack of credible commitment mechanisms, leaving private actors seemingly unconvinced that objective legal protections existed, as opposed to arbitrary "law" exercised by those possessing state power. The conclusions drawn by the Report of the Commission on Extraterritoriality reflected such assessments of the Beiyang legal system, claiming "it is well within the range of moderation to state that in China at the present time there is no effective security against arbitrary action by the military authorities with respect to life, liberty, or property" (RCEC 1926: 97-98).

4.2.2.3. Legal Development under the Guomindang Government

From 1928 onwards, reforming the Chinese legal system by establishing a western-styled legal and penal system was one of the stated top priorities of the Guomindang Party agenda. The newly formed Legislative Yuan was tasked with the responsibility for enacting the kind of comprehensive legal reform first broached by the Law Codification Committee formed in late Qing, with a new Commission of Codification of Law formed in 1927. Overall, the Commission helped to produce an estimated 4,369 laws and regulations that were enacted from 1927 to October 1936 (Yu 1993: 32), including the Civil Code (1929), Company Law (1929), Insurance Law (1929), Maritime Law (1929), Negotiable Instruments Law (1929), the Code of Civil Procedures (1935), Bankruptcy Law (1935), the Code of Criminal Procedures (1935), and Trademark Law (1936) (Fa 1980: 34).

However, the codification of laws was less problematic in regard to the fulfilment of legal reform, than was the actual implementation of said laws. Considerable attention has been paid in the literature on the legal aspects of Guomindang state-building efforts, and the intensity with which the state created new laws and legal regulations on a wide variety of

matters. Paauw (1957: 216) discusses the fanfare and public proclamation given to the passage of Land Laws, designed to realise Sun Zhongshan's advocacy of equalisation of land ownership, but which were not implemented after their enactment. Rawski (1989: 141) discusses the lack of implementation in regard to a set of enacted legislation designed to enforce women's rights in the workplace, in educational opportunities, and within the political process, none of which were meaningfully actualised.

Judicial reform was considered an issue of concern, especially in the area of civil law, given the historical lack of codification in the area. The principal author of the Guomindang Constitution, Wu (1928: 239) discusses at length in his 1928 treatise on Chinese law *Judicial Essays and Studies* that the Supreme Court of China had put forth the way in which civil law decisions were to be made: "civil cases are to be decided first according to express provisions of law; in the absence of express provisions of law, according to custom; and in the absence of custom, according to the principles of reason and right." As he further notes, express provisions of law should serve as the "primary source" for decisions making; however, given the general absence of civil code, there had been no such procedure as "express provisions" under the Qing and the Beiyang Republic. Hung (1932: 7-8), writing a few years after Wu, expresses nearly the same arguments, and indeed cites the same Supreme Court decision, arguing further that the absence of codified civil law meant that legal opinions themselves carried extra weight: "In the view of the limited amount of express provisions and the strict limit on the application of custom, the precedents laid down by the Supreme Court thus have occupied a place of importance in the field of law." Hence, the judicial reform process was viewed as tied to the codification of civil law itself.

In addition to codifying laws, the government also initiated judicial reforms to replace the magistrate courts with a new formal court system to enforce the newly promulgated codes, with the 1931 Organic Law establishing the Judicial Yuan responsible for the interpretation of the law (Ch'ien 1950: 132-133). From 1926 to 1937, the number of courts grew from 139 to 457 (Xu 1997: 26). In his review of judicial reforms undertaken by the Guomindang Party, Tang (1937: 7-10) discusses the impact of the Law of Judicial Organisation, enacted in July 1935, noting that within the course of one year (July 1935 through September 1936), over 155 new "modern" courts had been established (replacing the older "official-magistrate" style courts that had existed since the Qing in most localities), bringing the total to 395 modern courts in China at the time. Such a figure, however, represented a considerable shortfall in coverage, as over 1,400 localities lacked funds to establish modern courts, nor did it include the three provinces that at the time were under the control of the Communist Party, nor Manchuria under control of the Japanese puppet regime. Efforts introduced in 1937 organised "judicial offices" in localities lacking modern courts to work with the local magistrates and help standardise the application of law (Tang 1937:16). By 1937, with the passage of the Six Codes and creation of a judicial system modelled on European systems, China achieved a relatively extensive system of codified law. On paper at least, Guomindang government efforts succeeded in building a more comprehensive legal framework than had previously existed in China, particularly in the areas of private civil and commercial law.

According to the negotiations surrounding the Treaty of Nanjing and subsequent similar treaties, the claimed justification by western powers for the imposition of extraterritoriality had been that the existing Chinese legal system was inadequate. Of particular concern was the issue of judicial independence, with additional wording in the Commercial Treaty of 1902 noting that Britain would have no objection to ending extraterritoriality once the Chinese judges "have attained similar legal qualifications and a similar independent position to those of British Judges." While the ultimate sincerity of such words might well be considered doubtful, the emphasis on judicial independence was a stated primary concern of the treaty nations for most of the extraterritorial period. As such, judicial independence was a consistently expressed important goal of Guomindang legal reformers.

However, in terms of actual application of law, much of the arbitrariness—including uncertainty regarding the potential for government expropriation of private property—that plagued the Qing and Beiyang legal systems prevailed. While the Guomindang government made progress in building the physical machinery of a judicial system, the result was far from the expressed goal of an "independent judiciary" that could provide a check on the power of the government by preventing the executive branch, imbued with authoritarian power, from undertaking expropriatory actions.

Two primary reasons contributed to the failure of the creation of an effective independent judiciary that could help credibly check the power of the state. First, the Guomindang government never obtained sufficient levels of administrative competence, or financial capacity, to allow implementation of comprehensive judicial reform. As noted, funding constraints on the Ministry of Justice led it unable to establish a planned one thousand three hundred sixty-seven county courts by 1937, with instead less than four hundred created. With nearly half the government budget going towards military expenditures, there was little funding available to go towards "peripheral" projects such as judicial reform.

Second, the inability of the judiciary to serve as a check on government power was not unintentional—the Guomindang Party leadership lacked appropriate incentives to create credible commitment mechanisms that could have served as actual limits on the Party's power. While some legal reformers perhaps had a desire to create a truly independent judiciary, the Party leadership through its actions indicated a much greater concern for ensuring that the judiciary functioned so as to explicitly advance Party goals. Zheng Ju, who served as Chief Justice of the Supreme Court under the Guomindang, argued that all judges must be Party members, and moreover must accept and apply the Party's "Three Principles of the People" in their decisions (Zheng 1934). While such a conceptualisation of the judiciary's role—to serve to advance the interests of the particular Party in control of executive power—is antithetical to the functioning of a truly independent judiciary, judicial independence remained the touted goal. Ironically, "*partyising*" the judiciary (黨化司法) was openly discussed by Party leadership as an important (if inherently inconsistent) technique to develop an "independent" judiciary. Guomindang Party official Xu Qian argued that the Beiyang policy of prohibiting judges from being members of a political party was misguided, as "the judicial apparatus must be controlled by the political" (quoted in Xu 1997:9-10).

The "Partyising the judiciary" strategy was implemented in part by appointing only Guomindang party members to judicial posts. In May 1927, at the inaugural ceremony appointing the Chief Justice of the Provisional Court in Shanghai's International Settlement, Chen Dezheng, the head of the Propaganda Department of the Guomindang party municipal headquarters, delivered a speech urging the new Chief Justice to "uphold the doctrine and the traditions of the Kuomintang in the administration of justice according to the law" (NCDN 17 May 1927: 12). The irony of the message did not go unnoticed at the time. The editor of the *North China Daily News* observed: "We fail to see how Mr Loo [the new Justice] can honestly use a law court to forward the interests of the Party and at the same time administer justice" (NCDN 19 May 1927: 6). Indeed, Justice Lu apparently did find such a proposition problematic, as he was dismissed from the position after but five months after failing to observe a command from the Guomindang military to order the extradition of several Communist Party members who had been arrested within the International Settlement, since Chinese police lacked jurisdiction over arrests within the Settlement. His replacement, Justice He, was appointed in no small part given his assurance to "abide by the decisions of the party and do the best to carry out party principles" (Xu 1997:12).

Yet, indicative of the multidimensional nature of the property rights environment, it is also possible to identify examples where the judicial system served as a constraining force on the unconstrained exercise of executive state power, even under an authoritarian Guomindang state. For instance, Thai (2015:34-35), in an examination of the Guomindang legal system and its enforcement of antismuggling provisions, identifies the case a Shandong merchant accused of sugar smuggling in 1934, and in the process beaten by a state-employed customs agent, and his goods seized by the customs authorities. Bringing a complaint against the customs agency in district court, it was ruled in his favour that the raiding customs agents themselves had violated the Criminal Code by inflicting bodily harm against the merchant—notably, this ruling, Thai notes, was upheld when the case was appealed to higher courts. The accused merchant, however, was successfully convicted by court under antismuggling codes based on the charges by the customs agents. Higher provincial courts upheld the conviction upon appeal; nonetheless, in 1942, the Administrative Court overturned the conviction, citing insufficient evidence provided by the customs agents, after rejecting submitted testimony that was later attested to have been coerced by the police. Although the process took eight years to reach conclusion, the recounting of this court case provides evidence of a legal system capable of functioning utilising standardised legal process norms of appeals and citations of evidentiary procedures, and arriving at a judgement that represented a repudiation of the state's right to wantonly employ state-sanctioned violence and expropriation without proper adherence to proscribed legal rules. More important, it provides insight into the potential for the legal system to operate with an important degree of independence, and to utilise such independence to serve in ways that could be viewed by rational agents as credibly placing boundaries on the ability of state actors to utilise the coercive power of the state without respect to rule of law and private agents' private property.

While the prior example indicates the potential of the legal system, important caveats temper an overly positive portrayal of the legal system as it existed under the Guomindang. To begin with, while in this particular case, the particular presiding judges chose to apply legal precepts in achieving their finding that effectively admonished the state, the fact that the military authorities in control of the executive could order the removal of sitting judges operated to create an incentive framework on judges that worked against such findings, inherently limiting the actual independence of the judicial system. Further, as Thai (2015: 28-32) notes, the case also reveals how state actors increasingly turned to criminalising previously-legitimate customary commercial practices, in order to offset weakness in the bureaucratic capacity of the state to effectively implement new regulatory enforcement mechanisms, which Thai characterises as one of 'overcriminalisation', implying the use of criminal law to attempt to handle regulatory matters. More important, the case becomes interesting to highlight insofar as it represents an exception to the normal functioning of the adjudicative process, as opposed to signifying a common example. As Thai stresses, the overall legal system, at least in terms of antismuggling prosecutions, was characterised by administrative failure, severe enough so as to disallow the uniform application of justice. The number of outstanding cases far outstripped district courts' infrastructural capacity, with too few magistrates to arbitrate cases, and overwhelmed prison systems, leading to what Thai refers to as a systemic "uneven application of justice"; some suspected smugglers were held incarcerated without trial for periods of time greater than they would have served had they been justly convicted of the accused crime, while the accused in other locales often were quickly released without being formally charged, as local officials were disincentivised to pay the costs associated with jailing and feeding inmates accused of activities designated illegal by central government mandates (32-34), symbolising a justice system ultimately defined by arbitrariness.

Beyond the lack of judicial independence that constrained the ability of the courts from providing credible limits on governmental power in regard to private actors, ineffective or corrupt policing further contributed to the perception amongst the populace that an overall lack of rule of law pervaded society. It was open knowledge that there existed agreements between Guomintang political leaders and organised crime associations which permitted these associations to conduct illegal activities such as drug smuggling, bribery and even murder in return for support of Guomintang political objectives, such as engaging in anti-communist or anti-Japanese purges or assisting in the assassinations of those whom powerful state actors considered enemies (Martin 1991, Wakeman 1995a). As Woodhead (1931) reports, corruption pervaded the legal enforcement system, including in its supposed attempts to control opium smuggling. "The Opium Suppression Bureau, a government affair, has been functioning in a manner peculiarly its own for the past two years. At times a guard of soldiers and men bearing what are said to be the credentials of the O.S.B approach opium runners on ships and receive consignments of opium for which they pay 'transportation charges.' At other times a great show of a seizure is made but those 'in the know' usually hear afterwards that the consignment was the property of some small man not in the Ring and that the drug was returned to him on payment of 'squeeze.' "

The common knowledge of the inability or unwillingness by government actors to respect the rule of law contributed to the undermining of the perceived validity of the entire legal system. That disrespect of rule of law over political expediency resided at the top of state leadership was exemplified by the interference the Smuggling Prevention Office consistently ran into from government officials interested in protecting the ability of the Party's ally, the Green Gang criminal organisation, to conduct its opium trade. In one instance, the Smuggling Prevention Office determined that members of Jiang's own inner circle, including Jiang's brother-in-law, helped run a smuggling ring; in response, Jiang ordered the case dismissed, and fired the director of the Smuggling Prevention Office, defiantly replacing him with Du Yuesheng, the leader of the Green Gang (Wakeman 2003: 325-327; Taylor 2014: 40). That Jiang had the power to have a criminal case dismissed underscores the complete lack of judicial independence that defined the legal system.

The environment of disregard for the rule of law continued past the start of the 1937 Sino-Japanese War and through 1941. With the attack on Pearl Harbour and the United States' entry into the Pacific War, the majority of allied powers exercised a voluntary relinquishment of extraterritoriality. Internal discussions of consular officials suggest continuing concern over China's judicial system. The US Ambassador to China, upon learning of the State Department's plans to abolish extraterritoriality, stated: "The unsatisfactory Chinese police, judicial and prison systems have not improved during the past decade; they have, in fact, suffered in retrograde; and unfortunately, a system of both government and Party secret services has spread throughout the country and gained extensive power and domination which seriously threatens the enjoyment of "four freedoms" not only by Chinese people but by foreigners in this country" (FRUS 1942. 711.933/374). In sum, whatever advances that the Guomintang state made in terms of creating a more comprehensive judicial machinery and sophisticated legal system was consistently undermined by the subsequent disregard for that legal system by the state authority structure that was supposedly implementing it.

Chapter Five.

State Capacity: Protecting Private Property and Contract Rights via Effective Institutions — Bureaucratic Capacity

Prior to the late-Qing period, it is arguable that the Chinese state apparatus exhibited considerable bureaucratic capability—it possessed agency to institute relatively effective tax collection schemes and conduct decennial population censuses, a civil service appointment system based on a centuries-tested examination selection methodology, currency minting procedures to ensure standardisation across the empire, and a codified legal system which revisionist literature has argued was well capable of adjudicating criminal justice and supporting the use of commercial contracts.

The late-Qing period, however, brought forth new fiscal and political pressures that severely tested the administrative state bureaucracy's capabilities. The challenges the late-Qing state faced were numerous and varied—external wars and internal rebellions, economic growth dynamics including proto-industrialisation and foreign trade conducted on foreign powers' terms, introduction of new production and military technologies, and increased power of the merchant class with an associated increase in demands for greater commercial regulations and rights. Perhaps most important was the associated substantial increase in a perceived need for greater financing to utilise state tools to address many of these stressors, particularly to meet the costs of fighting multiple internal and external military ventures. The late-Qing leadership found it difficult to transform the low-tax and small fiscal footprint that defined earlier periods of the Qing into a state capable of significantly increasing tax revenues to support greatly increased expenditures. In particular, the state initially lacked the administrative capacity and infrastructure to meet these new needs. Domestic central governments succeeding the late-Qing also proved overall unable to successfully meet the financing needs their leaderships continually sought.

As a precursor to the following analysis of the fiscal issues and responses facing China's domestic governments over the late-Qing and republican period, we want to be careful to avoid any normative suggestion that the state apparatus should have expanded in order to successfully address the issues state actors perceived as requiring serious attention. Indeed, it is unlikely the entirety of the set of potential solutions to the pertinent issues were state-driven, or required larger expenditures. While possible to argue that some increase in expenditures was necessary to provide defence of the state against continued military threats by the foreign powers and Japan, and perhaps to address in military fashion the Taiping, Ning, Miao, Dungan and other internal rebellions, even in this respect other forms of conflict-resolution strategies could have been employed that might have better addressed the concerns behind the external and rebellious antagonists, thereby co-opting them, or, more radically, contested areas could have been ceded greater autonomy.

The analysis that follows, however, is less concerned about potential optimal strategies state actors could have chosen, as opposed to analysing the actual strategies undertaken, and the ability of the state bureaucracy to successfully achieve desired goals. Further, we focus less on whether domestic institutions might be considered strong in the sense of simple functionality, as opposed to on the ability to limit violations of private property rights. The historical record suggests that overall, the strategies employed centred on top-down solutions, associated with attempts to increase the size and functions of the state bureaucracy. Thus, for instance, in regard to economic issues, state actors sought to direct the nature of state-commerce relations and control the investment and managerial decisions of private entrepreneurs; likewise, on a broader scale, there was a continual trend by the state actors to control ever-greater portions of civil society.

5.1. Measuring Bureaucratic Capacity—Fiscal Issues

State capacity is most frequently operationalised in the literature along two vectors—tax revenues, and infrastructural power (Ottervik 2013, Acemoglu *et al.* 2015: 2365); as Johnson & Koyama (2017: 2) state, "State capacity can be thought of as comprising two components. First, a high capacity state must be able to enforce its rules across the entirety of the territory it claims to rule (legal capacity). Second, it has to be able to garner enough tax revenues from the economy to implement its policies (fiscal capacity)." Remick (2002: 404) argues it is the tax collection function to be of primary importance: "Tax and public finance administration is the key internal state function. Without effective means to extract revenues or to allocate the revenues as desired, states can not perform their other functions." Views on the importance of tax collections as fundamental to conceptualisations of state capacity owe their intellectual antecedents to arguments Schumpeter (1918) presents that stress the very nature and origin of the state was defined by its taxation ability and functionality, as from a historical perspective, while both taxation and other aspects of state functions developed organically and proved to be self-reinforcing, the development of other state functions were dependent upon the state first developing sufficient taxation capability. This self-enforcing aspect is noted by Strauss (2008:216): "tax is unusual because it is simultaneously a key enabler of other aspects of state-building... and a reflective (crude) indicator of the state's institutional capacity." Akanbi (2018) presents empirical support for such dynamics, finding bi-directional causality, with "both tax capacity and institution shocks have positive... long-run impacts on institutions and tax capacity, respectively" (23).

In response to the aforementioned challenges presented by an evolving socio-political landscape, domestic state leadership created new bureaucratic offices and roles to increase state capacity, many of which centred around and were dependent upon increasing state fiscal capacity. These efforts included methods to raise revenue, from both taxation policies and by way of issuing of government bonds, as well as bureaucratic structures designed to direct expenditures towards policy formation and implementation in line with state policy goals. As a result, new governmental ministries, departments and commissions were created, centred on economic planning and encouraging industrial innovation, although the focus of most remained related to military spending.

Yet it was in the area of taxation and revenue collection that the domestic state possessed particularly weak capacity. As Strauss (1997: 333) notes, during both the late Qing and Republican periods, "central state capacity was extremely limited with respect to the key issues of taxation and personnel." While the state apparatus grew substantially in size and new bureaucratic departments designed to facilitate the state building process were created, many of them lacked the efficacy to allow implementation of policy goals. Much of the issues surrounding the state's inability to successfully implement the policies its decision makers so desired appear to have been fiscal in nature, with the state facing a continual series of budget deficits.

The first pertinent issue this chapter considers is an analysis of domestic state fiscal state capacity. In general, there are three main components of fiscal capacity: revenue sources via tax collection, revenue sources from loans, and control mechanisms over expenditures. As issues pertaining to loans as represented by bond issuances will be addressed in extensive detail in Part IV of the dissertation, we focus the majority of our analysis on the state's ability to successfully raise capital via its taxation policies, and the bureaucratic structure that were designed to support and facilitate the implementation of taxation policies, and determined the effectiveness and efficiency of the tax collection process. Subsequently, we look at the bureaucratic fiscal structures and capability of governmental offices designed to control and achieve policy goals via governmental expenditures.

5.1.1. Fiscal Revenues—Tax Collection

While Deng (2015: 328) suggests the low levels of tax collection reflected factors that were related to a cultural-political ideological mindset amongst state actors, claiming "Heavy taxation remained politically taboo from the Song through the Qing, other more structural factors appear to point to low fiscal capacity playing a more salient role, at least by the late-Qing period. In regard to revenue from tax collection, the national-level domestic state did not effectively address its ineffective tax collection scheme over multiple successive national governments, from late-imperial times onwards, owing in general to two main factors. First, part of the reason was circular in nature. As new stressors created increased financial burdens, increased financing was necessitated; without bureaucratic capacity to increase funds, the state lacked resources to reform or improve the bureaucracy; yet without reforming the bureaucracy, the state could not bring about improvements in the bureaucratic efficiency of tax extraction. Under such conditions, Qing and later domestic government actors found themselves caught in a circular trap that severely limited their ability to undertake meaningful reform.

Second, the central state's inability to manage tax collection was primarily due to a poorly designed and administered tax collection methodology. By late Qing, aside from Maritime Customs duties, most major taxes such as *lijin*, salt monopoly, and land tax were under provincial and local administration. These indirect taxes were officially to be collected locally but then transferred in full to the national central government. In practise, however, this system generated adverse incentives, with local tax collectors possessing both opportunity and ability to engage in massive corruption. Although Strauss (1997) and Kung & Ma (2014) maintain that the Qing civil service examination system provides an example of a "good" institution (and one that also helped to indoctrinate individuals studying the Confucian texts to act as "good men"), thus limiting the amount of corruption in the civil service administration, detailed analysis of archival records suggests that by the late-Qing, corruption was already a significant problem. Much of this evidence is provided by research based on an exhaustive study of over 2247 volumes comprising nearly 150,000 pages of archival documents contained in *The Veritable Records of the Qing Emperors* of the period 1798 to 1911 (Yang 1959, Lau & Lee 1979). Based on these and additional data estimates, Ni & Van (2006) estimate that by the 1870s, money gained by officials via unsanctioned rent-extraction from land owners averaged between fourteen to twenty per cent of government officials' sanctioned salaries. Beyond the fact that punishments appear to have been non-commiserate with the benefits accruing from undertaking lucrative corruption behaviours, moreover only a small fraction of officials were caught, making the expected value of corrupt activity highly positive.

As outsiders who rotated their posts every three years as they worked their way up the hierarchy of the national civil service administration system, appointed magistrates relied upon local county clerks and other staff, as well as in some cases local gentry who served as nonstate benefactors to local officials. These local officials were able to exploit their knowledge of local conditions to extract extraordinary taxes from citizenry, frequently by way of manipulating original tax documents that were passed along to the magistrate to sign and send to higher officials, showing lower receipt of taxes received, allowing local officials to pocket the difference (Yang 1959, Lau & Lee 1979, Zelin 1984). In other instances, magistrates would participate in corrupt activity with lower officials, even passing along some of their received corrupt income to higher officials as gifts, important since provincial-level officials were responsible for monitoring and reviewing magistrates' performance at the end of their three years in a given locale (Ch'u 1962, Watt 1977). Following the suppression of the Boxers' Rebellion, the Court made attempts to unify currency issuance and to exert more control over local governments' borrowing and revenue reporting; the impacts of such policy changes however were relatively ineffective, as the local magistrates still controlled the administration and collection processes (Ichiko 1980: 403).

The end of the Qing government brought some limited changes in tax collection. Regulations to increase the percentage of collected tax revenues reaching the Beiyang central government saw some initial success under the military authority imposed by President Yuan Shikai, with the amounts received in central coffers increasing up to four times from the late Qing from certain taxes such as the salt gabelle, while effective tax rates remained nearly constant (Gale 1930: 250). Legislation in 1914 (國家稅地方稅草案) provided language centralising the control of various taxes, including land, salt gabelle monopoly, transit, and *lijin*, while reserving the right to apply additional taxes on land, livestock, and other categories to local authorities. The start of the warlord period, however, further increased the relative power of provincial and local state actors at the expense of central state actors, ultimately frustrating attempted tax reform. Given that such tax centralisation laws were designed to diminish the financial power and resources of local authorities, these efforts met considerable resistance on the local level, and the laws, while ratified, over time in practise were not enforced (T'ing 1994).

Further, those taxes that were successfully enacted under the Beiyang central regime appear indicative of fairly weak state bureaucratic capacity. For instance, while the government succeeded in enacting the country's first business tax in 1914, the tax's calculation methodology was purposely unsophisticated in design, so as to minimise administrative strain on the tax collection bureaucratic system. As announced by the Ministry of Finance, thirteen categories of industries were designated as subject to taxation, such as fur, pharmaceuticals, petroleum, retail services, and clothing manufacturing companies. Assessed taxes, however, were prescribed at a fixed amount based solely on the industry type (*Shun Pao* 14 July 1914). While such a simplified taxing methodology was thusly easy to administer, requiring less administrative capability on the part of the central tax collection authorities, the system was limited in the amount of revenue it could raise, as anything other than a low fixed amount would have represented a prohibitively high effective tax rate for smaller-revenue or poorer performing firms.

More aggressive attempts to centralise fiscal and tax control took place under the Guomindang Government. In June 1925, Liao Zhongkai, Minister of Finance of the Guangdong-based Guomindang Government, issued the "Order to Unify Revenue Collection Agencies", proclaiming that "all revenue must be collected and managed by legal organs. No civil or military officials may intervene under whatever pretext in tax collection or without authorisation retain funds. Those who disobey shall be regarded as criminals and dealt with under military law" (van de Ven 2003: 90). Liao was assassinated several months later, but Song Ziwen, who took over as the Finance Minister, continued with reform attempts. Writing at the time, Song laid out the difficulties the reform process faced: inability to correctly assess land taxes given the widespread destruction of land tax records resulting from the continual civil strife, lack of modernised accounting or central budgeting systems, and the imposition of a variety of unauthorised taxes by local militias (Song 1926).

The goal under Song's efforts at the Ministry was to reduce local militarists' power to extract taxes, depriving them of their financial independence, and consolidating taxing authority in the hands of the central government. The Ministry's efforts, however, proved mostly unsuccessful. To begin with, for much of the Guomindang period, the central government had effective control over only a few provinces centred around Jiangsu, Zhejiang, and Anhui. Southern provinces such as Guangdong were under the control of other military factions until 1933, while the Communist Party controlled parts of the Northwest, including Shaanxi and Gansu, and in 1931 Manchuria fell under control of the Japanese Imperial Army. Hence tax remittance revenue from these provinces was essentially absent. Even in those provinces loyal to the Guomindang government, the amount of local tax revenue collected and transferred to Nanjing remained circumscribed. As Remick (2002) stresses in her study

of Hebei's tax administration policies, the bureaucratic structure was inefficient in terms of tax extraction: "Hebei counties were never able to centralize funds as effectively or to reform the land tax. Hebei province was completely at the mercy of the county governments in tax collection, compromising the tax collection capacity of the Hebei provincial government and therefore of the central Guomintang government."

Second, the Ministry's attempts to concentrate taxing authority with central authorities at the expense of local governments met with only limited success. While *lijin*, a tax heavily disliked by domestic merchants, was substantially diminished and officially abolished in 1931, the central government was never able to either fully prohibit local governments from applying similar taxes, or to replace it with taxes that flowed more consistently to the centre. Local and regional provincial governments maintained effective administration and collection of the land tax until 1941—by the time land tax was centralised, the Guomintang had already lost much of the country to the Japanese (Liu 2016). Further, bureaucratic capacity issues undermined reforms to increase centrally-administrated tax policies. For instance, when the Guomintang initially secured power in 1927, a series of intended reforms on business taxes were proposed to replace the flat fee system propagated under the Beiyang regime with a system of progressive tax rates applied to either companies' capital size or earned revenues, based upon industrial category (Second Historical Archives 1994:426). However, the scheme was determined to be too complicated for the central tax authorities to implement, especially given the lack of standardisation in then-operating accounting standards left the system open to falsification without substantive oversight (Ke 2015). As a result, the Ministry of Finance decided to leave business tax revenue collection to local governments. In June 1931, when the Ministry implemented a substantial tax reform, a new set of Business Tax Regulations was officially issued based on the 1927 proposal, even adding to its complexity by demarcating three classifications on which tax rate calculations would be applied—revenues, profits, or capital size—again to be dependent on a company's industry category. Crucially, however, although the methodology had changed, the business tax remained locally-administered and collected; further, the added layer of complexity, based on profits, proved too complicated for tax authorities to monitor, and in June 1934 a new business tax reorganisation was enacted, leaving only two classifications on which tax rates were to be applied, revenues and capital size (Second Historical Archives 1994: 428).

The continuing inability for domestic central governments to protect private economic actors from unauthorised arbitrary and excessive takings via the tax collection system by state and quasi-state (warlord) actors at the local level led to a multitude of related issues that impacted the fiscal capacity of the government and re-enforcing impacts on the ability of the government to reform the tax collection system or increase its tax revenue receipts. To begin with, without employing an effective strategy to end corruption, the central government's policy set was partially constrained into the levying low formal rates, given that corruption behaviour on the part of local authorities created significantly higher effective tax rates. In fact, both Ma & Rubin (2017) and Ko *et al.* (2018) suggest that poor supervising technology available to central state actors over local tax collectors—given the size and scale of the Chinese state—and the nature of external threats on the Chinese state implied a low level of official tax rates from the centre to be more optimal than higher tax rates. This arrangement, however, ultimately led to a weakening of state fiscal resources and thereby state capacity over time which became particularly acute when the Qing and subsequent domestic regimes faced the confluence of military and societal challenges beginning in the mid-nineteenth century and continuing over the following century. Alternatively, Dincecco (2009) suggests central states are constrained into low levels of tax extraction since local elites will oppose tax reforms that favour the centre given incentives to free-ride off the tax contributions of other locales. While Dincecco's research focuses on state capacity development in premodern Europe, much of the same taxing constraint dynamics also played a role in late-imperial China.

Second, the lack of authority over local tax collection abuses also led to continual and substantial increases in the number and scope of taxes imposed at the local level over time, thus increasing total effective total tax rates on private actors. One issue came from the imposition of so-called "additional" taxes, a practice begun in the late-Qing period as a response to meet greater remittance requirements from central government imposed on provinces as a way to raise monies for indemnity payments (Liu 2016). Additional taxes were taxes levied on top of a given tax. Once created, these taxes became a permanent feature of the local tax landscape, leading to onerous total tax rates, especially on the rural populace. Although there existed regulations that additional taxes could not exceed more than thirty per cent of the stated regular tax, in many areas the additional tax amounted to over one hundred per cent of the regular tax (Wu 1937). Both the Beiyang and Guomindang government attempted to limit the problems associated with the multitude of additional taxes, each instituting a tax rationalisation reform that combined all prior additional taxes into a new, higher regular tax. The results, however, were predictable; in each instance, within several years of the new "permanent" regular tax, new additional taxes again began to be imposed on top of these now-higher rates.

Further, not only did local tax rates increase, but so did the number and variety of taxes imposed. Bernhardt (1992:2008) finds the assessment of additional levies and surcharges on land taxes in Jiangsu rose drastically rise under the Guomindang, while Bianco (1995) describes the sixfold increase in effective land taxes in Anhui in 1932; after locals resisted, military force was enlisted to compel payment. A Zhejiang provincial survey (*Commission for Agrarian Restoration* 1935: 8) conducted in 1933 found the number of "auxillary" taxes assessed in many counties to have been as high as twenty. Chen (1936: 74-75) cites the plethora of taxes local individuals were forced to pay, noting "The numerous taxes [are] imposed by both provincial and district governments, such as sales and transit taxes on oil, on hemp, on hide, on fish, on fruit, on cow, on ox, on pig, on sausages and on dried mushrooms"; after 1932, additional bureaucratic structures led to additional taxes: "a family tax, a land sur-tax, a vegetable-weighing tax, a tax for the watchmen on *Sha-tien* [an agricultural land area frequently owned by local governments], and sometimes also an export tax on fish and shrimps. (This "export" tax is, of course, a unilateral local transit tax and has nothing to do with the ultimate destination of the commodity)." Chen continues by noting that the local government administrative unit known as *qu* [ku] (区) itself accessed an additional extensive array of taxes, including "licence and sales taxes on gambling and on opium smoking, assessments on temples and monasteries, licence taxes on religious feasts, wedding ceremonies, and on pig butchering, transfer taxes on land sales and land mortgages. Widows are permitted to marry again only after paying a fee of 6 Yuan, and this fee also goes to support the Ku bureau. In Yuh-nan, the sur-taxes added to the existing fees for pig and ox butchering and the new taxes on the "export" of chickens, ducks, fish, firs and pines, usually suffice to maintain the Ku bureaus in general; but the bureau of the 6th Ku, with a monthly budget of 660 Yuan, is being financed particularly by a sur-tax in grain on every mow of cultivated land in that sub-district. Some of the Ku bureaus in Kwangtung have a monthly budget of over 1,000 Yuan; that of Kwang-hai-ku in the district of Tai-shan, which takes 0.40 Yuan per picul from the "export" of salted fish to supply 90 per cent of its funds, has an expenditure of 2,000 Yuan a month... at the periodical village markets, 0.02 or 0.03 Yuan is levied for every 100 eggs."

Chen's description is further supported by a recent analysis by Gu (2015) on local taxes in Hebei during the Guomindang era. Gu enumerates over three hundred highly specific types of taxes that were imposed on nearly any imaginable type of economic or productive activity, included among them: a tax on goods made from leather; a "measuring tax" if a product sold in the market necessitates the need for scale or ruler to be employed; a tax for each chicken one kills; a specific tax on the rope used tie up pigs; a tax applicable on soup pots. The

expanding multitude of taxes also dovetailed with the practice of additional tax imposition, with Wu (1937) describing cases where additional taxes were imposed on taxes for the number of sheep owned, the amount of leather produced, or the number of structures build on one's property; in Jiangsu, for instance, he found there to be over 105 different types of additional taxes imposed. The number and specificity of such taxes underscores the way in which state power via taxing authorities penetrated through the very micro levels of civil and economic society by this time.

Yet, while indicative of the intrusion of state actors into all aspects of the economic landscape, it must be simultaneously noted that the majority of these taxes—especially at the local level—were imposed outside of the scope of central government bureaucratic tax administration. Further, as Chen (1936:73-74) emphasises, the practice of tax-farming, wherein which local or provincial governments would farm out the collection responsibility to nonstate tax collectors, enabled a collection system that was ripe with abuse: "tax farmer who, once the Government has accepted his bid, thereby monopolizes the collection. The actual sums collected by these agents are several times, sometimes as much as ten times, what the Government receives. This almost un-believable statement has been verified in a number of instances."

Finally, the lack of central government authority over local militia and warlords meant no matter how well-administered the official central or local governments' tax policies and collection schemes, local warlords could demand extraordinary taxes on the populace. This was done with regularity, especially in the rural areas and small towns (Chen 1926: 14). Several instances related by Wu (1937) indicate local warlords often demanded (arbitrarily) assessed taxes be paid in advance, sometimes multiple times a year, the result of which being that in certain locales, after several years of such forced payments, such tax collections had been paid in advance by twenty years or longer.

Somewhat ironically, all of these issues were occurring while some aspects of institutional state capacity at the national level appeared to improve. Both Strauss (1998) and Yin (2013) point to evidence that indicate noticeable improvement in tax collection methods over the course of the Guomindang period, reflective in part of larger and more authoritative central bureaucratic institutional structures. However, the considerable differentials between official and effective tax rates saw central state tax revenues rise only slightly, while the problems discussed above in regard to excessive tax extraction at the local level remained (Thornton 1999). The continual disconnect between central government tax policy and local level tax administration and collection led to a continually increasing tax load on private actors, with concomitant worsening perceptions of private property rights, yet the central state facing continual fiscal shortfalls. The frequency of tax refusals by peasants and merchants in response to increases of rates or types of taxes grew more frequent over the period, sometimes turning violent or leading to massive strikes (Ku 1978).

Meanwhile, on paper, even by the Guomindang period, official tax rates imposed on private businesses and producers were not particularly onerous, at least not at the national level. For instance, in 1934 official business tax rates averaged from one-half to two per cent of either capital size or business revenues (Ke 2013). Thus, the fundamental issue centred on differences between formal and informal tax rates—that is, between what was ultimately received by the national government, and what was siphoned away at the local level by warlords or local government officials acting with impunity given they were not effectively constrained by either sufficient monitoring or control mechanisms that could limit their arbitrary exercise of state or quasi-state power. Liu (2016) estimates only a quarter to a third of collected taxes reached the central government, with the rest captured by local state actors.

Finally, of significant import not yet mentioned is that all of these increases in tax rates and changes in collection methods occurring under the Guomindang took place in an environment that was perceived to have been more fiscally favourable, all things equal, than the situation facing the Qing and Beiyang domestic governments. In the wake of the Opium War and subsequent military losses to Britain, the Qing government had ceded the right to set tariff and import tax duties on foreign imported goods, agreeing under the 1858 Treaty of Tianjin, Article XXI, to a tariff rate on imported foreign good fixed at five per cent (Wright 1938). It was not until seventy years later on 25 July 1928, with the completion of a process beginning with earlier negotiations started with the Beiyang government and nine foreign treaty powers at the Chinese Customs Tariffs Conference in October of 1925 (Finch 1926: 124), that the Sino-American Tariff Treaty between the Guomindang and the United States was consummated, granting the domestic government full authority over tariff policies and duties fee structures, once other major treaty powers joined as signatories (Japan was the lone exception, not negotiating a comparable settlement until two years later.) The Guomindang regime wasted no time in exercising its ability to increase tariffs, and over the proceeding decade, average tariff rates increased more than fivefold, to twenty-seven per cent (Hsiao 1974: 75). Such increases in tariff rates yielded increases in tariff duty revenues, albeit only slightly more than trebling over the same ensuing decade, as opposed to experiencing a similar fivefold increase (Hsiao 1974: 84, Ji 2003: 1972). While part of the difference between percentage increases in tariff rates and tariff received revenues could surely be due to welfare losses due to increased trade barriers that tariffs represent[§], as with other forms of tax collection, corruption and bureaucratic inefficiency also played a significant role; Keller *et al.* (2011: 860) cite a Chinese Maritime Customs official estimating in 1931 such losses amounted to approximately twenty-five per cent of total tariff revenues. Nonetheless, such increases in received tariff revenues were significant—as Boecking (2017:1) notes, by the start of 1930, tariff duties accounted for the largest share and "single most important source" of Guomindang central government revenue prior to its fall in 1937.

In many regards, the lack of ability of the central governments to effectively implement widescale reforms to rationalise the tax collection systems is in itself indicative of a lack in bureaucratic state capacity. Central bureaucratic power was insufficient to enforce local representatives' adherence to official policy directives that mandated full transference of collected taxes to the centre and forbid corrupt behaviours such as levying unofficial taxes on citizenry let alone sanctioning keeping collected taxes for personal use. As Paauw (1952: 7) notes in his study of Guomindang-period fiscal issues, the government's ability to collect sufficient levels of tax revenue was constrained both by bureaucratic inefficiencies and by its decision in 1928 to forgo its claims on land tax—the traditional base for central government tax revenue from historical times—and allow land taxes to be administered and retained solely at the provincial level. As a result, "[t]he central government was forced

§ For the most part, we put aside for this discussion the economic wisdom of imposing tariffs on imports as an effective growth strategy. This is an issue well-debated in the literature. While both classical and standard neoclassical static trade theory suggest barriers to trade such as tariffs reduce aggregate economic output (Smith 1776: IV,2, Boudreaux 2002; and Jones 1961, Krugman & Obstfeld 1994, respectively), Buchanan & Yoon (2002) present a compelling theoretical critique of both approaches. Further, more dynamic approaches taken by those such as Krugman (1987)'s learning-by-doing proposition, and the implications of discriminatingly-applied tariffs on selective industries under the assumptions of Grossman & Helpman (1991)'s endogenous growth models, suggest there are possible growth-enhancing features of tariff application. Such contested theoretical constructs are reflected in an associated conflicting array of empirical results, represented notably by what Clemens & Williamson (2001) label a "tariff-growth" paradox with higher tariff rates associated with both higher and lower economic growth rates across countries, differing by time frame; Rodriguez & Rodrik (2001) similarly highlights the lack of conclusive evidence in the empirical data, finding no significant relationship between tariff rates and national income, for several measures tariffs and trade protections. Keller *et al.* (2012) explore this issue in the Chinese context during this period.

to rely on the taxation of salt and manufactured goods for a great part of its disposable income. Because of the continuance of atavistic collection systems in these areas of taxation, however, costs of collection were extremely high. In some cases 20 per cent of gross revenues was allocated to the support of the collection system. The inability of the government to reduce these costs and its unwillingness to reach out to the field of taxation of agricultural returns made it impossible to produce tax revenues equivalent to the levels of total expenditures." Several motivations were behind the Guomindang's move to forgo the central state's historic right to the land tax. First, the government lacked bureaucratic capability in managing a widely-dispersed and atomised tax system to be collected at the local village level in predominantly rural settings; as discussed directly below in regard to the collection of salt monopoly taxes, corruption amongst local tax officials was extensive. Chen (1936:74)'s research indicates local tax collectors captured upwards of ten times the amount actually reaching the central state tax administration on central government taxes accessed locally; as he notes, while such figures might logically be met with scepticism, were consistently verified across multiple data sources. Focussing collection efforts on the more concentrated industrial sector could be viewed as a more tractable exercise, albeit one with growth-stifling implications (Paauw 1957: 217). Moreover, however, this decision might be better understood in light of the "violence trap" postulate, advanced below—facing powerful rivals with access to local military power that could threaten the power of the central state, Guomindang central leadership strategically chose to grant these provincial-level actors benefits in the form of full access to the land tax, as a way to receive political support in return, decreasing expected likelihood of military conflict with such rivals.

5.1.1.1. Salt Monopoly Tax Collection Analysis

Gale (1930: 241) partially confirms these contentions in his discussion of the salt gabelle tax. To begin with, he notes that by 1909, there existed large discrepancies between the amount of salt tax estimated collected and that received by the central government: "Estimates as to the annual gross collections varied from forty-eight to sixty-four millions of taels of silver. Only the *net* amount remitted to the Central Government was agreed upon by various authorities to be in the neighborhood of thirteen million taels."

The situation changed rather drastically, however, after the terms of the Reorganisation Loan Agreement of 1913 required the creation of the Central Salt Administration. While technically a bureau of the Ministry of Finance, it was organised under joint control of the Ministry and foreign administrators appointed by foreign bankers to represent the interests of foreign bondholders. The Chinese-appointed Chief Inspector was paralleled by a foreign associate of equal level, and likewise at the provincial level dual Chinese and foreign District Inspectors were in charge of the collection of salt tax revenue. Substantial increases in received salt tax revenues occurred. As Gale (1930: 250) reports, "The amount of thirteen million taels (silver dollars twenty million, approximately) generally agreed upon as the *net* sum obtained by the Central Government, prior to the reorganization, now swelled rapidly to \$60,409,676 in 1914, and by 1922 reached as high as \$85,789,049." This fourfold increase in net revenues was achieved, Gale stresses, not via increases in tax rates, which were held basically even, but rather as a result of better administration.

The benefits of the system accrued not solely to foreign bondholders dependent on the regular and sufficient collection of salt gabelle revenues as the income-generating vehicle for their investment—the central government treasury received the positive remaining balance after the Reorganisation Loan bond obligations were paid, and thus represented funds available to central state actors to allocate as they pleased. These balances proved considerable; whereas in 1913, there existed no surplus, by the following year the surplus amounted to over thirty-one million *yuan*, and by 1922 it reached seventy-eight million.

The significant contrast between the success the foreign-assisted salt monopoly tax administration had dealing with corruption, compared to that of the solely domestically-administered tax extraction system, as attested to by the threefold increase that occurred in the first year of joint foreign-domestic salt tax administration operations, is remarkable. Such drastic changes in tax extraction efficacy under the joint administration system begs the question—why was it that such high levels of corruption by local tax collectors were observed under domestic administration of tax collection, but relatively so little under the foreign-assisted administration?

To begin with, it is clear that the answer lies not with any inherent incompetence in the potential organisational capabilities of central-level tax bureaucrats. Central tax collectors were well-aware that vast amounts of collected revenues were not being forwarded to the centre, with Gale (1930: 241) noting the state treasury had made multiple, if somewhat high-variance, estimates of the size of such differentials. Thus, those within the central state tax administration well understood that improving tax collection efficiency by reducing the incidence of corruption would portend a much greater rate of collected tax revenues flowing into the central treasury from the local level. Further, these central administrators had access the institutional knowledge necessary to design a system to limit corruption so as to address such discrepancies. As Gale (1930:250) observes, the reform instituted by the foreign-assisted Central Tax Administration essentially reflected the return to tax administrative procedures that had been in existence in China for centuries; specifically, the reforms reflected the "restoration of the T'ang [methodology]". Domestic administrators did not require the assistance of foreign advisors to arrive at such an ingenious solution, for the "new" procedures implemented under the auspices of the Central Salt Administration were already well known. Hence, we require an alternative reason to explain the observed difference in corruption within the system than a lack of wisdom or ability on the part of domestic administrators to design a system less susceptible to such behaviours.

Similarly, no inherent fundamental flaw existed within in the corps of domestic local-level officials who served as the system's tax collectors. Even under "foreign"-assisted administration, the actual number of foreign staff was marginal compared to the total number of local bureaucratic staff involved in the collection of tax. The appointed foreign District Inspectorates and their foreign support staff were not involved in the minutiae of tax collection at the local-level in the scores of towns and cities where tax was actually collected. Nor did the creation of the Central Tax Administration involve the dismissal of the original local-level tax collectors who had been involved in imposing heavy taxes and extortion on salt merchants prior to 1913's reorganisation (Zelin 2004: 242). It becomes apparent that the same local tax collectors who had been so heavily engaged in corrupt tax collection practises under domestic administration of the salt monopoly tax system quickly became more competent and moral in the execution of their duties under foreign-assisted administration.

Given no inherent lack of incompetence or wisdom on the part of domestic central tax administrators or local tax collectors, we are still faced with the question as to what drove the sharp change in corrupt behaviour—why could foreign administration lead to changes in the interests and incentives shaping domestic local tax officials' behaviours that domestic central state tax administrators were unable to induce?

The answer revolves around a change in the power dynamics defining the relationship between administrators and tax collectors that changed the weight of consequences that central authorities' oversight ability could induce from local tax collectors. Under the system existing prior to the creation of the Central Salt Administration, oversight of salt tax collection occurred primarily at the provincial level—provincial administrators, headed by a provincial salt commissioner who ultimately answered to the authority of provincial

governors. Thus, the incentives of such a provincial oversight system did not align with the incentives of central tax administrators; provincial administrators necessarily were more interested in greater amounts of collected tax revenues remaining within the province than flowing upward to the central government. The new system brought with it a bureaucratic change where rather than a provincial salt commissioner responsible to the provincial governor, control was now in the hands of District Inspectorates, who were responsible to the central Chief Inspectorates. This change in the chain in command provided a different set of incentives behind those responsible for conducting oversight activities.

The answer to our first question however presents two related questions—one, why is it that local tax collectors responded to the pressure of oversight by the foreign-administrators? And, two, if simply changing the oversight dynamic from provincially-determined to direct central administration could have brought such significant increases in the amount of tax revenues flowing into the central treasury, why is it that central salt monopoly tax administrators did not undertake such changes earlier?

The answer to these two questions is related to the issue of political power; that is, the authority to enforce oversight, and to force changes in the tax administration system. The presence of foreign administrators changed existing power dynamics. The authority of foreign administrators was backed by the implicit power of "gunboat diplomacy", power that had been explicitly displayed just over a decade earlier in the form of the Eight-Nation Alliance military forces which overwhelmed China's military. As a result, foreign administrators were perceived as fully possessing the power to enforce oversight, and more fundamentally, to force bureaucratic changes to tax administration operation that brought the oversight process from provincial control to central control. Thus, when seeking to understand why it was that central tax administrators had not already implemented reforms to reassume control over the oversight process of local tax collection from the provinces, the lack of power possessed by the central government vis-a-vis the provinces proves highly salient. This can be evidenced by the fact that the administration of other taxes during the Beiyang period were not reorganised along the lines of the salt tax system, employing central as opposed to provincial oversight, even after the establishment of the Central Salt Administration clearly demonstrated that direct central oversight could produce greatly higher rates of the locally-collected tax revenues received by the central government's treasury. Unlike the appointed foreign administrators who had the implicit backing of foreign military to back their demands to wrest control of salt tax collection administration from the provinces, domestic administrators were backed only by the relatively weak power of the central state, whose military power compared to the that of the provinces was at best equal. As Ni & Van (2006) and Liu (2016) note, provincial and local administrators received great personal benefit from the way the domestic tax system operated. As such, they had no incentive to change the system; without power to force changes to the existing system, it was not possible to induce fundamental changes.

This issue of the lack of power by the central government to enforce a monopoly on violence in relation to other dispersed sources of potential violence recalls the argument put forth by Weingast and his co-authors that state actors in such weakened positions look to undertake actions that decrease the possibility of violence when the expected return from fighting is negative (North *et al.* 2009, 2013; Cox *et al.* 2017). In this instance, central state actors were likely to have perceived the expected return on attempting to force provinces to give up control over tax collection administration—and with it the ability to retain a majority of those collected taxes—to be lower than the expected costs that resulted from fighting the provinces on this issue, risking outright revolt on the part of the provinces and a high chance of the loss of power by central state actors. As later discussed in Section 3.3 of this chapter, the frequent occurrence of such revolts and loss of power that occurred throughout the warlord era indicates these risks were imminent and realistic.

Finally, an important coda to the Central Salt Administration account is that the period of bureaucratic competence with a high percentage of locally-collected tax revenues flowing to the central state treasury began to unravel as the warlord period advanced, and the level of central government control over the provinces diminished further. The high of eighty-six million *yuan* collected and remitted to the central treasury in 1922 fell to under nine million by 1926, as provinces resumed local control over the taxation on salt, expelling or ignoring District Inspectorates. These events underscore the costs of societal-level violence as related to the issue of state capacity. However effective and efficient the reorganised Salt Administration bureaucratic structure had become, the ability of the structure to function was undermined by the near-complete breakdown of an internal monopoly on violence exercised by the central state.

5.1.1.2. The *Lijin* Tax System

Lijin, a tax on traded goods that appeared in the late-Qing and survived well into the Guomindang years, is illustrative of the undulating level of the central state's ability to collect tax revenues from private actors in a rationalised manner. The decision by the Qing court officials to cede administration of *lijin* and other transit taxes to local provinces created a taxation structure susceptible to arbitrariness and corruption, and led to *lijin* becoming a severe imposition on the private property rights of domestic Chinese merchants. In addition, the exemption from the tax of most foreign merchants that was granted under the late nineteenth century's "unequal treaties" agreements, resulted in *lijin* taxes only applying to goods traded by Chinese merchants, creating an unequal playing field as well as contributing to additionally pernicious conditions for domestic economic development.

Up through the mid-Qing era, the Court had maintained a relatively light tax burden on the population. From the start of the Qing, the government had assessed taxes based on population (丁銀)—every household paid taxes based on its number of male adults. In 1712, in an effort to lessen the burden on the poor, Emperor Kangxi converted the tax system to a land-based tax and announced a promise to "not increase taxes despite population increase" (滋生人丁, 永不加稅). Subsequent Qing emperors abided by this promise for almost 140 years (*Qing shenzu shilu* 1712: 249; Zhang 1787:19/502).

Prior to 1851, the main sources of government revenue came from three categories: land and crop taxes, customs duties, and salt monopoly taxes, with land and crop taxes comprising the majority of government revenue. Scholars generally agree that the tax burden was rather light—from the eighteenth through the mid-nineteenth centuries, imperial taxes comprised no more than approximately two to four per cent of the total agricultural output; such rates were considerably lower than the ten per cent or more found in Meiji Japan and European feudal states (Wang 1973, Huang 1985: 278-81). Records indicate that in 1821, the government collected a total of about 45 million *taels* in tax revenue, of which land and crop tax constituted 33,348,034 *taels*, salt franchise tax 7,475,879 *taels*, and customs duty 4,352,208 *taels* (Luo 1936: 4). However, by late-Qing the state often faced budget deficits, with collected taxes insufficient to cover annual government expenses. While the Court supplemented state income by sale of official titles or imperial favours, new revenue sources were desired.

One of the more destructive forms of tax employed under the late-Qing was a series of "transit taxes" levied on the internal shipment of goods. Of these transit taxes, the *lijin* (*likin* 厘金; or 厘捐) proved to be perhaps the most onerous. Initiated in 1853 as a voluntary donation by local merchants at the exhortation of a lower Yangzi government official, Lei Yixian (雷以誠), it was designed to support military expenses to quell a local outbreak of the Taiping Rebellion (Liu 2007: 45). The tax was intended to be modest; 厘 refers "one

thousandths of a *tael*", and 捐 refers to "donation" or "tithe"; hence, it implied a tax rate of one-tenth per cent (Mann 1987:75 argues that the original intended amount of the tax, regardless the technical meaning of 厘, was one per cent surcharge, although this matter still faces some debate). At Lei's urging, merchants and shop owners were urged to donate one-tenth per cent of the value of their goods in transit or in the shop to the local military fund initiative. Lei, in his submission to the emperor Xianfeng, extolled the advantage of *lijin*: in his view, the small percentage charge would not impose material burden on the populace, yet could significantly to raise much-needed funds for the government. Xianfeng endorsed the practise, and as the concurrent Taiping, Du Wenxiu and Dungan rebellions continued to drag on, in 1861 the emperor requested officials in other regions to adopt the same policy.

While Lei had initially envisioned *lijin* a temporary measure to be discontinued after the rebellion ended, as frequently occurs in public finance, the introduction of a new revenue stream is not readily relinquished by government actors. Whereas *lijin* was initially treated as a "voluntary donation" and not a formal government tax—with collection originally conducted by designated local business leaders as opposed to state tax officials—the state's need for revenue coupled with the relatively easy access to the revenue quickly led to *lijin* evolving from voluntary donation, based on the power of moral suasion and social pressure, to being replaced by a mandatory payment obligation backed by the authority of the state.

A crucial factor regarding the *lijin* tax was its administration—specifically, that provinces controlled the collection methods. The implication of this approach was a great complexity and duplication of taxation on traded commodities. Goods were taxed multiple times and in multiple ways—at the place of production, in transit, and at the market (Luo 1936: 55-57). As such, effective tax rates were considerably higher than the originally-envisioned one-tenth per cent. In addition, *lijin* represented only one of a host of transit taxes that came to be imposed on internal trade. Anhui, Jiangxi, Hunan and Zhili imposed "destination tax" (*loti shui*); other provinces levied differing forms of transit taxes: boat tax, coast tax, canal use tax, "gate" (entrance) tax, distance (里) tax, and provincial tax (Muhse 1935:240).

Lijin collection was especially heavy in the littoral Yangzi regions where commerce was most developed. Jiangsu province alone accounted for more than twenty per cent of all *lijin* revenue from 1869 to 1908; while this fell to fourteen per cent by the early 1920s, it remained the largest contributor (Luo 1936: 464-467). Jiangsu, Anhui, Hubei, Guangxi and Gansu adopted a checkpoint collection system, with local tax authorities setting up multiple checkpoints along transport routes where *lijin* was required to be paid at each. In 1880, a letter to the Qing Court indicated that from Yangzhou to Huaian (two Jiangsu cities about 150 kilometres apart), there were no less than eight *lijin* checkpoints; from Suzhou to Kunshan, a distance of about 30 kilometres, there were four checkpoints (Luo 1936: 61). Moreover, while *lijin* taxes were prescribed to not total more than five per cent within any single province, in practise such limits were not adhered to by local officials, and depending on the distance and place of transit, goods could potentially be subject to as high as twenty per cent cumulative *lijin* rates, and averaged from ten to fifteen per cent (RSA 126: 886).

In contrast to the experience of domestic Chinese merchants, foreign merchants were exempt from paying the *lijin* tax, owing to a provision in the Treaty of Nanjing of 1842. In addition to requiring China to pay the British an indemnity, cede the territory of Hong Kong, and extend extraterritoriality to British citizens, the treaty compelled: "His Majesty the Emperor of China agrees to establish at all the ports which are, by the 2nd Article of this Treaty, to be thrown open for the resort of British merchants, a fair and regular tariff of export and import customs and other dues, which tariff shall be publicly notified and promulgated for general information; and the Emperor further engages, that when British merchandise shall have once paid at any of the said ports the regulated customs and dues, agreeable to the tariff to be hereafter fixed, such merchandise may be conveyed by Chinese

merchants to any province or city in the interior of the Empire of China, on paying a further amount as transit duties, which shall not exceed ___[unspecified in Treaty] per cent on the tariff value of such goods" (Article X, Treaty of Nanking and Declaration Respecting Transit Duties 1842-1843, Kew National Archives: FO 1080/341).

The Declaration on Transit Duties, signed 26 June 1843, further elaborated on the transit duty, with the final tariff rate set at five per cent *ad valorem* in 1858, with transit duty an additional half of the tariff duty, 2.5 per cent. Much of the subsequent Treaty of Tientsin, signed on 26 June 1858, was also concerned with tariff and customs dues, with thirteen of the fifty-six articles directly addressing this issue (Articles XXV-XXXI; XLI,-XLVI). Article XLIII, for instance, provided custom duties dispute resolution methods and provided rights to British citizens to protect themselves from arbitrary tax extraction by local officials. These and subsequent treaty provisions were soon extended to apply to traders of other European nations. As a result, western merchants were not subjected to *lijin* and some of the other transit taxes that domestic merchants faced when shipping goods. The consistent fixed tariff rate and one-time transit tax provided relative transit cost predictability to foreign merchants.

The disparate experience regarding transit taxes facing foreign and Chinese merchants was considerable. A 1926 report commissioned by the US Department of Commerce on political and conditions within China describes the transit tax situation by noting that while, "likin is generally recognised as one of the serious detriments to trade development in China, comparatively few foreign merchants have ever been conscious of it... It is the Chinese merchant who loads the goods on to freight car, steamer, junk mule pack, and contrives them as best he may through the barriers, enduring at each succeeding one new charges and new vexations that may bring him to the end of his journey faced with a heavy loss" (RSA 1926: 888).

However, while in practice foreign and domestic merchants faced different transit tax costs, the observed differentials should not be ascribed to an implementation of imperialist power, forced upon the Chinese state by foreign powers. Designed to provide predictability and standardisation in tax costs, no treaty provision language required foreign merchants to receive preferential tax rates vis-a-vis domestic merchants. The wording negotiated by British representatives at the Treaty of Tientsin, for instance, clearly intended the exclusion from additional inland tax obligations contained within Article XXVII to apply to all merchants shipping goods intended for export, regardless nationality—foreign or domestic (Hertslet 1908). In practice, however, local tax authorities refused to exempt Chinese traders from the tax (Wright 1920:92-93;109). Hence, the greater tax burden on domestic merchants is indicative of a Chinese state overtaxing domestic commercial activities. While treaty provisions provided foreign merchants protection of their property rights; domestic merchants, conversely, lacking the backing of foreign gunboats as a balance to domestic state power, were consequently not afforded the same protections.

The differential impact of multiple layers of transit taxation on domestic merchants was considerable. The 1926 *China Handbook* describes several examples of ways that the same goods shipped from overseas by foreign merchants could be sold more cheaply on the market than domestically-produced goods, simply due to transit tax differentials: "timber from abroad paid 5 per cent, while timber from Kweichow [Guizhou] province moving to Hankow or Shanghai had to pay a total of 17 per cent in inland charges; Hangcho silk, shipped to Peking by native merchants paid a total of 18 per cent, while the foreign trader could ship the same silk via Tientsin under the protection of a transit pass for 2¹/₂ per cent" (208).

Chinese and foreign merchants responded to the incentives of the institutional arrangement of the imposed tax structure and its unequal application across foreign and domestic market

participants accordingly. Already as early as the late 1850s, Chinese tea merchants often transported their shipments via foreign merchants, such as the British firms Dent & Co., and Jardine, in order to circumvent the *lijin* system (Hao 1986: 266). Indeed, some foreign merchants sold to domestic merchants the use of their passport or identity (Zheng 1893:533), or specialised in helping Chinese ship-owners obtain British registry (Dennett 1963: 583-584). Chinese merchants also tried to disguise their business as western in order to utilise the transit tax privilege accorded to their western counterparts. Reports of Chinese vessels flying foreign, especially British, flags were common, with Jardine representatives describing the practise and attributed the reason to the Chinese ship-owners seeking to avoid the extraction and harassment from local Chinese officials or from pirates (JMA Letter to Thomas Dick, 27 April 1869). In 1882, the British consular report recorded Chinese merchants taking advantage "of the provisions of the British treaty...by employing a foreign merchant as his agent to bring down the goods [from upper Yangzi] and pay the duties [instead of *lijin*] on them" (British Parliamentary Papers, Chinkiang 1882: 3). Such arrangements did not always end well for the domestic merchant; Zheng (1893: 534) describes cases where Chinese merchants suffered losses after entrusting their goods to foreign merchants, either due to fraud or financial distress on the part of the latter. In such cases the Chinese merchant had little recourse given that their agreement with the foreign merchant was undertaken to circumvent *lijin* taxes required by domestic authorities.

Thus, the primary problematic feature of the *lijin* tax system was owing to the nature of its administration. Although originally sanctioned by the central government's imperial court, it was administered by local provincial governments, with decisions on the specific rates to be levied, the number of times goods might be taxed, and the methods of collection all left to local authorities. The ceding of authority of *lijin* and other transit taxes to local provinces created an incentive structure that encouraged the entrenchment of the transit tax system, and a coordination problem amongst tax-imposing localities.

To begin with, that local authorities were fully responsible for the application and oversight of the transit taxes opened the doors to high degree of arbitrariness in its application, and to abuses of power. The aforementioned 1926 US Department of Commerce report further states that "In four cases in Kiangsi [Jiangxi] the same kind of goods paid over the same route to Shanghai in one instance a total of 2.2 per cent, in another 3.7 per cent, in a third 3.9 per cent, and in the fourth 7.5 per cent" (RSA 1926: 886). Likewise, embezzlement and abuse by local officials became widespread. As early as 1875, reports in the local newspaper *North China Herald* (19 June 1875: 233) were calling attention to the plethora of tax collection offices set up to patrol boundaries of Shanghai's extraterritorial settlements, designed to capture revenues on goods leaving the tax-exempt settlements to the domestic interior. Some of these tax-collection offices were run by government officials, while others by private merchant associations; both however, reportedly operated by accepting "squeeze" (bribery). Bell & Woodward (1912: 87) note that it was commonplace for the official tax rate to be "practically ignored by both officials and traders, by the former in order to allow for 'squeeze', and by the latter in order to pay an enhanced rate (which would have been imposed in any case) on a lesser amount of goods than is actually being cleared." As Zheng (1893: 534) notes, such a situation disadvantaged law-abiding domestic merchants while rewarding ones willing to engage in bribery and corruption. Chen (1914: 102-104) describes numerous abuses by the tax officials at the expense of the merchants, including that administrators would pocket the transit fees for themselves, hence leading to official records of *lijin* collection amounts to heavily undercount the true amounts paid by merchants. Luo (1936), too, presents dozens of recorded instances of fraud practices and extraction. Collectors frequently demanded small bribes in order for them to issue receipts or release goods. In provinces where regulations decreed *lijin* on a shipment of goods was to be paid only once, the merchant was supposed to be able to show a receipt indicating prior payment of *lijin* at the other collection points to prove that *lijin* had already paid.

However, it was not uncommon for the officials at the next collection point to claim an insufficient amount was paid at the previous collection point, and demand additional payments (Muhse 1935: 239, Luo 1936: 128-131). Thus, domestic merchants were subject to the whim of local collection officials, for in order to obtain the release and avoid impounding of their goods, payment had to be made, especially since there existed no formal procedural system for merchants wishing to dispute the imposition of a given tax fee.

That the localities collected and kept the tax proceeds directly indicated the degree to which the central government lacked the power to exert control over the provinces in their manner application of these taxes. By the turn of the century, the *lijin* tax had become further entrenched as it accounted for the vast majority of provincial government revenue; given that Qing, Beiyang and Guomindang governments were all heavily fiscally strained, they were loathe to dismantle the system without possessing a replacement stream of income (Bird 1899: 537, RSA 1926: 885).

Kang Youwei (康有為), a leading late-Qing reformer, writes in 1904 of the way in which the central government had lost control over the provinces via fiscal decentralisation: "The power of financial control is now vested not with the central government but with the provincial authorities. When the [national government's] Board of Revenue needs money, it asks the provinces to apportion among themselves without bothering with the methods of fund-raising... The Board of Revenue exerts no direct [financial] control over the nation... It is so obvious that provincial authorities exert financial control to the utmost and the Board of Revenue is utterly powerless" (quoted in Ho 1959: 66).

Soon after the establishment of the Republic in 1912, there were immediate efforts to create a more uniform tax system, with intention to either abandon or significantly simplify the *lijin* system, which was increasingly recognised as an obstacle to greater interprovincial and international trade. As Robinson (1913:451) relays, "One of the chief obstacles to trade in China is the almost absolute lack of anything resembling order in the assessment of taxes and *liken* or customs duties. In many instances goods in transit are subjected to repeated assessment en route from province to province and sometimes from town to town, in order to furnish 'squeeze' for the officials." Although the author optimistically reports that based on "receipt of recent personal communications from high authorities... a change for the better is confidently looked for in the near future," his optimism proved unjustified, or at the least, the private information upon which he based his assessment was flawed.

Conflicts of interest between central and local governments remained a perpetually unresolved issue. Bloch (1939:133) reports that much of the Guomindang central government's fiscal issues were exacerbated by its weaknesses in administrative authority, explicating the range of ways local officials extracted property from private economic actors: "local authorities levied a multitude of different assessments on urban rent, on pawnshops, on butchers, etc, many of these levies taking the form of lump sum contributions of all the firms in one line of business individually assessed by the guilds or chambers of commerce themselves. Moreover, in some provinces, internal customs levies continued; and, actually, illegal revenue from the taxation of opium, gambling and vice (officially suppressed) often played a major role in the budgets, not to mention the rich source of monetary inflation to which quite a few of China's provincial satraps resorted even as late as 1937."

Thus the system was entrenched even while the central government wished to dismantle it. At the Chinese Customs Conferences held in Beijing in 1925 and 1927, foreign government representatives repeatedly suggested for the removal of the *lijin* system, to which central government representatives agreed, but were unable to implement (Muhse 1935: 241). The Guomindang Party also attempted to abolish the *lijin* in 1926 over the limited territory it controlled at the time, but proved unsuccessful. Even after the Party secured control of the

central government after the Northern Expedition, a proclamation to abolish the *lijin* system on 10 October 1930 failed to actualise (Coons 1934: 79). It was only after land tax revenues were allocated directly to the provinces to serve as replacement for *lijin* that a second mandate by the Guomindang Party on 31 January 1932 proved slightly more successful in ending the practice. Nonetheless, writing nearly three years later, Muhse (1935: 242) notes that several outlying provinces such as Sichuan were still employing the *lijin*.

Of far greater importance was the fact that while the *lijin* was eventually nominally abolished, it was soon replaced by numerous other transit taxes that remained in effect far longer. An editorial by the *Jen Min Jih Pao* newspaper entitled "Is Likin Abolished?" answered its own query strongly in the negative, noting that the 'Special Consumption Tax' and 'Consolidated Tax' that replaced the *lijin*, and whose combined scope covered twenty-four broad categories of commodities, simply represented the same as that which they replaced: "is there really any difference as to their [the old *lijin* and new taxes'] scope? Is there any commodity which does not fall under one or the other of the 24 headings to which the Consolidated and Special Consumption Taxes apply?" Going further, the article laid out in detail that the fact that the new taxes were to be collected in the same manner as the old *lijin* had been that there was to be no difference in the application of the new taxes with that of the original: "In *Regulations Governing the Collection of the Special Consumption Tax* it is stated in Chapter II, Article 7: 'The tax offices shall be established at places where the goods are produced, manufactured or concentrated.' In *Regulations Governing the Inspection of goods subject to the Special Consumption Tax* it is stipulated in Article 2: '(1) When goods are in a centre convenient for inspection, the tax office shall send its inspectors to inspect directly the quantity in stock and sold, and to determine the amount of the necessary taxation. (2) When goods are scattered in various places not convenient for inspection, branch offices shall be established at the main routes through which goods are transported, where the goods shall be examined according to the bills of lading. (3) Goods transported on rivers and their tributaries, which are not convenient for direct inspection, shall be subject to inspection by inspectors on boats possessed by the tax offices.' In other words, the Special Consumption Tax will be collected at the same points where *likin* was (and still is) collected, causing the same inconvenience and trouble to merchants as its predecessor *likin*, the same delays releasing goods under inspection, and creating the same opportunities for exaction and extortion. And against administrative negligence and misbehaviour, the poor merchant has no effective remedy. ...with legal costs and lawyers' fees so high, and the machinery of the law inefficient and undependable, who would care to settle disputes by recourse to administrative law?" (*Peoples Tribune* 1931: 23).

It is noteworthy that the final sentence of the cited editorial conveys concern not only on issues relating to the unjust application of taxes on commercial activity, but also speaks to the lack of protection afforded private economic actors from an independent application of the law against the overreach of state power. If anything, the creation of new taxes simply added to the existing *lijin* taxes, which continued to be applied sporadically. As noted by a report in the 31 December 1933 issue of the *North-China Daily News*, high transit taxes in the form of a modified *lijin*, and the *lo ti shui* destination tax, were in heavy use in Shaanxi province at the time, depressing local trade. Xu (1935:53) reports that as of December 1934, interprovincial transit of a shipment of sugar between Zigong and Chongqing was levied twenty unique transit taxes as it made the journey across nine counties.

Oddly, the view of the *lijin* as a relatively benign tax system is sometimes advanced in the literature, here exemplified by Perkins (1967:482): "But the tax was not excessive if one abstracts from foreign competition and arbitrary administration...Much of the burden could be readily passed on to the consumer. Seldom was the tax administered so harshly that it destroyed commerce in an area altogether... Generally the transport costs entailed in avoiding a tax station were much higher than the tax."

Conversely, we argue the opposite—that *lijin* and other transit taxes represented a severe imposition on the private property rights of domestic Chinese merchants. To begin with, the *lijin* tax system symbolise an example of the disruptive presence of the state in commercial affairs, exemplifying aspects of both facets of the way in which the domestic Chinese state contributed to a relatively weak private property rights environment. On the one hand, these transit taxes were symbolic of the role of the "state-as-leviathan" framework, as the imposition and expansion of such taxes represented the "grabbing hand" of the state, especially in so far as it took from the sector of the economy that was most successful, thereby undermining economic growth. At the same time, the way in which these taxes were administered is equally illustrative of the relatively weak power the central government possessed to prevent other actors (in this instance, local authorities invested with the trappings of local state power) from infringing on the private property rights of merchants. As described, it was in fact well recognised by numerous contemporary actors that the existence of transit taxes was harmful to trade and economic growth; these actors included many within the central government. However, given the fiscal autonomy possessed by the provinces—as Wu (1935:190) comments at the time, "Most provinces have their own treasuries and their own provincial banks"—combined moreover with the implied threat of locally-based military power backing many local provincial leaders, the various central authorities continually lacked the power to coerce the provinces into ending these taxes.

Second, it is instructive to note that once introduced, the effective tax burden on domestic merchants ballooned from one-tenth of a per cent, up to ten to twenty per cent. Such a system represented a tremendous disincentive on (inland) trade activity, which had previously served as one of the main drivers of commercial growth for the Chinese economy over the preceding century. Third, relatedly, these disincentives were applied discriminatorily on domestic merchants, as they suffered a tax burden of which businesses operating under extraterritoriality were exempt. This not only economically disadvantaged domestic economic agents, but also created resentment towards both the government and foreign business, especially since many local tax officials would seek to recoup fees they might otherwise have charged foreign merchants by levying higher rates on domestic traders (Muhse 1935:238). In general, the system placed domestic business at a tremendous disadvantage, increasing their cost of production and transit, as well as the amount of time attending to administrative and rent-seeking activities. Fourth, it was the administrative process of the tax's application that exacted the most negative impact on commercial activity. The arbitrary nature of its administration generated additional business uncertainty for the domestic merchant. Arbitrary tax rates are arguably more disruptive to economic activity than consistently-applied high taxes. The system also led to an increase in corruption, as bribery and abuse became widespread. Both factors represented a deterioration in the overall private property rights framework in which domestic economic agents conducted their economic activity.

It is hardly reassuring to note that "seldom was the tax administered so harshly that it destroyed trade altogether"; indeed, as argued above, the tax was applied to the most commercially active and vibrant section of the economy and country; the question is not whether trade was completely stifled, but rather, what might it have been if not for a discriminatorily-applied onerous tax burden. Further, the secondary and tertiary effects of the tax scheme were likely extremely high. Trade flows create multiplier effects throughout the economy—indeed, one of the reasons the size of the financial sector in Shanghai was so large was because of the amount of trade flow through it owing to its treaty port status, since trade flows require capital moving in and out in support of the flow of goods. The development of financial services leads to easier capital supply and hence lower capital costs, which other business ventures could have accessed. The suppression of trade activity throughout China due to the imposition of *lijin* created disincentives for trade and thereby depressed financial development, hurting overall economic growth opportunities.

Additionally, beyond the impacts of paying arbitrarily higher tax rates compared to foreign merchants, rent-seeking behaviour was encouraged amongst domestic merchants. As indicated above, considerable time and effort was spent on efforts to avoid the tax, or to bribe or coerce tax officials to lower the effective tax rate; all these efforts, therefore, went towards non-productive activities. Hence, rather than creating beneficial conditions within which private economic agents and entrepreneurs could most-readily identify and respond to economic opportunities, the unequally-applied *lijin* tax system represented an example in which state agents—starting with the Qing and continuing through the 1930s—impinged heavily upon the private property rights for domestic economic agents.

The detrimental effects of the *lijin* and other transit taxes were well-recognised by contemporaneous observers. Zheng (1893:534) in his *Words of Caution* treatise directly labels the *lijin* tax system extremely disruptive to commerce, and argues for its outright abolishment. Bird (1899: 537) notes transit taxes "effectively hamper trade". Chen (1914: 103) decries the practice of goods subjected to repeated taxation, as well as the interference with trade owing to increased uncertainty for merchants. Nonetheless, weak central state capacity enabled this economically harmful tax system to remain in place through the mid-1930s.

Note that this situation is reflective of the type of behaviour expected under the Violence Trap framework, as to be explored later in more detail. Emblematic of a weak state capacity that was unable to enforce control over local players who possess their own power base that included military might, central state actors were incentivised to mollify local elites with favours. Since fighting these local elites was costly, even when there were indications that central state actors desired to end the *lijin* policy, its accounting for such significant amounts of local provincial revenue, meant local elites and provincial rulers would strongly resist, and in ways that could include the power of violence to resist.

5.1.2. Fiscal Expenditures

While the state faced a multitude of difficulties raising sufficient capital, ultimately, it was state actors' inability to control expenditures in line with the constraints imposed by limited revenues that drove the country's mounting fiscal problems. Earlier periods of Qing governance are typically described as *laissez-faire* and low-expenditure in nature. The shift towards greatly increased expenditures during the late-Qing was driven primarily by increases in military spending, and subsequent increases in the size of state administration. In spite of continued expressed commitments to increasing investment in economic development and social welfare goals, in practise, the domestic Chinese governments in the post-Opium War time frame spent essentially the same percentage of their budgets on socioeconomic programs as it had in the prior. Instead, military and related spending continued to dominate the budgets of the successive domestic Chinese governments.

Spending on actual military outlays was significant under the late-Qing, as the costs of controlling the Taiping, White Lotus, Small Swords, Nian, Miao, Du Wenxiu, Dungan, and other concurrent internal rebellions of the second half of the nineteenth century quickly drained existing military resources and required extensive fiscal outlays to raise additional military forces. Over the same time period, the Qing faced multiple external wars, including successive Opium Wars, the Sino-Japanese War in 1895, and the war instigated by the Eight-Nation Alliance in response to the Boxer Uprising. The financial costs of fighting these internal rebellions and external wars were huge, to say nothing of the cost to human life and destruction of human capital potential and stocks of physical capital. It is estimated that monetary costs of the internal rebellions totalled eight hundred and fifty million *taels*, while the external wars added another one to two hundred million *taels* (Liu 2016). From 1850 through the turn of the century, therefore, this nearly one billion in military outlays added an additional two hundred million *taels* in annual expenditures to the fiscal budget.

Yet, just as important as the costs of waging actual battle were the resultant costs borne by the Chinese government in the form of indemnities imposed by victorious foreign powers in the aftermath of Qing losses. For instance, the Treaty of Tianjin that concluded the Second Opium War in 1858 imposed fees of four million *taels* and two million *taels* accruing to Britain and France, respectively. Subsequent Qing losses were far more costly; Japan imposed an indemnity of 230 million *taels* in the wake of the Sino-Japanese War, and the Boxer Rebellion indemnity totalled 450 million *taels* (Ning 2015: 23). Thus, another nearly 800 million *taels* could be included in military-related costs, bringing total such costs up to approximately 1.8 billion *taels*.

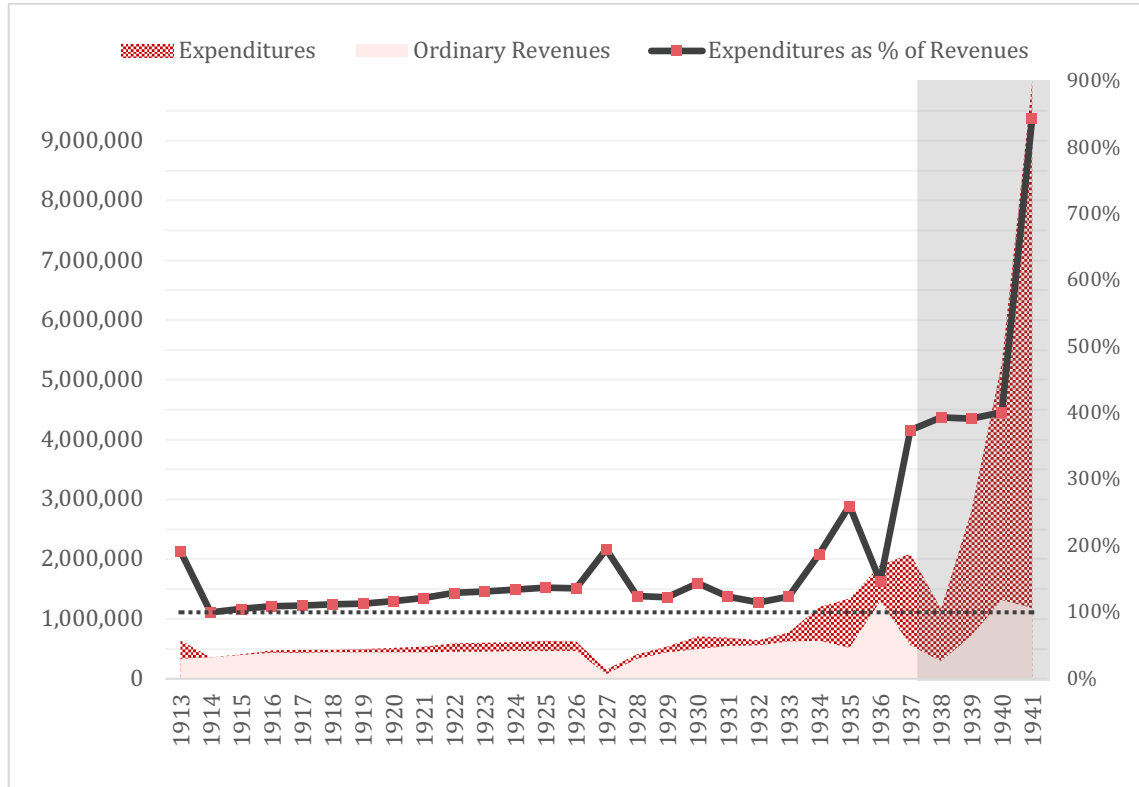
Such military and indemnity-related costs represented considerable percentages of annual Qing government outlays. The First Opium War alone, at a cost of thirty million *taels*, represented nearly two-thirds of annual government revenues in the mid-1850s. Adding in the costs incurred from rebellions and later wars and indemnities, it is not surprising the Qing government found itself in deficit for basically eight out of every ten years of its remaining time in power. Even as revenues climbed over subsequent decades to reach approximately two hundred million *taels* annually, with combined military and indemnity costs averaging nearly the same, the government was forced to turn to debt financing. With the source of such financing to repay indemnities coming primarily via foreign borrowing, the ancillary impacts of such fiscal conditions were significant. Given the size of the indemnities and subsequent borrowings, Chinese governments were strapped into paying out large amounts of debt service as a result of these wars and indemnities. As late as 1935, slightly more than one-third of debt service went to foreign bondholders and indemnity payees (MOF 1935: 5).

As indicated in Figure 5.1a, government spending consistently outstripped ordinary revenues. Initially, beyond the first years of the new government, deficits under Yuan Shikai and immediately afterward remained relatively small, within ten per cent of ordinary revenues. By the later stage of the Beiyang period, expenditures began to increase while real income slightly dipped, widening the size of deficits incurred. The start of Guomindang period saw deficits widen further. Although by the early 1930s the government had begun running smaller deficits, they grew considerably in the ensuing years, especially after the outbreak of war in 1937, culminating in the fall of the Nanjing government and its retreat to Chongqing; the area on the chart for the years 1938 through 1941 is shaded, as the spending and revenue data apply to the Chongqing Republican government only.

Given the scale of inflation during the late 1930s, we also present equivalent data in Figure 5.1b, with revenue and expenditure figures adjusted for inflation. This view allows us to observe that spending levels in real dollars increased prior to the outbreak of war in 1937. Spending as a percentage of revenues grew exceedingly high as the war progressed and the economy within the Guomindang-controlled areas deteriorated further under heavy government intervention within the economy, whilst spending levels remained high. A continual trend toward greater levels of deficit financing occurred over the entirety of the early-Republican period, as evidenced from our calculations of average ratio of expenditures to ordinary revenues, which at 125 per cent over 1913 to 1926 climbed to 175 per cent over 1927 to 1937, before rising drastically to 508 per cent from 1938 to 1941.

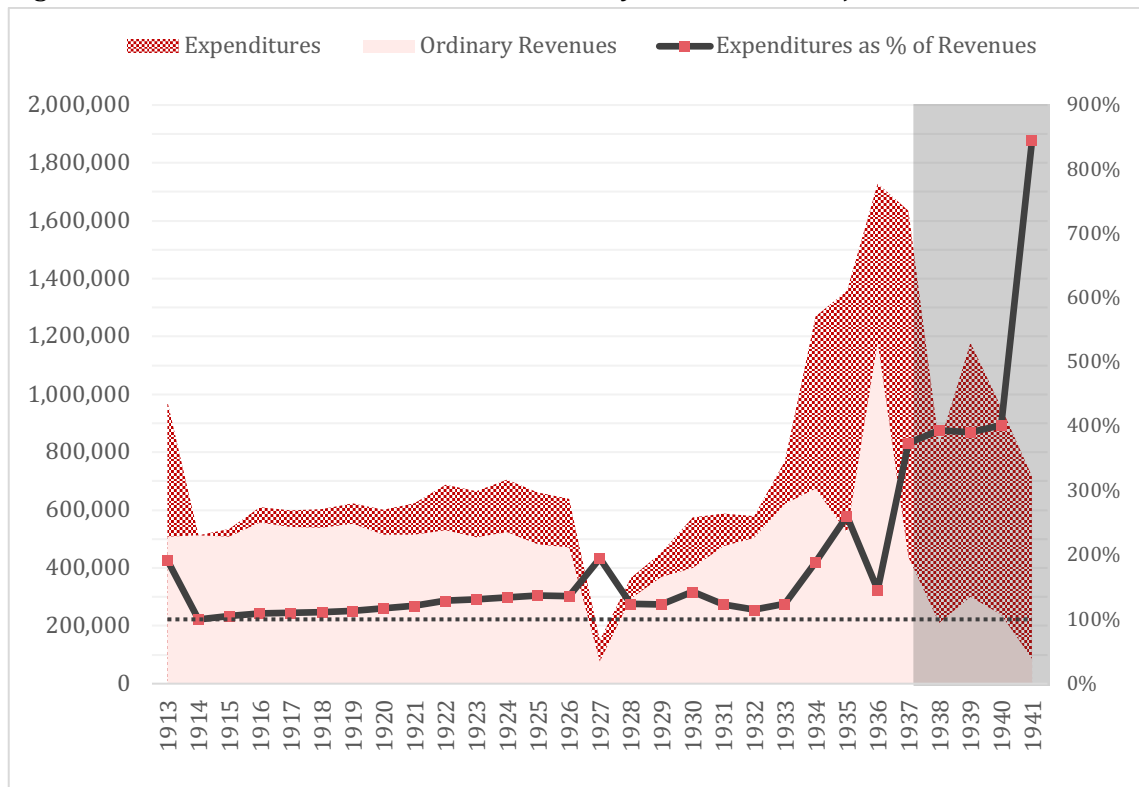
Not unlike the budgets of the late-Qing, Republican governments were likewise dominated by military expenditures, which accounted for much of the observed increases in budgetary outlays. This was certainly true in the period following the death of Yuan Shikai, as the given military clique in control of the central government during a particular time period would strive to keep control over the country by alternatively placating and then fighting its rivals.

Figure 5.1a. Central Government Fiscal Position, current *yuan*, 1913–1941



Source: Expenditure and Revenue data from Yang (1985)

Figure 5.1b. Central Government Fiscal Position, *yuan*, inflation-adjusted, 1913–1941



Sources: Expenditure and Revenue data from Yang (1985); inflation adjustments based on price index constructed from He (1927) and Shanghai Economic Research Institute (1958).

This was equally true of the period's Guangdong-based rival Guomintang government's budget, with the military receiving the lion's share of government outlays. Pan (2003) finds that the majority of internal debt issuances by both the Beiyang and southern-based Guomintang governments went into non-productive uses, primarily military expenditures, as opposed to creating opportunities for entrepreneurial or economic development.

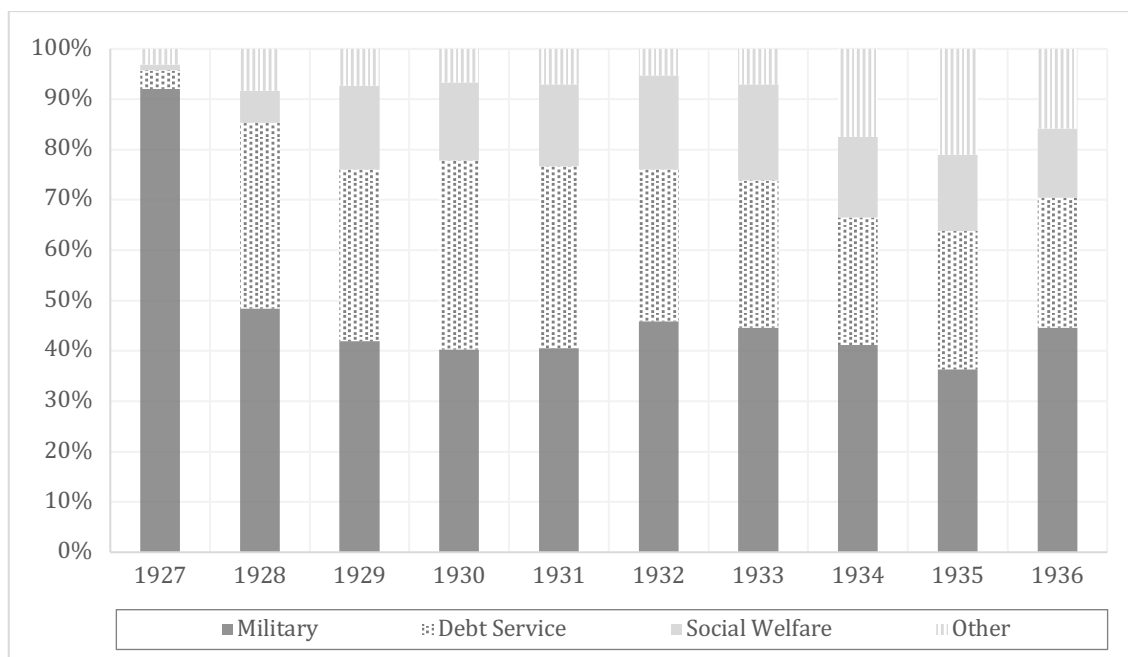
Even reformers in the Guomintang government who sought to contain military spending so as to focus greater resources on outlays that could set the stage for economic growth felt constrained by the circumstances they faced, surrounded as they were by credible military threats; as Chen (2000) notes, although Chen Jiongming, the military leader of Guangdong, continually expressed a desire to reduce military spending and focus more resources on economic development, he did not, given that while "Chen had recognized that the reform of Guangdong depended on his drastically reducing military spending... Chen understood that his power depended on a strong Guangdong Army under his control." Chen argued with other Guomintang leaders, including the nominal leader Sun Zhongshan, to limit military expenditures and focus more on social spending, but was eventually ousted from power by Sun and Jiang Jieshi in 1924, and forced to flee overseas, with Jiang amassing forces and increasing expenditures in support of his subsequent Northern Expedition offensive.

The success of the Northern Expedition, however, did not lead to a subsequent reduction in government budgeting concentrated on military expenditures. Officially, based on the breakdown from the budgets approved by the Legislative Yuan, from 1927-1936, the proportion of the national budget allocated towards military spending averaged over forty per cent for the decade, as can be observed in Figure 5.2; as indicated in the figure, military expenditures took up at least forty per cent of the budget in every year except 1935, for which the percentage was thirty-six. Data for 1927 can be considered outliers; to begin with, total revenues and expenditures were considerably lower than in other years, as they reflect solely the areas of the country that the Guomintang controlled during the course of the year, much of which was time prior to the final resolution of the Northern Expedition. Furthermore, the Guomintang government serviced almost none of the country's outstanding debts that totalled nearly two billion *yuan* (nor, for that matter, did the disintegrating Beiyang), hence decreasing outlays considerably. In fact, nearly the entirety of the budget for this year was nearly entirely consumed by military expenditures, representing ninety-two per cent of total spending.

As skewed towards military spending the official budgetary figures appear to show, the detailed study of actual budgetary outlays conducted by Paauw (1952) finds the official figures to understate the actual levels of military spending during the latter prewar years of the Guomintang era by ten per cent or more. Paauw's comparative auditing research based on publications obtained from the Ministry of Finance, the Directorate-General of Budgets, Accounts and Statistics, and the public finance yearbook, indicate that much of the spending allocated into the "other" designation in the latter three years was actually funnelled into military spending, categorised differently for political reasons (Paauw 1952: 8-9, 20-22). The situation became even more skewed after 1937—years for which, as observed in Figures 5.1a and 5.1b, expenditures outpaced revenues by a factor of five—when protracted wars against Japan and the Communist Party saw military spending consume upwards of seventy to eighty per cent of the national budget.

As Figure 5.2 also makes clear, service on existing debt also dominated government outlays. With the exception of 1927, unusual for the reasons noted above, debt service payments represented approximately one-third of annual expenditures over the Guomintang pre-war period. That so much of spending went towards debt service was obviously problematic, given that an inherently unsustainable fiscal situation was implied by the government's inability to pay down the debt, combined with the government's inability to obtain sufficient

Figure 5.2. Government Expenditures by category, fiscal years 1927–1936



Source: Constructed from data provided in Paauw (1952)

ordinary revenues requiring much of current period borrowing to go towards servicing debts acquired in prior periods (Paauw 1952: 17). Song Ziwen himself recognised this, noting in June 1932 that the government was following a "disastrous" strategy of a "vicious circle of meeting deficits with short-term loans" (*China Weekly Review* 18 June 1932).

Given that besides its use to pay down existing debt, the remaining majority of current-period borrowing went towards military spending, the per cent of combined spending directed towards military and debt service—which for the years 1928 through 1933 averaged 78, and officially 67 for 1934 through 1936 (albeit adjusting upwards ten per cent, as Paauw (1952)'s research suggests, brings the figure in line with prior years)—further demonstrates the dominance of military spending. In essence, therefore, over three-quarters of the pre-war Guomindang government budget was military in nature. While specific data on the allocation of Beiyang period budgets are not available, they are estimated to be proportionately similar (Feuerwerker 1983, Strauss 1997).

Several important implications on the nature of the domestic institutional environment flow from the dominance of expenditures going towards military purposes. First, the high levels of military spending were a direct outcome of the fact that domestic state governance structure was that of an authoritarian military regime, with the major leadership of the state dominated by members of the military. Hence, it was in the interest of those state actors in control of the budgetary and expenditure process to continually funnel funds into those areas that directly benefitted themselves. This included not only directing funds into sections of the government by which their growth could increase controlling actors' prestige and power within the government bureaucratic apparatus, but further allowed in many cases for the personal enrichment of state leadership through extra-legal means. Noting the use of "loose accounting" procedures that labelled budgeted expenditures into unspecified categories such as "unallocated", "advances", or "temporary disbursements"—representing in some years upwards of ten per cent of total expenditures—Paauw (1952: 12) observes these practises allowed for "considerable leakage of Nationalist financial resources to provide for the amassing of fortunes by government officials."

Recent research by Wang (2016), using materials at the Hoover Institute's archives of the Guomindang economist Zhang Jiakuan (Chang Kia-ngua), uncovered important evidence of the scale of the amount of personal wealth accumulated by the Guomindang leadership. A report conducted by Japanese secret intelligence services in October of 1939 on the personal wealth of the Guomindang leadership held in the foreign banks of the Shanghai foreign settlements found the combined balances of the top four members of the Guomindang leadership—Jiang Jieshi, Song Ziwei, Kong Xiangxi, Chen Lifu—alone totalled 6.1 billion yuan (this figure includes monies held jointly by their close relatives, mainly that of Song Meiling, Song Yuling, and Song Ziliang). To place this amount in proper context, one can observe that the size of the government revenue in 1939 approximated 715 million yuan (Wang 1985), roughly equivalent to twelve per cent of the amount the top Guomindang leadership had absconded into the accounts of Shanghai's foreign banks.

Thus, authoritarian military power structures enabled corruption to become systemic, consistently directing state resources to personally benefit privileged actors with access to the military leadership. That widespread corruption was so prevalent was commonly recognised, undermining trust in political institutions. A litany of contemporaneous academics, journalists, politicians, and businesspersons constantly commented on and were "repelled by the corruption, inefficiency, and repression of the Guomindang government" (Speer 1947: 160). Similarly, Eastman (1984a: 225), in his study of the government during the Sino-Japanese War, criticises its administrative functioning by emphasising the prevalence of "corruption and ineffectiveness... and pervasive incompetence" that characterised state institutions.

Second, with the overwhelming percentage of government expenditures being utilised for military purposes, little was available for investment in the development of institutions and associated credible commitment mechanisms able to provide protections on private property rights and contracts, and therefore create a more hospitable environment for organic entrepreneurial activity. For instance, the circumscribed plans for the replacement of the magistrate-style court system that still operated in places throughout the country so as to increase the efficacy of the legal system and protection of contracts owed in part to the military-dominated budget allocation. The low levels spent on institution-building, social welfare, or civil expenditures under the Guomindang simply continued a trend that predated the Republican era. For instance, by the end of the Qing, just two per cent of the 1911 central government budget went towards public services such as health, education, or welfare expenditures (Liu 2016). Further, by the time of the Guomindang, much of the spending labelled "civil expenditures" or "social welfare" included funding that supported the administrative organs of the state. Thus, even bureaucratic inefficiencies can mistakenly be perceived as contributing to funding civil society programs; for instance, in years 1934 onwards, costs associated with tax collection began to be included under the "civil expenditures" category, a change accounting for almost one-third of observed increases in civil expenditures occurring after this accounting change took place (Paauw 1952: 11).

Third, the scale and concentration of government expenditures around military purposes impacted the development of the economy, primarily by crowding out funding for private industry, as well as cannibalising available productive resources. In the late-Qing period, for instance, Generals Li Hongzhang and Zuo Zhongtang helped direct large amounts of financial and productive resources into two large government-owned military enterprises, the Jiangnan Arsenal and Fuzhou Navy Yard. These state-owned, centrally-controlled, government official-managed ventures each ended in financial and operational failure, defined by massive cost overruns, underachievement of production goals, and low-quality output, as highlighted by the poor performance of their manufactures during their deployment in the Sino-Japanese War of 1895 (Pong 1987).

By the start of the Guomindang period, the military's central role in the government bureaucratic administration and economic planning apparatus had become more formalised. In 1928, for instance, the Bureau of Armaments was created, taking an active role in managing the munitions industry, consolidating and coordinating the production activities of ostensibly private existing weaponry and ammunitions factories, as well as establishing new government-owned firms. The degree of government involvement was extensive, with Bian (2002: 85) finding the central government to have established over one hundred fifty military-related heavy industry and munitions enterprises from the mid-1930s onwards. Ultimately, the goal of these state-led development efforts was to direct economic resources to serve the interests of the military leadership of the Guomindang Party. As a *Jen Min Jih Pao* editorial opined in 1931, "The reason why China's industrial economy is in such a deplorable state is not that there is no capital in China (there is some 200 million ounces of silver lying idle in the vaults of the Shanghai banks), but that the Nanking Government has used every available cent in the Government Treasury for the purchase of arms and the recruitment of new troops" (*People's Tribune* 1931: 27).

Military involvement in all aspects of state economic planning was led in large part by the National Resources Commission, a government department established in 1935 after it had been reorganised out of the National Defence Planning Commission, clearly denoting its focus. Even the National Economic Reconstruction Campaign, also begun in 1935 at the Fifth National Party Congress, had as its stated goal to "promote economic development during peace time but to prepare for economic mobilization at a time of war" (Bian 2005b: 119). Economic development was to be centred around militaristic goals. While some voices in the government—such as Wang Jingwei and Chen Gongbo—argued for a more civilian- and less military-based approach to economic development efforts, their political power was circumscribed, given that as civilians, they lacked control over the Party, which at that time was dominated by the military (Zanasi 2006: 25-27).

Overall, the involvement of the military in economic planning—and, over time, in terms of its ownership of an increasing share of productive resources—led to a distortion in the private economy away from focussing production on meeting consumer demand, to one designed to meet the demands of government actors, particularly the military leadership of the Guomindang. This also led to an increase in rent-seeking activities amongst private entrepreneurs, further shifting attention and resources away from productive activities. Paying attention to the directives of government economic planning bureaucrats became paramount for entrepreneurs, as it was the government which controlled access to productive and—through its increasing control over the banking sector—financial resources. As Ting (1935) notes, loans to government entities to finance state expenditures consumed ever-larger proportions of banks' loan portfolios, at the expense of financing private commercial activities. This became especially true once the Ministry of Finance assumed outright control over the banking industry in 1935.

As a result, obtaining access to limited financial resources required membership in a group of privileged firms willing to acquiesce to the state's developmental and policy goals, which included shifting production into military-related efforts. For instance, given government spending levels on purchase of battlefield provisions, textile companies began focussing on the manufacture of clothing designed for soldiers, with less effort directed towards meeting the needs of civilian customers (Paauw 1952:15, Wang 2017). Rent-seeking behaviour was also encouraged—given the *ad hoc* nature of the overlapping and arbitrarily-prescribed system of transit taxes, whether *lijin* up through the mid-1930s, or its differently-named albeit similarly-structured successors, it was important for manufacturers and shippers to

expend efforts to attempt to reduce transportation costs. As Wright (1984: 158) describes in regard to the coal mining industry, relationships with state authorities were crucial for the success of mining enterprises, not only so as to be granted monopoly production rights, but especially to obtain reductions in transit taxes, which could be considerable—in the Qing period, reductions were on the order of sixfold less than the official rate; by the 1920s, that differential had increased to tenfold or greater. As such, businesspersons focused much of their time not on private entrepreneurial activity, but rather on the development of political connections that could provide large cost savings. Given the systemic corruption that characterised state officialdom in general, it is not unsurprising that state-commerce relationships were dominated by bribes that accompanied rent-seeking behaviour, including to military officials who dominated the state bureaucracy elite (Marshall 1976).

5.2. Measuring Bureaucratic Capacity — Infrastructural Power

While raising and channelling money are two of the most vital indicators of bureaucratic capacity, state capacity bureaucratic capacity also encompasses other aspects that include planning apparatuses and delivery of specific services and provision of public goods. For Mann (1986: 113) this formulation of state capacity is determined via manifestation of state "infrastructural power": the ability "to implement logistically political decisions." Acemoglu *et al.* (2015) refer to a similar conception of state capacity by focussing on the actions of state functionaries and agencies. For instance, as indicated in the prior section, work by Bian (2005a, 2005b) and others focusses on the extensive nature of bureaucratic organisational resources devoted to economic planning and directing various productive assets towards uses in the economy that government policy-makers placed the highest priority.

For all the effort in state planning, however, much of the bureaucracy was characterised not only by, as previously discussed, corruption, but also by government administrative inefficiency and ineffectiveness. The domestic bureaucracy repeatedly faced challenges in effectively marshalling resources to achieve desired policy goals. Already noted were difficulties in implementing desired tax policies, or successfully conducting military actions. Hanwell (1938: 96) calls attention to the reputed inefficiency of the central government, noting it to be "notorious for its paper plans. Mountains of paper [are] consumed in the publication of plans never put into effect." Myers (2000: 60) recognises the increasing state planning structures instituted by the Guomindang, but finds them lacking competency, labelling the National Resources Commission, the major economic planning apparatus created in 1935, "a bureaucratic monstrosity of planners and technicians who wasted vast resources building inefficient state-owned and state-managed factories." Eastman (1990:12) relays a description by a contemporaneous official in a provincial agency describing the thirty-seven separate processing steps a document had to go through once received by the office, the result of which frequently ending with such documents becoming lost.

In general, the bloated bureaucracy and high levels of corruption, coinciding with increased state authority over private actors, meant state actors had both the power and opportunity to continually extract greater resources from private actors. Thornton (2007: 102) sums up the fiscally-inefficient while expropriating leviathan nature of the Guomindang state, by noting, "The ponderous increases that funded the new militias, new schools, and new public facilities proposed by modernizing state-makers in Nanjing all too frequently translated into dramatic increases in taxpayer burdens without commensurate improvements in the quality of life... The continuing expansion of often overlapping state and party agencies was funded by increases in miscellaneous fees and levies, which in turn required an increasing number of tax collectors and state agents to calculate, levy, and administer them."

5.2.1. Revisionist Views on Domestic State Bureaucratic Capacity

The descriptions provided above of state bureaucratic capacity underscore many of the difficulties that domestic Chinese central governments had in overcoming the serious challenges that defined much of the late imperial and republican time periods. As evidenced by the litany of narratives above, it is possible to paint a fairly dim portrait of domestic governments' abilities in implementing successful strategies to raise capital resources or conduct centralised planning and policy realisation, saddled as it was by corruption and bureaucratic inefficiencies that affected multiple departments and agencies, affecting its ability to effectively exercise infrastructural power (Wu 1937; Hanwell 1938; Paauw 1952; Yang 1959; Coble 1979, 1980; Lau & Lee 1979; Eastman 1984a, 1990; Myers 2000; Gu 2015; Wu 2015, amongst others cited in the preceding section).

However, we should be cautious in painting a broad brush characterising domestic state bureaucratic capacity, as much of the revisionist literature on domestic state capacity and institutional quality provide a different set of examples, focussing on the actions of state functionaries and agencies that portray a narrative much more positive of the level and nature of domestic state bureaucratic capacity. Revisionist scholars argue that, at least for certain time periods or certain components of the state apparatus, depictions of domestic state capacity defined solely by corruption and bureaucratic ineffectiveness are misleading or overly simplistic, identifying instances of effective implementation of government plans. The main approach of the revisionist literature has been to emphasise the bureaucratic strength and capacity of a number of domestic state institutions. Utilising researches based on the late-imperial and republican historical record, numerous examples of successful domestic bureaucratic policy planning and implementation have been ascertained.

5.2.1.1. Revisionist Views on Qing-Era Bureaucratic Capacity

The so-called California school of Chinese history has produced considerable research identifying positive aspects of state capacity under the Qing government. One of the more important examples in this line of research has been work expanding upon Hsiao (1960) to detail the sophisticated strategic reserve state granary storage system maintained under the Qing, as provided by Wong (1982), Will & Wong (1991), and Li & Dray-Novey (1999). These and other revisionist scholars discuss the positive state capabilities the Qing official bureaucracy exhibited in implementing strategies that proved relatively effective in reducing the frequency of famines, and mitigating associated negative impacts.

While the concept of a strategic grain storage reserve system was an extension of a crop failure insurance policy the roots of which stretched back millennia to the Wei period in 450 b.c.e. (Hui 2005: 61), under the Qing the system was expanded throughout all provinces, as a deliberate anti-famine strategy (Jia 2013: 107). By the mid-nineteenth century, however, such efforts had become considerably less standardised and more locally-determined (Wong 2002: 30). In a sharply non-revisionist analysis, Edgerton-Tarpley (2017) notes that by the late-Qing, the state's ability to limit the outbreak of famines in the face of natural disasters such as droughts or floods was severe enough so as to China was referred to in the popular press as the "land of famines."

Revisionist arguments, however, emphasise the effectiveness of the state bureaucracy in operating a nationwide state granary system. To begin with, the state-run granary system was extensive in scale; Li (2000:690) provides a description of the substantial inter-province importations of grains between local governments, which totalled over one million *shi* of grain per annum. Second, the system proved itself to be relatively effective as a state-sponsored crop insurance program that helped to prevent the occurrence of severe famines.

Relatedly, the literature largely presents the program as successful in so far as it was able to achieve its more primary goal of regime stability. The impetus behind the granary system, stretching back to its earliest incarnations under prior dynastic periods, was driven not by simply by altruistic impetus on the part of state officials but rather by the recognition that famines and associated food riots were associated with the overthrow local and even provincial governments (Hsiao 1960). As Du & Zhong (2011) demonstrate, data on incidences of peasant uprisings suggest that increased levels of granary storage holdings diminished the frequency and success rate of civil uprisings.

5.2.1.2. Revisionist Views on Republican Beiyang-period Bureaucratic Capacity

For the most part, even scholars strongly associated with revisionist views of domestic state capacity present fairly critical views regarding the aptitude of the state apparatus during the latter half of the Beiyang period, riven as the country's political structure was by factionalism and civil war. Julia Strauss, well-identified with the overall revisionist approach, nonetheless presents a fairly dismal view on the bureaucratic state capacity of the Beiyang government, arguing it "had no means by which to project its authority much beyond Beijing into highly unstable and militarized provincial and local environments. Taxes from the provinces simply did not come in and government regulations had little meaning. During the Beiyang period the central government of China operated as a head without a body, fiscally kept alive by regular transfusions of the surpluses remitted by quasi-government tax collection agencies that it did not control, and loans from Western banks " (Strauss 1997: 336).

Nonetheless, revisionist arguments portray the Beiyang period as demonstrating greater bureaucratic competency than commonly suggested in the literature. Myers (2000: 50), for instance, pushes back against the standard trope of the ineptitude of the Beiyang period with his argument that there occurred significant "bureaucratic modernisation" under the Beiyang. Myers claims that central government officials during this period exhibited tendencies suggesting a commitment to supporting constitutionalism. Specifically, he suggest there was a clear recognition within the bureaucratic officialdom that in order to secure necessary loans from foreign lenders, it proved helpful for Beiyang officials to be able to cite the nominally democratic and civil protections private economic actors were afforded under the constitution; that is, rather than functioning as an authoritarian monarchy, as under the Qing, the Beiyang republic was now committed to upholding the rule of law and protecting private property and other economic rights under a constitution. Thus, maintaining this perception of the Chinese state was beneficial to government officials because of the potential financial benefits to be gained via foreign loans.

While compellingly presented, Myers' argument suffers from a lack of accord with the historical record. As described in Section 4.1, the Beiyang regime in practice operated as an authoritarian state. That state officials exhibited a commitment to honouring the constitution is difficult to support, given the multiple constitutions cycled through, quickly ratified but subsequently discarded (RCEC 1926), such as when in 1915 president Yuan Shikai declared himself emperor. Nonetheless, Myers' argument underscores that domestic state actors perceived it advantageous to present an image of the state structure as constitutionalist in order to increase the legitimacy of borrowing on the behalf of the Chinese people. However, a commitment to maintaining this image of legitimacy as a nominally democratic republic did not result in the Chinese state operating as one, perhaps only functioning so foreign lenders could justify the loans extended to the Chinese state.

Bureaucratic capacity in regard to the state's ability to combat famine via its granary system and associated anti-famine policies is argued by Fuller (2013), whose revisionist analysis of domestic institutions purports to show that the scope of the famine in northern China in 1920 and 1921 was considerably moderated by effective bureaucratic actions on the part of state officials, as well as from efforts by domestic Buddhist organisations. According to Fuller, these public and private charity efforts proved to be "significantly more viable and attentive to social welfare needs than has been previously recognized" (820). Conversely, however, Myers (1986: 257) notes that by the middle of the Beiyang period, famines and associated "rural misery" had "increased by leaps and bounds", with suffering playing out in the form of "famine; farmers fleeing to towns to beg; the degradation of women; parents forced to sell their children; huge rural unemployment; widespread rural debt and forced sale of land. Such events became as familiar as they had been previously rare." In this sense, the example by Fuller of a singular instance of potential bureaucratic capacity in handling a single famine event must be counterbalanced by the fact that the bureaucracy proved considerably less able to prevent famine and associated conditions from continually afflicting the rural landscape during the period.

5.2.1.3. Revisionist Views on Republican Guomintang-period Bureaucratic Capacity

Much of the revisionist literature argues state capacity increased dramatically under the Guomintang, appearing particularly supportive of the regime's attempts to centralise control of state bureaucratic authority. Our own primary-source literature review finds multiple instances of examples of demonstrated bureaucratic capacity during the Guomintang Nanjing government period. For instance, Fong (1936: 31-32) describes a relatively successful attempt that took place over the early years of the Guomintang government to increase bureaucratic efficiency by limiting and streamlining the number of bureaucratic offices in certain administrative areas. Fong chronicles the way in which the Marine and Navigation Bureau, created in 1930 under the Ministry of Communications, with three primary regional offices across the country (the fourth, located in Harbin, was soon shuttered once the Japanese military took control of Manchuria in 1931), went from an initial bureaucratic structure that saw approximately one hundred sub-offices under each of the three regional offices, to four primary regional offices, but with only fifty sub-offices under each, somewhat reducing the amount of bureaucratic overlap and excessive redundancies.

Furthermore, the ability of the central state administration to plan and complete relatively successful infrastructure-building projects was repeatedly demonstrated. For instance, by the mid-1903s, the construction of an extensive national highway service was completed, along with expanded development of interprovincial railway lines (*Far Eastern Survey*, May 8, 1935: 69-70; July 3, 1935: 102-3; May 12, 1937: 114). The completion of such state-led efforts, undertaken during the time period's considerable political discord, can be interpreted as positive evidence underscoring the capacity of the domestic state apparatus. An additional associated example of infrastructure creation capacity can be found in the implementation of a nine-province plan under the Ministry of Communications, initiated in 1934 and completed by 1936, for the laying of phone cables allowing long-distance connections between localities, achieved by linking up local phone systems under a single system operated by the Ministry of Communications (M.S.F. 1937: 125). Certainly, this project represented an impressive display of bureaucratic state capacity—in just over two years, the Ministry of Communications was able to implement a nationwide program to install long-distance phone lines across much of the nation. However, while successful, the methodology employed in this Ministry of Communication project underscores the top-down nature of such policies. Rather than an example of the state creating conditions for private enterprise to undertake the lead in developing communications connections, this

was another instance where state planners coordinated efforts. Further, as noted in an article at the time, much of the rationale for planned, centralised state involvement was driven by military concerns: "Efforts are also being made... to centralize administration in the Ministry of Communications... While much remains to be done, the foundations have been laid for a unified national telephone system under government auspices. Like the recent activity in regard to railways and highways, the new telephone developments are of considerable political and military significance" (MSF 1937: 126). While state-driven, it is noteworthy that the privately-operated extraterritorial-incorporated Shanghai Telephone Company played an outsized role in this effort; out of nearly 164,000 telephone subscribers in all of China by the end of 1936, approximately half were located within the International Settlement and on Shanghai Telephone's system.

The previously-described anti-famine granary system that had initially been expanded under the mid-Qing was still operating in varying forms well into the Guomintang time frame, albeit in ways that could be described as relatively circumscribed and regionally differentiated. Nonetheless, reference to the system was included in the text of the June 1931 provisional "political tutelage" constitution was Article 34, which stated that "the State shall take active steps for the carrying out the... enforcement of the public granary system for the prevention of famine and other calamities and replenishment of the people's food supplies" (Tung 1964: 346). As Lee (2015) and Stewart (2015: 36-42) note, however, Guomintang efforts towards famine prevention and agricultural productivity improvements were often centred on scientific-based research efforts divorced from actual farming and marketing practices, thus limiting their effectiveness; combined with a lack of qualified personnel and administrative inefficiencies, little improvement in famine reduction was realised. This was underscored by the fact that the suffering referenced above by Myers (1986) that began in the middle of the Beiyang continued throughout the Guomintang period, with agricultural output stagnating over the 1929 through 1937 time frame, including in terms of food grains as well as cash crops such as cotton and other fibres (259); similarly, Liu (1946: 12)'s estimates for the period from 1932 through 1936, calculated from National Agricultural Research Bureau data, show per capita agricultural output slightly fell.

Within the revisionist literature, Guomintang efforts at centralisation and top-down planning are frequently cited as evidence of a sophisticated administrative bureaucracy that demonstrated much greater efficacy than exhibited under the late-Qing or Beiyang periods. Bian (2005a:37), for instance, venerates the concerted effort to adopt "rationalised" public administration principles advocated by Leonard White, an American academic who argued administrative efficiency was achieved by centralised, top-down planning structures: "the Guomintang succeeded in creating institutions of central planning and assessment and thus increased the rationalization of state institutions." Bian builds on a revisionist approach that assigns the reason for the failure of earlier domestic governments to a lack of top-down, centralised control; Xu (2001: 226), for instance, argues the Qing state failed to "modernise" and adapt to internal and external pressures because it could only muster "a proliferation of ad-hoc administrative organizations from the bottom up." Similarly, Ko (2016: 206), who characterises Guomintang industrial policy as an "authoritarian-friendly market control model", emphasises the benefits of domestic state power in shaping and controlling the corporate business form. Conversely, however, some revisionist scholarship goes as far as to claim that certain domestic periods, especially the Guomintang era, were defined by *decreases* in the level of centralised control. For instance, Ma (2012:15), in a relatively non-standard reading of the evidence, asserts the monetary reform undertaken by the Ministry of Finance in 1935 was "successful" because, "The close cooperation and consultation between the finance personnel of the Nationalist government, such as Kong Xiangxi and Song Zhiwen, and the private banking community in Shanghai marked an important departure from the traditional imperial governance model of top-down coercion."

Strauss (1997, 1998, 2008), recognised as one of the more prominent revisionist scholars, provides research directly challenging the mainstream interpretation that all Guomintang state bureaucratic offices were defined by incompetence and malfeasance. Strauss' work underscores that concepts such as state capacity should not be considered monolithically, as she finds considerable variation in terms of efficacy and efficiency existing across various domestic state bureaucratic organisations. Strauss (1997) is relatively critical of state bureaucratic strength under the late-Qing and Beiyang, describing it as weak, corrupt, ineffective. Even under the Guomintang, she finds some ministries within the central government exhibited characteristics associated with poor state capacity, recognising that during the period "institutional capacity [was] inherently fragmented, ambiguous, and weak" (1998: 2). For instance, Strauss (1998)'s description of the ministry responsible for the maintenance of the civil service exam system, the Examination Yuan, indicates it was unable to enforce its policy goals across the other ministries. The leadership of most of the other ministries were protective of the power to appoint their own staff, and frequently proved able to resist the implementation of uniform hiring standards by the Examination Yuan, given its lack of inter-organisational authority, with its leadership and spokespersons able to only internally or publicly admonish other government ministries that appointed personnel outside its published rules.

Nonetheless, Strauss (1998: 6) argues that the Guomintang state apparatus was "capable of building strong and proactive institutions under exceptionally difficult circumstances." Echoing previous work by Bedeski (1981), who similarly argues that the Guomintang successfully undertook state-building activities within a number of bureaucratic offices, Strauss identifies the Foreign Affairs and Finance ministries, and the Salt Inspectorate, as successful state bureaucratic structures. According to Strauss, for instance, the Ministry of Finance exhibited a relatively high degrees of effectiveness in implementing policy goals by engaging in strategies such as instituting a set of non-subjective goals based on impersonal norms, and creating "bureaucratic organisational insulation." Other revisionist work, such as Slack (2001: 77, 83) and Boecking (2011a), also emphasise the strong bureaucratic capacity of the Guomintang Ministry of Finance, exemplified by the overall increase in tax revenues achieved in the early part of Guomintang party rule under the leadership of T.V. Soong. Even Paauw (1957: 213), albeit highly critical of overall state capacity levels evidenced by the Guomintang government apparatus, recognises the introduction of federal annual budgeting and more centralised indirect taxation methodologies represented positive steps in increasing bureaucratic competence during the period.

5.2.2. Revisionist Views on State Capacity evidenced by Joint-Administered Organisations

Much of the revisionist literature seeking to demonstrate the effectiveness of domestic bureaucratic capacity, and push back against the image of weak domestic institutions, cites several particular examples of domestic state organisational structures unique in form, given that they were jointly-administered by both foreign and domestic nationals, with the leadership of these organisations predominated by foreign personnel. Three examples are consistently cited in the revisionist literature—the administration of the salt gabelle, the postal service, and the Chinese Maritime Customs. Harris (2012:38) exemplifies the revisionist view by noting that while much of the late-imperial and republican administrative bureaucratic structures signified failures, these three "semi-colonial foreign-administered Chinese-staffed" government organisations symbolised singular exceptions.

Strauss (1998, 2008) identifies the successes of the Sino-Foreign Salt Inspectorate as indicative of one of the "strong institutions"—by this, she specifically is referring to government ministries with effective bureaucratic administrative capacity—within the Guomindang state. Strauss (2008: 213) emphasises analysing the strength and efficacy of bureaucratic state organisations is particularly in their ability to implement "uniform application of impersonal rules." According to Strauss, it was the unique joint foreign-domestic management structure that enabled the national-level Sino-Foreign Salt Inspectorate to exhibit a relatively high degree of effectiveness in implementing policy goals by engaging in strategies such as a focus on impersonal norms, objective goal orientation, and "rigorous bureaucratic organisational insulation" (217), owing in large part to its organisational structure that included being headed by British civil servant, as well as both foreign and domestic regional administrators that reflected a "preponderance of foreigners in position of real administrative decision-making, rather than simple advising", providing it with "de facto independence from the Chinese government" (219-220).

The primary emphasis of Strauss' argument is that the Sino-Foreign Salt Inspectorate was effective because its unique organisational structure enabled maintenance of bureaucratic autonomy and internal insulation within a larger republican "weak polity" where "the majority of government organisations, especially in tax collection, were ineffective, inefficient, rent seeking and corrupt" (221). This was accomplished via creation of an independent civil-service recruitment system, and official ranking and salary scales separate from those employed in other areas of the government bureaucracy, enabling the inspectorate's leadership to implement standardised goals and oversight methodologies.

Related to revisionist arguments on the Salt Inspectorate are those regarding the National Postal Service and the Chinese Maritime Service. Both of these organisations date back to the late-Qing period, and many arguments cite these bureaucratic structures possessing strong capacity from early on. Fairbank & Teng (1939), in a historically-orientated analysis, note China's first national postal service, initially monikered the Imperial Post Office, was created in 1896 under joint foreign and domestic administration, with extensive and sophisticated service continuing throughout the entirety of the republican period. Miller (2000: 22)'s revisionist approach stresses the efficacy of the imperial postal service system, with a distributed delivery system that within ten years of its formation enabled delivery from Guangzhou in the south up to Beijing in the north to be completed in under sixteen days. Harris (2012: 450)'s revisionist analysis emphasises the importance of the postal service's organisational insulation from the broader state apparatus, with its "high degree of administrative independence", noting specifically that civil servants within the "Post Office viewed this independence as absolutely essential to its survival, and the survival of the state, when confronting various attempts to either interfere with its operations or divide it territorially. Postal administrators pursued a series of successful strategies to insulate, protect, and strengthen the institution from external disruption and territorial division."

One of the most recognised recent framings of revisionist analysis of the Chinese Maritime Customs Service is provided by van de Ven (2014). His research details the growth of an administrative structure similar to those of the Salt Inspectorate and the postal service—a technically domestic government organisation, under the purview of the Chinese authorities inside the larger Chinese state apparatus, yet one operating under foreign leadership throughout its existence (up until its seizure by Japanese military forces in 1941). The Maritime Customs Service was able to consistently and efficiently assess, collect and allocate customs revenue, even within chaotic political environments, and even facing political pressures applied from competing government factions seeking to use customs receipts in differing fashions. The true power of the Customs Service came from its control

over vital revenues for the state. After 1911, the Service assumed responsibility of not only revenue collection for government foreign bond issuances collateralised with customs receipts, but on a much broader scale, of general oversight of all central government bond issuances, including domestic bonds. While such direct control was circumscribed with the ascendancy of the Guomindang after 1927, the import of the Service remained, given it provided over half of government revenues. Similar to the analysis of the other joint foreign-domestic bodies, van de Ven argues the Customs Service was a successful domestic government institution because its foreign-administration—backed in this instance by implicit coercive military force of provided foreign powers' gunboats along the Huangpu River—provided significant administrative insulation from overt domestic political influence, and hence effective administrative independence.

Focussing on the Guomindang time frame of 1928 through 1937, Boecking (2011b, 2017) echoes much of van de Ven in arguing the importance of the Customs Service to the fiscal health of the regime; his primary concern is to laud the ability of the central state to increase Maritime Customs tariff revenues, which thus allowed domestic central government actors to continually increase fiscal inflows, with tariff duties soon becoming "the single most important source of government revenue for the Nationalist government prior to the beginning of the Second Sino-Japanese War in 1937" (Boecking 2017: 1). Interestingly, Boecking takes the increasing nature these inflows to be indicative of their sustainability. This claim is an expansion of that made first in Boecking (2011b: 13), where he argues that depictions in the mainstream literature of Guomindang state bureaucracy "fiscal incompetence" are belied by its ability to increase tax extraction: "And yet central government revenue increased on an annual basis for most of this period [1929 to 1937], indicating that the extraction level of Nationalist fiscal policy was sustainable." Boecking (2017)'s vociferous revisionist argument centres on dispelling the mainstream perception that the Guomindang's loss to Chinese Communist rebels in the Chinese Civil War should be interpreted as a sign of weak state capacity and bureaucratic corruption and incompetence, arguing instead that it was only after the fall of the Nanjing government to the Japanese military in 1937, with the resultant loss of access to Maritime Customs tariff revenues, that later iterations of the Guomindang government were forced to turn to the kind of "rapacious" tax extraction policies so famously criticised by Eastman (1974: 229), let alone its policies of outright expropriation of private resources, violence committed against private civilians, or intrusions into private civil life we describe later.

5.2.3. Domestic State Bureaucratic Capacity — Mixed Evidences

Clearly, considerable disagreement exists within Chinese economic history literature regarding the degree of state capacity and institutional strength of the domestic state apparatus during late imperial and republican periods. Revisionist scholarship seeking to push back against the mainstream view of the domestic administrative state as monolithically defined by inefficiency, ineffectiveness, and malfeasance has enriched the literature, cataloguing a set of evidences argued to show that at least some domestic state organisations at various time periods possessed sufficient capacity to enable domestic state actors to achieve their goals—such as extracting wealth from the populace via effective taxation methodologies, enforcing an adherence to a dominant political party ideology, or setting and creating and enforcing regulations on economic activity. However, the interpretation of revisionist citations of such evidence requires care in order to place their overall arguments in the proper context within the broader literature. In particular, the findings of this revisionist scholarship are often presented as indicative that the domestic state, especially under the Guomindang, had "strong institutions" (Boecking 2017). It is in regard to this interpretation that several important caveats are salient.

5.2.3.1. Contested Factual Depictions

Although Strauss, van de Ven, Boecking, Bian, Young, and others argue the domestic state—particularly under the Guomindang—exhibited positive signs of state bureaucratic capacity, their arguments appear insufficient to close the issue in the literature. To begin with, there are multiple factual issues used as support for their argumentation that can be too readily contested, with cited state bureaucracies claimed as exemplifying successful and competent bureaucratic organisations sometimes based upon questionable evidences. For instance, while Strauss (1989) argues the Guomindang Ministry of Finance to have been an effective state organisation based on the Ministry's ability to formulate and implement bureaucratic policies, such as its attempt to restructure tax system to stimulate commerce through abolition of the *lijin*. But even here, Strauss finds fairly uneven results, given the lack of government authority over much of the country. The state bureaucracy could only implement desired policies within a limited sphere of influence centred mainly around the capital, as common with nations defined by weak state capacity (Johnson & Koyama 2017: 2). Thus, for example, the Ministry was unable to halt the practise of *lijin* in peripheral provinces, even after it was ostensibly declared illegal nationwide. Furthermore, and of perhaps greater damage to Strauss's argument of the Ministry representing a "strong" institutional construct was that short-term financial needs of for revenue sources outweighed ideological arguments that transit taxes harmful to commerce, as reflected by the fact that even after the *lijin* was discontinued, it was soon thereafter replaced by a host of similar transit taxes. A *Jen Min Jih Pao* editorial answers its rhetorical question, "Will the abolition of likin and its substitution by the Consolidated and Special Consumption Taxes make any difference to the burden of the sorely tried populace?", by acerbically noting that, "the Special Consumption Tax will be collected at the same points where likin was (and still is) collected, causing the same inconvenience and trouble to the merchants as likin, the same delays in releasing the goods under inspection, and creating the same opportunities for extraction and extortion. Against administrative negligence and misbehaviour, the poor merchant has no effective remedy" (*People's Tribune* 1931: 22).

Strauss cites an additional source of bureaucratic strength of the Ministry was its "independence", which she argues was exhibited by the Ministry's disregard of the Examination Yuan's directives on personnel hiring and advancement, implementing instead its own systems. The Ministry was also largely immune from disciplinary action against its personnel brought forth by the Control Yuan, a body ostensibly empowered to investigate and prosecute cases against public officials suspected of corruption, but that in practise lacked sufficient political clout to investigate or enforce findings against officials in powerful agencies such the Ministry of Finance (Thornton 2007: 80-81). If anything, however, this form of independence on the part of the Ministry serves to underscore the overall weakness of domestic state capacity, and the lack of adherence to rule of law and protocol defining the administrative state, if powerful ministries could disregard supposedly uniform and universal state bureaucratic directives. Moreover, as Strauss admits, much of the "independence" of the Ministry derived from the personal power of the head of the Ministry, T.V Soong, and later H.H. Kung—the first of whom was Jiang's wife's brother, and the latter married to Jiang's wife's sister. Thus, the Ministry derived much of its political dominance not from professionalised employment or technocratic mechanisms, but rather from the personal patronage of the country's *de facto* authoritarian ruler.

In addition, presenting the Ministry's ability to use to circumvent employment and promotion policies designed to decrease corruption and favouritism as evidence of "purposely built bureaucratic organisational insulation" from political pressures seems problematic, given the source of the Ministry's ability to circumvent such policies was in fact an application of political pressure based on the ministerial leadership's personal connections to political authority. Furthermore, rather than a positive example indicative

of organisational independence, that the Ministry actively disregarded rules and regulations over employment procedures mandated by the Examination Yuan designed to limit corruption might well be read as a contributing factor allowing for the relatively high degree of corruption and politicisation of the Ministry's policies. This accords with the evidences presented by Paauw (1952) and others demonstrating the degree of political party control over bureaucratic independence, such as that nearly the whole of the available budget funnelled to the military apparatus in contravention to legislatively-mandated budgeting guidelines—beholden to political expediencies, the Ministry of Finance continually facilitated spending levels demanded by the executive leadership that exceeded yearly fiscal budgets, and helped direct monies allocated for education or other areas to support the more politically-powerful military departments.

Claims of bureaucratic capacity within the Ministry are also undermined by the overall difficulty it had in effectually collecting tax revenues; as Strauss (1998: 133-140) recognises, the Guomintang administration proved unable to replicate the successful tax collection managerial strategies and structure of the Beiyang-era jointly foreign-and-domestic administered Salt Inspectorate on a larger scale across other tax collection divisions of the Ministry. Strauss (2008: 233) finds that "programmes for direct income tax, inheritance, savings, property and windfall profits were simply beyond the technical and manpower capacity" of the Ministry's tax collection infrastructure. Net tax revenues fell as corruption proved rampant, leading to high effective tax rates on businesses, as private entrepreneurs were squeezed while the central government bureaucracy struggled to prevent funds from being siphoned off at lower levels of government. Such indicators of corruption in tax administration are relatively unaddressed by the revisionist literature, as are additional examples of corruption within the Ministry leadership as described by Paauw (1952), Eastman (1984a), Slack (2001) and others. Thornton (2007) provides more extensive documentation of the scope and scale of corruption that permeated and defined Guomintang government bureaucratic offices, including the Ministry of Finance. Overall, the degree of documented official corruption within the Ministry run counter to portrayals of an organisation exhibiting strong bureaucratic capacity.

In regard to what we have labelled as Boecking (2011b, 2017)'s vociferous advocacy of the revisionist position, particularly his claims of relatively strong Guomintang bureaucratic capacity and institutional quality prior the fall of the Nanjing government in 1937 and its concomitant loss of customs tax revenues, there exist several weaknesses. To begin with, much of the objectionable taxation and expropriation policies undertaken by Guomintang state actors to which Eastman and others refer occurred before the overthrow of the Nanjing government in 1937. Moreover, the suggestion that Guomintang tax extraction policies were "sustainable" simply because they lasted over the majority of the Nanjing Decade fails to account for the role they played in creating a weak institutional environment that discouraged private investment and sustainable private-led economic growth. Boecking (2017: 151, 157, 237) provides only perfunctory acknowledgment to the pernicious impacts that the Guomintang's policy of high tariffs had upon domestic consumers, and upon economic growth in general. As delineated in Chapter Seven, the Guomintang state took an ever-increasing role in the private economy, displacing private companies through the creation of state-owned enterprises, and by expropriating the assets and managerial independence of private corporations via state regulatory authority. Furthermore, while Boecking regards the ability by the Guomintang state to increase tariff rates on the modern trade sector of the economy as an important policy achievement indicative of strong state capacity, these policy decisions can equally be portrayed as indicative of the state's weak bureaucratic capacity. First of all, the Guomintang state simply appropriated an existing efficient tax collection apparatus in the form of the Maritime Customs Service and used it to increase tax rates on the more modern and growth-generating sector of the economy. Second, according to figures Boecking (2017: 193) cites

in his own work, while by 1936 trade accounted for less than four per cent of gross national income, revenue from tariffs represented forty-four per cent of government revenue. The fact that government revenue was so dependent on tariff income was recognised by multiple contemporaneous observers; Su & Barber (1936: 115) comment, for instance, that "To an unusual degree, the Central Government of China derives its support from customs imposts and duties." Yet in weak capacity states with ineffectual bureaucratic and administrative resources, it is typical for modern sectors, including the trade sector, to be taxed at higher rates, at the expense of informal and traditional sectors (Besley & Persson 2014).

Meanwhile, tax revenue received on agriculture, still by far the largest sector of the economy, accounting for sixty per cent of gross national income in 1936, remained low. As described above in Section 5.1.1, this can be seen as indicative of the lack of bureaucratic capacity on the part of the Guomindang central state to be able to effectually capture tax revenue, suffering as it did from both ineptitude and corruption in its tax collection administration. Importantly, however, low tax revenues flowing to the central state did not imply that private actors in the agricultural sector were not heavily taxed; indeed, as Section 5.1.1 outlines, the number, variety and scale of taxes on rural farmers were extremely high during the Guomindang period, with the state unable to limit either private nonstate actors or local government officials from exploiting their access to either state police or military power to force rural farmers to yield not only financial assets in tax fees but also payments in kind, and productive private assets such as land and labour. Such high levels of taxation produced strongly negative output on agricultural productivity, with Hsiao (1974:83) providing statistics indicating imports of grains—including the staples of rice, wheat and flour—more than doubled in the five years following the start of Guomindang rule and the implementation of its tax policies; such increases did not reflect substitutions from food crop to cash crop cultivation or output (Liu & Yeh 1965), with exports of grains in fact falling (Hsiao 174:83), nor increased demand resulting from increased per capita income levels (Ou 1946:553).

Additional mixed signals regarding the bureaucratic capacity of the Guomindang Ministry of Finance also exist. For instance, the portrayal by Young (1963, 1971), Strauss (1998) and Ma (2012) of the Ministry's move from metallic-backed to pure paper currency as "successful" is a subjective analysis highly dependent upon the scope of the behaviour analysed. Objectively, it is accurate that the Ministry of Finance employed several successful strategies in its move to implement a paper currency, including by November 1935 wresting the ability of other independent entities, such as primarily foreign banks, from issuing competing notes (Horeh 2008a: 287). However, while these steps indicated a bureaucratic capacity to achieve a stated policy goal, controlled the issuance of a fiat currency, we argue that consideration of the economic impact of the move to paper currency is equally salient in measuring success. Given the move to a fiat paper currency was used to control the money supply allowing for greater levels of government spending at the expense of private savers by debasing the currency, and resulting in abject hyperinflation, with inflation rates easily exceeding one thousand per cent per annum by the mid-1940s, it is difficult to ascribe the policy undertaking as particularly "successful". Overall, therefore, evidences regarding the strength and efficacy of bureaucratic state capacity of the Ministry of Finance appear mixed at best.

Moving beyond the question of whether revisionist claims of bureaucratic capacity are valid characterisations of select domestic Chinese state organisations, there is also the question of the representativeness of the organisations the revisionists identify to argue their claims. Specifically, insofar that state organisations did exhibit strong bureaucratic capacity, it appears disingenuous to attempt to demonstrate the strength of domestic state institutions by pointing primarily to those state organisations that were jointly foreign-and-

domestically administrated, such as the imperial postal service, the Maritime Customs, and the Salt Inspectorate, given that by definition the jointly-administered nature of these organisations were not expressly domestic and typically acted under foreign leadership. Nonetheless, by far the most compelling example Strauss (1998) provides of a "domestic" state organisation to have exhibited "strong" bureaucratic capacity is the jointly-administered Salt Inspectorate. Similarly, the representation of a strong domestic institution for van de Ven (2014) is the Chinese Maritime Customs Service. For Harris (2012), the Chinese Post Office is identified as a domestic state organisation that exhibits able bureaucratic capacity.

Yet, that the most significant examples of effective domestic state bureaucratic organisations were only partially domestic in nature underscore their nature as exceptions to a more general condition of weak domestic state bureaucratic capacity. Of primary salience, therefore, is why it was primarily only jointly-administered state bureaucratic organisations that succeeded bureaucratically in circumstances where wholly domestic state bureaucratic organisations did not. It is clear that issues of corruption, inefficiency, and bureaucratic ineptitude are features not unique to late-Qing and republican state organisations. Such an obvious claim is underscored by denouncements of the practise of bribery in the application of the laws of justice and legal cases found in early biblical references (Exodus 23:8). In the economic discipline, the lack of market discipline has been theorised to act as an inherent blockade to efficiency in state bureaucratic structures (Mises 1944, Mosher 1968, Freeman 1975, Boardman & Vining 1989, Johnson & Libecap 1994, Arum 1996). Contemporaneous observations at the time regarding the universality of the "problem of bureaucracy" were rife throughout all forms of political systems and governments; for instance, official corruption during the Prohibition period of the 1920s in the United States frequently led to cases of state officials accepting bribes (Behr 1996, Burns & Novick 2011), accentuated by the several major scandals that rocked the period's Harding administration, and punctuated by convictions of fraud, bribery and divergence of federal funds for personal uses by top cabinet-level officials, including Charles Forbes, Albert Fall, and Harry Daugherty (Stevens 2016, Rapp 2017).

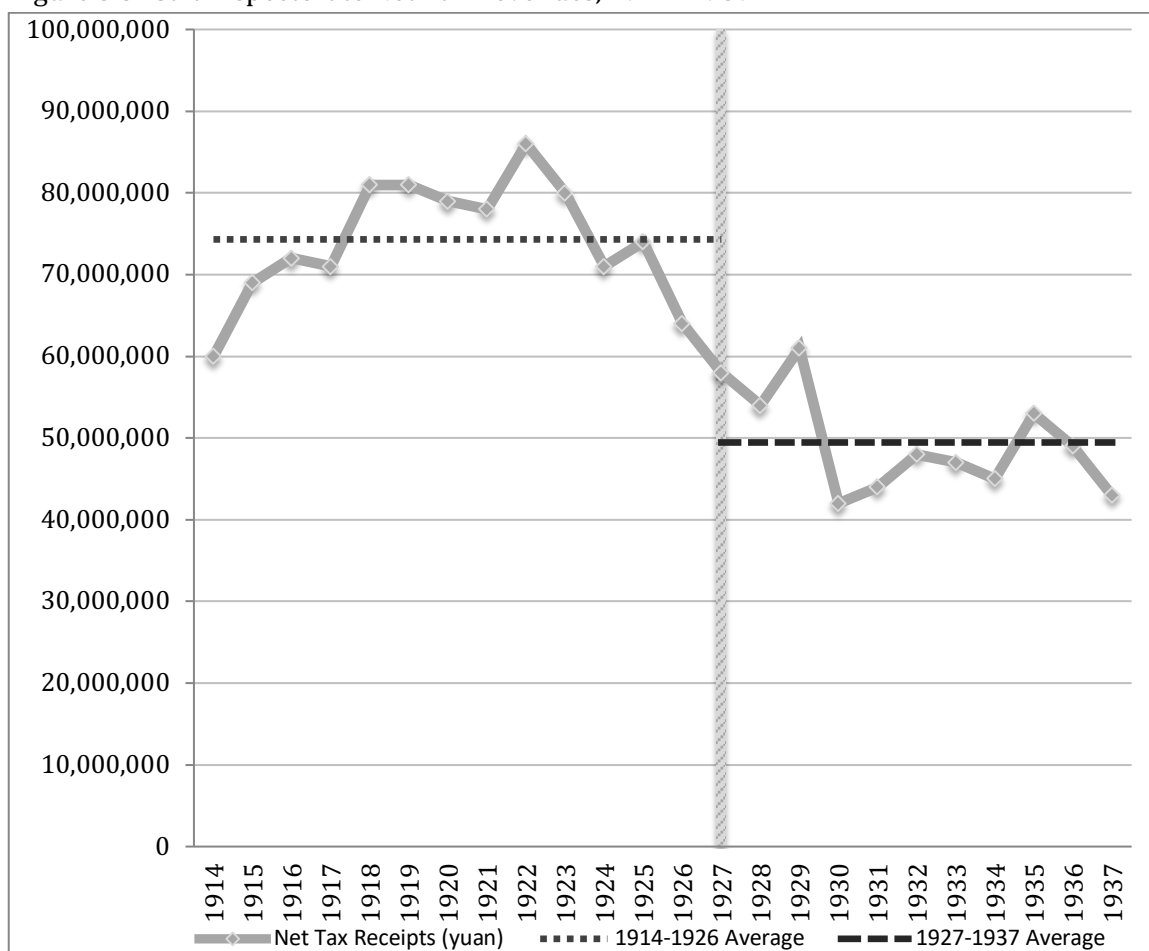
Such examples underscore that it was not any inherent feature of domestic Chinese compared to foreign officials responsible for the prevalence of bureaucratic capacity weakness, but rather specific qualities of the structure of domestic state organisations contrasted with their jointly-administered state bureaucratic counterparts. Specifically, the fundamental difference lay in the fact that the quasi-foreign structure of these jointly-administered state bureaucratic departments provided for a classic credible commitment mechanism that was lacking in purely domestic equivalents. Thus, for instance, van de Ven's description of the Maritime Customs Service highlights that the organisation's fundamental role in the development of a viable overseas market for Chinese bonds derived precisely from the insulated and quasi-independent nature of the Service, which implied protected and dedicated revenue collection for foreign bond payments. Effective foreign control over customs funds outside the control of domestic state officials served as a credible commitment mechanism, as it created a structure that implied attempts by state actors to abdicate on their debt obligations would prove difficult and costly, thus according with Schelling (2007)'s definition of credible commitment mechanisms as contractual or institutional mechanisms that lower the utility agents might gain from violating the terms of an agreement. Thus, partial foreign control over funding dedicated to foreign loan repayments created credible commitment mechanisms in the Salt Inspectorate and Maritime Customs Service. Foreign control did not grant credible commitment via superior organisational or bureaucratic technology possessed by foreign bureaucrats, but rather via effective insulation from the political environment that incentivised corruption amongst domestic state bureaucrats and associated rent-seeking from outside private agents.

Relatedly, the revisionist argument that jointly foreign-and-domestically administrated state bureaucratic organisations represented examples of strong domestic institutions is weakened when considering these organisations' performances under the Guomindang period when foreign control and influence was weakened or removed. The emphasis by the Guomindang to remove foreign control of these organisations also effectively removed their accompanying credible commitment mechanisms, thus removing the primary driver of effectiveness of the structure. This was observed quite clearly in case of the Chinese Postal Service—shortly after Guomindang came to power in 1928, the Postal Service's foreign administrative leadership was replaced by domestic officials, and these state actors immediately moved to outlaw private mail-delivery companies, known as 民信局 *minxinju* (Harris 2012: 155-158). Although the Guomindang framed their takeover of the Postal Service from foreign administrators as a nationalistic action undertaken to benefit the country's citizens, by restoring the "dignity and glory of the Chinese people", the result was a series of actions that served to benefit state actors' interests at the expense of domestic private entrepreneurs. Further, monopoly control over mail delivery by the Chinese Postal Service increased the power of domestic state actors and the ability of the state apparatus to enforce the power of the state to control freedom of expression through its policy of monitoring and censorship of communications via absolute control over domestic mail delivery. Harris (2012: 291) praises the Guomindang for "utilizing postal bans very effectively", while noting, "The effectiveness of Nationalist censorship stemmed from its re-organization of censoring bureaucracies and the promulgation of new media laws and regulations."

In similar fashion, the removal of foreign control over the administration of the Salt Inspectorate led to noticeable declines in net revenue collections, even while the Inspectorate simultaneously imposed increases of tax rates. Strauss (1998, 2008)'s attempts to argue that under the Guomindang the Salt Inspectorate exemplified successful state bureaucratic capacity, is partially undermined by data presented in Gale (1930) cited previously in Section 5.1.1.1, and by data presented by Strauss (2008) herself. These data indicate the significant degree to which net tax receipts fell once the Guomindang removed foreign oversight over the Salt Inspectorate. Figure 5.3 reproduces graphically data presented in Tables 9.1 and 9.2 from Strauss (2008), the original data for which is Chen (1935) and Ding *et al.* (1990), respectively. Net tax revenues, which had averaged 74 million *yuan* prior during the Beiyang period, averaged only 49 million *yuan* after the Guomindang ended the system of joint foreign-domestic administrative control over the Salt Inspectorate beginning in 1927.

The decline in net tax receipts obtained by the Inspectorate in the wake of the end of foreign administration was not due to any inherent benefit to foreign oversight of domestic administrative bureaucratic offices, *per se*, but rather only insofar as foreign oversight had served to break the incentive and opportunity for corruption by domestic civil servants by creating an oversight structure that incentivised maximisation of net revenue collection, and not vested in a system open to arbitrary taxation collection. The domestically-administered system that replaced the jointly-administered system failed to replicate this oversight structure. Instead, the Inspectorate under the Guomindang was administratively weakened given it had, per Strauss' own depictions, less political independence and autonomy, given the party leadership increasingly used political appointees to lead the Inspectorate, who pressured Inspectorate officials to "raise tax rates continually" (Strauss 2008: 233). As with the drive to end foreign administrative authority over the Postal Service, the language of combatting "foreign exploitation" was a politically expedient rationale provided to justify ending foreign oversight of the Inspectorate; yet control of the Inspectorate by domestic state actors led to the imposition of higher effective tax rates on domestic salt producers, implying a greater share of private resources were transferred to state actors at the expense of private actors.

Figure 5.3. Salt Inspectorate Net Tax Revenues, 1914–1937



Source: Constructed from data provided in Strauss (2008: 222-223).

5.2.3.2. Foreign Control and Credible Commitment Mechanisms

It is notable that domestic state actors viewed the ability to control state bureaucratic organisations that could allow for the extraction of private resources from economic actors as delivering greater expected gains than gains expected from maintaining partial foreign administration of these organisations. Foreign administration provided a degree of credible commitment to state promises to honour agreements (for instance, contractual payments on bond obligations) by increasing the difficulties and costs of defecting. The source of the credible commitment in this case therefore was that the control of revenues or other things that state actors might wish to control for themselves, whereas foreign control meant these benefits were outside the purview of domestic state actors, thereby imposing effective limits on domestic Chinese state actors' behaviour in order to create some institutional constraints and effectively bind themselves to respecting private property rights.

Unlike liberal democracies that possess institutions, such as free and open elections and free and open media structures that help to impose substantial costs on state actors deviating from previously-promised obligations, the absence of similar institutions and other formal or self-enforcing constraints in authoritarian regimes imply credible commitments are difficult to create. Grzymala-Busse (2007:81) emphasises that electoral competition creates incentives for state actors to impose limits on the state's ability to expropriate, so that state actors facing electoral contestation "would rather constrain themselves, and all subsequent governments, than allow their successors to have access to state resources."

As their regimes lack such self-enforcing structures contributing to commitment, contemporary authoritarian leaders often seek membership in international organisations, such as the World Trade Organisation or International Monetary Fund, in order to utilise the required adherence to the organisations' membership rules as signalling mechanisms to substitute for credible commitment devices (Fang & Owen 2011). In many regards, we can view foreign control over the Maritime Customs Service or Central Salt Administration as similar tools—that is, quasi-international institutions—that enabled domestic state actors to signal commitment to bind themselves to previously-promised obligations. For instance, in regard to its foreign bond issuances, the domestic state's promises to repay such debt obligations were backed not only by the signatory promises of domestic state leaders, but also by the fact that quasi-foreign (i.e., jointly-administered) institutions exercised considerable control over the funds to be used to repay the country's foreign debts.

Such forms of external or other control mechanisms appear to have been necessary to overcome foreign investors' hesitation to hold Chinese external bonds that would have otherwise been secured only with the promise to repay by the Chinese government. As explored in Chapter Eleven, when the domestic state did have discretion to defect from honouring its repayment obligations on its bond commitments, it did indeed often do so. For instance, in regard to domestic bonds, whose loans were secured by subordinated collateral and general tax receipts, state actors had much greater discretion to choose to default, acting to do so on multiple occasions throughout the republican period. Conversely, on its external foreign bonds, since foreign administrators (who had been approved or sanctioned by the foreign lenders) controlled monies designated for collateral on the external bonds, domestic state actors had considerably limited options or extremely high costs associated with defecting from honouring its repayment promises; therefore, its commitments were viewed as credible, and thus the Chinese state was able to access the foreign debt markets so long as foreign-controlled collateral sources were available. Once such insulated or externally controlled collateral sources were exhausted, however, foreign credit markets for additional Chinese debt effectively dried up. That is, the credible commitment device directly came from the fact that it was outside-imposed via foreign control of the collateral sources, not an otherwise self-enforcing domestic institutional arrangement signalling a commitment to protection of private property rights.

Interestingly, however, unlike in the cases Fang & Owen cite involving authoritarian states that actively seek to leverage outside-imposed rules provided by membership in international organisations as a way to signal credible commitment, in the case of republican China, the multiple Beiyang and Guomindang domestic regimes were continually seeking to end the system of joint foreign-and-domestic administered organisations. Although domestic governments officials sought to utilise international bond markets to raise funds, they chafed at the arrangements that facilitated foreign creditors' willingness to proffer capital—such as foreign control over collateral sources designated for repayment of such international bonds—and continually attempted to end foreign involvement in the management of the salt gabelle and customs taxes.

The reason for the disconnect between behaviours of authoritarian regimes cited by Fang & Owen and that of the authoritarian republican governments could well be related to the degree of regime uncertainty state officials faced. Regimes facing serious existential threats are primarily concerned with short-term goals such as regime preservation, as opposed to more long-term goals that involve future access to credit markets. Thus, one possible reason for attempts to end foreign control of collateral sources was to gain access to these revenue streams so as to use them for regime preservation purposes that in the eyes of state actors would take precedence over repayment of prior loan commitments.

Soothill (1928:124) notes Beiyang negotiators continually pressed for sovereign control over the use of tariff revenues from the Chinese Maritime Customs at the international tariff conference of 1926 held between China and principal treaty powers. The results of the conference were inconclusive owing to increasing levels of internal civil strife, such that "the Chinese Delegation, owing to the resignation or flight of most of its members had ceased to exist and the conference was postponed *sine die*." The breakdown of national central government control during this period, however, underscored to foreign investors the lack of domestic internal mechanisms that could sufficiently bind domestic actors to protect the investor property rights and ensure funds designated for loan repayment would not be directed into other purposes such as regime maintenance. Indeed, as the historical record makes clear, numerous local warlord leaders did in fact use military force to take control of local tax receipts in order to use them to support their goals of additional military action.

While the rationale for state officials to gain direct control over designated collateral revenue sources might have well been owing to a desire by officials to spend such revenues on activities that would benefit themselves by violating the property rights of those who had previously lent money, in practise it was not so articulated. Instead, to justify attempts at ending foreign control over revenue streams designated for bond repayment, the issue of control over collateral was often presented as representing an affront to the sovereignty of China over its own resources, and employing calls to nationalism to fight against the "humiliation" imposed upon the Chinese nation by foreign powers.

5.2.3.3. Addressing mixed evidences within mainstream and revisionist literatures: Contemporaneous Actors

One of the more perplexing issues in Chinese economic history scholarship is the seemingly widening gap between mainstream and revisionist viewpoints regarding the level of domestic institutional strength and capacity, with Miller (2000: 15) characterising the scholarship on the period as "less settled than ever." As indicated from the above-citations of both mainstream and revisionist literatures, such contrasting viewpoints is partly due to the existence of credible evidence that can be used to support of either side of the argument.

Such conflicting conclusions are partly a reflection of a methodological approach based upon current-period scholars looking back at innumerable and divergent sets of historical data. As such, we argue a potentially more methodologically sound approach is not to rely on the opinions of current-day researchers, but rather analyse the response behaviour of private economic agents acting within their time period-specific conditions.

While the subsequent analyses in Part IV explicitly employ this strategy using market data from Shanghai's early financial markets, we can also utilise this strategy on a limited scale in an analysis of the Ministry of Finance's aforementioned policy implementations to monopolise the production of legal tender, and move from commodity to fiat money. On this issue, the contrasting views advanced, for instance, by Paauw (1952) and Eastman (1974) as evidence of weak institutional capacity, and by Strauss (1998) and Ma (2008) as evidence of strong of institutional capacity, appear difficult to square on the surface.

In this case, an analysis of the willingness of private agents to hold banknotes issued by various economic entities is appropriate. Such an analysis finds that prior to the domestic government's ending the era of free banking and monopolising money issuance, much of the domestic public chose to hold foreign banknotes over domestic government-backed banknotes (三民主義千子課 1928: 34; Wu 1935: 192, Stapleton 2004: 5), with Wu (1935:192) noting, "[foreign] banks in China have long been issuing their own paper currency and the latter has usually been favored by the populace."

Such behaviour provides an instance of revealed preference by contemporaneous domestic rational actors that indicates an indictment on the amount of trust placed in the domestic state-run financial entities as compared to privately-operated foreign financial entities, and in the differential in institutional quality backing these entities. While theoretically a hundred-*yuan* note issued by a foreign private bank could represent the same value as a hundred-*yuan* note issued by a domestic government bank, private economic actors' preference to hold foreign private banknotes represented an inherent discount applied to domestic government-backed financial institutions, reflecting a lack of faith in domestic issuing entities to uphold their promise to back the issued currency with silver.

Such misgivings might have logically come from the forced nationalisation of much of the domestic banking system, which not only deprived private shareholders of power to choose managers or force dividend payments, but also enabled the placement of forced loans and bond purchases onto the balance sheets of these banks so as to make the bank technically economically not viable without explicit regulatory support granted by the Ministry of Finance. In this sense, it should come as no surprise that domestic economic agents were neither interested in investing in these banks' equity shares, nor holding their bank notes.

Such revealed preference in this instance accords with the overall story presented in ensuing chapters regarding the reluctance of domestic economic actors to hold domestic financial instruments, absent a steep discount, when presented with the option to hold similar extraterritorial financial instruments. It also suggests that revisionist analyses that seek to cast the domestic state as exhibiting high levels of state capacity and institutional strength are potentially overweighting or misinterpreting evidence they observe from the current framework by discounting the actual viewpoints of contemporaneous actors on the relative degree of domestic state capacity and institutional strength.

5.2.3.4. Missing the Point: Terminology and the significance of bureaucratic capacity

The caveats cited above aside, Strauss (1998, 2008), van de Ven (2014), Bian (2005a, 2005b), Ko (2016), and others within the revisionist scholarship provide robust challenges the uniformly dismal view of late-imperial and republican domestic state capacity suggested by much of the traditional literature, by identifying sources of evidence to suggest that domestic bureaucratic capacity was more centralised and potentially more effective than previously depicted. Putting aside questions as to whether the discrete pieces of evidence the revisionist literature cites are of a universality and scope sufficient to support their claim of a domestic state with substantive state capacity, or that bureaucratic state capacity markedly increased under the Guomindang, of far greater salience is the issue of the relevance of state capacity to the question of "strong institutions." Certainly, the ability of the state bureaucracy to define and accomplish goals is important to understand and document; however, it cannot be simultaneously assumed that high levels of state capacity are necessarily correlated with the presence of the type of institutional strength that encourages social and economic freedom and growth. However, effectiveness of government bureaucracy is not a positive attribute, *per se*, but rather simply a measure of the ability of state actors to implement policies they so desire.

Thus, while bureaucratic structures that allow state actors to achieve their own goals more effectively and capably is arguably beneficial to state actors, of more salience is employing state capacity to create a framework for economic growth and a free civil society, which requires limits on the ability of state actors to use state power to engage in arbitrary or excessively extractive actions against private actors. Bureaucratic state capacity in and of itself is not particularly beneficial to private actors if state actors are not bound by structures

that allow and incentivise them to credibly commit to respecting private property rights. In fact, strong state structures that imbue state actors with strong political power but fail to limit state actions violating private property rights can generate worse outcomes than if the state is too weak to do so; i.e., authoritarian regimes with high state capacity simply mean state actors can more effectively act in ways that violate private property rights.

As Chapter Two emphasised, governmental power presents a double-edged sword: while society can benefit from strong and effective state authority that allows for the provision of protection of private property rights from arbitrary takings by internal or external actors, state power can also be employed to expropriate property from private individuals. Strong and effectual bureaucratic offices that can efficiently tax the populace in order to provide military and police protection against arbitrary takings, can also readily be employed to extract private resources and transfer them to state actors. It can be argued, as revisionist scholars do relatively effectively, that compared with the bureaucratic capability of the earlier late-Qing and Beiyang governments, the Guomindang government possessed a more complex and extensive bureaucracy, imbuing state actors with greater capability to accomplish their desired goals. Greater complexity and even capability within the bureaucracy cannot, however, be presumed as an inherently positive aspect of "state-building", as is frequently found directly or indirectly in the revisionist literature.

Given that increasing bureaucratic capability was not accompanied by credible commitment mechanisms—such as an independent judiciary, open and free elections, representative government structures, and a free press that allow citizenry to be informed of the actions of government actors and hence held accountable—that placed checks on government actors' behaviours, much of state bureaucratic capacity was in fact channelled into using state power to exploit private economic actors, as described in detail in previous sections of this chapter. Bureaucratic state structures were employed to extract private wealth for personal gain of state actors, create effectual monitoring of private agents civil lives using secret police, arrange assassinations of political opponents, develop sophisticated political censorship and propaganda mechanisms, and use regulatory and oversight authority to direct economic and financial resources from private entrepreneurs to state-controlled enterprises, such as by nationalising much of the banking system. All of these actions involved constraining the choice set of individual private agents to meet the desires and benefit of state leadership, rather than creating an environment for in which private agents could shape and determine their economic and social lives.

Thus, care is necessary when considering revisionist claims about, for instance, "successful" Guomindang institutions. To begin with, while the revisionist literature is often presented as providing a counter to the traditional depiction of a weak late-imperial and republican institutional framework, the specific claims of the revisionist literature are in regard to the bureaucratic capacity of a few specific state organisations. The inherent ambiguities in terminology implied by concepts such as "institutions", or "institutional strength" has led to a conflation in the implications of the workings of specific government bureaus and ministries with much broader concepts regarding the overall domestic institutional framework. For instance, when Strauss makes reference to the existence of "strong institutions" in republican China, she is specifically referring to strong bureaucratic administrative capacity in one or two specific government organisations, such the Ministry of Finance and the Salt Inspectorate, not, necessarily, the broader unit of analysis of overall institutional structures—made up of multiple social, political, civil organisations—that constitute the way concepts such as private property, contract, corporate and investor rights are defined, developed and implemented within economic civil society. Overall, therefore, the focus of much of the revisionist literature on the capability of state bureaucracies to effectively enact policies considers an important yet nonetheless ancillary portion of the focus of the broader institutional literature.

Second, many of the examples of strong state bureaucratic capacity by the Guomintang that Strauss, Bian, Ko and others describe are in fact centred on examples of the state implementing actions that intruded on the private economic and social spheres, as opposed to examples of ways that state capacity was directed into creating credible commitment mechanisms. For instance, the depiction by Young (1963, 1971), Strauss (1998), and Ma (2012) of the Ministry of Finance's move from metallic-backed to pure paper currency is described in their subjective analyses as "successful" based on their reading that the Ministry developed the prerequisite bureaucratic capacity to carry out such a policy. This reads quite differently, however, than an analysis of the positive or negative implications the policy imposed on the broader Guomintang institutional framework of private property rights. Specifically, while the Ministry did indeed institute a policy of a single paper currency, successfully wresting the ability of independent entities such as foreign banks from issuing competing notes, this move was indicative of a lack of commitment by the Guomintang leadership to institutional protections of private property rights. This dichotomy between "strength" of bureaucratic capacity, and broader strength of private property institutions, is underscored by the ensuing hyperinflation that followed the Guomintang's monopolising of power to issue currency, followed by a currency debasement so as to allow for ever-greater levels of government spending at the expense of private savers.

Further, the implicit view of state power as an inherently positive, or even necessary, force to bring about economic and social development, characteristic of much of the revisionist and state capacity literature, ignores the state's role as a possible threat to economic growth and civil society. This is reflected within the revisionist argument that centralised political power is required for states to exhibit "institutional strength"; both Strauss (1997, 1998, 2008) and Bian (2005a, 2005b), for instance, show a veneration of centralised—and therefore, in their wording, "rationalised"—governance structures. Some of this emphasis derives from the implicit application of a false inverse between conditions of political discord resulting from political strife and civil war versus top-down, centralised government and social planning, as opposed to more appropriately defining the distinction as one between centralised, top-down control structures versus more federalist structures that allow for a high degree of local autonomy. Many revisionist analyses of the domestic central government portray it as having lacked "sufficient" centralisation. For instance, in support of Strauss (1998)'s conception of the late Qing polity, Xu (2001: 226) argues the Qing state failed to "modernise" and adapt to the pressures brought to bear by outside European powers and internal changes because it could only muster "a proliferation of ad-hoc administrative organizations from the bottom up." However, while the political chaos of late Beiyang period defined by warlordism and protracted war civil strife did contribute to difficulty in bureaucratic and administrative capacity enabling centralised government control, as discussed later in this chapter, political strife proved a constant throughout the entirety of the late imperial and republican period. Thus, even granting the Guomintang to have been more administratively centralised than prior domestic governments, that the level of political strife remained extremely high suggests a lack of relationship between political centralisation and levels of political strife. In addition, regardless of issues of political centralisation, the authoritarian government structure implied a lack of sufficient credible commitment and political mechanisms—such as independent courts, political rules, electoral options—which could have fostered confidence amongst private actors to support the state and its interests, regard it as a viable institution, or permitted provincial leaders to contest central authority through nonviolent means, and which therefore instead contributed to creating conditions incentivising the utilisation of violence by political power brokers outside the central government apparatus.

Chapter Six.

State Capacity: Protecting Private Property and Contract Rights via Effective Institutions — Ability to Enforce Monopoly on Internal Coercive Violence

In this chapter, we analyse the role of the domestic Chinese state from the standpoint of its ability to protect private property rights by preventing nonstate intrusions on such rights. As explored in Chapter Two, one theory of the state originating with Hobbes (1651) is that governments serve as a coordinating mechanism to limit the theft or destruction of economic agents' property endemic to the State of Nature, so as to allow private agents the ability to own and control (some) of the goods they produce. According to this view, the role of the state is to implement a rationalised rule of law by way of the coordinated martial power of the state to provide protection from—employing Olson (1962)'s figurative terminology—"roving bandits" who might otherwise wantonly take or destroy agents' private property. In order to fulfil this primary role, the state apparatus must possess sufficient capacity to enforce a monopoly over the legitimate use of coercive force.

The governments in nominal control of China from the late-Qing through the republican period, however, proved consistently unable to perform this basic role of the state. Instead, these governments oversaw conditions in which internal violence was endemic and where the state lacked sufficient capacity to enforce a monopoly on internal violence, typifying the classic example of a low-capacity state, and exemplifying what Weingast (1997) and North *et al.* (2006) refer to as state institution structures constructed as "limited access orders." We analyse the performance of the domestic state in this regard using a conceptual framework that partly extends state capacity arguments to specifically utilise those of what Weingast and his co-authors refer to as the "violence trap" approach (North *et al.* 2009, 2013; Weingast 2010, 2017; Cox *et al.* 2017; Levi *et al.* 2017), as well as what we have referred to as an extension of the violence trap thesis as presented in Section 2.5.4.2.

Section 6.1 provides a brief overview of the violence trap thesis, as well as reference to our extension of the thesis. Section 6.2 presents a historiographical analysis of domestic state capacity vis-a-vis its ability to maintain a monopoly on coercive violence within its internal domestic borders. Finally, Section 6.3 attempts to link the two previous sections, by explicating the way in which the specific actual history of the late-imperial and republican eras exemplifies rather well that which is predicted by the Violence Trap thesis, as well as our own extension to their thesis, in both antecedents relating to its weak state capacity, and in terms of outcomes owing to the attempts by state leadership to overcome the problems posed by endemic social violence.

6.1. The Violence Trap Thesis

As previously introduced in Chapter Two, Weingast and his co-authors suggest the leadership in many developing nations face a "violence trap" that limits their policy options. Governments with weak state capacity frequently are unable to enforce a monopoly on coercive violence. As a result, multiple dispersed actors with access to means of organised violence can pose a credible existential threat to the state. The existence of such distributed sources of access to coercive violence helps explain the high levels of violence so prevalent in low capacity states. As the prevalence of multiple sources of violence pose serious danger to those in power—from either destruction or capture of their assets via violence, or being overthrown by those with access to alternative sources of violence—in order to protect their privileged economic positions, state leaders engage in strategies that attempt to reduce the probability of violence. Congleton (2010) finds rent-extraction regimes, rather than free trade, to have been the norm throughout history, owing to the political difficulties of enacting liberalisation policies. Weingast and his co-authors present an additional

impediment to adoption of liberalisation policies, arguing that one of the most common strategies sovereigns use to decrease the probability of violence centres on creating economic rents that can be distributed in a politically expedient manner to co-opt potential rivals and induce support for the existing political order. While rent-creation strategies potentially reduce the incidence of violence, in general they prove antithetical to economic growth. Yet abandoning such rent-creation strategies can increase the likelihood of political violence. Hence, therein lies the development trap to which Weingast and his co-authors refer, wherein which leaders of states with weak capacity to enforce a monopoly on violence find themselves incentivised to institute highly inefficient economic policies.

Our extension of the Violence Trap thesis suggests that weak states under constant existential threat are unable to create effective credible commitment mechanisms, as *ex-ante* promises made by states facing existential threats are inherently not credible. As private actors can recognise existential threats to the state, they can also recognise that state actors will place the short-term goal of regime continuance over longer-term goals that might foster credible commitment, implying state actors will be more willing to undertake drastic actions to prevent their overthrow, such as the declaration of military law, the suspension of civil liberties, or engaging in onerous taxation or outright expropriation of private economic output in support of military efforts. Therefore, private agents are likely to discount attempts by the state promising to honour commitments to protect private property rights. Further, just as private actors anticipate the state failing to honour commitments to protect private property rights under severe existential threats, so too will state actors anticipate this expected response of private actors, and as such are further disincentivised to attempt the construction or maintenance of credible commitment mechanisms. As a result, a "low credibility trap", is created that locks the state into an action set that severely undermines its ability to credibly commit to protect private property rights. The dynamics of the trap are self-reinforcing—facing serious existential threats, incentives on state actors to honour prior commitments to protect property rights are considerably reduced, given that private actors will react similarly whether state actions uphold or violate commitments. This condition therefore increases the likelihood that the state will in fact violate its prior commitments. Recognition by private actors that state actors are more likely to violate prior commitments under such conditions creates secondary effects that further strengthen the overall dynamics of the described incentive structures.

6.2. Existential Threats facing Late-Imperial and Republican Chinese Governments

The state capacity and violence trap literatures frequently employ a dichotomist concept of internal versus external threats as a way to distinguish not simply different sources but also different degrees of existential threats that states might face, with the supposition that external threats represent the more serious. On this issue, however, and certainly within the context of post-early modern Chinese history, we deviate slightly from the standard conception of "internal" versus "external" threats analysis regarding the monopoly on violence and the type of threats that the state can face from rival actors with access to coercive power of force. In fact, we argue it is not necessarily the case that external threats are inherently any more serious than internal conflicts. The complexity of the situation in late-imperial and republican China was one of such varied and dispersed sources of violence across many multiple actors. Certainly, the internal Taiping rebellion was an existential threat of quite serious degree; at its height, the rebellion managed to take control over a significant portion of the Qing state, establishing its own competing capital in Nanjing and nearly took Shanghai and other crucial cities. Similarly, the internal threat presented by the communist rebellion in the 1930s and 1940s was equally as dangerous to the Guomintang regime as was the external threat posed by the Japanese military, as evidenced by the regime's ultimate successive defeat at the hands of both.

To provide an organisational framework to the discussion, we divide the analysis based upon the required method of enforcement necessary to respond to threats of nonstate violence. In general, states implement a monopoly of force through the two vehicles of internal police, and military forces. In general, police forces are designed to minimise internal disorder by compelling adherence to laws, including the protection of private property rights, and limiting the threat of small-scale acts of violence by non-state actors; that is, to limit the behaviours of Olson's "roving bandits." Military forces, conversely, are typically employed to provide defence against the threat of larger-scale forms of violence, especially those that present immediate existential threats to regime survival. These large-scale threats include internal threats such as rival military cliques, and armed political forces or rebel groups, as well as external threats from foreign militaries.

The late-imperial and republican domestic state apparatus constantly faced serious existential threats from multiple rival sources of violence. Competing militarist groups, major armed social uprisings such as Taiping and Communist rebellions, rival armed political parties such as the Guomindang Party based in the south of the country during the Beiyang era, and major military offenses on Chinese soil executed by Japanese military forces. Such serious and powerful internal and external threats from competing sources of violence demonstrated an inability by the domestic Chinese state to maintain a monopoly on internal violence. Ultimately, the domestic state lacked adequate state capacity to either efficiently spend the financial resources it possessed, or to raise additional capital, to enable effective militarisation that could have prevented competing internal and external groups from posing existential threats to the domestic regimes.

The domestic governments in nominal control of China were consistently unable to perform the fundamental and necessary role of the state—protection of private property rights from destruction or expropriation by external or internal nonstate actors. Economic agents' perception of private property rights was therefore likewise consistently affected by the knowledge that the importance of keeping whatever promises the sovereign might have made—and even whatever credible commitment devices were connected to such promises—would be subordinated when faced with an existential threat. More important, there was real concern that any realised output achieved by costly investment undertaken could be plundered or destroyed by "roving bandits" represented by internal rebels, militarist leaders, bandits and organised crime members, or foreign military forces. Potential investors who might consider financing entrepreneurs had to likewise worry that their investment risks not only involved the expected probability of the entrepreneurial venture being economically successful, but whether at some point the gains of that venture would be expropriated or destroyed. Furthermore, the investor also faced the additional concern that whatever level of private property and contract protection the current state apparatus offered, that state apparatus could become incapacitated or removed altogether.

The intricacies of the complex and fluctuating vagaries of the political situation of the late imperial and republican period have been handled in multiple other historical researches. The following section is centred primarily upon the ways in which national governments attempted to fulfil the fundamental state function to defend and protect both its own sovereignty and individuals' property rights. A new emphasis in the literature seeks to stress the fundamental importance of the constant wartime conflicts and impacts these had on the development of the Chinese nation-state and on state-society relationships, and the economic and political space within which individual economic actors operated. Dong (2017: 175) for instance, seeks to link contemporary Chinese society with this period of a constant militarised environment, stating "Many key factors in contemporary China's ideological constitution, administrative and military systems, social structure, collective memory, cultural values, and even aesthetic choices originated in wartime experiences or were even enabled by wars."

6.2.1. Credible Commitment Mechanisms: Internal Policing Forces— Securing a Monopoly on Violence Against Small-Scale Internal Threats

To address threats presented by nonstate actors able to partake in small-scale violence, especially in regard to the taking of private property from private actors, typically requires an effective state police force. Yet the inability of the state to control non-sanctioned use of force by nonstate actors in the taking of private property appears to have been endemic throughout much of the time frame. Much of these unwanted takings came in the form of unorganised, localised criminal activity such as banditry. Such activities did not necessarily begin in the late Qing period. Reports of piracy and banditry existed throughout the breadth of Qing rule, with Buoye (2006: 59) finding state officials employing poverty-alleviation strategies designed to limit banditry activities during the end of the late eighteenth century. Although archival work by Antony (1989: 128) finds most bandit associations in Guangdong during the early nineteenth century were "small, ad-hoc groups of eight to ten men", MacKay (2013: 551) argues that maritime piracy groups that simultaneously sprung up along China's southeastern seaboard amassed sufficient power to serve as independent "political actors distinct from the Chinese imperial project around them. They controlled sea routes, collected taxes, and often governed territory." Yet the weakness of the late imperial state, along with similar weakness of successive republican governments, led to marked increases in common banditry activities, as noted by Ly (1918) in his study of its incidences and causes. Such problems persisted throughout the so-called warlord period, with van de Ven (2003: 78) noting that gangs of bandits were often able to control small villages in the countryside. Relatedly, Wu (1935: 193) highlights the weakness of state police power to curb criminal activities, observing that "smuggling has assumed such proportions in China today, that it constitutes a threat to the entire fiscal as well as financial structure of the nation. No decrees of the Government to date have been able to stop it. In addition to foreign concessions over which China has no jurisdiction and the ports, such as Amoy, Swatow, etc, all notorious for smuggling, the whole of North China is practically open; and present political developments in the latter section can only aggravate the situation."

Unorganised social unrest and associated violence did not only include activities of criminal gangs but also citizen riots. Wong (1982: 781) describes the high frequency of food riots that occurred up through the end of the Qing, including a large-scale riot in Hunan in 1910 on the eve of the 1911 Revolution that Wong assigns blame for on landlords: "The gentry were doubly responsible for the violence. By hoarding grain for export and refusing to make grain available locally, these men created the classic conditions for a food riot. In order to oppose the state's new policies, the gentry helped to organize popular protests against the expansion of government functions. They simultaneously undermined the ability of the state to meet the old problems of food riots and attacked the new policies designed to strengthen the state." While Wong's analysis lacks an appreciation for free trade to stabilise prices, his research nonetheless highlights not only the severity of civil unrest throughout the period, but also highlights a central state structure too weak to either implement its desired trade policies so as to be thwarted by local elites, or to prevent outbreaks of civil unrest such as riots. These riots frequently led to further acts of violence directed at merchants (including Japanese and British steamship operators responsible for transporting grains outside the province), and central government reformers.

While unorganised and often spontaneous, the economic impacts of such forms of social unrest and violence destructive to private property were significant. A 1931 editorial in the *Jen Min Jih Pao* newspaper decries the economic impacts of banditry as severe, arguing that "China has enough capital within her own boundaries for industrial reconstruction, at least for several years to come, the only thing necessary is confidence in the Government's sincerity of purpose and in its ability to carry out its bandit suppression intensions. ...[The government] is unable to cope with the bandit-communists in the interior, with the result

that individual fortunes are not devoted to the development of industry, but to the purchase of Government bonds, and other unhealthy speculative activities" (*Peoples Tribune* 1931: 27). The claims regarding entrepreneurial investment behaviour made by this editorial match well with the type of behaviour that associated theoretical arguments predict—entrepreneurs will not invest under perceptions of weak protections on private property rights. In this instance, available investment capital was being redirected from profitable productive activities in the real economy towards so-called "speculative" activity. The warping of the economy given the state's dominance over productive assets is underscored by the fact that rather than money directed towards private financial instruments, investors' funds primarily flowed into government-backed securities.

Beyond unorganised banditry, a more problematic and serious threat came from increasing levels of formally organised criminal syndicates. Much like the pirates referred to by MacKay (2013), these criminal organisations, by way of their access to sources of violence, were able to vie with and even take over designated functions of the sovereign state, such as enforcing rules and collecting taxes. Perhaps best indicative of these organisations, and one that was especially active in Shanghai, was the so-called "Green Gang" (青幫). The Green Gang, originating as a loosely knit secret society during the Qing period, came to dominate the underworld of Shanghai by the second half of the nineteenth century, amassing its wealth and power through opium smuggling, systematic extortion, and human trafficking.

Through its association and support of the Guomindang Party, the Green Gang grew into an integral albeit corrosive part of the fabric of the Shanghai business world. Gang bosses sometimes attained prominent social positions, such as Huang Jinrong, who was given a position on the French Concession police force, and charged with maintaining peace within the local Chinese community. Martin (1995:267) cites estimates that the organisation employed approximately 100,000 people by the 1920s, representing a seemingly-staggering three per cent of the city's population. While much of the income the Gang received was related to its monopoly control over the city's illicit opium trade, similar to nearly all other organised crime syndicates, extortion of legitimate entrepreneurs and business operators by way of intimidation and actualised terror and violence was an integral part of the Green Gang's financial operations. The Gang was also recorded to have been involved in major incidents of price manipulation in the bond market, substantially undermining the trust investors could place in the operation of the financial system (经济科学出版社 1991: 66-67). By supporting the lawlessness of a mafia running much of China's largest and most economically important city—i.e., fostering the type of lawless "bandits" governments are supposed to prevent—the Guomindang Party helped create an economic environment of excessive business costs and uncertainty on entrepreneurs and investors, undermining the ability of private economic actors to function efficiently.

6.2.2. Credible Commitment Mechanisms: Internal and External Military Forces— Securing a Monopoly on Violence Against Large-Scale Existential Threats

Late Qing Period: Introduction of Existential Military Threats

Large-scale existential threats requiring state military action include both internal and external-based nonstate actors with access to their own sources of power to inflict violence within the borders of the domestic state. Beginning in the late Qing, the imperial government faced its first serious existential external military threats with the arrival of western warships in the early nineteenth century, which spilled into open military warfare with the British-led First Opium War (1839-1842). The Opium War proved a watershed moment in the sense that it served to reveal the Qing's military weakness vis-a-vis western naval powers. Prior to the war, players on sides faced a hidden knowledge problem, each

unsure of the other's capabilities in relation to their own; for the British, "Chinese aloofness and relative passivity served to create a false impression of strength" (Shai 1996:5). However, the commencement of actual military battle served to reveal such hidden knowledge to all actors regarding actual relative strengths. As a result of the loss of the Opium War, the Qing government was forced to signing the 1842 Treaty of Nanking. Numerous subsequent military defeats at the hands of foreign powers confirmed the initial reveal of Chinese military weakness, including the Second Opium War (1856-1860), the Sino-French War (1884-1885), the First Sino-Japanese War (1894-1895), and the Eight-Nation Alliance war in response to the Boxer Rebellion (1901). The result of these losses was a series of "unequal treaties" granting foreign powers territorial and economic rights within China. From the Treaty of Nanjing onwards, the Qing and ensuing Chinese governments were forced to acquiesce to the system of "extraterritoriality," wherein which sovereign control over certain sections of various port cities, including Shanghai, was ceded to foreign governments, allowing for the creation of legal and other institutional systems to operate outside the full sovereign jurisdiction of domestic Chinese government control.

In addition to external military pressures, the Qing government was simultaneously besieged by numerous concurrent internal rebellions, some of which began as nominally nationalist responses to the weakness of the Manchurian-dominated Qing government in the face of external foreign threats. Most notable among these was the Taiping Rebellion, which started in the southern province of Guangxi in 1850 and spread northward, engulfing nearly all of China in civil war for over fourteen years before its eventual defeat by Qing forces in 1864. Shanghai itself was attacked several times by Taiping forces; in response, the French naval force bombed the rebel's positions, helping Qing Imperial army forces push the rebels away from the city (Cranston 1936). The rebellion imposed tremendous costs on the Chinese economy and population. An estimated twenty to thirty million people died from war and ensuing famine and economic disruption, with the populations of the lower Yangzi provinces of Jiangsu and Zhejiang estimated to have been halved (Fairbank 1978 vol. 10: 316-318; vol. 11: 582). The Taiping rebellion also triggered a major fiscal crisis. With rebels controlling significant numbers of cities and land area, land, commerce and customs tax receipts suffered greatly. Deng (2003: 327) finds over a third of agricultural taxes and nearly a half of customs revenue, excluding Shanghai, whose customs receipts came to be protected by foreign control, were disrupted by the rebellion. The imperial government, in an effort to raise revenue, debased its copper cash and issued inconvertible paper notes, which led to the so-called "Xianfeng inflation" during the reign of Emperor Xianfeng from 1850 to 1861 (King 1965).

Concurrent with the Taiping Rebellion, a host of other rebellions raged, including the Nian Rebellion (1851-1868) centred in the north, the Du Wenxiu Rebellion (1856-1873) in the southwest, the Miao Rebellion (1854-1873) in the south, and Hui Minorities Uprising (1862-1877) centred in the west. These rebellions mostly sought independence from Qing rule for mostly Muslim ethnic groups. While ultimately all defeated, these concurrent rebellions brought to the fore numerous serious problems for the Qing governing coalition.

To begin with, these continual military battles imposed enormous fiscal costs on the state, as discussed in the previous section of this chapter. As van de Ven (2014) argues, it was the need to pay for these wars that helped drive the Qing government leadership to turn to debt financing through the issuance of external and later internal bonds. Second, the drive to suppress these western-based rebellions led to intense debate within the leadership of the Qing Court as whether to focus attention on bolstering frontier defence, including perceived threats from Russia as well as the central Asian steppes, versus maritime defence, which many officials, advocated especially by Li Hongzhang, saw as important particularly in light of Japan's rising power (Hsu 1965). Third, associated costs of these internal rebellions weakened the ability of the Qing state to respond to external conflicts, and vice versa.

The First Sino-Japanese War, waged July 1894 until April 1895, proves instructive in demonstrating the lack of institutional capacity to prevent external powers from imposing external-originating violence within China's internal borders. The impetus for this war was over the control of Korea, traditionally viewed as a tributary state by Chinese rulers as far back as under the Tang, a view reinforced at the start of Qing rule when Manchurian forces conquered Korea and forced the Joseon emperor to submit to the Qing emperor. By late-Qing, however, encroaching Japanese influence over the Korean peninsula was signified by the signing of the 1876 Treaty of Kanghwa, which ostensibly ended the tributary relationship between the Korea Joseon and Chinese Qing governments, and granted extraterritoriality to Japanese in Korea. Subsequent actions on the part of Japanese military advisers in Korea led to the outbreak of war in 1894, a war that most outside observers assumed China would handily win. Yet the Japanese navy proved far superior to that of China's, leading to another military loss with an external power. The military failure by the Qing government highlights the Imperial Court's weakened position, as well as the power struggle occurring within China that was symptomatic of a society undergoing major institutional change. For instance, the defeat of Chinese forces at the hands of a Japanese military that had clearly technologically surpassed China in terms of military aptitude was used, ironically, by conservative elements within the Qing Court to help bring an end to the Self-Strengthening Movement, which preached the importance of importing foreign technologies to fight foreign imperialism. Li Hongzhang, as one of the movement's most respected advocates, had focussed much of his attention on developing the country's naval power. Yet after several years of development and expensive outlays on ships and training, the Qing navy had been soundly and readily defeated in the War. While Li argued this to be a result of inadequate resources directed to increasing military technological capabilities, conservatives argued the defeat demonstrated the failure of the Self Strengthening Movement as an effective strategy.

6.2.2.1. Late Qing: Increasing Seriousness of Existential External Military Threats

The Qing state, considerably weakened from internal conflicts and besieged by external threats, became ever less able to defend its borders. Loss of state territorial integrity became a frequent theme during the era. Russia, for instance, succeeded in securing concessions and extraterritoriality claims to parts of Manchuria with the China Eastern Railway pact signed in 1896 (McCormick 1912: 50-1). Russia's subsequent defeat by Japan in the Russo-Japan War saw Japan claim the rights to the territories Russia had taken from China, in an agreement signed between Russia and Japan on 4 July 1910 at the end of their conflict (Hart 1913: 262).

By the end of the nineteenth century, China's economy was beset with problems owing to decades of internal warfare, including rising poverty levels, which were further compounded by a spate of natural disasters. The flooding of the Yellow River in 1898 was followed by a severe drought in the north in 1900. Ensuing social unrest and dissatisfaction with officials' responses culminated in a rural-based movement known as the Boxer Uprising. Fearing another internal rebellion that could spiral out of control, Qing government leaders managed to co-opt the movement and redirect hostility onto foreigners as responsible for exploiting Chinese citizenry. Boxer rebels sought to destroy foreign forces and their collaborators, ultimately killing 231 foreigners and many thousands of Chinese Christians in an attack on the foreign section of Beijing in June 1900, with Empress Cixi immediately thereafter declaring war on all foreign nations with a presence in China.

The response of leading foreign powers to such attacks on their economic interests and own citizens was swift and intense. Using the uprising of what was a rather unorganised and lightly armed rural-based rebel movement as a pretence to exhibit their military superiority and dominance, the foreign powers amassed a 20,000 Eight-Nation Alliance force of armed troops. This force marched to Beijing, driving the empress and high government officials out of the palace, dealing an unprecedented blow to the Qing state sovereignty. The degree of destruction brought on by the Boxer War was severe. As Louis Seaman (1913:287), a medical officer in the US military in China at the onset of the Boxer Rebellion, provides in an eyewitness account: "The eight allied armies of the 'great powers' marched to their capital, slaughtered their people, raped their women, looted their temples, their treasure and their habitations, committed brutalities that would have made Nero envious, and created a sentiment in China which fairly crucified Christianity, and which should redound to the shame and humiliation of the Christian nations whose forces participated in the outrages; but which, instead, secured monstrous indemnities and subjected China to the most humiliating terms of peace that were ever inflicted upon a nation, and that have kept her poverty-stricken ever since." The Boxer War ended in September 1901 with a peace settlement negotiated by Li Hongzhang that required 450 million *taels* of silver—approximately seven billion pounds at 2017 silver prices and more than the government's annual tax revenue—to be paid out to allied foreign governments over the course of the next 39 years at 4 per cent annual interest (Hsu 1980: 117-127).

6.2.2.2. Xinhai Revolution and the Fall of the Qing

After several failed rebellions against the Qing—including the Zhennanguan, Huanggang, Anqing, and Qinzhou uprisings in 1907, and Mapaoying, Qinlian and Hekou in 1908—the Xinhai Revolution of 1911, culminating with the Wuchang Uprising in October 1911 under the nominal leadership of Sun Zhongshan and the Tongmenghui (同盟會), succeeded in bringing an end to two hundred and seventy-five years of Manchu rule, and two thousand years of imperial government form. With the fall of the Qing government and the abdication of the emperor in early 1912, however, China entered a period of further political instability.

The chaos of revolution and the fall of the Qing central government brought a temporary power vacuum that led to increased uncertainty, negatively affecting economic conditions across the country. The *North China Herald* described the situation shortly after the fall of the Qing as one where business was at a standstill: "From bad to worse is the cry everywhere; and, the progress of events, whatever effect it might have on affairs in general, has thrust the merchants deeper into the mire of an almost hopeless loss during this year....Rich and poor, foreigner and Chinese, and every one in any part of the world having any dealings with China are being indiscriminately hit by the present unsettled condition in the country" (*NCH* 9 Dec 1911: 649). Reports in the *North China Herald* noted three factors hindering normal commercial operations in its articles from the time, and especially highlighted the enforced levy by a government badly in need of funds to fund its military operations: "The first of these, as we have stated often is the practical anarchy in the country, and the insecurity which prevents the free movement of goods or money. The second is the prospect of military operations following upon the success of one party or another, and the fear of reprisals. But the third and most important is the dislocated finances of the country. The revolutionary party is badly in need of funds, and Chinese merchants in Shanghai and elsewhere would seem to be loath, indeed in many cases unable, to make further inroads into their purses. Owing to the stagnation of trade consequent upon the financial crisis, money is scarce, prices have risen and everybody, rich and poor, is feeling the pinch. The issue of revolutionary banknotes has proved a failure, as was only to be expected. Subscriptions are being sought, but, as the same time, we understand there is a good deal of disaffection in the camp owing to the enforced levy on people who are not in a position to afford it" (*NCH* 9 Dec 1911: 650).

6.2.2.3. Republican Era: Early Beiyang Period

The newly-formed Nanjing-based Republican government, represented primarily by the Tongmenhui Party, was initially led by Sun, but while it had succeeded in seizing control over much of the southern and middle sections of the country, it still lacked the commitment from important leaders of the Qing army that they would support the new government backing necessary to force the abdication of the throne. In order to secure such commitment, Sun turned to Yuan Shikai, the most powerful of former military commanders under the Qing, and also the leader the Qing was simultaneously courting to lead the fight to retake the country. Yuan used this leverage with both sides to convince Sun to cede the new republic's presidency to Yuan. In return, Yuan persuaded the Qing emperor to abdicate, given the loss of the last of the remaining chance of military power to be exercised in support of retaining the monarchy. As the former founder of the Beiyang (Peiyan) military school, created in 1905 by imperial edict, Yuan's power base was in the north, and as such he demanded and succeeded in moving the new republican capital to Beijing from Nanjing, leading to the formation of the Beiyang government (北洋政府) in February 1912 (Lee 1926: 15). Yuan immediately turned to placing powerful military leaders, whose loyalty to Yuan had been forged at the Beiyang military school, into important government positions within the central government in Beijing, and as governor-generals throughout the country.

Meanwhile, Sun's supporters and those committed to the Tongmenhui and similar revolutionary parties combined to form the Guomindang political party, whose power was now centred in the southern provinces. After Yuan unilaterally ordered the disbandment of Tongmenhui-affiliated troops in June 1912, in violation of the new republican constitution, the current premier Tang Shaoyi (唐紹儀) and four other cabinet ministers resigned in protest. By July 1912, concerns that the country would be split in two as a result of contested infighting between supporters of rivals Sun and Yuan, were already appearing in the press, with a 22 July 1912 article in *Shun Pao* warning of the "credible chance of civil war with a result for China to become divided into two republics—one north, and one south." This threat became more pronounced after, with the Guomindang securing the majority of seats in December 1912 parliamentary elections and their leader Song Jiaoren (宋教仁) designated to become premier, Song was assassinated by what was widely recognised at the time parties working under the direction of Yuan.

Tensions further increased in the spring, when Yuan agreed to the £25,000,000 Reorganisation Gold Loan of 1913 with banking officials representing the governments of Britain, France, Germany, Russia and Japan, without consultation of the parliament, in violation of the constitution. When the National Assembly subsequently ordered impeachment against the presidency, Yuan ordered all Guomindang governors dismissed, which led to the outbreak of the "Second Revolution" in July 1913, which saw seven southern provinces declare independence; this revolution was short-lived however as Yuan's forces quickly overwhelmed those troops loyal to the southern general-governors. With this attempted rebellion crushed, Yuan forced through the National Assembly his appointment as President, after which the following month Yuan outlawed the Guomindang Party, resulting in the dismissal of over half the parliament. This move effectively made quorum impossible to achieve, leading Yuan to dissolve the parliament and formally assume dictatorial control over the state. Yuan solidified his control by holding a national conference of parties loyal to his presidency who passed a new constitution in May of 1914 that extended Yuan's term to ten years and allowed for his unlimited re-election. The following year, Yuan agreed to a return of monarchy rule, with Yuan to become the first Hongxian emperor in December 1915. This move, however, spurred another rebellion movement, and by May of 1916 eight southern provinces had declared independence (Young 1983: 252-255).

6.2.2.4. Republican Era: Late Beiyang Period— Political Chaos and Warlordism

The political situation deteriorated further when Yuan unexpectedly died in August 1916. As Yuan's power base of northern militarists subsequently broke with the Beiyang government and fought for control of the Chinese government, the nation fell into disintegration. The period's militarist leaders, who possessed localised power bases and ruled independently from the central government, were referred to as "warlords" (军阀), although whether this term unnecessarily implies inherently negative connotations is debated (Ch'i 1976: 1, Waldron 1991:1087, McCord 1996: n.55). Given the chaotic state of central authority, the years 1916 through 1928 are often referred to as the "Warlord Period", although provincial warfare was already widespread prior to 1916. The actual number of warlords numbered in the hundreds, with the less powerful controlling a district or two, while others amassed enough power to exercise military control over entire provinces, which Billingsley (1988) refers to as "bandit mini-states." The period was characterised by constant warfare between these local militarist groups—for instance, more than 140 military clashes are estimated to have taken place from 1916 to 1928, and over four hundred large- and small-scale episodes of civil strife were counted after 1911 in Sichuan alone (Sheridan 1975: 88). Terror, looting, pillaging and tax demands plagued the general population and further impoverished rural communities, with residents often forcibly conscripted to serve in local military armies.

Following Yuan's death, General Li Yuanhong (黎元洪) quickly assumed the presidency, appointing General Duan Qirui (段祺瑞) Premier, and reconstituting the parliament (Burt *et al.* 1925). This arrangement proved untenable, however, as Duan continually took actions without consultation of parliament in disregard to constitutional procedure. Although subsequently formally dismissed by President Li, Duan held more power, backed as he was by the Wanxi (皖系) (or Anfu) group of northern militarists. In May 1917, Duan organised the so-called Dujun rebellion of militarist leaders intended to pressure President Li and the National Assembly support China's entry into the First World War against Germany (Li 1967: 438, Xu 2005: 209-217). President Li sought the assistance of General Zhang Xun (張勳) to mediate the issue; this proved a poor strategy, however, as in June 1917 Zhang brought his Anhui- and Jiangsu-based army northwards and subsequently overthrew the Li government, and instituting the "Manchu Restoration" on 1 July 1917 by reinstating the Qing emperor Puyi to the throne. This action brought about immediate further military action and subsequent overthrow of the Zhang-backed monarchy just eleven days later by General Feng Guozhang (馮國璋), leader of the Zhili (直系軍閥) militarist group, who restored Duan as premier. Seeking greater power, Duan secretly negotiated the so-called Nishihara loans (西原借款) from Japan in September 1917 to fund the build-up of his Wanxi army, in exchange granting railroad concessions to the Japanese government and authority for Japan to base military troops in Shandong (Schiltz 2007: 24-30, Masafumi 2010: 1308).

With political chaos dominating the northern-based central government, authorities in Guangdong and Guangxi provinces declared their refusal to recognise the authority of the Beiyang government in September 1917 (RCEC 1926: 98), with Sun Zhongshan forming a rival government to the northern-based regime. Ostensibly based on the Constitutional Protection Movement, Sun soon declared himself Generalissimo of the Republic, claiming his Guangzhou-based government the one true government, albeit, beyond Guangdong, possessing only nominal control over Yunnan, Guanshi, and Sichuan (Gray 2002: 171-174).

In Beijing, President Feng was pushed into retirement by the Duan-led Wanxi group, who installed the former Secretary of State, Xu Shichang (徐世昌) as President in 1918 (Burt *et al.* 1925). Dissatisfaction with policies advocated by the Duan-backed regime, particularly those related to military reunification efforts with the southern-based Guomindang government, led to increasing internal conflicts amongst various military factions (Chen 2011: 141). In July of 1920, a major civil war—the Zhili-Anhui (直皖戰爭) war—broke out for control over Beijing between the Wanxi clique and an alliance of two militarist groups, the Zhili clique,

led by General Wu Peifu (吳佩孚), and the Fengxi group (奉系) (also referred to as the Fengtian group), led by Marshal Zhang Zuolin (張作霖) (McNair 1930: 216). Although the Zhili-Fengxi union defeated the Wanxi and removed Xu from power, the coalition between Wu and Zhang was short-lived, and a subsequent civil war between the Zhili and Fengxi groups took place from April to May of 1922 (首次直奉戰爭). The Zhili group defeated the Fengxi clique, and Zhang's Fengxi forces retreated to Manchuria and immediately declared independence from the central government. General Wu, holding effective control over the Beiyang government, persuaded Li Yuanhong to return to serve as president, but less than a year later in May 1923 Wu, with pressure from the powerful Zhili warlord General Cao Kun (曹錕), grew to view Li as a liability and sought to have him overthrown. Under orders from Wu, General Xue Zhi-Heng, head of Beijing police, had his forces surround the presidential palace and demand Li resign; Li acquiesced in June, but initially hid the presidential seals with his concubine who had taken refuge with French missionaries, until pressure by General Feng Yuxiang (馮玉祥) and Xue persuaded Li to reveal the seals' location (Nathan 1983: 280, Chang 1991: 23-25). General Cao then succeeded in assuming the presidency in October by openly bribing parliament members to receive their support, which, for 5000 *yuan* apiece, they quickly provided (NYT 6 October 1923, Hicks 1923, Gao *et al.* 2015). Cao's investment only earned him one year of the presidency, however, as tensions between the military governors of Zhejiang, Lu Yongxiang (盧永祥), and Jiangsu, Qi Xieyuan (齊燮元), led to the outbreak of the Second Zhili-Fengxi War (第二次直奉戰爭), that included multiple battles fought at Shanghai's doorstep. Lasting from September through November of 1924, the war's resolution resulted in Feng Yuxiang conducting his Beijing coup on 22 October, overthrowing Cao and installing General Huang Fu (黃郛) (NYT 4 November 1924). Unsatisfied with the situation, Fengxi militarist forces led by Zhang Zuolin succeeded in wresting control of the government and replacing Huang with Duan Qirui as president. At the urging of Feng Yuxiang, however, Duan and Zhang agreed meet with Sun Zhongshan in an attempt at national reunification of north and south China, but Sun died of cancer upon his arrival in Beijing in March of 1925. Duan remained in control of the presidency, but given the earlier defeat of his own Wanxi forces, he possessed somewhat limited actual executive powers, attempting to enhance his position by playing members of the rival Zhili and Fengxi factions against one another.

In the southern part of the country, the death of Sun Zhongshan led to a power vacuum that brought about the start of the Yuunan-Guanxi War in March 1925, after Tang Jiyao claimed control over the Guomindang, defying the appointed Hu Hanmin. The war brought about the rise to power of Jiang Jieshi, who along with Wang Jingwei in the summer of 1925 seized power of the Guomindang from Hu, with Jiang as military commander and Wang as party leader. Simultaneously, a coalition between General Sun Chuanfang (孫傳芳), the warlord governor of Zhejiang, and several warlords who had previously supported the Wanxi group took control of the southeastern provinces, as well as Shanghai. In the central provinces, Wu Peifu led a competing group of warlords who had previously supported the Zhili group. While civil war continued in the south, war also broke out in late 1925 first between the Zhili warlord General Guo Songling (郭松齡) and Zhang Zuolin's troops who supported the Duan presidency. After defeating Guo, Zhang's government faced an attack led by Feng Yuxiang's newly-created National Army (國民軍). Duan was deposed from power by way of a coup on 9 April 1926, orchestrated by Feng Yuxiang, who installed Hu Weide (胡惟德); Hu's time in power however lasted less than a month, as Zhang's forces, receiving support from the Japanese military, and having formed a new coalition with Zhili warlords loyal to Wu Peifu, defeated Feng's National Army in the Guominjun-Fengxi War (國奉戰爭), albeit destroying in the process many government buildings in Beijing, greatly damaging the bureaucracy's ability to function (Nathan 1983: 282). Wu subsequently forced out President Hu, installing Yan Huiqing (顏惠慶) in his stead (NYT 14 May 1926). Yet this move proved unsatisfactory to Zhang, who removed Yan after but one month in office, replacing him first with Admiral Du Xigui (杜錫珪), then in October 1926 with Gu Weijun (顧維鈞), before finally installing himself as president of the Beiyang government in June of the following year.

As the political chaos continued in the north, the Guomintang Party attempted to consolidate its strength in the Nanjing region. Having been rejected by western powers for assistance, some members of the party turned to the newly-formed Soviet government, which was also assisting the nascent Chinese Communist Party based in Shanghai. Initially united with communist forces under the First United Front and receiving financial and tactical assistance from the Soviet Union, the Jiang Jieshi-led Guomintang National Revolutionary Army represented a significant new military threat to the politically unstable Beiyang regime. With the start of the Northern Expedition (北伐) in July 1926, Guomintang military forces travelled northwards and soon expanded their active fronts under Jiang's leadership (Kotenev 1927: 117, McNair 1930: 215-217, Li & Li 2011: 731-739). Quickly securing several important military victories, Jiang declared by early 1927 the formation of a new central government, with Nanjing as its capital. In late 1927 Jiang supported the rebellion of Gansu province, led by Ma Tingxiang, against the remnants of Feng's National Army. At this time, China essentially had three "capital" cities—the Beiyang government in Beijing, the coalition Communist and left wing of the Guomintang Party in Wuhan, and the rightist Guomintang government in Nanjing, along with a fourth area that the Fengxi militarist group controlled in Manchuria, supported by the Japanese military. By June 1928, however, Guomintang-aligned generals had defeated troops loyal to Zhang Zuolin's Beiyang regime in Beijing, hastened by Zhang's assassination by Japanese military operatives in the so-called Huanggutun affair (皇姑屯事件). Zhang's son, Zhang Xueliang (張學良) assumed leadership of the Fengxi clique, but soon surrendered to Jiang in December 1928, bringing a formal end to the Northern Expedition.

6.2.2.5. Republican Era: Guomintang Period— Political Chaos and Warlordism

With the capitulation to Guomintang authority by Zhang Xueliang, the militarist leader of Manchuria, at the end of 1928, and with the Northern Expedition officially concluded, Jiang declared China once again reunified. This reunification, however, was nominal at best. Yet in terms of actual levels of civil strife and political chaos, the Guomintang period represents a continuance of that experienced under the Beiyang period. In contrast to Jiang's assertion of a "united" China, the Guomintang period does not represent a sharp break in regard to the political disintegration. Rather, the so-called warlord era persisted throughout Guomintang rule, albeit with Jiang using the state's financial resources to induce warlord support the Guomintang government.

The success of this strategy was mixed at best, as the warlord support Jiang managed to obtain was mostly given begrudgingly, mercurially, and temporarily. Even after 1928, various military factions controlled five provinces, with on-going conflicts still occurring across the country. Hebei, for instance, under the control of Zhang Xueliang, never came under direct control of the Guomintang government through the prewar era, although Zhang maintained relations with Jiang and agreed to make certain fiscal contributions to the Nanjing government (Remick 2002: 406). Conversely, the warlord leader of Guangdong, Chen Jitang, was only partially aligned with the Nanjing government, and later in 1931 formed a separate branch of the Guomintang and led a military campaign against the Nanjing government, albeit one that ultimately ended in his defeat in late 1936 (Lian 2005).

The Guomintang also faced numerous rebellions from warlord leaders, such as revolts in 1928 and 1929 by the Guangxi clique, whose regional power was significant enough that Lary (1975) argues was able to threaten the authority of the Nanjing government. Other outbreaks of rebellion by forces still loyal to the National Army leadership occurred in October of 1929, with both sides winning military skirmishes (*NYT* 25 October 1929). By

the following year, the seriousness of the existential threat to the Nanjing regime represented by this rebellion—led by Feng Yuxiang and other warlord leaders from Anhui, Henan, Shandong and other central provinces—was illuminated with the outbreak of the Central Plains War (中原大戰), involving over 1,300,000 troops and approximately 300,000 battle deaths, while requiring such significant financial resources so as to bring Jiang's Guomintang government close to fiscal collapse. While defeated in the Central Plains War, Feng remained powerful enough that he continued to be viewed as a threat by Jiang, who in 1933 attempted to weaken both Feng and western-based Hui warlords known as the Ma clique by ordering the warlord Sun Dianying, into the western areas where Feng and Ma warlords had their power base. These events led to the outbreak of the Ningxia War in 1934.

Numerous other episodes of violence persisted throughout the Guomintang period, including the Red Spears uprising, in 1929 in Shandong, in which rural farmers revolted against perceived high taxes, corruption and oppression by the Guomintang-aligned warlord head Liu Zhennian, leading to a rebellion of lower-level warlords against Liu. Han Fuju eventually won in September 1932, ruling as dictator over the province until his government's defeat to the Japanese army in 1937. Other wars included the Sino-Tibetan War which lasted from 1930 through 1932, and the Kamul Rebellion in Xinjiang, which lasted from 1931 through 1934; the rebellion, while initially supported by the Guomintang military leadership, eventually backfired when Uighur rebellion leaders demanded independence from China and was unable to be contained by the Guomintang military. However, in 1934 Russian military forces invaded Xinjiang, squashing the independence movement, while claiming sovereignty over most of Xinjiang in the process.

Overall, throughout Guomintang Nanjing period, in terms of actual authority, the central government primarily controlled the Yangtze Delta including Nanjing, Shanghai, and the provinces of Zhejiang, Anhui, Jiangsu and Jiangxi (Sheridan 1975: 167, 184). While Strauss (1998) suggests an overly-optimistic estimate of the Guomintang government controlling two-thirds of the country, in actuality, much of the areas under the nominal control of the central government were in fact ruled by powerful local militarists (i.e., warlords) who continued to operate independently. Meanwhile, Communist forces, with Soviet military assistance, formed the so-called "Soviet Chinese Republic" in the western interior of China, using Yan'an as its headquarters, instituting separate economic and social policies. Also in Later, after 1931, all of Manchuria, representing nearly a quarter of the country's land area, was lost to Japanese military control.

The situation thusly described is consistent with the depiction of weak states employed within the State Capacity literature as those unable to effectively control regions outside the geographic region close to the capital. Huang (2017) argues therefore that from the late-imperial through the Guomintang period, Chinese central governments cannot be described as representing a unified or coherent nation-state, but rather as a collection of groups fractured along "serious fissures" politically, economically and culturally. Nonetheless, Jiang continued to assert his government possessed sovereign authority over all of China, in what Thornton (2007: 101) refers to as a "facade of national unity and social stability" that in reality did little to mask what was a "myriad overlapping webs of power and influence connecting a broad range of state and non-state agents jockeying for local and regional dominance [amongst] strongmen who dominated county and sub-county politics during the 1930s." Such claims were not uncommon, however, as Ch'i (1976:190) notes that legitimacy over the entirety of China was frequently claimed by each of leaders of concurrent (effectively) sub-national governments during the republican period, no matter how limited in actuality be the geographic area under their control.

6.2.2.6. Republican Era: Guomintang Period—External Japanese Military Existential Threats

Increasing Sino-Japanese hostilities in 1931 represented a serious external threat, bringing about an additional fundamental existential crisis to the state. In September of 1931 Japan used the pretext of the Mukden (Shenyang) Incident to invade Manchuria, soon thereafter renaming it Manchukuo and installing the last emperor of the Qing, Puyi, as the ruler of this puppet government. Jiang made a strategic decision not to put on a military challenge to the Japanese, arguing at the time that the poorly trained Guomintang army would face certain defeat in a hasty full-scale war with the more advanced Japan force. Jiang's policy of "first internal pacification, then external resistance," was centred on defeating rival military fractions and building military strength before an eventual confrontation with Japan. This policy, however, was not shared by many within the Party leadership, nor with much of the public, leading to internal power struggles, and a great deal of public criticism of the lack of response by the Guomintang to Japanese aggression. In response, Jiang briefly resigned as executive and military leader after the loss of Manchuria, although he quickly reassumed his role as undisputed leader of the party less than one month later (Mitter 2013: 56-57).

Public anger in other parts of China in the aftermath of the Japanese invasion led to mass protests and boycotting of Japanese goods, especially in Shanghai where a large Japanese population resided, and where likewise much of the anti-Japanese student movement was concentrated. Shanghai attracted a large amount of Japanese capital, much of it going into cotton and textile factories that Japanese manufacturers opened in the countryside surrounding the city, and by the start of 1932, Shanghai already had a Japanese population of nearly 20,000 (SMC 1932). In the three-month period after the Mukden Incident, 138 anti-Japanese protests were held in Shanghai alone (上海通史 1999b: 268).

With tensions between the two countries running high, and expressions of strong anti-Japanese sentiment continuing within Shanghai, there were sporadic incidents of violent acts committed by and against Chinese domestic and Japanese residents within the city over this period of unrest. However, the situation became particularly critical when on 18 January 1932, a clash involving a group of five right-wing Japanese monks and nationalistic Chinese factory workers ended with an officer on the domestic Chinese police force, and a Japanese monk, were killed in the course of an ensuing public brawl. According to Wakeman (2006: 187-194), however, this incident, while reflective of an underlying politically charged atmosphere with nationalist sentiments heightened on both sides, did not occur organically; instead, a Japanese intelligence officer, Ryukichi Tanaka, had in fact paid the Chinese workers to attack the monks, seeking to provide justification for an increase in Japanese military presence in the city.

In response to the incident, a Japanese Admiral in charge of Japanese military forces in Shanghai demanded the Shanghai municipality mayor for an apology, reparations to account for the death of the monk, as well as suppression of anti-Japanese demonstrations in the city (FRUS 793.94/3970. 30 January 1932). Despite the mayor's agreement to comply with the demands, Japanese troops nonetheless attacked the Chinese part of the city without warning in the following night, forcibly seizing Zhabei, home to the Chinese municipality administration, and in the process destroying the municipality's then-newly constructed three million *yuan* municipal administration building, with multiple reports of fleeing Chinese residents gunned down by Japanese military personnel (*China Weekly Herald* 27 February 1932). Although initially blamed as random acts of violence by untrained *ronin* reservists, attacks by the Japanese military directed on the Chinese civilian population and residential communities appear to have been well-coordinated (Henriot 2010:297-304).

Eventually, a peace deal was reached with Nanjing government acquiescing to the Japanese government's demands to formally accept expanded Japanese control of Manchurian territories. By 1935, the Japanese military had consolidated control over most of northern China, although skirmishes continued within and around Manchuria. Yet, tensions between the countries remained high, with the Guomindang government under considerable pressure from the populace to take more aggressive stance against continuing Japanese encroachments on Chinese territories. A subsequent full-scale Japanese invasion of China occurred five years after the initial attack on Zhabei, with the impetus deriving from the Lugou (or Marco Polo) Bridge Incident on the night of 7 July 1937—what started as a small military skirmish between Chinese and Japanese troops quickly flared up into a full-scale battle, with Japanese forces taking control of Beijing and Tianjin by August 1937. The inability of the Guomindang government to provide basic protection of national security was most apparent in the Battle of Shanghai of 1937. Since 1932 and with the continuing control over much of the country by Japanese military forces, Jiang Jieshi had lost considerable public esteem due to his failure to mount an effective resistance against the Japanese invasion in the north. With nationalistic public sentiment running strong, Jiang was forced to mount a stronger military response. Undertaken partly as a way to shore up support within the Party and amongst his generals, Jiang made a strategic decision to militarily engage the Japanese in Shanghai, hoping that by bringing Shanghai into war, Western powers, who had been unwilling to intervene in the Japanese aggression toward China thus far, would see their economic interests at stake and have an incentive to aid China in mediating a peace settlement with Japan.

Jiang's calculated risk would prove extremely costly, as well as bring about a partial realisation of the existential threat the Japanese military posed to his regime. To begin with, the war that started within Shanghai led to grave losses of private property and life for its domestic and extraterritorial residents, greatly diminishing the region's productive capacity. In August 1937, skirmishes between Japanese marines and Guomindang armed forces in Shanghai led to the Battle of Shanghai. Jiang's hope for an effective defence of Shanghai using his elite troops and an air force trained by the German von Falkenhausen was quickly shattered. On 14 August, while aiming to take out a Japanese warship parked in the Huangpu River, the Guomindang military planes completely missed the target, instead dropping three bombs on two of the biggest shopping streets in the International Settlement, Nanjing Road and Avenue Edward VII, leading to the death of more than three thousand mostly Chinese civilians, and causing severe damage to businesses in the heart of the city. For the following three months, Shanghai became a battlefield with combat aircrafts flying overhead and bombs being dropped.

The Battle caused unprecedented devastation to Shanghai's economy, with vast areas of the city destroyed and hundreds of thousands of civilians made homeless. The number of factories destroyed was estimated to be 5,255. In different areas of the city, anywhere from seventy to nearly one hundred per cent of industrial enterprise was destroyed, and total property damage was estimated to be over three billion *yuan* (Hanwell 1938). Domestic businesses suffered outright pillaging, and those that managed to remain were forced to take on Japanese partners to remain viable. Henriot (2004: 31) recorded activities by the Japanese invading force that constituted textbook roving bandit behaviour—after open hostilities ceased, the Japanese army barred the Chinese population from entering the areas under its control, so as to provide Japanese military personnel enough time to survey the remaining factories and to remove undamaged stocks and the machinery that could be used for military purposes or by Japanese firms. Subsequently, Chinese industrialists were forced

to either work in collaboration with Japanese firms, or have their factories confiscated. By May 1939, for instance, forty Chinese cotton mills were under Japanese control, and by 1940, the Japanese seized more than two hundred enterprises in Shanghai.

On a national scale, the years following the Battle of Shanghai would see continued war atrocities, along with the Chinese state's continued inability to protect and defend the life and property of its citizenry. There are numerous contemporaneous reports of countless atrocities committed by Japanese soldiers during the 1937 Nanjing Massacre, including the murder of up to 300,000 Chinese (mostly civilians and surrendered soldiers) and raping tens of thousands of women (Vautrin 1937; Espy 1938:8). Charles McDaniel (17 December 1937) of the *Seattle Daily Times* provides another report on the scale of the looting, deaths and atrocities that took place: "Watched Japanese throughout city looting. Saw one Japanese soldier who had collected \$3,000 after demanding civilians in safety zone to give up at bayonet point. Reached north gate through streets littered with dead humans and horses. ...My last remembrance of Nanking: Dead Chinese, dead Chinese, dead Chinese." The contemporaneous accounts of Vautrin, Espy, McDaniel, and others underscore the lack of protection of private property, or life, provided Chinese citizens by their government.

In addition to the grave economic, property, and life and liberty losses suffered by private actors, the potential existential threat the Japanese military represented to the Guomindang government was partially realised as a result of the war. Faced with what became apparent was as an overwhelmingly superior military force, Guomindang troops were continually pushed back by waves of Japanese offences, forcing the government to cede territory, including the central seat of power in Nanjing, signifying the fall of the Nanjing Guomindang government. Jiang ordered the Guomindang military government to relocate to Chongqing. After overthrowing the Guomindang Nanjing-based regime in the eastern part of the country, the Japanese military sponsored the formation of a new central government, the Provisional Government of the Republic of China, based in Beijing, on 14 December 1937 (Mote 1954). A former Guomindang government official in Hebei who had also previously served in several Beiyang administrations, Wang Kemin, was installed as president. Wang remained in power as president until March of 1940, when the Japanese military, seeking to bolster the legitimacy of its political authority in China, reorganised the political system and created a new Nanjing-based national government, the Reorganized National Government of the Republic of China (中華民國國民政府), with Wang Jingwei, the former Guomindang leader ousted by Jiang, as the leader of the new government.

While often categorically dismissed by both contemporaries and modern accounts as simply a puppet regime led by a traitor, Mitter (2013: 196-209) provides a more nuanced account of Wang Jingwei's decision to lead a rival Japanese-sponsored Guomindang government, which he argued would improve the lives of ordinary Chinese people by bringing an end to war with Japan. Admittedly, such rationalisation was perhaps assisted by motivated reasoning, given that it brought him to power after having been exiled from the Guomindang by Jiang. Notably, the creation of the Wang regime did help produce more stable property rights protections within areas where military operations had ceased. The Wang regime issued their own currency (Central Reserve Banknotes, C.R.B.), operated their own budget, and directed resources rebuilding the country's damaged infrastructure. Chinese citizens in Nanjing, Shanghai and surrounding regions who had not been killed or fled began rebuilding residences and businesses. Indeed, the post-1937 period saw business start to prosper again in Shanghai, in particular in the International Settlements.

6.3. The Violence Trap Framework and Late-Imperial and Republican China: Analysis

In their work on the Violence Trap thesis, Weingast and his co-authors argue modern economics has systematically under-accounted for the importance of political violence as a fundamental reason countries fail to undertake policies necessary for sustained economic growth. Their research finds political violence to be endemic to poor countries, observing that from 1840 through 2005, violent regime change occurred on average once every seven years for the bottom fifty per cent of countries, compared to only every sixty years for the top decile of countries, as ranked by gross domestic product. Thus, for most states, the actuality of serious, existential political violence is the norm, not the exception. Creating the sufficient level of state capacity necessary to maintain an internal monopoly on violence, rather than dispersed amongst multiple non-state actors, in practise proves difficult for the majority of states.

The section immediately prior discussed at length the extreme levels of political violence that persisted throughout the entirety of the late imperial and republican period, with the central state under continual existential threat from a multitude of concurrent internal and external dispersed sources of violence outside of the state's control, underscoring the domestic state's inability to secure a monopoly on coercive force. In this section, we seek to emphasise that the political violence so described is directly responsible for the inability and lack of incentives for the state actors to create a set of credible commitment mechanisms, leading to poor property, contract and investor rights that defined the domestic Chinese state's institutional environment. Much of this analysis comes out of issues relating to overall the state capacity exhibited by domestic Chinese governments during the period. More specifically, we derive our analysis within the theoretical framework provided by the Violence Trap thesis, as well as our own "low credibility trap" extension of the Violence Trap argument, which suggests it to be intrinsically difficult for states facing continual existential threats to create credible commitment mechanisms. These related conceptual tools can help illuminate some of the incentives shaping state actors operating within the chaotic political environment that characterised the time period.

Indeed, much of the theoretical frameworks developed within the state capacity literature, and within the Violence Trap and our "low credibility trap" theses, appear particularly relevant in describing China's domestic political institutional environment. To begin with, late-imperial and republican China typifies the definition of a "weak state", or what North *et al.* (2006) refer to as a "limited access" state, exhibiting some of the classic weaknesses as described in the state capacity literature, with "national" governments frequently exercising *de facto* control over but a fraction of the country outside areas close to the capital, and unable to enforce adherence to desired policies. Commenting at the time, McNair (1930: 217) notes that, "A study of the political changes in North China from the death of Yuan in 1916 to that of Sun in 1925 leads to the conclusion that the successors of the first substantive President, Yuan, were rather more than less *fainéant* rulers. Often they were able to force obedience to their orders hardly beyond the walls of Peking itself. Nevertheless, the fiction that he who held Peking was the *de jure* ruler of China, was maintained by the powers down to 1927." Such a fiction continued to be perpetrated throughout the Guomindang era, as areas of significant import and geographic size—including Manchuria, central and western regions, and Guangdong, were frequently controlled by non-Guomindang authorities.

While defined by periods of lesser and greater bureaucratic state capacity, domestic central governments consistently lacked sufficient capacity to effectively enforce a monopoly on internal violence, also consistent with the description limited access orders. As a result, and as the Violence Trap thesis would suggest, internal violence was endemic throughout the time period. To mitigate the probability and effects of outbreaks of political violence, central government leaders often could only maintain their power by relying on nearly autonomous actors who possessed their own military power bases. Fostering such alliances required the creation of economic rents that could then be distributed. The history of frequent violent turnovers in political leadership, defined by continual warfare between competing militarist cliques and a confusing array of numerous shifting alliances, helps underscore the match existing between the actual empirical historiographical description of the period, with the theoretical concepts presented in the state capacity and Violence Trap literatures.

6.3.1. Empirical Analysis of Levels of Political Violence

Empirical support for the theoretical concepts can be found by several indicators of government change and political instability throughout the period. Note this form of political instability is fundamentally different in form from the type of political "churning" frequently observed in the parliamentary governments of southern European states traditionally criticised for low stability governments because of a predominance of too many veto players (Sartori 1966; Tsebelis 1995, 1999, 2002). Instead, we are concerned with instances of government change defined by a forcible reordering of the entire government structure via violent military power.

One such indicator can be found in the number of constitutions adopted over the republican era. These include the 1911 Provisional Constitution, 1913 Tianjin Draft, 1914 Constitutional Compact, 1923 Cao Kun Constitution, and 1925 Duan Constitution. After 1928, the Guomindang Party ruled without adoption of a formal constitution until 1948, although the 1930 Taiyuan Draft and 1931 Provisional Constitution of Tutelage represent modest attempts to provide formal structure to transition to constitutional governance (Bedeski 1981: 67, Pan 1945: 48). While substantial in number, these seven different constitutions over the course of less than three decades of republican rule fail to capture the scope of political chaos that defined the era, given that most regime changes occurred outside the scope of a constitutional framework, and that those assuming power frequently ruled without the adoption of a new constitution, such as when Yuan Shikai briefly assumed the role and title of emperor in 1915, or the short-lived restoration of the Qing dynasty in 1917. Nonetheless, the number of constitutions does underscore the lack of sanctity such documents represented to potential political actors. The lack of institutional protection these documents provided civilian agents is further evidenced by incidences of continual military intervention in politics. McCord (1996: 808) provides a telling example during a meeting of northern militarist leaders called by Zhang Xun at Xuzhou in September 1916 after Yuan Shikai's death, in which one participant stated that they as military leaders must act against politicians when they observe them doing wrong for the good of the nation, with others noting in agreement that "If politicians are bad, we naturally should overthrow them" (trans. McCord). Or, as opined a newspaper editorial at the time, "If peace and order is to reign in the country it is necessary to have some kind of Constitution and other fundamental laws, to be observed not only by the common people, but also by the Government itself. This is not a matter of opinion and of political propaganda; it is a choice between order and chaos, between civilisation and barbarism" (*Jen Min Jih Pao* 1931: 20)

A second measure, relating to our analysis using the framework of the violence trap, is consideration of the number violent regime changes that occurred over the period. To conduct our analysis, we first consider the methodology employed by Weingast and his co-authors in Cox *et al.* (2017), which provides empirical background to the theoretical framework developed in their Violence Trap thesis. The data Cox *et al.* use to produce their analysis are twofold—country-specific counts of violent political transitions via military coups or civil wars, matched with post-1950 country-specific measures of Gross Domestic Product (GDP) from the World Bank used to rank countries.

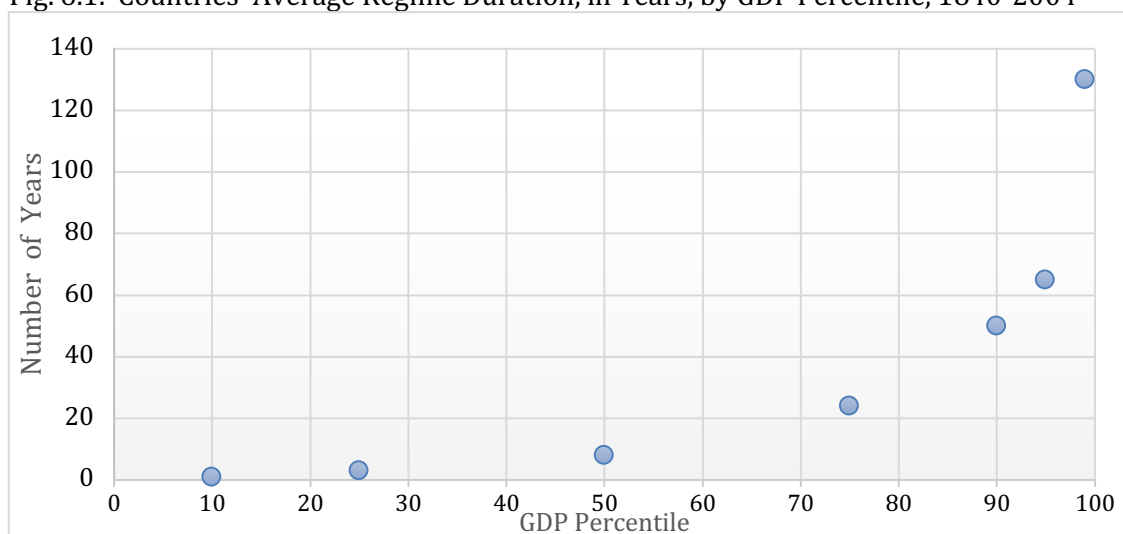
To construct country-specific counts of violent political transitions, Cox *et al.* utilise data documented in the Archigos dataset†, a massive cross-country data set compiled by Hein Goemans, Krisitan Gleditsch, and Giacomo Chiozza (Goemans *et al.* 2009b) that provides data on leadership transitions from 188 countries between 1875 to 2004. As explained in the Archigos codebook, the dataset is designed to identify "whether transfers of power between leaders take place in a regular or irregular fashion. We code transfers as regular or irregular depending on the political institutions and selection mechanisms in place." The dataset developers account for the fact that, "many autocracies have... implicit or explicit rules for transfers of executive power. Leader changes that occur through designation by an outgoing leader, hereditary succession in a monarchy, and appointment by the central committee of a ruling party would all be considered regular transfers of power from one leader to another in an autocratic regime" (Goemans *et al.* 2009a: 1-2). In support of the Violence Trap contention of political violence as endemic throughout most limited-access orders, Goemans *et al.* (2009b: 273) note their data indicate that "Most irregular removals from office are the result of the threat or use of force as exemplified in coups, (popular) revolts, and assassinations, and occur at the hands of domestic opponents."

Utilising the Archigos dataset, Cox *et al.* (2017:5) identify several important stylised findings. First, violent regime change is endemic: for the 162 countries included in their analysis, 697 cases of leadership succession took place via violent regime change from 1840 through 2004. Second, a key component of their findings is that occurrences of violent regime change are not distributed evenly amongst countries ranked by national income; rather, there is a clear correlation between political stability and economic output, with wealthier countries less likely to undergo violent regime change than poor countries. However, the structure of the correlation is not linear in nature, but rather highly skewed, with the top-most wealthiest countries experiencing vastly a lower degree of violent regime than all other countries. As Cox *et al.* (2013: 5) report, "the richest developing countries are more like poor developing countries than they are like the developed world. In the poorest half of the countries (ranked by income), fifty percent of regimes last only seven years, and only one-quarter last beyond seventeen years. In countries ranking between the 75th and 90th percentiles of income—the developing world elite—corresponding figures are 12.5 and 45.5. Finally, for the developed world (the richest decile of countries), the figures are 60 and 88."

† It is necessary to mention some data irregularities regarding the Cox *et al.* (2017) dataset. To begin with, there is the issue of temporal mismatch; Cox *et al.* claim their data on violent political transitions go back to 1840, whereas their GDP data are from 1950 onwards, suggesting the economic ranking of countries prior assumes a consistency in relative positions of national income that is perhaps unwarranted. There also exists the issue of selection bias, given that some countries are necessarily removed from analysis because they do not exist after 1950, so cannot be included. More significant is the somewhat puzzling assertion by Cox *et al.* that their dataset measures violent political transitions from 1840 through 2004; it is unclear why they do so, since the Archigos dataset is formally constructed using data from 1875 onward, and Cox *et al.* do not make any claims to have collected additional data on political transitions in countries via coups or civil war themselves for time periods prior to 1875. In any event, however, the findings Cox *et al.* provide are stark enough that the overall findings are robust beyond these idiosyncrasies in regard to the data compilation.

Figure 6.1 demonstrates the relationship between national income levels and regime stability, constructed using data presented in Cox *et al.* (2013: 6)'s Table 1. Such findings impress the strength of the correlation between regime stability and national income, as well as its highly skewed nature, with a large jump in regime stability occurring at the ninetieth percentile. For Cox *et al.*, this correlation is due to a set of factors owing to the type of actions limited-access countries often employ to mitigate the threat of political violence, insofar as these actions include strategies such as rent-creation, price controls, and other policies damaging to the protection of property rights, all of which reduce expected national income. As a result, leaders in countries where the level of political violence is relatively high—which includes middle income developing nations—are trapped into implementing political actions that lead to poor economic output; hence the observed correlation.

Fig. 6.1. Countries' Average Regime Duration, in Years, by GDP Percentile, 1840-2004



source: data derived from Table 1 from Cox *et al.* (2013: 6).

We seek to replicate the methodology in Cox *et al.* (2017), measuring political violence through the very defined but circumscribed indicator of the number of violent regime changes that occurred as a result of violent military coups or civil war, while using the historical record to focus solely on late-imperial and early republican era China. To do so, we identify the number of changes in government leadership that took place by political violence, outside the designated succession process, over the century-long period from 1840 to 1941. As presented in Table 6.1, we find thirteen identifiable instances of violent political regime change to have occurred over the time frame.

Before turning to an analysis of based on this tabulation, we first note that the data included in Table 6.1 represent a conservative depiction of the number of violent political regime transitions over the period. Specifically, we omit several instances that represent instances of authoritarian military power overthrowing civilian political structures. These include, for instance, when Yuan Shikai dissolved the National Assembly and outlawed political opposition parties in 1913, in violation of the Provisional Constitution. Similarly, the political assassination of Prime Minister-elect Song Jiaoren is not included in this measure, since as prime minister-elect, he was neither in office when assassinated, nor as prime minister was his role the head of state; however, surely one can argue this to have been an instance of political violence, albeit technically not one inducing political regime transition.

Table 6.1. Number of Forced Political Leadership Transitions, China, 1840–1941

Count	Date	Outgoing Government	Incoming Government	Mode of Change
1	Feb 1912	Qing Imperial Government	Republic of China, Beijing (Gen. Yuan Shikai)	Civil War: Xinhai Revolution
2	Jul 1917	Republic of China, Beijing (Gen. Li Yuanhong)	Manchu Restoration (Gen. Zhang Xun)	Military Coup: Zhang Zoulin Army
3	Jul 1917	Manchu Restoration (Gen. Zhang Xun)	Republic of China, Beijing (Gen. Feng Guozhang)	Military Coup: Zhili Clique
4	Oct 1918	Republic of China, Beijing (Gen. Feng Guozhang)	Republic of China, Beijing (Xu Shichang)	Military Coup: Wanxi Clique
5	Jun 1922	Republic of China, Beijing (Xu Shichang)	Republic of China, Beijing (Gen. Li Yuanhong)	Military Coup: Zhili Clique
6	Jun 1923	Republic of China, Beijing (Gen. Li Yuanhong)	Republic of China, Beijing (Gen. Cao Kun)	Military Coup: Zhili Clique
7	Oct 1924	Republic of China, Beijing (Gen. Cao Kun)	Republic of China, Beijing (Gen. Huang Fu)	Military Coup: Zhili Clique
8	Nov 1924	Republic of China, Beijing (Gen. Huang Fu)	Republic of China, Beijing (Gen. Duan Qirui)	Military Coup: Fengxi Clique
9	Apr 1926	Republic of China, Beijing (Gen. Duan Qirui)	Republic of China, Beijing (Hu Weide)	Military Coup: National Army
10	Jun 1926	Republic of China, Beijing (Hu Weide)	Republic of China, Beijing (Yan Huiqing)	Military Coup: Zhili Clique
11	Jun 1926	Republic of China, Beijing (Yan Huiqing)	Republic of China, Beijing (Du Xigui)	Military Coup: Fengxi Clique
12	Jun 1928	Fengxi Republic of China (Gen. Zhang Zoulin)	Guomindang Government, Nanjing	Civil War: Northern Expedition
13	Dec 1937	Guomindang Government, Nanjing	Japanese military-backed provisional government	War: Japanese military invasion

sources: please refer to discussion presented in Section 6.2.2.

Likewise, the forced upending of adherence to a republican form of government in late 1915, when Yuan declared himself the first Hongxian emperor, is not included, although this did represent a military power-backed overthrow of the existing political government structure, albeit one that maintained Yuan as leader of the state, changing only his formal title; hence, its omission from the table. Similarly, the transfer of power from Yuan Shikai to Li Yuanhong after Yuan's death was not included in the table, given it did not occur as a violent transfer. Instead, following classic imperial tradition, Yuan—having assumed the mantle of Hongxian emperor—left a will designating one of three designated personages (Li, Duan Qirui, or Xu Shichang) should be chosen as his successor. With the backing of several powerful Beiyang generals, Li henceforth assumed the presidency. While accomplished without bloodshed, this procedure was well outside the designated transfer of power under the civilian constitution, and in this regard, similarly could be thought of as another example of a leadership transfer undertaken utilising authoritarian military power.[§]

[§] Our reading of the historical data differs slightly from that presented in the Goemans *et al.* (2009a) dataset utilised by Cox *et al.* (2017). Specifically, as indicated in Table 6.2 below, their dataset identifies fourteen political rulers of China over the course of 1861 through 1941 (note while the Archigos dataset officially includes data from 1875 onwards, data from earlier years are also included if the sovereign in power in 1875 began her or his reign earlier). Of those fourteen men, six are identified to have lost power by way of violent political change. As indicated in our historical analysis

Beyond the issue of possible inclusion of borderline instances of irregular political transitions, as Weingast and his co-authors well recognise, a measure of political violence that limits its scope to successful instances of military coups and overthrows often represents a significant underestimation of the true scale of political violence. This is certainly the case in regard to China over the course of the late-imperial and republican time frame. As discussed in detail in Section 6.2.2., there were a multitude of major violent internal and external military events affecting actual levels of realised political violence. For example, the Taiping Rebellion represents perhaps one of the most significant instances of internal civil disorder to have occurred over the past two centuries. Resulting in over upwards of twenty to thirty million deaths, this rebellion movement led to an unprecedented degree of civil strife within the country, as well as disrupting much of the productive capacity of the economy (Ho 1959: 247; Eng 1986: 30, 96; Motono 2000: 28). While not successful in overthrowing the Qing state, the Taiping Rebellion did for a period of fifteen years control a significant portion of eastern part of the country, creating an alternative functioning government based in Nanjing that ruled over thirty million people, and by some assessments came close defeating the Qing had alternative military strategy been undertaken (Kuhn 1978: 275, 281).

Although the Taiping Rebellion represents an instance where a successful alternative government that lasted for over fifteen years was created within the sovereign boundaries of China, major episodes of political violence of this kind that do not lead to a complete overthrow of the existing regime are not included in the measure utilised by Cox *et al.* (2017). Similarly, additional episodes of major political violence owing to other serious rebellions during the late Qing—including the Nian (1851-1868), Du Wenxiu (1856-1873), Miao (1854-1873), and Hui Minorities (1862-1877) rebellions—are also not included in the formal Cox *et al.*-based measure of political violence, notwithstanding the incredibly high levels of destruction and loss caused by these wars, which were likely responsible for the deaths of an estimated sixty million people (Fairbank 1986: 80).

§ (cont.) presented in Section 6.2.2, however, their dataset suffers from several omissions, which is why we identify thirteen as opposed to only six instances of violent political regime change over the course of the pertinent time frame.

Table 6.2. List of National Government Leaders, China, 1875–1941, Archigos Database

Number	Year	Ruler	Entered Office	Exited Office	Violent Exit
1	1861	Tz'u His	22/08/1861	15/11/1908	
2	1908	Zaifeng	02/12/1908	06/12/1911	
3	1911	Empress Jonyu	06/12/1911	12/01/1912	X
4	1912	Sun Yat-sen	12/01/1912	15/02/1912	
5	1912	Yuan Shih-kai	15/02/1912	06/06/1916	
6	1916	Li Yuan-Hung	06/06/1916	14/08/1917	
7	1917	Feng Kuo-chang	14/08/1917	04/09/1918	
8	1918	Hsu Shih-ch'ang	04/09/1918	02/06/1922	
9	1922	Li Yuan-Hung	11/06/1922	14/06/1923	X
10	1923	Tsao Kun	05/10/1923	02/11/1924	X
11	1924	Tuan Chi-jui	24/11/1924	20/04/1926	X
12	1926	Chang Tso-lin	21/04/1926	10/10/1928	X
13	1928	Chiang Kai-shek	10/10/1928	14/12/1937	X
14	1937	Wang Kemin	14/12/1937	30/03/1940	

source: Goemans *et al.* 2009a Archigos dataset

Similarly, much of the continual instability during republican period, while undeniably exemplative of political violence and chaos, are not captured by the Cox *et al.* measure, such as Sun's Second Revolution in 1913, which eventually led to the creation of a separate sovereign southern faction of the central government throughout the early republican period, with nearly half the country ruled by a government structure different from that operating in the nation's capital of Beijing. Further, the seeming stability indicated by the measure during the Nanjing government period from 1928 through 1937 masks the actual amount of civil and military strife that took place. As documented, there were numerous rebellions and warlord-related battles, including the Central Plains War (1929-1930), Sino-Tibetan War (1930-1932), Kumul Rebellion (1931-1934), Red Spears Revolt (1932), and Ningxia War (1934), as well as fratricidal battles between rival Guomindang Party factions in Guangdong, let alone the military conflict Jiang Jieshi saw as perhaps the most serious existential threat to his regime—presagely, it turned out—that with the Communist Party. Additionally during this period, the Chinese state lost sovereign control of significant geographic areas, such as all of Manchuria in 1931 after its seizure by the Japanese military and subsequent creation of the Manchukuo puppet state, or the loss of all of Xinjiang in 1934 in wake of the Kumul Rebellion which led to the takeover of the province by Soviet forces. Neither are any of the military battles with foreign powers, commencing with the 1854 Opium War, captured by the Cox *et al.* (2017) measure, with the exception of the 1937 Japanese military invasion that resulted in the loss of power by Jiang of the Nanjing government. Finally, and of further significance, also not captured is the scope of violence associated with an overall lack of adherence to law and order; yet, as conveyed by our discussion on the criminal activities perpetrated by the Green Gang, the existence of daily violence on a personal level within Shanghai and other affected cities was considerable.

In some ways, the omission of so many significant instances of political and civil strife would suggest there exists an inherent fundamental weakness of the measure Cox *et al.* (2017) employ to capture levels of political violence within countries. While not resulting in a violent overthrow of an existing leader, the events described above bely the existence of a peaceful, orderly political order. Yet, as the authors make clear, they well recognise their descriptor might well undercount—and in some instances, such as in the case of late-imperial and republican China, quite significantly—the true degree of political violence. They argue, however, that this only bolsters their claim regarding the overwhelming frequency and importance that political and societal violence plays in the economic development patterns of limited access order countries, given that the degree of political violence captured by their preferred metric represents at best a lower bound of actual societal violence.

Putting aside this issue of undercounting the scale of political violence in its entirety, the findings suggested by our analysis of Table 6.1 are nonetheless significant. To begin with, the table indicates a considerable degree of violent political regime change. The thirteen occurrences over the course of the approximate one hundred years of our analysis imply an average of violent political transition occurring more than once every eight years. Second, however, it is clear that these violent political transitions are not spread equally across the time period; instead, all occur in the time frame starting from the beginning of the republican period in 1912, until the disposal of the Nanjing regime by Japanese military invasion in 1937. Constricting ourselves to consideration of this twenty-six year time frame indicates a very concentrated period of violent regime change, with incidences of violent political transition occurring on average a staggering once every two years. Such an average places China over this period in line with data that matches those deriving from some of the poorest countries in the Cox *et al.* (2017) dataset, suffering from the most violence. In this regard, the limited economic growth that did occur in China over this period might well be considered surprising to have been as strong as it was under such an environment.

Third, even within the limited time frame of the republican period, the distribution of violent overthrow of the central government is itself skewed, with all but the final incidence occurring within the Beiyang era. From 1912 through 1928, there occurred a total of eleven military coups resulting in change of the nominal seat of central government power. This represents an average of one violent military coup occurring once every year and a half over this seventeen year period. Thus, the stability of the Nanjing Decade, with ten years consecutive years of an absence of violent overthrow of political leadership, represents a substantial difference from the previous several decades.

6.3.2. The Violence Trap thesis and late-imperial and republican China: some caveats

Of course, as with any generalised analytical theoretical conceptualisation, there exist caveats where our theoretical constructs fall short in application to analysing late-imperial early republican China case. In particular, one of the arguments advanced by Cox *et al.* (2017) is that one possible way for countries to overcome the violence trap is from the impetus of external existential threats, since potential disruption of the social order from battle with an external power likely represents considerably greater costs than internal fighting amongst rivals. Therefore, Cox *et al.* surmise, the presence of an external threat incentivises internal domestic rivals to settle differences to address the more serious external threat, banding together in face of a common external enemy. This commonality of interests can lead to a reduction in rent creation arrangements, and therefore greater economic growth, increasing power of merchants and other private actors compared to the state, initiating a virtuous growth dynamic. This argument represents an extension of that advanced earlier by Epstein (2000) and within the state capacity literature, which attributes the increase in European government size and state capacity as due to increased external threats. Problems of weak state capacity were overcome as a result of the necessity to defend themselves from existential threats posed by their external neighbours, leading to greater focus on mechanisms that could successfully raise and capture tax revenue. Hoffman (2012) further argues the fiscal and technological developments that led Europe to outpace other parts of the world were likewise spurred by military competition between European nations.

Whether or not such an argument represents an accurate recounting of the dynamics of early western European growth, and while ostensibly theoretically parsimonious, it is nonetheless evident that the same story does not hold for late imperial and republican China; in fact, in many instances, it can be argued, the opposite effect occurred. To begin with, while various internal rivals often collaborated with other internal rivals, they also occasionally collaborated with external rivals as well, such as when the Fenxi warlord Zhang Zuolin turned to align with the external Japanese military when faced with a serious existential threat from his internal rival Feng Yuxiang. Similarly, the Guangdong military-governor Chen Jitang consistently dealt with Japanese economic actors in order to import in large quantities of sugar outside of the required tariff provisions on the commodity, depriving the central government of customs duties, while simultaneously receiving sugar at considerably lower costs; as Hill (2010: 5) notes, most of these "disputed imports either originated in Japan or were carried to China's coastal waters in Japanese ships." In general, therefore, as advanced at the start of Section 6.3, rather than an "internal" versus "external" dichotomy, we find it more useful to analyse state behaviour in terms of responses to serious existential threats, whether internally or externally based.

Second, even in instances where state actors perceived serious existential threats such that they were incentivised to work together with rivals, they failed to develop strategies that reduced rent-creation. For example, in the wake of the Boxer Rebellion, the Qing state faced a number of serious external existential threats, with a united military force of foreign

powers having just destroyed the imperial palace and forced the Court to flee the capital, and just recently having lost major military battles with Japan and Russia, losing significant territory in the process including the vassal states of Taiwan and Korea. Yet, such serious external existential threats were unable to overcome internal divisions so as to successfully address interventionist behaviour in the economy, or to rationalise the tax collection system to significantly amass tax revenues into the centre from the local provinces.

Additionally, while the Guomindang government and Green Gang collaborated to attack the existential threats each faced coming from the communist movement and Japanese military aggressions, this collaboration failed to lead to a reduction in economic rent creation. Indeed, in many ways it incentivised the Guomindang leadership to further protect the Green Gang's monopoly control over the illicit opium trade. Thus, in this sense, the collaboration actually solidified the rent-creation dynamic, as well as contributing to a generalised decrease in perceived and actualised rule of law defining the domestic institutional legal environment.

Thus, it is possible that in certain instances, existential threats can serve to induce state actors into actions that might worsen the private property rights environment, as opposed to improving it. This can occur because in response to existential threats, state leadership can be incentivised to bring in more nonstate rival actors to bolster their position against serious existential forces. Even when these rivals find their interests co-aligned, often rivals to the state act in ways that are inherently damaging to the creation of an effective institutional environment with strong support of private property rights and law and order. In order to have the Green Gang strong enough that they might effectively harass communist supporters and the Japanese military, the Gang needed income from its opium smuggling activity and other criminal endeavours; yet by allowing such inherently criminal activities that had the rule of law blatantly circumvented and diminished the overall private property rights environment. In this regard, therefore, the existence of serious external existential threats might actually serve to reinforce behaviours that undermine the rule of law, and therefore the degradation of overall protection of private property rights.

There have been multiple attempts in the literature to provide a possible explanation for why Chinese state actors were unable to reform the inefficient rent-seeking structure of the Chinese economy during this crucial period. For some, the directionality of factors starts with the initial weakness of the late-Qing state capacity. Ma (2013) and Johnson & Koyama (2017) start with the supposition that the Qing state was weak, and reason that as a result of its weak capacity to raise revenue, the state apparatus could not respond to external or internal threats. For these authors, it was the state's initial weak capacity that created the conditions leading to the development of internal rivals who could gain access to levers of organised violence, and once there were existing rivals with access to organised lever of violence, this weakness precluded the state from being able to raise the capital necessary to either defeat foreign external imposed threats. Thus, what internal coalitions state actors formed by way of economic rent offerings to rivals became necessary to maintain.

Another line of argument focusses on the self-replicating nature of decentralisation of power, weakened state capacity, and an inherent inability to reform. Ma & Rubin (2017) argue that by the mid-Qing, central state officials had already allowed a system of corruption to become ingrained into the local tax collection process, which over time had increased the power of local authority over the centre. As a result, when the central Qing state actors needed to suddenly induce greater tax receipts, found the state apparatus had a weakened capacity to do so, and in turn, in an attempt to raise more tax revenue, gave more power to local authorities in terms of tax collection and administration. This begins a self-replicating process that continually reduces the power of the centre to local. As local areas increased their power relative to the centre, they were more able to exert that power by limiting the amount of tax remitted to the centre. This led to continual weakened fiscal position of the

central state, which therefore had less resources to devote to accomplishing some of the desired defence-related projects, such as investment into the Jiangnan Arsenal and Fuzhou Dockyards, both of which abandoned before completion because of lack of funding (Pong 1987). The lack of financial resources of the Qing state to complete these and other military projects decreased their ability to succeed in military contests, losing wars with Russia, Japan, and the eight-powers coalition, incurring both huge military and subsequent indemnity costs. This situation continued the self-replicating downward spiral, as the central state was put in a worse financial situation, hence making it less able to prevent local authorities from further withholding taxes to the centre, thereby further increasing the power of local militarists and decreasing the power of the central state, so much so that the capacity for large-scale violence was ever-greater dispersed internally amongst powerful state actors in control of large armies, the upkeep of which demanded greater fiscal resources and led to local actors imposing greater tax burdens on private actors and keeping more of it locally at the expense of the central state.

Additional avenues involve recent exercises in game theoretic modelling that has emphasised the serious coordination problems large states such as China face. This research suggests the scale of countries and economies plays an important role in the ability of state actors to respond to external threats in ways that provide the kind of benefits Epstein, Hoffman or Cox *et al.* claim. For instance, Ko *et al.* (2018) model finds that a single existential threat drives centralisation of state power across states of all sizes. However, when faced with multiple existential threats, while small states are pushed towards centralisation and are incentivised to undertake political and economic reform measures, large states facing multiple threats conversely are moved to undergo decentralisation of political power, accompanied by a weakening of reform efforts. Ko's theoretic results therefore match in many respects the political economy observed in China during this period, as the late Qing experienced considerable political decentralisation of its political authority and recurrent undermining of reform efforts.

Other arguments attempt to explain why Japan succeeded in successfully developing during this period while its larger and seemingly advantaged (in terms of labour force, absolute size of fiscal means, and natural resources) neighbour China could not. For instance, Koyama *et al.* (2018) surmise that while both small states and large states are disadvantaged in responding to external threats, constrained by a lack of resources, and by organisational complexities, respectively, "by comparison, states in the middle of the spectrum, like Japan, were most incentivized to embark on a program of centralization and modernization." Thus, unlike medium-sized nations such as Europe or Japan, as a large state, late-imperial China faced excessive coordination costs and inefficiencies in attempting to respond to external and internal threats. Koyama *et al.*'s model "further highlights that for a large state, the goals of defense and development are not congruent. To take full advantage of the new economic and technological possibilities, a large state like China needs to decentralize and allow provincial authorities to take the lead in implementing initiatives such as building schools and roads that serve local needs. However, decentralization may generate collective action problems in defense and diplomacy." While the game theoretic approach taken by Koyama *et al.* (2018), or as in a similar attempt by Ma & Rubin (2017), is admittedly overly simplistic, suffering from what Hayek would label a category error—given that individuals have goals, whereas the actors in these models are states, which whether large or small, are but conceptual constructs that do not "act" nor have goals that can be modelled or maximised—nonetheless their work serves as an additional potentially useful approach to understand the forces that drove state actors to continue to thwart liberal economic reform efforts while instead promoting inefficient and rent-seeking based economic policies.

Chapter Seven.

The Violence Trap and Related Theoretical Constructs: Consequences on Economic Outcomes

The nature of the relationship between state capacity and economic growth is one of the most studied topics in the recent economic development literature (De Long & Shleifer 1993, Acemoglu 2005, Dincecco 2009, Knutsen 2013, Acemoglu *et al.* 2015, Dell 2015, Wang 2015, Dong & Guo 2017, Liu & Zhao 2017, Dincecco 2018, Geloso & Slater 2018, van Noort 2018). Dincecco (2018) in his opening chapter presents a series of bivariate correlations showing strong relationships between per capita national income and various measures of state capacity—tax as a percentage of GDP, average income tax share, strength of state capacity scores as constructed by Rice & Patrick (2008), the International Country Risk Guide property rights protection index, and the World Bank *Doing Business* contract rights enforcement index. His publication represents one of the more recent efforts demonstrating strong empirical correlations between economic output and state capacity indicators.

However, while robust single variable correlations are observable, they nonetheless fail to demonstrate casual linkages. Whatever the relationship existing between state capacity and modern economic development, it appears highly complex, with numerous transits existing by which levels and degrees of state capacity can influence and shape economic outcomes. To begin with, as Johnson & Koyama (2017) argue, state structures that create credible commitment mechanisms in the mould of North & Weingast (1989) are fundamental to constraining the power of the sovereign from violating rights of private actors, and hence leading to long-run economic development. Johnson & Koyama primarily focus the considerable variety of historical outcomes resulting from attempts to constrain absolutist sovereigns, arguing that in some cases these fostered a decentralisation of taxation and other state capacity factors that led to a weakening of overall central government state capacity and poorer outcomes. § Knutsen (2013)'s evidence is slightly contradictory—while his cross-country analysis confirms strong correlations between state capacity measures and economic output exist for all regime types, he finds increases in state capacity to have a greater positive effect in authoritarian regimes, compared to democratic countries; conversely, however, he finds the independent effect of democratic state structures lead to considerably more positive economic growth than do authoritarian state structures, suggesting a complex dynamic exists between state structure and state capacity that impacts economic outcomes differentially.

§ While acknowledging Weingast (1995)'s contention of the effectiveness of federal forms of governance, Johnson & Koyama focus on issues related to decentralisation of government power, especially in relation to the ability of central states to effectively capture and control tax revenues. Specifically, they attribute the success of England in centralising tax authority to its ethnic and geographic homogeneity, albeit without development of a direct casual hypothesis or testing methodology, other than by way of contrasting the historical example of post-Glorious Revolution England with the cases of seventeenth century Spain and France, where they attribute greater ethnic and geographic heterogeneity to have led to a less centralised polity and hence less central control over tax collection. Without more substantive historical research that address the many other differences between England, Spain and France during these periods that could also factor into differing levels of state capacity, it is necessary to consider such arguments as at best tentative; nonetheless, the importance of the degree of centralised tax authority remains prevalent in the state capacity literature as an explanatory factor ascribing overall levels of state capacity.

Other avenues explored in the state capacity literature emphasise the importance of state functionaries' ability to provide services to the public, which in turn can lead to better economic outcomes. Dittmar & Meisenzahl (2016) identify the beginning of the growth of the modern European state as starting with the late sixteenth century and development of state capacity enabling the delivery of public goods such as mass education, which in turn increased levels of human capital, leading to economic growth over the long-term. Similarly, Acemoglu (2005) finds that for states defined by either autocratic political structures, or possessing excessively weak tax collection capacity thereby constraining revenues, state actors will underinvest in socially productive public goods, leading to lower economic growth. It is possible to argue that the late-imperial and republican China in part might well have exhibited both of these conditions, of militarily powerful autocratic leaders in charge of a state apparatus that nonetheless proved relatively ineffective in terms of tax extraction. Both Acemoglu's and Knutsen's findings accord with the conceptualisations developed by Bueno de Mesquita *et al.* (2003), who emphasise the importance of state structure—especially in regard to the way in which state leaders are selected—in shaping the incentives acting on state actors in determining their decisions to allocate efforts towards the provision of public goods versus private benefits, and thus leading to growth-enhancing or growth-limiting institution formation and policy implementation. A recent critique by Arena & Nicoletti (2014), however, calls into question Bueno de Mesquita *et al.* (2003)'s choice of model selection, and after rerunning the data based on revised modelling obtain results that suggest a more ambiguous and attenuated relationship existing between state capacity aspects of public good provision, and the nature of state structure.

The relationship between state capacity and growth is further addressed in the literature in regard to the importance of societal warfare. However, it is a matter of some contention within the state capacity literature as to the degree that warfare proves to be a beneficial or confounding influence on economic development. For much of the literature (Tilly 1990, Besley & Persson 2008, Dincecco & Prado 2012, Gennaioli & Voth 2015, Rasler & Thompson 2017), military conflict fosters state capacity by providing the impetus for greater reform and mobilisation of resources to undertake combat, with greater long-run economic growth rates attributed to the increases in derived fiscal capacity. For others, however, the focus remains on the importance of the state to prevent the destruction of economically valuable resources due to warfare. Imai & Weinstein (2000) note that while military conflict can lead to greater levels of government investment in military-related resources, it also leads to lower levels of private investment, which overwhelms any economic growth or productivity effects of greater government-led investment; this effect is further impacted by destruction of capital stocks, leading to lower rates of future investment. (Peng 2018) finds evidence that warfare impairs state capacity through undermining bureaucratic capacity, especially as measured through staffing, as again resources for aspects of bureaucratic capacity that could be focussed on growth-enhancing activities are directed towards military uses. Relatedly, as Paauw (1952) emphasises in his research, bureaucratic resources and functions that were designed to enhance economic growth were consistently can be siphoned off and re-directed towards military expenditures. Bueno de Mesquita *et al.* (1999, 2013) link state structure with levels of state capacity to wage war, based on the types of institutional constraints facing leaders under differing political formulations. Bueno de Mesquita *et al.* argue democratic state structures generate superior institutional structures that allow for greater resource mobilisation for military purposes; this increased capacity to conduct warfare in turn leads to reductions in the actual occurrence of war for democracies, since they appear as more formidable to other potential adversaries, presenting their findings as a possible explanation for the greater levels of warfare and societal violence observed in historical data. Clarke & Stone (2008), however, attack Bueno de Mesquita *et al.*'s testing methodology, and claim that when accounting for biased results due to omitted variables, the relationship no longer is statistically significant.

In summary, therefore, it appears that whatever the relationship between state capacity and economic development, the findings from large, cross-country testing strategies has yet to produce definitive and compelling empirical results. Overall, it seems clear from theory that greater state bureaucratic and fiscal capacity must have some bearing on a nation's economic development, yet the specific mechanisms by which such a relationship is manifested appear to be highly dependent on country- and time-specific factors. Further, a similar confusion exists in regard to studies attempting to relate the development of state capacity and state structure with the incidence of war, and how these factors ultimately impact economic outcomes, with cross-country statistical studies again failing to provide definitive answers. Nonetheless, it would be hard to argue that the prevalence of war has profound effects on the development of state capacity and on economic growth; yet once again, the dynamics of these impacts might well be more granular requiring a more historical and country-specific empirical approach.

To that end, we look to consider the specific historical case of the impact that the domestic Chinese state actors played in affecting economic outcomes through their policy choices, focussing on the incentives and rationales that impacted state actor behaviour. In line with the above literature, we conduct our analysis within the broader state capacity framework, with, however, our primary methodological approach more specifically focussed on an application of the twin theoretical constructs outlined in the previous chapter relating to the Violence Trap and low-credibility trap. Thus, we hope to shape an understanding of the reasons that late-imperial and republican state actors undertook the kind of policies choices they did that so impacted the nature of the period's economic activity, by relating this to the incentive structures placed on state actors under an environment in which the state apparatus proved continually unable to enforce a monopoly over coercive internal violence.

7.1. State Capacity: Ability to Enforce Monopoly on Coercive Violence—Economic Impacts

An enduring question within Chinese economic history scholarship remains that given the potential of the Chinese economy—with a massive labour force, numerous natural resources that included coal, robust internal and external trading networks, and a nascent financial system able to accumulate and direct capital—what accounted for the lack of sustained economic growth taking hold? While no single definitive reason for such a multidimensional and multifaceted dynamic as country-level economic growth exists, one approach based on using general state capacity arguments is to suggest a reason for why late-imperial and republican China was unable to overcome issues antithetic to economic growth—such as corruption, rent-creation via monopolies and barriers to trade—was due to a lack of capacity by the state bureaucracy to implement policies that can promote growth in an effective and rationalised manner. As Acemoglu *et al.* (2015) claim, "the weakness or lack of 'capacity' of states in poor countries is a fundamental barrier to their development prospects. Most poor countries have states which are incapable or unwilling to provide basic public goods such as the enforcement of law, order, education and infrastructure." Thus, one potential answer could be to that the late-imperial and republican state lacked the capacity to implement the "correct" policies. In this regard, the debate in the literature between revisionists and conventional scholars in regard to the degree of state capacity looms particularly relevant; the question partly becomes, therefore, were there enough institutional and bureaucratic constructs that were sufficiently effective so as to have been able to generate effective implementation of desirable policies?

However, as suggested by the analysis in Chapter Five, there appears to be a disparate set of evidences available to researchers regarding the degree of state bureaucratic capacity over the period. Moreover, as argued as far back as Smith (1776), powerful states can also implement policies that harm growth; indeed, states might well be effective at creating monopolies or other rent-creation strategies. Thus, whether the degree to which the state apparatus was capable and effective in implementing the desired policies of state actors does not answer the question as to whether observed anti-economic growth policies were due to weak state capacity leading to ineffective implementation of desirable policies, or strong state capacity that effectively implemented negative policies; or, for that matter, what might well be a conflicting a combination of both.

The more fundamental question that we are presented with is therefore rather why do countries undertake strategies that lead to poor economic growth, whether effectively implemented or not? As such, our approach is to focus on a more specific feature of the state capacity argument, that encapsulated by the arguments presented within the violence and low-capacity traps, which centre on explaining—regardless of whether the state possessed the ability to implement economically-productive policy choices—the reasons why state actors were incentivised to implement policies that were necessarily economically destructive. Thus, rent-creation, generating barriers to entry and trade, bureaucratic structures that encouraged corruption, outright expropriation of private property and growing presence of state control over civil society—all of these actions on the part of the state were not due to failures of state capacity *per se*, but rather directly resultant from the fact that state actors in states with a high degree of political violence and lack of civil security, such as clearly observed in late-imperial and republic China, are incentivised to undertake a more weighted consideration on an action set focussing almost exclusively on obtaining short-term benefits, including especially those that reduce the likelihood of overthrow from power. We find that utilisation of this theoretic approach to the available qualitative evidence helps to provide a significant part of the explanation as to the inability for the Chinese economy to achieve a sustained growth path. Overall, the persistent inability of the state to enforce a monopoly on coercive violence, leading to extreme levels political violence throughout late imperial and republican China period, profoundly impacted the country's economic growth process and the nature of state-society relationship in multiple and diverse ways. Below, we describe the severe impacts on the domestic economic landscape and on private economic actors, via both primary and secondary effects, that such frequent and endemic episodes of internal violence ultimately produced.

7.1.1. Primary Level Economic Effects

It seems clear there are significant negative consequences on economic growth in countries where weak state capacity does not enable the maintenance of an internal monopoly over coercive force. Indeed, the deleterious economic effects of violence are cited as far back as Smith (1776: II, 30), who notes that, "In those unfortunate countries, indeed, where men are continually afraid of the violence of their superiors, they frequently bury and conceal a great part of their stock." The actions of Olson's "roving bandits"—represented by corrupt state police or military forces, internal rebels and militarist leaders, thieves and organised crime members, or foreign military forces—often lead to the direct and literal actual destruction or theft of productive assets. The costs of the inability for the state to enforce a monopoly on coercive violence are borne by holders of property and productive assets, to say nothing of the toll accruing to the loss of life and human suffering. Factories can be bombed and destroyed, traded goods confiscated by soldiers, transportation pathways trade depends upon disrupted, fields burned, labour forces depleted and dispersed, and numerous other direct impacts are among the most obvious impacts on economic output. Furthermore, economic agents, aware of the potential for such direct theft or destruction of their assets to occur, are therefore loathe to utilise them or undertake costly investment.

7.1.1.1. Direct Effects—

Physical destruction or theft of productive assets

The historical record of the late imperial and republican time period is replete with a nearly innumerable set of examples highlighting the scope and scale of such economic and human costs. To begin with, there was widespread theft and seizure of private property carried out by warlords, bandits, or organised criminal syndicates, due to the inability of the domestic state to enforce a monopoly on internal violence. For instance, an eyewitness account by a British official to the British Minister regarding looting of Yueyang, Hunan in 1920 by the troops of militarist leader Zhang (Chang) Jingyao (张敬尧) underscores the lack of protection on private property and life during the time: "The arrival of Chang himself on June 13th was the signal for a general looting of the city. I have never seen more thorough work. Every shop, every house in this beautiful and prosperous city has been literally stripped. There is not a vestige of any usable commodity from one end of the city to the other, including the great old yamen used by Chang himself. The place is furnished only by troops, who lie disconsolate, dirty, hungry and demoralized on the floors and the counters of the shops and on every flat surface that is shaded from the sun. Most of the population has fled, but some 10,000 remain all crowded into the American Mission Hospital" (Rose 1920).

McCord (2012) emphasises how the weak central authority was not only unable to control powerful regional military leaders, but was in fact beholden to them for the maintenance of civil order, thereby partly complicit for acts of looting and other expropriatory behaviours. The case of Wang Zhanyuan proves instructive. Sent by Yuan to command the Second Division of the Beiyang Army stationed in Hubei in 1913, by 1915 Wang had leveraged his military power to become the province's military governor. As McCord (2012:482) notes, the fiscal weakness of the central government led to social unrest, including armed mutiny by troops owed back wages: "units based in Hubei with 'national' designations (including Wang's 2nd Division) were, in theory, supposed to be paid by the central government, [but] the depletion of the national treasury made it increasingly difficult for central authorities to meet their payrolls. Thus, in August 1919, troop pay for some national units in Hubei were four to eight months in arrears. One by one, the affected units began to mutiny."

Given the lack of fiscal, organisation, bureaucratic and military state capacity on the part of the central government, central state actors chose to rely on the military might of local warlords to obtain financial resources necessary to deal with issues such as mutinies and other social disruptions. "The [central] government increasingly relied on Wang Zhanyuan to find the resources to support these troops within Hubei itself. Wang did this by raiding the provincial treasury, withholding national taxes and fees, negotiating major loans from foreign banks, and issuing bonds. As these sources also began to dry up, Wang began to demand loans or 'advances' from public organizations, particularly chambers of commerce, to meet military payrolls. Thus, we can see that the central state was sufficiently weak so as to not be able to protect its own state property (its provincial treasury, or enforcing the transference of locally-collected national taxes), let alone protect the property of private actors (public and commercial organisations).

The economic impact of these behaviours is referenced by Chen (1926: 14), who describes how local military warlords used their non-state-sanctioned military power to extract property from private citizens through "repeated [forced] contributions and taxes to their armies... [leaving] industry is virtually at a standstill." Chen provides an example of why industry becomes so poor in such an environment by describing the case of a pawn shop business in Guangdong that went bankrupt as a direct result of civil war waged nearby. In order to wage their war, the local warlord army needed money, and thus, "over the course of 12 months, military officers and soldiers went to the shop 175 times, demanding money on each occasion... all under the threat of the gun", eventually driving the venture into bankruptcy. Similar examples abound. The Jiangsu-Zhejiang War in 1924 led to numerous

instances by the armies on both sides committing acts of expropriation of private assets. After Lu Yongxiang fled Zhejiang in the wake of his loss to Sun Chuanfang's forces, the fourth and tenth divisions of his army, having not received their military salaries, forced a payment of five hundred thousand *yuan* from the Hangzhou Chamber of Commerce as compensation (*Yuehto Jihpao* 越鐸日報 21 September 1924); the arrival Sun's conquering army in Hangzhou led to demand of an additional eight hundred thousand *yuan* from the city's banking community (*Yuehto Jihpao* 2 October 1924). Myers (1986: 262) cites a contemporaneous report produced in the 1920s by Japanese academics which described the misery facing much of the rural population: "arson, theft and rape occurred everywhere... [F]ood mobilized for the military has been seized by bandit groups, moreover food is forcibly taken by various warlord armies. In this fashion, peasants in the same locale are pillaged two and three times by outsiders. Bandits and warlord factions abscond with their children and dogs." Chen (1936: 81) describes the similar plight of small farmers during the Guomindang period, who not only had the majority of their output taxed away by onerous levies imposed by local state officials, but also faced arbitrary takings by what can justly be characterised as exemplifying Olson's "roving bandits": "As a rule, the tenants pay one half of the total amount [of formally assessed taxes] directly to the tax collectors, the other half being paid by the landlord, but in addition they often have to make regular payments to the organized bandits. These payments to bandits are called the 'black ticket fees.' For, should a peasant family in the *Sha-ku*, nearly in every case a tenant, neglect to pay such fees, the bandits would issue a 'black ticket' to prevent it from cultivating or from reaping the harvest. Thus every year, at the time of planting in March, the *Sha-ku* tenants have to pay 3.00 Yuan per mow to the bandit organization; and in July and in November, they have to pay for every mow the taxes amounting to 1.60 Yuan as well as the 'black ticket fees' of 5.00 Yuan. The total tax burden per mow which is borne by the tenants is, therefore, no less than 9.60 Yuan." § Foreign military actions also led to instances of theft of domestic actors' private property, such as the blatant example cited by Henriot (2004) of Japanese military forces expropriating productive assets from Chinese privately-owned factories in Zhabei in the wake of the Japanese seizure of the domestic section of the city in August of 1937.

Beyond theft of private property, another direct effect of the period's multitude of military battles fought on Chinese soil was the damage and destruction of private property and productive assets, thereby diminishing the productive capacity of the Chinese economy. Here, too, the historical record provides a seeming unending set of examples that stretches back to include the devastation writ large due to the Taiping Rebellion which engulfed the majority of the most-populated regions of the country, to the unrest caused by the overthrow of the Qing empire ("Rich and poor, foreigner and Chinese, and every one in any part of the world having any dealings with China are being indiscriminately hit by the present unsettled condition in the country" notes the 9 December 1911 *North China Herald*), to trade disruptions caused by the persistent civil wars of the so-called warlord era ("incessant and widespread civil wars has trade hampered enormously and silver supplies cannot freely be moved throughout the country", as per the 16 October 1926 *North China Herald*), to the reports of bombings and fires engulfing Zhabei—the primary residential, commercial and manufacturing centre of domestically-governed Shanghai—during both the 1932 and 1937 Japanese military invasions as described in detail in Section 6.2.2. The weight of these and many other instances all serve to highlight the constant loss of agricultural-, trade-, financial-, and industrial-related productive assets suffered by private entrepreneurs throughout the course of this period of tumultuous political strife.

§ Chen's appraisal of the situation underscores the lack of respect for rule of law by noting that even when organised criminal elements were removed by authorities, the exploitation continued, with only a change in regard to the exploiting party: "In some places where bandits have been driven away by the governmental troops, the 'black ticket fees' are abolished only to make room for new extra assessments made by the military authority on the spot."

Moreover, perhaps the most significant and tragic aspect of such destruction of private property involved the magnitude of the loss of the most valuable class of property possessed by private agents, life itself. The loss of human life, the many who were maimed and tortured, and the associated emotional suffering that common citizenry experienced as a result of the constant warfare engendered by a series of domestic governments enable to successfully maintain a monopoly on internal violence should not be glossed over in the discussions cataloguing the number and years spanned of various internal rebellions, or tabulations constructed such as in Table 3.3 of the number of violent political transitions, the often-glorified exploits of the Shanghai-based organised criminal syndicate the Green Gang, or recounts of external military battles. All of these involved immeasurable human suffering, experienced most intensely and often by those with the least power in society, the common private citizen, whereas the powerful autocratic state official or warlord leader was mostly protected from the human suffering that was the consequence of self-interested decisions undertaken for personal aggrandisement, greater political power, or financial benefits. In truth, it is difficult to fully conceive the level of human tragedy and suffering experienced by common private agents in China during this period due to constant coercive civil strife and violence. The horrendous scale of loss of life due to the Taiping Rebellion, with the lowest estimates of wartime deaths at twenty million people, the additional estimated seventy million deaths from other internal rebellions and the warlord period, the number of murders, kidnappings and torture inflicted by members of the Green Gang on Shanghai's citizenry, the human rights abuses committed by the Japanese military during the Rape of Nanjing and similar military exercises—all of these represent just some of the largest and most significant examples of societal violence perpetrated by nonstate actors in an environment where state capacity was insufficient, or state actors disincentivised, to limit such unsanctioned violence.

7.1.1.2. Indirect Effects—

Perceptions of expected destruction or theft of productive assets

Another set of primary economic effects related to the inability of the state to maintain a monopoly on internal coercive violence impacts economic output via the expectations and perceptions of economic agents. While the realisation of civil strife and violence can lead to the theft or destruction of actors' private productive assets and output, the existence of the threat of violence acts to prevent the necessary investment that produces productive assets and output from taking place via two primary mechanisms.

First, in an environment where the threat of violence is as high as it was in late imperial and republican China, private domestic entrepreneurs are likely to anticipate future occurrences of violence that can destroy or lower the value of the output from costly investment or trade, or subject their output to expropriation by force from non-state actors. Thus, beyond the effect of the actual destruction or theft due to actual violence, the expectations of private entrepreneurs and investors of future possible destruction or theft due to future possible violence changes the calculus of the investment decision. Anticipating their output from costly investment can be destroyed or stolen, economic agents are less likely to engage in costly investment; the higher the perceived likelihood of violence, the less likely are investors to invest. In an environment as politically chaotic and violent as was China during this period, and actors constantly observing the scale of destruction of productive output, or the loss of output from theft or seizure by bandits or warlords or foreign militaries, increased business uncertainty and lowered perceptions of expected returns on costly investment.

Such impacts on investor and entrepreneurial activity were often noted at the time, with a 1931 editorial in the *Jen Min Jih Pao* newspaper arguing that the lack of monopoly on internal violence, which allows activities of bandits expropriating private business goods, leads to investors reluctant to place their capital into productive investment assets: "China has enough capital within her own boundaries for industrial reconstruction, at least for several years to come, the only thing necessary is confidence in the Government's sincerity of purpose and in its ability to carry out its bandit suppression intensions. ...[The government] is unable to cope with the bandit-communists in the interior, with the result that individual fortunes are not devoted to the development of industry, but to the purchase of Government bonds, and other unhealthy speculative activities" (*Peoples Tribune* 1931: 27). Similarly, uncertainty regarding political violence often affected entrepreneurial investment and production decisions, with the North China Herald reporting in early spring 1933 that, "Shanghai millers have adopted a waiting attitude which possible is principally due to the uncertainty regarding the northern situation, and little business has been done..."; and that, "the political situation in the north has cast a heavy shadow over the local markets... [it] has been inactive and no business has been reported, buyers preferring to wait until the political situation clears. Similarly, importers do not desire to increase their commitments under present conditions." Such conditions were highly detrimental to the formation of a stable private property rights environment—domestic private economic actors in Shanghai and throughout China could not be confident that the returns to *ex ante* costly investments would not be *ex post* expropriated or destroyed by the activities of non-state actors. Such additional levels of risk above and beyond normal business risk lowered incentives to engage in private entrepreneurial and financial activity.

Second, the perception by entrepreneurs and investors of the realistic threat of violence affects their associated perception of the efficacy of institutional structures designed to enable the enforcement of rule of law and protection of private property and contract rights—such as police and legal systems, business associations, and social mores—as weakened or incapacitated. Similar to the impact on investment that results from the anticipation of potential destruction or expropriation of realised output, perceptions of poor institutional environments increase overall business uncertainty while decreasing expected returns, thus reducing actual outlays of costly investment, dampening overall levels of private investment necessary for sustained economic growth. As Chen (1926: 14) notes in his description of the societal costs associated with the warlordism of the period, the institutional environment of areas under the control of local military leaders is poor, one that is "based on personal rule [of the warlord leader], which is rule of thumb, not rule of law. Prosecutions may be proceeded without warrant and trials held without public hearing. Militarism knows no due process of law, and gives little protection to life, liberty, and property...".

That the impacts of warlordism on Chinese state development were massive was well recognised at the time by contemporaneous actors, with Park (1929: 25) noting that the actions of competing local military leaders referred to as warlords "did more harm to China in sixteen years than all the foreign gunboats could have done in a hundred years." Or, as he toll of destruction from war was expressed in a newspaper editorial during the midst of the Guomindang period, "Every patriot realises the futility and the waste involved in civil strife, both as regards the loss of lives and the destruction of national wealth. How great the actual damage has been in the trampling of the farms and in the ruin of commerce we cannot know. We only know that the longer the civil strife, the greater the number will be of bankrupts and unemployed, and of those dependent for their living on parasitic militarists and bandit leaders" (*Jen Min Jih Pao* 1 February 1931).

7.1.1.3. Summary: Direct and Indirect Economic Effects of Lack of Monopoly on Violence

Recognition of the massive scale of economic harms owing to the direct and indirect primary level effects of actual destruction or theft of productive assets—or the damage to the overall institutional environment due to the future expectation by agents of future destruction or theft of productive assets—helps provide a mechanism to understanding some of the dynamics behind the failure of the Chinese economy during this period to achieve a sustained steady-state high growth path. As Rodrik (1999) notes in his research paper that asks, "Where did all the growth go?", most developing countries do in fact experience economic growth, in many instances quite substantial rates of growth. As Rodrik also notes however, developing economies frequently subsequently experience growth reversals, oftentimes due to civil or external war. It is not difficult to interpret the economic growth experience of China in such a light. We argue that much of the debate in the economic history literature on late-Qing and republican China over competing growth rates, with some evidence indicating high growth and other suggesting depressed growth rates, is at least in part due to the phenomenon suggested by Rodrik's research. As Rawski (1989), Ma (2008), and others demonstrate, it is possible to identify industry- or period- or region-specific discrete instances high rates of economic growth and industrialisation, in particular the Yangzi littoral region. Yet, as delineated above, much of this Yangzi area also experienced some of the most severe levels of expropriation, damage and destruction of factors of production during periods of intense warfare. But, temporal matters take on particular importance in such analyses, as measures of increases in output and factories and other productive assets can be valid, but when such output and factories and other productive assets are subsequently burned down, bombed, or stolen, absolute levels of income can fall dramatically, and the growth path can continually be reset backwards. Finally, it is necessary to emphasise the persistence of the violence that took place in China over this period. The key factor is that there was a continual, constant pattern of internal civil strife and military warfare that created a constant cycle of severe growth shocks and never allowed sustained, long-term economic growth to take hold. Thus, it is plausible that occurrences of civil conflict are a primary reason for continual episodes of growth reversals that undermined sustained economic growth rates.

7.1.2. Secondary Level Economic Effects

The primary level effects of sustained societal violence on the dynamics of economic growth are generally well understood from a theoretical standpoint within the economic development literature, although there remains considerable debate regarding the relevant factors affecting the degree, sectoral impact and persistence of economic performance declines due to internal and international armed conflict (Blattman & Miguel 2010: 39-44). Beyond the twin aspects of primary level effects of realised violence owing to a diminished private property rights environment given the actualisation and expectation of theft or destruction of private productive assets and output, such effects are compounded by the existence of two main secondary level economic effects that impact particularly the incentive mechanisms shaping the behaviour of key state actors, each deriving out of the conceptual considerations developed under the Violence Trap thesis, and our "low credibility trap" extension of that thesis.

7.1.2.1. Low Credibility Trap: Lack of Credible Commitment, Weak Institutions

First, as our suggestion of a "low credibility trap" emphasises, the existence of persistent existential threats to the political survival of state leaders causes state leaders to operate under an exaggerated "short-term" mindset. As a result, such short-termism on the part of state actors creates strong incentives for them to disregard the development of credible commitment mechanisms to protect private property rights of private actors. Given the primacy of maintain their hold on power, under threat as it is from immediate and credible existential threats, state actors are therefore incentivised to focus on undertaking behaviours minimising the likelihood of being overthrown in the short-term, while discounting the long-term consequences of such behaviours.

Credible commitment mechanisms represent ways government agents bind themselves so as to limit their policy choice sets and thereby increase the credibility of their promises to adhere to protections of property rights. In reality, of course, state actors rarely willingly seek to bind their power; instead, state actors, each acting in their own self-interest, and based on their access to power, attempt to implement policies that will provide themselves economic, social or other benefits. As illuminated within much of the public choice and political economics literature, it is in the process of acting in such a self-interested manner that credible commitment mechanisms can in actuality be created. However, as we also demonstrate in this section, it can also frequently prove to be the case that in the process of acting in their self-interest to maintain themselves in power, state leaders can also take actions that actively undermine credible commitment mechanisms. As emphasised by our own extension of the violence trap thesis, this is particularly true in the case of state leaders who find themselves continually under the threat of being disposed from power in the face of substantial and sustained existential threats of political violence.

Operating as they are under constraints of severe short-termism, the incentive structure facing state actors leads to actions that are not conducive to the formation of effective credible commitment mechanisms. In order for governments to make credible their commitments to protect private property rights, state actors need to be seen as justifiably not willing to suffer costs associated with breaking the commitments they have made. For instance, while the sovereign has the ability to default on bond payments, recognition by state actors that such action will lead to future increased borrowing costs helps serve as a deterrent to default; and knowledge of that deterrent by private agents increases their perception that the sovereign's commitment to repay is credible. If, however, state leaders are continually faced with existential threats, the power of the deterrent is marginalised—that is, the priority of state leaders is first and foremost to remain in power; only after that immediate and primary goal is secured will leaders consider the more distant and secondary level goals, such as attaining a favourable cost of capital in the future.

Given the constant state of political violence that defined the period's political conditions, it can therefore be argued, our theoretical framework suggests that we should expect the domestic institutional environment to have been characterised by relatively poor private property rights, as a result of the lack of incentives and means enabling state actors to develop credible commitment mechanisms. Rational private agents perceived attempts by government actors to bind themselves to their promises to protect private property rights to be inherently hollow, given that as a regime under constant threat of violent regime change, state actors were likely willing to consider any action set in the immediate to stay in power, including those that violated seemingly credible commitments—i.e., those that had large negative costs on the state actors—given that the costs associated with being overthrown would be even greater. Furthermore, even were agents to view the state's commitments as credible, the existence of serious existential threats implies a likelihood that the existing state could be overthrown, along with existing institutional structures

defining property rights; this, too, works to cause rational agents to discount attempts by the state to credibly commit, which again diminishes expected benefits to state actors from attempting to develop credible commitment mechanisms and protect private property rights. Given the frequency of political civil wars waged throughout the period, as well as incidences of political assassinations, the precariousness of any particular leader's hold on power was apparent to all. Further, it was also well-recognised that when a new regime came to power, there was a frequent restructuring of the political and institutional environment in ways that greatly impacted and changed economic relationships, highlighting the uncertainty facing entrepreneurs and investors at the time.

Thus, it is not surprising to observe the number and consistency of defaults on sovereign debt payments, since even in the face of clear increased costs and difficulty in obtaining future funding, the incentives brought on by endemic political violence induced such strong short-termism that future costs were so heavily discounted by state actors in the present as to diminish their otherwise credible commitment effects. So, too, did the gravity and immediacy of existential threats provide impetus for state officials to engage in expropriation or onerous taxation of economic agents' private property. Again, while such actions could logically be foreseen as deleterious to future long-run economic health and hence expected government tax receipts, the immediate nature of existential threats led to short-term needs for resources to maintain state existence outweighing long-term considerations of the negative effects on the broader economy or financial markets. Consequentially, rational private economic agents—recognising the threat to state survival, and anticipating the rational reaction by state actors would lead them to expropriate—were less likely to trust the state to not engage in expropriation, thereby ultimately limiting the ability of the state to credibly commit to not expropriate private assets.

As a result, state actors were more likely to discount the long-term costs of expropriating the property of private actors, or not developing institutions that could create a strong property rights regime and lead to sustained long-term economic output—such as an independent judiciary, transparent government financing and oversight structures, adherence to rule of law by all including state actors—and only focus on the short-term benefits gained from expropriation, which included in the instance of late imperial and republican China, not only unrequited takings of private productive assets, but also onerous taxation, debasement of private savings, directing nearly all government expenditure on military undertakings rather than construction of fundamental infrastructure, and even the takings of life of own private citizenry when their actions were viewed as disturbing the short-term goals of state actors. In all such cases, the long-term highly negative costs of such actions on the overall perception of the institutional environment defining and protecting private property rights and the rule of law was discounted in favour of gaining short-term benefits to further the immediate continuance of state actors' hold on power in the face of existential threats. Finally, note that, just as with harmful primary economic effects, faced with a poor institutional environment, lacking as it is in credible commitment mechanisms, and in which private property can be expropriated not only by nonstate but also by state actors, private entrepreneurs and investors are disincentivised from engaging in costly investment necessary for the creation and development of long-term growth.

7.1.2.2. Violence Trap: Government Corruption and Rent Creation

The second of the two main secondary level economic effects impacting incentives shaping the behaviour of key state actors is derived out of conceptual considerations developed under the Violence Trap thesis. An important contribution of the work by Weingast and his co-authors is the recognition that conditions of large-scale and continual political violence in developing countries shape the incentives acting on key state actors affecting the organisation of these countries' economies in ways that incentivise rent-creation, leading

to much of the inefficiency and poor growth outcomes observed in many developing countries both today and throughout history, including late-imperial and republican China. Given that political violence poses such negative potential consequences on those in power—namely, their removal from power or loss of life or other benefits—state leaders seek to minimise the likelihood of political violence from occurring. When political leaders do not possess a sufficient monopoly on violence so as to negate the ability of potential rivals from engaging in political violence that threatens political leaders' hold on power, one strategy often employed to diminish the probability of violence is via the creations of economic rents that can be distributed to potential competitors. Yet such rent-creation strategies, while potentially reducing the incidence of violence, are economically inefficient, involving the creation of state-enforced monopolies and barriers to entry, barriers to the free exchange of goods and capital, price controls, and other impediments to efficient market functioning (Tullock 1967, Tollison 2012). Such strategies are inherently designed to create concentrated economic benefits, so that these concentrated benefits may be directed to those the rent creator seeks to reward or co-opt. Therefore, the "trap" faced by leaders of states unable to enforce an internal monopoly on coercive force derives from the fact that abandoning economically-inefficient rent-creation strategies increases the likelihood of political violence, given that those nonstate actors with access to coordinated violence who would lose their privileges under liberalisation are incentivised to use their access to violence to attempt to overthrow the state via violent regime change.

The authoritarian nature of the late-imperial and republican Chinese state was a contributing factor to the observed levels of corruption and rent-seeking behaviour. Liberal democratic government structures, and rights to open media that supports them, are viewed as mechanisms disincentivising corruption by state actors (Montinola & Jackman 2002, Brunetti & Weder 2003). While Heymann (1996) raises concerns that these same factors can also work to pressure state actors to respond to lobbying efforts that leads to corruption, in ways that Kubbe & Englebert (2018) note vary considerably based on country-specific characteristics, leading to observed levels of corruption in democratic government forms (Fisman & Golden 2017), for Hollyer & Wantcheckon (2015:501) the key factor is that in authoritarian regimes, the incentives for corruption are inherent, not country-specific: "Authoritarian states have an incentive to systematically rely on corruption as a means to motivate bureaucratic agents and ruling party members"; similarly, Kukutschka (2018) highlights that anti-corruption measures undertaken within authoritarian systems are more dependent upon the decisions of only a few high-level state actors, and hence easily subject to change based on whim, as opposed to defined aspects of the political system. Meanwhile, Rose-Ackerman (1999) suggests government structures such as liberal democracies where multiple political actors are forced to bargain to achieve political goals increases the impediments to receiving benefits from rent-seeking opportunities. While the frequency and costs of rent-seeking activity under authoritarian dictatorships versus majority voting settings is still a topic of theoretical debate within the public choice literature (Congleton 1980, Hillman & Riley 1989, Mohtadi & Roe 2003, Li 2013), recent empirical work has indicated a negative relationship between rent-seeking and economic growth, with the observed relationship to be stronger in poorer countries with worse institutions (Schwab & Werker 2018). Such empirical findings are in line with the Violence Trap claim that rent-seeking and associated poor economic performance are a partly a consequence of the high levels of political violence found in developing nations.

This theoretical framework contributes to our understanding of some of the policy choices undertaken by domestic state actors within the historical framework of the late-imperial and republican period. The historical description of the magnitude of political existential violence provided in Section 6.2, in part represented by the measure presented in Table 6.1, underscores the precarious hold on power state leaders faced. Those securing power did so by only slightly besting a group of powerful rivals, implying their hold on power to be

tenuous, with a low expected value assigned to their chance at remaining in control of the state for a substantial period of time. As such, they were highly incentivised to take steps to reduce the probability of political violence being perpetrated against their hold on power. Our argument is that the high degree of political interference in the economy by state actors—including a great deal of rent-creation via state-controlled monopolies, amongst the many inefficiencies throughout the economy—was not a coincidence, but rather a direct outcome of the low weak state capacity that exhibited itself via an inability to enforce a monopoly over political violence. Given the multiple dispersed sources of violence present throughout the society, domestic state actors sought to reduce the probability of such political violence via the creation of economic rents to be used to co-opt their potential rivals with access to the machinations of coercive force, thereby decreasing the threat of violence. This dynamic was clearly observable both through the practice of outright corruption, wherein which state funds were directed to nonstate actors for the expressed purpose of inducing their support of the existing political regime, as well as generating considerable impact on the structure and performance of the domestic economy via the creation and maintenance of state-enforced monopolies, reflected in ever-increasing levels of state intervention in the domestic economy.

7.1.2.2.1. Incentives for State Corruption Shaped by the Lack of Monopoly Over Violence

Official corruption manifested itself in several ways. Often, monies that were intended for development purposes "mysteriously disappeared" and instead were directed to powerful potential rivals of state leadership. This was the case with nearly all of the controversial £25 million loan President Yuan's government negotiated with five creditor nations; several years later, a senior official in the Chinese Maritime Customs Service was quoted remarking that "the greater part, if not all, of the reorganisation loan of 1913 was accounted for by statements and vouchers, but that in actual fact very little of it was ever applied to the purposes for which it was lent", instead used to solidify Yuan's relationship with his former Beiyang military school associates, who as commanders of powerful armies represented potential rivals (Thomson 2012). Similarly, Paauw (1952:11) notes several examples during the Guomintang period of payments that flowed from the central state to provincial and local leaders; these leaders, given their command over powerful armies, represented substantial threats to the central state: "In 1928 the Nationalist government had assigned ample revenue sources to provincial and local governments, renouncing the claims of the central government to lucrative sources of income. ...[These] subsidies were employed to buy the loyalty of strong local and provincial rulers." Paauw (1952: 16) further puts into scale the degree to which the state leadership went to secure the support of potential rivals, arguing that "Military expenditures were not made to provide for the political and economic security of the masses; by and large they were used to protect the political and military position of the Kuomintang from the challenge of internal military revolt. Less military resources were used to repel the Japanese aggression in Manchuria and North China than to preserve the military supremacy of the Kuomintang among a group of Chinese military rivals." Thus, direct flows of financial resources to potential rivals were purposely designed to create a degree of reliance on the existing political structure for financial resources, thereby decreasing the probability for potential rivals to attempt to dispose the current state leadership. Nonetheless, even paying such subsidies, the Guomintang faced continual rebellions by rival warlord groups, such as the extensive Central Plains and Ningxia wars.

That corruption and bribery were so widespread partly reflected the low costs to government officials in engaging in such behaviour. As Eastman (1990: 18) describes, the government watchdog agency, the Control Yuan, over the seven years from its founding in 1931 through August 1937, was rarely able to even bring formal charges against

government officials without encountering resistance for such actions from senior-level Party leadership, whose interests often dovetailed with the maintenance of the corruption scheme under investigation. This lack of enforcement reflected the conflict within the state bureaucracy between the official, stated desires for reduction in levels of corruption, and the incentives as discussed above regarding the underlying need to use government funds in ways that allowed for the essential pay-off of political and military rivals who presented serious threats to the current political order.

7.1.2.2.2. Incentives for Rent-Creation Shaped by the Lack of Monopoly Over Violence

Beyond the direct transfer of monies involving official corruption, domestic state officials often supported policies related to the creation of economic rents via the construction and maintenance of state-controlled monopolies and other barriers to free exchange of goods, allowing for the generation of concentrated benefits able to be transferred to potential rivals. Thus, the government created barriers to entry on large industries, serving as gate-keeper to access certain markets. The state also used numerous aspects of its regulatory and enforcement power to affect such monopolies. This was true, for instance, especially in the area of anti-smuggling efforts, leading to what Thai (2015: 2,5), in consideration of the Guomintang government's "militarized antismuggling campaign to protect its revenues and assert its authority as China's new central government", suggests was representative of part of the state's overall "creeping regulatory encroachment in everyday life."

Numerous prohibitions existed, designed to place limitations and restrictions on the size of markets and amount of trading activity. Rice produced in a certain region was often restricted to be sold within that same region, with strict prohibitions placed on the transportation of rice along the Yangzi, with similar restrictions being placed on other commodities, such as salt. For instance, Gale (1930: 248) notes that salt derived from the brine wells found in western China was prohibited to be sold outside the west-China region or shipped on the Yangzi river. Indeed, the entire salt production industry operated under strict state control, with the state granting monopoly rights to privileged merchant groups. The same was true for numerous other industries, such as tea, porcelain, and coal mining, monopoly status granted, usually on the provincial or local level, to a sole producer of a commodity within a given region. In Guangdong, for instance, the provincial government founded six modern sugar mills and then used its legal power to ban imports, police and military power to limit smuggling of sugar, and regulatory power to prevent the issuing of business licenses to private entrepreneurs seeking to open competing sugar mills. In this manner, the powerful state actor, provincial leader Chen Jitang, used the power of the state to create rents via a monopoly and then hand them out to privileged cooperating merchants, such as Mo Yinggui and Feng Rui (Lian 2005). Chen also employed selective enforcement of smuggling laws to allow the duty-free importation of certain types of refined sugar to supply favoured suppliers with cheap imported sugar and avoid the collection and transference of required customs duties to the central government, which had established customs collection stations throughout the province's ports (Hill 2010: 5-8). Numerous other market restrictions were continually created by domestic governments. Under the Guomintang, the Ministry of Industries established numerous joint government-private enterprises that were granted monopoly control over the sale of specific commodities, such as firms that dealt in paper, tea, vegetable oils, and even founded the Central Fish Company in Shanghai, which was granted monopoly control over the fish trade in the Jiangnan region. Given that the Ministry itself was the controlling shareholder, in these concerns, the significant economic rents created from these monopoly ventures were under its control and able to be directed to privileged parties the Ministry and the Guomintang sought to favour (Coble 1980: 245-246).

7.1.2.2.3. Corruption and Rent-Creation as an outcome of Lack of Monopoly on Violence: The Guomindang and the Green Gang:

Understanding the usefulness of rent creation and official corruption play in obtaining the political and military support of potential rivals helps to illuminate the rationale for the Guomindang leadership to provide support to the Green Gang. Having developed from a small secret society into a full-scale sophisticated criminal syndicate, the Green Gang had access to sources of coercive violence of considerable magnitude; although in a vacuum perhaps unlikely to represent an existential threat to the Guomindang regime by itself, in a political environment in which the Guomindang government faced multiple additional existential threats, the level of violence able to have been inflicted by the Green Gang was potentially highly destabilising. Similar power dynamics between the state and organised crime syndicates frequently exist within other developing countries, such as in Mexico between the government and paramilitarised drug cartels (Correa-Cabrera *et al.* 2015). As a result, rather than attempting to enforce an adherence to rule of law and directly combat the disruptions to the social order, defiance of police control, and violations of private property rights of Shanghai's residents inflicted by the Green Gang, the state leadership apparently found it more advantageous to co-opt this criminal organisation through the creation and enforcement of a monopoly on opium smuggling—as Wakeman (1995a: 254) describes it, "the creation and elaboration of an official narcotics monopoly." This extensive and highly lucrative venture delivered concentrated and excludable benefits to those who could utilise it. Thus, by allowing the Green Gang exclusive rights to run this monopoly, the Guomindang leadership was able to successfully demand in return support of the Party's anti-communist and anti-Japanese political goals. Such an arrangement began early on in the Guomindang regime with the infamous April 1927 white terror episode in Shanghai, in which Jiang Jieshi ordered a purge of Communists from the Guomindang Party and used his relationship with Green Gang boss Du Yuesheng (杜月笙) to have the Gang coordinate the round-up and murder of thousands of the Party's former allies.

The Guomindang leadership was already familiar with the lucrative financial benefits generated from creating a monopoly in opium trade. Song Ziwen, acting as Finance Minister of the southern-based Guomindang government in the 1920s, had helped create an opium monopoly in Guangdong (van de Ven 2003: 90-93). With the ascension of the Party to achieving nominal control over the central government apparatus by 1927, the size of the economic rent created from a nationwide opium monopoly was not small. As a result, the illicit opium trade brought in huge sums of money to the Green Gang, much of which was then funnelled to the Guomindang benefactors (Wakeman 1988, 1995a, 2003; Taylor 2014). As Finance Minister, Song was able to extract large tax payments from the opium cartel, since it earned monopoly profits. Wakeman, (1995a: 34) even goes so far as to claim that "modern Shanghai was literally built on the proceeds of the opium trade". Further, the monopoly and co-option exemplified exactly the kind of *quid pro quo* Weingast and his co-authors argue are representative of the type of violence-reduction techniques commonly employed in low-capacity states. According to Wakeman (1995a: 205), the agreement between Du and Jiang was explicit: "Du Yuesheng agreed to organize anti-Communist terrorist activities in Shanghai in exchange for Chiang's recognition of his drug monopoly in the Yangzi Valley." Thus, the Guomindang state created monopoly rents, and then used the expected benefits of access to that rent to buy off one of its rivals, who in return agreed not to use their access to mechanisms of violence against the state, but rather against other rivals of the state. Hence, we observe a set of behaviours well suggested by the violence trap theory—lacking the ability to secure a monopoly on force, and faced with multiple existential threats, Guomindang leaders engaged in a policy to co-opt a potential rival who also possessed access to coercive violence to decrease the probability of such violence being directed towards them and negatively affecting their ability to remain in power.

Of course, beyond the rent-creation aspect, much of the relationship between the Guomindang and the Green Gang involved corruption, with various state actors receiving personal financial benefits deriving from their cooperation and implicit support of Gang's opium trading and other illicit business activities. It was certainly in the interest of Green Gang members to entice greater cooperation from Guomindang authorities by way of offering financial bribes, helping to further the justified reasoning behind the Guomindang rationalisation of their acquiescence of Green Gang activities. Wakeman (1995a) goes into extensive detail regarding the ways in which Jiang and his family became personally enriched via their implicit approval of the opium smuggling trade. In one instance, the Smuggling Prevention Office determined that members of Jiang's own inner circle, including Jiang's brother-in-law, helped conduct a large smuggling operation; in response, Jiang ordered the case against his compatriots dismissed, and instead fired the director of the Smuggling Prevention Office (Wakeman 2003: 325-327; Taylor 2014: 40).

Whatever sincere attempts at control of the illicit drug trade by some state actors that did occur were often undermined by countermeasures taken by other state actors. The Smuggling Prevention Office consistently experienced interference from other branches of government whose principals were invested in protecting the Green Gang's ability to conduct its opium trade. That elements in the government were involved heavily in opium trafficking and trade, beyond even simple tacit non-enforcement, in an inherently corrupt manner, was well-known. Major English- and Chinese-language newspapers of the period often recounted instances of government involvement in promoting and sanctioning trade in opium. For instance, a March 1931 *Shanghai Evening Post & Mercury* article notes that, "The Opium Suppression Bureau, a government affair, has been functioning in a manner peculiarly its own for the past two years. At times a guard of soldiers and men bearing what are said to be the credentials of the O.S.B approach opium runners on ships and receive consignments of opium for which they pay 'transportation charges.' At other times a great show of a seizure is made but those 'in the know' usually hear afterwards that the consignment was the property of some small man not in the Ring and that the drug was returned to him on payment of 'squeeze'" (Woodhead 1931). In any event, all pretence that the government was interested in preventing Opium smuggling came to be discarded when Green Gang boss Du Yuesheng himself was appointed head of the National Board of Opium Suppression Bureau in 1932, providing the Gang essentially official control over the entire opium trade in China.

Yet while corruption was endemic, the rationale for the Guomindang leadership to support the activities of the Green Gang clearly go beyond the simple explanation of a result of personal corruption. The corruption observed was of an institutional nature, and not one that can easily be ascribed to uniquely poor moral character of those employed by domestic Shanghai police forces in the Public Security Bureau or the Opium Suppression Board. Instead, the agreement between Jiang and Du, so well-known and observable by private actors and police force members, institutionalised and incentivised a culture of corruption. There was little benefit for police personnel to behave in an incorrupt manner, as they well knew that sincere efforts to fight opium smuggling were prone to be reversed and subverted at the highest levels of government. In such an environment, where corruption was so obviously officially sanctioned, it likely appeared more rational to accept the financial incentives in the way of bribes and avoid potential violence that the smugglers could direct their way. In this manner, widespread corruption became normalised. So, too, therefore, did a more generalised lack of adherence to rule of law throughout society, thus clearly degrading the overall environment of private property rights.

In this regard, we disagree with much of the literature that ascribes the Guomintang government, or its municipal police force, to have been "corrupted" by the criminal elements of Shanghai. For instance, Wang (2017) suggests Jiang Jieshi "wished" to control corruption and attempted to establish good governance, arguing that corruption derailed the Party's state-building efforts. The University of California Press' review of Wakeman (1995a) notes that "Chiang Kai-shek wanted to prove that the Chinese could rule Shanghai and the country by themselves, rather than be exploited and dominated by foreign powers. His efforts to reclaim the crime-ridden city failed, partly because of the outbreak of war with Japan in 1937, but also because the Nationalist police force was itself corrupted by the city." Likewise, Li (1997) confidently claims, "In 1927, at the beginning of the Nanjing decade, the Nationalists' goal in Shanghai was to build a new civic society in which the primary function of a professionalized police force was law enforcement, as it is in any modern civilized society", but then laments that by the start of the next decade, already ambitions had been tempered by the realities of a "crime- and crisis-ridden society."

Yet while many state actors certainly received personal financial and other benefits deriving from their cooperation and implicit support of the Green Gang, Guomintang leadership was not incentivised to create policies to reduce corruption, and were themselves open to receiving benefits from corruption, because the benefits of doing so outweighed the alternative costs from fighting the Green Gang. Thus, the Guomintang and the police were not "corrupted" by the Green Gang; rather, given the existential threats faced by the state, the short-term nature of the incentive outlook implied that rent creation—in the form of opium trade made illegal and hence closed off to competitive entry—that could be used to buy off a potential rival of the state created conditions for corruption to so readily thrive. The "crime-ridden society" of Shanghai was an outcome of the Guomintang policy of placating, enabling and even encouraging the Green Gang, the city's major criminal organisation that was directly responsible for the city's high crime and murder rates, with much of the civilian community terrorised by the organisation's illicit and extortionist practices that disregarded the private property and lives of private agents.

Ultimately, the leadership of the Guomintang state were attempting to stay in power, and in order to do so it was necessary to prevent those outside the state—such as military commanders, communist forces, or external Japanese military forces—from overthrowing them using violence. In an environment fraught with existential threats from rivals who possessed access to sources of coercive violence, the violence that the Green Gang could bring to bear on the Guomintang military and police apparatus was sufficient to represent a credible serious threat to their ability to stay in power. Therefore, Guomintang leaders were open to engage in strategies that could co-opt private actors with access to coercive violence, inducing such actors to not use such violence against state leaders, but rather against state leaders' rivals. The desire to stay in power outweighed any rationales Guomintang leaders might have had in regard to allowing the Green Gang to engage in highly illegal activities that so thoroughly corrupted the domestic environment for rule of law and the overall state of private property rights protections, clearly negatively dampening entrepreneurial activity.

Interestingly, for all the use of rent creation and delivering economic rents to entice support from political rivals possessing the power of coercive force, the strategy proved only partially effective. Certainly, that is apparent if from nothing more than the frequency of realised violent regime change and outright civil war that dominated the period. Chen (2000:195) reflects the precariousness of the strategy by noting the inherent difficulty of using rents to bribe rivals, leading to it being "extremely difficult to follow the shifting alliances among the myriad military and political leaders in China at this time. Most agreements were simply cynical short-term arrangements to eliminate a rival before turning against one's erstwhile partner."

Such complex shifting alliances were often due to changes in perceived expected gains a given political rival might anticipate in response to changes in group power dynamics or the likelihood of military victory, affected as well by changes support or capacity demonstrated by other rivals (Powell 2006, Driscoll 2015, Cox *et al.* 2017). Indeed, an important caveat is necessary in regard to the nature and causes of political violence that took place throughout the period. While we have focussed on the way in which political violence poses existential threats for state leaders and incentivises them to undertake policies that reduce the probability of violence, so too is it true that in certain instances, when the risks of undertaking violence appears high relative to the potential benefits received, state leaders can actually be the drivers of political violence, rather than attempting to limit its outbreak (Cox *et al.* 2017 model a subset of the factors that can lead actors to choose violence in their development of their 'proportionality principle', which balances the costs of fighting versus the benefits from receiving rents). Dincecco (2015:903), building on work by Cox (2011) and Hoffman (2015) regarding the problem of royal moral hazard wherein which monarchs do not bear the full costs of warfare but do gain full benefits, presents the reason European states were unable to overcome institutional impediments to the creation of credible commitment mechanisms: "To evade parliament, monarchs used fiscal predation including forced loans, the sale of state lands, monopolies, and offices, and the seizure of private goods. The problem of royal moral hazard in warfare aggravated this fundamental tension between monarchs and parliaments. Monarchs saw definite upsides from military victory, such as personal glory, but few downsides from defeat... Parliamentary elites, by contrast, had to bear new tax burdens related to the monarch's military adventures... Royal moral hazard helps explain why monarchs were nearly always in battle; wars involving major powers were underway in 78 to 95 percent of all years between 1500 and 1800." In certain ways, this description accords with behaviours of the domestic state leadership during the late-imperial period onward—the constant wars fought whose costs were borne primarily by the common populace, and the use of authoritarian state power to create monopolies, impose forced loans, and undertake the seizure of private property.

Nonetheless, as indicated by the number of violent regime changes as displayed in Table 6.1, and by the outcomes of many of the civil wars and foreign invasions, at least a significant number of the military threats faced by domestic state governments were of sufficient seriousness as to have been considered existential; thus, the conditions necessary to generate our "low credibility trap", or to support the rationale by state actors to engage in rent-creation as per the Violence Trap, remained. Moreover, regardless the impetus of the entire range of civil strife and warfare experienced over the course of the period, the primary economic impacts relating to the actual or future expectation of destruction or theft of productive assets also remains consistent.

7.1.2.4. Lack of Monopoly on Violence: Further Implications

An advantage of applying this analytic approach is that it also proves useful to better understand some of the more-contested aspects of Chinese economic history. As mentioned, there exist conflicting views regarding the level of Chinese economic growth over the late imperial and republican periods. The observed relative political stability during the so-called "Nanjing Decade" admittedly fits with some of the revisionist economic historical research on the Guomindang period, which argues the Chinese economy underwent substantive growth (Brandt 1989, Rawski 1989). While true that certain indicators might suggest growth to have been comparatively stronger than in previous periods, even the most optimistic appraisals, when viewed in comparison with the growth experienced by Japan, or European and American economies, are not particularly impressive. Though increased industrialisation took place, the number of factories and the degree of capital utilisation in manufacturing remained low in absolute terms, especially given the size of the

economy. Ultimately, however robust was actual economic growth, it appears to have been uneven throughout the period, given that nothing approaching a Rostowian "take-off" was achieved, signifying perhaps the strongest indicator that the seeming great potential of the Chinese economy remained unactualised. Yet the opportunities presented by ready access to modern industrial technologies—as well as to capital via Shanghai's financial markets—suggest the outcome could have been much different. Brandt (1997: 287) outlines the pertinent issue facing economic historians of the period: "the important question is: why after the opening up of China in the 1840s did the utilization of new technology take so long to cement and the modern sector take so long to emerge?" For Brandt, the real puzzle is the lack of modern industrial technology transfer that economic logic suggests should have taken place: "Insofar as the transfer of technology to China in textiles and other emerging industries was profitable –and estimates suggest that it usually was– what combination of forces prevented this transfer from successfully occurring earlier, or at a more rapid rate? [C]ase studies on technology transfer... generally suggest that the technologies introduced were not economically incompatible with China. That is, they could produce at lower cost than their traditional counterparts and were not crowded out by more efficient indigenous producers." And yet, such technological transfers were rare, and those that did occur often failed or were incomplete. Brandt continues to present his puzzle by noting that, "When they failed, the problem appears to lie in the non-economic costs of the transfer, which were frequently tied to China's system of political economy. These costs frequently forced firms to shut down after a few years and discouraged investment by others." Brandt finds the situation particularly puzzling given that "it is probably correct that no potentially profitable industries failed in 19th or 20th-century China because of official opposition."

To answer the puzzle Brandt poses as why domestic Chinese entrepreneurs would not take advantage of profitable new technologies for "non-economic" reasons that did not include official opposition, we consider the peculiar system of political economy to which Brandt refers. Due to the high degree of political violence, and the resultant low level of credible commitment mechanisms that could assure entrepreneurs of the state's institutional ability and resolve to provide private property rights protections, we would argue that the risk return profiles domestic entrepreneurs faced were driven too high and too volatile to allow the undertaking of costly investment opportunities, such as implementing modern industrial technologies in production. The lack of private property rights that existed, due to the level of destruction writ large brought on by the constant condition of civil strife, meant that the "non-economic costs" to which Brandt refers above included the potential of a representative entrepreneur's property destroyed or expropriated by nonstate actors, or by state actors unable to constrain themselves to honour commitments not to expropriate when faced with the a constant stream of existential threats—i.e., one's factory getting bombed, burned, or confiscated. All of these factors implied very real economic costs discouraging entrepreneurial investment. Of course, other factors undoubtedly also played important roles; for Wang (2013), who reiterates the puzzle Brandt raises, the role of information costs was an important early factor when price and supply information could not be transmitted between commodity producers and manufacturers quickly and at low cost; as he notes, however, this constraint was removed as early as the 1880s with the development of better transportation networks and laying of telegraph lines.

Another puzzle in the historical evidence, identified above, is why the institutional environment providing private property and contract rights protections appeared more robust during the early- and mid-Qing period compared to what followed starting in the late-Qing (Ocko & Gilmartin 2009). Extensive research illustrates a legal environment that successfully provided protections on contracts (Liang 1996, Buoye 2000) supporting a robust set of market exchanges (Huang 1996, 2010; Allee 2004; Chui 2008), including the development of domestic proto-financial instruments that pre-dated the arrival of similar instruments by foreign businesses (Zelin 1988, 2005a; Morck & Yang 2011). Thus, if late-

imperial and republican governments lacked appropriate legal institutional environments for dynamic economic and financial development, it must have come from conditions unique to those time frames, and not inherited from prior institutional structures. Similarly, state bureaucratic, fiscal and military capacity also appears to have been demonstrably stronger during these earlier periods when contrasted with the latter (Kung & Ma 2014).

Early period Qing governments, defined by low levels of taxation and concomitant small fiscal expenditures, exhibited little direct active role and large-scale interventions in the economy (Wang 1973: 79-83), with Miller (2000: 23) noting that "Taxes on commerce were insignificant until the institution of the *lijin* (likin) in the mid-nineteenth-century." Rowe (1993) has written persuasively in regard to the relative market orientation of mid-Qing economic policy, embodied by the two concepts of 流通 (free circulation of commodities), and 市價 (adherence to market prices). Using archival sources, Rowe documents the actions of Chen Hongmou, a provincial official whose economic liberalisation efforts led to the reduction in trade barriers. An opponent of price controls, Chen maintained his stance that market forces could better allocate scarce goods. When a poor harvest drove up prices on rice in Jiangxi in 1740, Chen stated that "any action [government officials] took should show respect for actual market prices and, however alarmingly grain prices shot up, [officials] must never impose official price controls nor compel owners to sell at sub-market prices. In Chen's logic, just as buyers would be attracted to an item at the right price, so too would sellers sell when they felt the price to be favourable.... To alter it by fiat would be unnatural and immoral, as well as counterproductive"(14).

If depictions of a less intrusive, *laissez-faire* government prior to the start of the late-Qing are correct, the Violence Trap analytic approach provides potential insight explaining the existence of stronger protections on private property and contract rights during the earlier period. Importantly, the degree and consistency of political violence that dominated China from the late-Qing onwards was unique, signifying a sharp break from the relative stability of earlier Ming and Qing periods. Those imperial states did not face continual existential violence threats; while uprisings, wars and episodes of social instability were present, the scale and persistence of such social unrest was dissimilar to that of the subsequent period. The implications of such differences fit well with the historical evidence regarding the nature of legal and other institutional protections on private property and contract rights, and degree of state capacity, which defined the earlier periods of Qing rule. It is perhaps therefore more than an interesting coincidence that a deterioration in institutional and bureaucratic capacity appears to have occurred with the onset of continual and existential levels of political violence starting in the late-Qing, when the incentive structures that shaped the behaviour of state and private actors thereby changed considerably, increasing short-termism and reliance on rent-creation and corruption amongst state actors.

Both aspects of the secondary level economic impacts caused by weak state capacity in the enforcement of a monopoly on internal coercive violence, and the concomitant condition of continual and persistent existential political violence, led to conditions where private entrepreneurs and investors were disincentivised to engage in the kinds of costly investment required to generate sustained economic growth. On the one hand, given the existence of constant existential threats, state actors undertook strategies that encouraged the creation of economic rents in order to deliver concentrated economic benefits to rival nonstate actors so as to secure their support or reduce the probability of them using violent means leading to the overthrow of the state. Such policies, however, were conducive to state control and intervention into the economy, designed to limit the free trade of goods and create government-controlled barriers to entry. As such, the environment for business was not conducive to encouraging costly investment by private entrepreneurs and investors, as it required private actors to engage in unproductive rent-seeking behaviour to gain favoured status as opposed to channelling scarce resources into productive activities.

Relatedly, the degree of corruption engendered by these policies contributed to a clear weakening of institutional structures such as the rule of law. In addition, the continual existence of existential threats meant state actors were effectively unable to create credible commitment mechanisms necessary for the development of a strong institutional environment supporting the protection of private property and contract rights. Under such a political environment, state actors discounted the long-term harms to the overall institutional environment caused by state interventions in the economy and violations of private actors' private property rights, instead only concerned with increasing the likelihood of regime survival to be derived in the immediate from undertaking such actions. Support for theoretical arguments regarding the importance of the relationship between state capacity to maintain a monopoly on violence, with levels of institutional strength and economic development is suggested by the findings in recent empirical work by Haggard & Tiede (2011: 683) indicating that there exist "complex complementarities" between rule of law and property rights institutions, and that many of these complementarities seem to rest upon issues pertaining to political and social violence: "The incidence of violence appears to be a powerful factor in discriminating among rule of law complexes in developing countries and was an important determinant of the volatility of economic growth."

7.2. The "Grabbing Hand" of Taxes, Regulation, and Expropriations Violations of Private Property Rights by State Actors as an Outcome of Lack of Monopoly over Violence

As noted, state actors operating under conditions of continual threats of severe existential violence are incentivised to engage in behaviours that reduce the threat of the regime overthrow in the short-term, at the expense of the long-run consequences of those behaviours. As a result, deterrents that can typically induce state actors to avoid engaging in the expropriation of private actor assets because of the long-run harms that come from such actions—e.g., low economic output because of poor property rights institutions, or the inability of the state to obtain low-cost financing in the future if the state defaults on loans in the present—are so heavily discounted that the short-term benefits of expropriatory behaviours outweigh expected long-term harms. Similar dynamics can induce state actors to seek to exert control over other areas of private civil society so as to limit the probability that public dissatisfaction with expropriatory behaviours can spur dispersed private actors to overcome coordination problems so as to represent a credible threat to the stability of the existing regime. We find ample evidences of state actors undertaking steps to continually expand control over increasing aspects of society, in both economic and civil spheres, over the course of the time period, with many of the drivers for such behaviours owing to pressures and incentives on state actors as they operated within a highly uncertain and unstable political environment defined by the threat of violent overthrow.

7.2.1. Violations of Private Property Rights by State Actors: Expropriation

In this section, we highlight actions taken by state actors that involved specific violations of private actors' private property rights. Note that while the end result is the same—private actors deprived of their private property via taking by force—the means by which such takings occurred represents an important philosophical distinction from that previously discussed in Sections 6.2 and 7.1.1, of state actors unable or disincentivised to enforce an internal monopoly on violence, thereby allowing nonstate actors (e.g., Taiping rebels, warlords, Green Gang members, the Japanese military) to expropriate private property via coercive force. Instead, what is discussed here are systematic examples where the state itself was involved in the taking of private actors' property.

Given the extensive time scale, size of the population, multitude of political actors, and complexity of the Chinese economy, it is not feasible to provide a representative accounting of the innumerable examples regarding instances of domestic state actors engaging in expropriation or other forms of taking actions against private actors. Any compiled sample can reasonably be viewed as necessarily selective, and suffering from confirmation bias. Moreover, many examples of such behaviour on the part of state actors has already been well-explored in previous discussions throughout this chapter. Recognising this inherent deficiency in the following analysis, we nonetheless attempt to limit such adverse effects by identifying several examples indicative of consistent and systemic utilisation of the tools of state authority by domestic state actors that violated private actors' property rights.

7.2.1.1. Legal System

Legal systems help safeguard protection of private property rights by enforcing previously-agreed to limits on state actions, thus serving as a credible commitment mechanism. However, for this role to be realised, legal systems need to possess authority outside of and over the sovereign; otherwise, the legal system can serve as another tool of state authority to exploit private actors. Given that at no time during either the Qing or Republic periods did the legal system possess independent authority over executive state power, it not only lacked the ability to provide limits on expropriative or extra-legal behaviour of state actors, but instead frequently served to advance state interests over those of private actors.

We observe this dynamic under the Qing from research by Kwan (2004), who provides a telling example of the way in which state officials adjudicated cases under the Qing Code. The role of the magistrate was not to conduct a dispassionate application of immutable law, but rather to treat the law as an adaptable tool to be used to ensure the protection and advancement of state interests. In 1911, for instance, after merchants holding state-granted monopoly rights fell into arrears on their loan obligations, "the state expropriated the ten merchants and had their monopolies, leased or otherwise, seized and operated by the state. The lessees suddenly found themselves dealing with government officials who refused to pay rent while demanding repayment of security deposits owed to the bankrupted merchants" (192). Importantly, the legal decision behind this move did not conform to standard norms or previous rulings: "It did not matter that the registration of monopolies under different names had been a widespread and long-standing practice. It did not matter that a record of household division, though filed, was not under seal and therefore legally invalid. It did not matter that the authority of the household head might be compromised as a result of the ruling" (191). All of these factors cited would have traditionally signalled the case should have been decided differently. Yet the ruling ignored those factors so as to ensure the furthering of state interests, via the expropriation of merchant private property, both that of the bankrupted merchants, and that of their lessees and creditors.

Under circumstances where the application of the law was often fungible, adapted and interpreted on a case-by-case basis, used to ensure the desired outcome—advancement of the interests of the state—the legal system could not serve as an effective check on government power. Utilisation of the legal system in such a manner continued throughout the Republic period, as indicated with the previously-cited government-mandated policy of enforcing a "participation" of the judiciary, as appointed judges were expected to "forward the interests of the Party", ensuring judiciary power remain subordinate to the executive branch, represented by the Guomindang Party itself. This was made clear by examples such as after Chief Justice Lu made a ruling that upheld the law at the expense of government (i.e., the Guomindang Party) interests, he was immediately removed from power and replaced with a judge who had provided his assurance to "abide by the decisions of the party and do the best to carry out party principles" (Xu 1997:12), clearly underscoring the lack of judicial

independence, and thereby lack of ability to impose limits on the state power over private individuals. Although Thai (2015) was able to identify an example showing an instance where the national-level court exhibited a degree of independence, providing limited protection for an individual from the arbitrary application of state power in a particular case, his study suggests this to have been more the exception than the rule of an administration of the law that was more often than not applied non-uniformly.

7.2.1.2. Financial and Monetary Systems

State actors also frequently utilised coercive state power to aspects of the domestic financial and monetary systems. For instance, as initially explored in Section 3.2.3.1.2, and to be explored in considerable detail in Chapters Five and Six, the central government continually renege on its promises made to bondholders to repay their debts, by way of forced "renegotiations" and repudiations of the loans. As a result, the government faced a high cost of capital and often faced difficulty placing its bonds with domestic investors without the use of the coercive power of state authority; thus, for instance, during the Guomindang period, the Ministry of Finance used its regulatory over the banking industry to enforce the purchasing of government bonds. The framework of the Violence Trap and what we label as the "low credibility trap" help illuminate why knowledge of future difficulty in raising capital often proved an insufficient impediment for state actors to violate their promises to bondholders in the immediate—short-term needs for funding to pay for military defences against existential internal or external threats to the state leadership's hold on power outweighed such future considerations. Further, few internal checks—such as independent courts to enforce bond repayment, or the threat of removal from power by property holders through electoral means—existed on state actors beyond future considerations of access to capital. Conversely, externally-imposed checks on state actor behaviour—primarily through foreign control over certain bonds' funding mechanisms—did prove relatively effective in inducing state actors to honour the state's debt obligations. Once again, however, we saw the impact that the threat of violence played in shaping the incentives of state actor behaviour in ways that from a long-run perspective, seem perverse—unlike the examples identified by Fang & Owen (2011) of authoritarian regimes turning to membership in international organisations as supplying otherwise difficult to achieve domestic credible commitment, state actors in control of domestic Republic governments, in the face of a multitude of existential threats, took steps to remove those externally-derived credibility devices and gain control over the funding sources of such bonds. As noted above, it is noteworthy then that after doing placing these funding sources under domestic rather than external control, the funding revenues collected from sources such as salt taxes fell, and the default rate on bonds dependent on such funding sources rose. For instance, from 1927 to 1933, the Nanjing government floated over 1.6 billion *yuan* of internal loans; as most had no secured collateral, the majority fell into default or underwent reorganisation.

In addition, various domestic governments used the tools of state power over the banking industry and monetary system to advance state interests to allow for greater levels of government spending, at the expense of private savers. Without the existence of credible checks on state actors, promises to balance the budget or avoid inflationary policies were easily broken without recourse. Thus, for instance, when faced with existential pressures, government actors in charge of monetary policy increased spending levels, yet proved unable or disincentivised to institute taxation systems enabling sufficient revenue collection. As a result, Horesh (2007) notes, "Though both [the Qing and Beiyang governments] promulgated countless measures to the contrary, the Beijing-based late-Imperial and early Republican governments further complicated the situation by resorting to debasement in order to jack up seigniorage revenue from newly-founded state mints", undertaking policies that Yan (2015: 140) describes as "over-issuing for seigniorage profit."

While domestic governments were able to finance budget deficit spending by enacting inflationary policies, the *tael* and *yuan* were nonetheless silver-backed currencies, and as such currency devaluations were necessary to enable continual deficit spending. As such, as previously referenced, the Guomindang government took steps to abandon the silver standard and move to a pure fiat paper money system. The Guomindang government had prior experience with paper-backed currency; during its control over the southern provinces as the opposition government to the Beiyang, it had relied on printing money to meet financing needs. For instance, as reported by the Hongkong Telegraph (30 November 1922) newspaper, in October of 1922, in order to finance the government's military expenditures, the provincial treasury had issued over twenty-six million *yuan* unsecured official state bank notes, leading to sudden inflation, with the value of the notes dropping forty per cent. A decade later, the Nanjing-based Guomindang government used the move to pure fiat money as a way to finance budgetary shortfalls; as Yan (2015: 183) states, "Another driving force behind the abandoning of silver was the Chinese government strategy to escape the 'silver fetter' and to increase the government ability to extract seigniorage revenues." While part of the *fabi* reform process in 1934 saw the Ministry of Finance assuring the public it would balance the budget within eighteen months to reduce inflationary pressures on the *fabi*, by mid-1935 the fiscal deficit had actually risen, and the Ministry continued to undertake a policy that Ho (2010: 43) describes as an "excessive expansion of the money supply, via bank advances, to finance budget deficit." Bloch (1941: 28) critiques the government's "large-scale borrowing" used to finance spending, blaming it for the major currency devaluation in taking place in late 1935. As with prior devaluations, the domestic government's debt burden was sharply reduced; however, once again, this was accomplished at the expense of domestic private economic actors who, after the currency reform, were forced to hold government banks notes.

7.2.1.3. State-run Economic Planning Structures

The relationship between the business community and state actors was complex. While private merchants were often eager to see the power of the state used to provide protection from competitive forces, they chafed at state officials exerting control over business decisions. This dynamic played out continually in the undulating state-merchant relationship throughout the period. Overall, however, state actors, unconstrained by governmental structure, an independent judiciary, or other commitment mechanisms, were able to use state power to advance state goals at the expense of policies to improve the overall business environment; further, when protectionist policies were instituted, the frequently were used to provide the state with control over economic rents that could be directed towards individual privileged actors, as opposed to an entire industry. For Yeh (1990: 26), the reason government officials treated private business interests as subordinate to those of the state was partly cultural, owing to an adherence within official circles of the Confucian concept that goal of business activity was to "support the nation". Yet, patriotic calls to "support the nation" are typical across nearly all regimes, conveniently employed by state actors as cover to utilise the tools of state authority to acquire assets from private business for personal gain.

Government interference and control over the market were commonplace during the late Qing. Wong (1982: 781)'s analysis of price controls on grains and limits on commodity trading during the course of the second half of the nineteenth century serves to highlight government intervention in commodity markets. These policies were repeated throughout the Republican era as well, with Brandt (1997:296) noting that in provinces along the Yangzi, during periods of rising grain prices, government officials would attempt to prevent

river-based trade. As a result of such government intervention in the marketplace, enforced grain prices frequently did not reflect market prices, instead the result of trade blockades and rationing schemes. These policies reflected a move away the greater market orientation efforts led by reformers in the mid-Qing, such as the influential government official Chen Hongmou, whose economic liberalisation efforts led to the reduction in trade barriers.

Another important policy initiative initiated in the late-Qing that reflected greater state intervention in economic activities was that of joint-stock firms founded under the principle of 官督商办 (government-supervision, merchant-management). The concept envisioned an idealised partnership between government officials and private merchants, as these firms would benefit from the financial contributions and business acumen supplied by private merchants, and preferential taxation and financing policies from the state; overall, however, the firm would operate under the guiding direction of state officials. The system was initially enthusiastically supported by merchants when perceived as a way to promote business activities by providing private ventures with government capital, enforcing barriers to entry on foreign firms, and bestowing favourable tax policies. Over time, however, enthusiasm waned as it became clear that state actors would play an interventionist role in the relationship, with government officials installed in managerial roles, resulting in companies undertaking actions for political, as opposed to economic, reasons. In practice, merchants could invest capital in these concerns, but exercised little input after their initial contribution. In the 1890s, a businessman, Wu Zuoqing, summarised the disadvantages faced by private capitalists under this system as, "If you think it [a business] is private operated, there are [government nominated] general managers, assistant managers and supervisors. Private businessmen, once they become shareholders are no more than strangers. They do not have decision rights even in whether they should receive annual dividends, let alone in matters such as whether fees should be paid, and appointment of managers. Even though there is an annual shareholders' meeting, business shareholders are frequently uninvolved and feel at a loss" (quoted in Du *et al.* 2007).

Beyond the implementation of the government-supervision, merchant-management, mercantilist style policies that included the granting of monopoly rights and the erection of barriers to entry and trade also represented important and oft-used policy options employed by state actors. Such interventions in the markets led to several long-term economic consequences. Wang (1994)'s analysis of the origins of cotton manufacturing during the Qing makes note of the frequent use of granting of monopoly production rights, as well as the attempted implementation of tariff structures or import quotas, was designed to provide protection to domestic producers using non-mechanised and low-efficiency technology in their production of cotton goods, as a way to combat the impact of importation of low-cost cotton products from abroad. Adherence to mercantilist policies prevented the acceptance of plans by foreign investors to set up factories employing modern technology within China, even when these plans were supported by local entrepreneurs and investors; this included the rejection in 1877 of a proposed cotton mill factory, the Anglo-Chinese Shanghai Cotton Cloth Mill Company, to be financed primarily by domestic Chinese investors and managed by Jardine, Matheson and Company (LeFevour 1970: 37). Another domestic entrepreneur, Peng Rucong, had his plans in 1878 for the establishment of a domestically-owned cotton manufacturing mill denied by Governor-General Li Hongzhang, when Peng refused to structure the venture under the government-supervision, merchant-management corporate management structure that included government official oversight (Wang 1994: 66). Government officials resisted granting license to these attempts to build modern cotton manufacturing concerns in China because they sought to control the industry by the creation of a single firm under the direction of the government. As a result, they supported the granting of a monopoly license to a single firm controlled by state actors. Overall, Wang finds that the use of monopoly rights for the creation of mechanised cotton manufacturing to have set back the adoption of modern

technology by Chinese entrepreneurs; "The ten-year monopoly of the Shanghai Cotton Cloth Mill was implemented to simply prevent foreigners from setting up mills in China. It was effective as such, but it also restricted investment in the cotton manufacturing industry by Chinese merchants" (77). We would argue that, contrary to Wang's assessment, the self-interests of state actors suggest that the monopoly granted to the Shanghai Cotton Cloth Mill firm was not "simply" to limit foreign competition, but rather all competition, as the management structure of the firm included political and business allies of Li Hongzhang who could benefit from the economic rents that a monopoly structure could provide.

By the Guomindang era, government bureaucratic machinery had become more sophisticated and extensive, responding to the desire on the part of Party leadership to exert greater control over the direction of industry. Zanasi (2006) explains at length the attraction that fascist and corporatist economic strategies held for the senior leadership of the Guomindang, including Jiang Jieshi, Chen Gongbo, and Wang Jingwei, focussing on the importance of instituting tight control over the economy—in practise, therefore, tight control over the decisions and behaviours of economic actors. The Party leadership instituted a number of measures in their attempts to increase the level of direct control the Party exerted over private economic actors.

First, there was an increase in regulatory measures, designed to bring about greater control over private industry. These measures were combined with a concomitant increase in the number of state economic planning and regulatory organisations which could set and enforce regulations over private industry. A complex morass of bureaucratic state planning agencies, operating under the Ministry of Economic, the Ministry of Finance, the Ministry of Industries, and other state organs, all had authority to create various regulations and demands on the business community. Bian (2005b: 101-102), for instance, makes note of the extreme regulation to which private and state-owned firms were subject, citing as an example the detailed directives to ordnance enterprises regarding intricate required accounting methodologies produced by the Bureau of Ordnance, a division under the Ministry of Military Administration. Such regulations were replicated across a wide array of enterprises, given the extensive number of national development plans state economic planning organisations generated, including the 1928 "Plan for the Development of Basic Industries in China", the 1929 "Programme and Budget for Material Reconstruction in the Period of Political Tutelage", the 1931 "Six-year Programme for Material Reconstruction", the 1931 "Ten-year Plan for China", and the 1932 "Three-year Plan" of the National Economic Council, the 1932 "Four-Year Industrial Plan", the 1933 "Three-Year Industrial Plan" (Fong 1936).

Complying with the plethora of bureaucratic regulation measures imposed large costs on industry, as efforts were directed into activities such as submitting reports to various regulatory oversight agencies in order to fulfil the minutiae of regulatory measures, leading to overall inefficiency within the economy. For instance, the Ministry of Economics, as well as serving as an implementing arm of state economic planning, functioned in large part as a regulatory body over domestic private enterprises, and enforced requirements on all companies, not just those publicly traded, to submit documentation in line with bureaucratic reporting regulations regarding issues such as financial statements, board of directors meetings, appointments of senior personnel, wages of employees, justification of staffing decisions, and an inordinate degree of other business activities (Eastman 1974, Cochran 2000, Zanasi 2006, Ko 2016). In a similar vein, Thai (2015: 30) notes the impact of increased regulation on merchants, including those involved in the shipping business, some of whom were accused of smuggling not because they wilfully partook in transportation of contraband, but because an ever-shifting and increasingly complex set of regulations often made previously legitimate commercial activity illegitimate.

Second, Guomindang Party leaders sought to increase control over the economy by way of control over economic resources; by limiting access to the supply of necessary economic inputs to those companies that acted in accordance with the desired behaviours of government actors, private industry was compelled to conform to serve the interests of the state, rather than the interests of their private ownership. One of the most important tools the Party had at its disposal in this regard was control over access to financing. The Ministry of Finance was active in its promulgation of directives to the banking sector regarding which industries should receive preferential loan treatment; the level of control over these decisions became much more direct after the domestic banking sector was effectively nationalised in 1935. Such regulations had serious impacts on the efficiency of utilisation of financial resources, as well as negative consequences regarding the deepening of business acumen within the banking industry. Pan (2003) finds the fiscal dependence on funding internal debt issuances by the Beiyang and Guomindang central governments led to "lopsided" development structures within the banking industry—given that so much of their revenue streams were derived from underwriting and placing domestic central government bonds, banks focussed much less on other parts of their business model, including developing sufficiently sophisticated risk management practices for private loans, or supplying sufficient capital to private entrepreneurs.

Beyond control over financial resources, numerous industry-specific organisations were formed to exert control over the business decisions of private businesspersons on a more granular basis. For instance, the Cotton Control Commission, a state agency designed to promote and control the development of the cotton textile manufacturing industry, controlled access to technological, managerial and financial resources which to engage in factory modernisation efforts; such resources were only directed to privileged firms selected by state bureaucratic decision-makers (Shepherd 1939: 172). The Commission also actively encouraged industrialists to place "public" (*viz.*, state-actor designated) interests over private. "If a Chinese industrialist was not willing to do so, the economic-control apparatus of the [Cotton Control Commission] would intervene to impose change. Private industrialists, although respected as producers, were to be circumvented if they followed their own interests and not those of the industry and the nation" (Zanasi 2006: 176).

Such strict control of access by state bureaucrats over limited beneficial resources led to additional adverse economic effects. Most notably, it induced considerable amounts rent-seeking behaviour on the part of private businesspersons. Thus, for example, in the cotton industry, as Zanasi describes, it was in the interests of cotton textile manufacturers to engage in rent-seeking activities, lobbying the Cotton Control Commission for access to valuable limited resources, as well as to avoid potential intervention from state regulators if their behaviours were seen to run counter to state policy goals. Similarly, Cochran (2000:168-170) details the extensive efforts of Lui Hongsheng, the founder of the China Match Company, to obtain protectionist and other favourable policies for his company, devoting much of his time over the first six years after founding his company to intense lobbying to members of the Ministry of Finance, the Ministry of Industry, and the National Economic Council. While such actions can be characterised as economically wasteful, they proved personally beneficial to Liu, and his private shareholders, once he received in 1936 a national monopoly for the production and sale of matches in China, which included clear barriers to entry, prohibiting the establishment of new match factories, and designating Liu's company the sole authorised seller of matches within China. Hence, a highly anti-competitive scheme that brought about reduced supply and higher prices for consumers yet proved highly beneficial to a single firm was instituted in the name of "national economic progress."

A related regulatory control measure was the use of tariffs and other trade barriers that effectively limited access by economic actors to imported economic resources. In the aftermath of the 1928 Sino-American Tariff Treaty granting the Guomindang government authority over the setting of tariff and customs duties, tariff rates were steadily increased on a wide array of imported goods. While much of the impetus for increasing tariff rates was driven by a desire to increase fiscal revenue, their function in creating barriers to entry for protected products, implied, as Su & Barber (1936: 115) comment at the time, the tariffs were to be used, "even more importantly, to protect and foster the development of native industries." Protectionist tariff policies are lucrative for domestic manufacturers if placed on competing imports (Grossman & Helpman 1994). Under the Guomindang, such protection from import competition could be considerable—tariffs on refined sugar, for instance, reached upwards of two hundred per cent (Boecking 2011b: 17), and similarly high tariffs on were placed on cigarettes, matches, kerosene, and fertiliser (Tan 1990: 100)—generating additional rent-seeking opportunities for companies. Indeed, part of the motivation behind the lobbying efforts of Lui Hongsheng described above in regard to his match cartel was to secure protection from imports, which he ultimately received. Wright (1991: 655-656) describes similar extensive lobbying efforts to the government for increased tariffs by the Flour Manufacturers' Association in 1933, the Cement Manufactures' Association in 1934, and the Chinese Cotton Mill Owners Association and a group of fifty factory owners in Shanghai in 1935. Beyond furthering non-productive rent-seeking activity, increased tariff schedules also led to excessive smuggling opportunities, as consumers sought access to greater product choice and lower prices offered by imports that were either banned due to import quotas, or priced higher due to tariff fees (Thai 2016, Boeking 2017). As with other rent-creation strategies undertaken by the state, so too did the strategic application of selective smuggling enforcement and seizure and distribution of contraband provide state actors with the ability "to reach revenue-sharing agreements with [the Guomindang]'s local political rivals" (Shiroyama 2018: 334).

Beyond the pernicious effects of rent-seeking on economic output, Coble (1980) and Eastman (1986) highlight the ways the control over scarce economic inputs created incentives for individual government officials to increase their own personal incomes via corruption under the Guomindang. Indeed, this outcome follows in general under most rent-creation schemes—because the benefits of accessing rents are high, private actors are willing to bestow gifts to the decision-makers, the granters of the rents, benefits (viz., bribes) nearly equal to the value of the rent (Tullock 1980). Concordant with the theoretic prediction Tullock lays out, and with the concerns Coble and Eastman highlight, Cochran (2000: 169) details the bribes that Liu Hongsheng funnelled to the Minister of Finance to help win support for his proposals, including paying the rent on the Minister's private home. In general, the many forms of rents controlled by state bureaucrats—the approval of the formation of companies, the awarding of favourable financing (or access to any financing after 1935), the granting of monopoly rights, or the arbitrary strictness in application of regulatory control—implied that the ability to favourably influence the decision-making of certain state actors could prove financially beneficial, thus creating strong incentives for corruption. For instance, despite aggressive lobbying efforts by domestic industry groups, taxes on cigarette manufacturers remained high, with the British-owned British-American Tobacco Company enjoying tax advantages of up to ten per cent reductions vis-a-vis domestic producers, given its ability to enjoy discounts from prepayment of assessed taxes that domestic producers were hard-pressed to match given cash-flow concerns. The situation suddenly changed in April of 1937, however, a month after Song Ziwen, the former Minister of Finance and governor of the Central Bank of China, became a significant shareholder and chairman of Nanyang Brothers Tobacco Company, the largest domestically-owned tobacco manufacturer. Taxes on domestic tobacco producers were drastically slashed while those on foreign producers significantly raised (Wright 1991: 657, Swan 2005: 75).

The third strategy the Guomindang Party leadership undertook to exert greater control over private economic activity was through the creation of an increasing number of state-owned enterprises. Such enterprises, which operated under the direct control of the Ministry of Industries, or other economic planning bureaucratic offices, represented a more deliberate attempt on the part of state actors to control economic activity. As Ko (2016: 173) notes, the focus of the state economic planning apparatus directed by leadership of government bureaucratic organisations such as the National Resource Commission, besides explicitly focussing its efforts bringing the activities of private entrepreneurs under the control of government planners that is, existing companies), it increasingly turned to modes of direct control: "In the Republican period, existing businesses were either taken over by government investing in their companies or new businesses were formed by government corporate investments." State-owned enterprises represented the possibility for greater control, given that, as under the former Qing policy of government-supervision, merchant-management, government officials were placed in managerial positions within economic firms, and hence firm decision-making accorded with political objectives above and beyond economic objectives. Indeed, the focus of activities undertaken within state-owned enterprises became so intertwined with conforming with state interests that many positions became quasi-government roles, even when the particular managers were not technically employees of the state bureaucracy. As Qi Zhuli, writing in 1948 shortly after the conclusion of the Anti-Japanese War, notes, "State-owned enterprises... treated department heads and other administrative leaders as 官吏 (officials); pointedly, he continues by commenting that those in such roles "paid little attention to issues of efficiency" (Qi 1948: 126).

The structure of most of the new state-owned firms facilitated their control by government actors. These were enterprises that were organised as joint-stock companies, partly government financed, and partly private financed; however, given that the corporate governance structure of these firms mandated that a state organisation (such as the Ministry of Finance, the National Economic Council, or one of the smaller industry-specific commissions) retained ownership of at least a fifty per cent of outstanding shares, actual control of the firms managerial policies was possessed by government authorities. Over time, the share of productive output attributed to state-owned enterprises as a percentage of total output continued to grow. Eastman (1986) notes that over the course of its time in power, the degree of government control by the Guomindang Party over the productive assets of the economy increased, such that by 1937, the government "was operating fifteen spinning mills, which comprised 30 per cent of all the spindles in Chinese-owned mills. It also held investments in, *inter alia*, flour, meat-packing, telephone, paper, and vegetable-oil companies."

Paauw (1952)'s research on the fiscal budgets of the Guomindang central government also finds state-owned enterprises to have comprised a large part of economy, and of the budget. As Paauw shows, many of the line items in the budget were labelled in ways to obfuscate the degree of state spending on state-owned enterprise activities, by falling under categories such as "civil expenditures" or "reconstruction", rather than under the separate budget item labelled "investment in state enterprises". Paauw also finds large differences between the amounts reported in Chinese language versions of the national budget, and those found in the bi-lingual Statistical Abstract published for international consumption (for example, in 1935 reported investment in government enterprises totalled 610 million yuan in domestically published sources, but only 164 million in international versions), surmising that "This may indicate an effort to obscure the increasing encroachment of the government on private industry from Western readers" (11-12).

7.2.1.4. State-directed Expropriation: Nationalisation and Seizure of Assets

Beyond the several examples provided indicating the use by state actors of the tools of government authority to advance their interests over those of private economic actors through economically-interventionist policies, the historical record of this period is also replete with more drastic cases of state power utilised to engage in outright expropriation of private actors' properties. These examples of takings frequently involved more blatant use of the coercive power of the state—via force, or the threat of force—to induce taking actions. The authoritarian governmental form of both the Qing and Republic governments facilitated state actors' ability to expropriate private property, given state actors were neither accountable to an electorate comprised of property holders, nor restrained by credible commitment mechanisms such as an independent judiciary, yet possessed complete control over the levels of coercive authority of the state.

Examples of domestic state actions falling under this rubric comprised one of two general categories. The first approach involved using the tools of state authority to simply nationalise or otherwise take control of privately-held productive assets. One reason state actors undertook these types of actions was to gain greater control over a firm or industry. An example of this can be observed in the response of state officials to calls for assistance from the domestic silk industry business community in the 1930s in the face of competition from Japanese producers. Total relative silk production in Japan and China, respectively, had fallen from 31,485,000 versus 19,678,000 kilograms of raw silk in 1925, to 44,120,000 versus just 10,555,000 kilograms by 1932, with Japan's share of world supply of silk production rising from fifty-five to seventy-five per cent, while China's fell from thirty-four to only eighteen per cent. For state officials, the solution was more government ownership and control: "The Chinese Economic Council has recommended to the Central Government that it assume control of the supply of cocoons and of silk filatures, establish sales offices in foreign silk centers, and aid in the formation of research and financing organizations" (*Far Eastern Survey* 1935: 54). Hence, the state responded by taking ownership of the productive assets of cocoon and filature production, at the expense of private ownership and control of the industry. Far from atypical, the behaviour of state actors in this case reflected a common pattern during the Guomindang period, when the government forcibly nationalised some of the country's largest businesses and industries. As to be described in Chapter Ten, the China Merchants Steamship Navigation Company, the country's oldest joint-stock company and largest domestic steamship company, was nationalised in 1928 against the wishes of the firm's management. Similarly, the domestic banking industry was effectively nationalised in 1935. Nationalisation in these instances allowed the Guomindang government to force the affected firms to institute the policies desired by state decision-makers; in the case of China Merchants, that meant using their fleet to advance military over commercial purposes, and in the case of the banking system, it allowed the Ministry of Finance to more directly control monetary policy, including the practise of financing the deficit through the issuance of fiat currency unbacked by silver, as well as directing banks to lend capital to those firms and industries the government leadership felt was advancing Party interests, while limiting funding access to those firms which had fallen out of favour.

Beyond reasons of increased control of managerial decision-making, the attraction of financial gain via capture of profits also drove state actors to use the power of state authority to take over private firms. The access to authoritarian state power, and the lack of a countervailing independent court system, meant such abuses of government power could occur unchecked. In 1905, for instance, after the completion of an official government field report on mining production in Guangdong showed that the privately-owned Qujiang Baochang Coalmine Company was generating large profits, state officials issued orders to nationalise the firm (Gong 1999: 262). During the Beiyang period in Hunan, government officials justified the nationalisation of several private mining companies as one of financial

benefits to the provincial treasury, noting nationalisation and capture of the firm's profits would "improve the future outlook of the financial difficulties facing the province" (Zhu 1993: 107). Such state actions were not confined to corporations, but also individual private actors; indeed, it was often those least organised and without easy access to advocacy tools that were most exploited. Chen (1936: 77-78) notes how during the Guomindang Nanjing period private holders of rural lands were often expropriated without appropriate remuneration, ostensibly for the purpose of road-building: "Often agricultural lands have been confiscated, or nearly confiscated, because of road building; after having been heavily taxed for this purpose, they are incorporated in the road area without payment." Chen goes on to describe a specific example in Weiyang, where a twenty-five miles stretch of property was confiscated from agricultural lands, with the original landowners not even eventually receiving the one-half market price of the land that had originally been promised in way of remuneration... [Moreover], agricultural lands have been confiscated not only because of road building, but also by unexpected orders of military and civil authorities to establish some real or fictitious public institutions, experimental agricultural stations, and charitable homes being a favourite form of such deceit. The villages of *Shih-pai* and *Tang-yai* can best testify to this—in some cases, the Government has made a promise to pay from 80 to 100 Yuan per mow, according to the grades of the land; but while this promise remains unfulfilled, the authorities keep on collecting the land tax year after year." Finally, beyond expropriation of land assets, Chen (1936:78-79) describes the similar expropriation of labour, where private individuals were conscripted into working to build roads or other tasks determined by local government officials, yet again no remuneration was provided for the provision of such conscripted labour. Chen concludes by pointedly noting that, "As most of the confiscated lands belong to unorganized small peasants, their feeble attempts to protest are of no avail"; further, even in those cases where local landholders did attempt to withhold assessed taxes, the power of the state was exercised to compel compliance; Chen (76) cites an example from 1932 from a village in Guangdong: "in the 3rd sub-district of *Hwa-hsien*, immediately north of *Pan-yu*, every adult male was ordered to pay 6.00 Yuan for a public road. The villages tried hard to dodge this tax, and even organized themselves to oppose it. Troops were sent to subdue them, their leaders were imprisoned, and finally they had to pay according to the governmental orders."

The second approach of state-directed expropriation involved cases of outright seizure of assets by way of use of governmental force, or the threat of force equivalent to extortion. Many of these actions involved powerful state agents threatening either economic or personal harm to the private owner of the property or asset so as to compel the private owner to acquiesce to the government's taking demand. For instance, in February 1890, a government auditor decided that the China Merchants Steamship Navigation and the Imperial Chinese Telegraph Administration companies were making "excessive profits", and decreed they should therefore pay increased distributions to the government. Not coincidentally, for each of the following two years, China Merchants' leadership decided it was in their interests to donate one hundred thousand *taels* to government coffers per annum, and eventually by the mid-1890s, both companies had submitted to agreeing to pay the government a minimum of sixty thousand *taels* in "contributions" each per annum.

This form of the use of state power to compel donations from private businesses to the government continued to occur over the course of successive governments. In 1913, for instance, Yuan Shikai demanded from Changlu salt merchants a forced contribution of 120,000 *taels* made to the Beiyang government under the threat of nationalisation of their businesses (Kwan 2004: 279, 292). In a similar fashion, in 1927 the Guomindang government in Wuhan assessed a donation of 250,000 *yuan* to the Wuchang and Hankou Merchants' Association (武昌漢口商會) in support of the Northern Expedition. Compliance was assured after the government had the two leaders of the Association arrested after their initial decline to make the required donation (Zhu 2010).

In addition, throughout the Republic period, companies faced demands for "contributions" from both national and sub-national government actors; further, similar to the situation described above regarding China Merchants and Chinese Telegraph, the same company could face repeated demands over the course of multiple years. Table 7.1, for instance, provides an illustrative account of the "donations" assessed to Yudahua Textile Company (裕華公司), a private cotton-spinner located in Hubei, over the first three years of the Guomindang rule. All of the donations listed were assessed to the company management, as opposed to voluntary donations decided on by company management for political, rent-seeking, social signalling, or altruistic reasons.

Table 7.1. "Donations" and forced loans assessed to Yudahua Textile, 1927-1930

Date	Enforcing Party	Form of Donation	Amount (<i>taels</i>)
1927.12	warlord	Cheng Ruhuai Army borrowing	16,000
1928.5	Hubei Provincial	Cigarette Donations	24,000
1928.8	Nanjing Guomindang	Disarmament Borrowing	50,000
1928.1	Nanjing Guomindang	Government Finance Borrowing	136,000
1928.11	Nanjing Guomindang	Government Finance Borrowing	34,000
1929	Nanjing Guomindang	Government Bonds Purchases	34,000
1929.1	Nanjing Guomindang	Military Reorganisation Bonds	46,000
1930.9	Nanjing Guomindang	Tariff Short-term Treasury Bills	92,000

Source: 裕大华纺织资本集团史料 (1984), Luo & Li (2010: 210).

The information provided in Table 7.1 is instructive in underscoring the multitude of ways that the government failed to protect private property rights of private actors, in this case, the owners of the Yudahua Textile Company. To begin with, the company was forced to pay donations to powerful nonstate actors (or, "roving bandits"), such as Cheng Ruhai's warlord army. Second, the local provincial government forced the company to donate money to buy cigarettes for the government, with the central state authorities or institutional legal system unable to provide protection from such unauthorised taking. Finally, the central government, itself also leviathan in nature, and with no limits on its power to violate private property rights, also forced monies from the company, by way of assessed loans and forced purchases of government bonds.

Given the political turmoil and violence characterising especially the Guomindang era, the rationale provided by state actors for the numerous coercive loans, forced donations, and outright confiscation frequently took the form of "state security" issues. Facilitating the ability of the government to easily turn to this rationale for seizure of private assets was a series of regulations enacted soon after the founding of the Guomindang Nanjing government. Promulgated on 7 May 1927, 處分逆產條例 (Regulations Regarding Disposition of Traitors' Property) expressly provided that all property and money belonging to "counter-revolutionary people or enemies of the Nanjing government" were to be taken over by the government. Both the ambiguous nature of who could be characterised as "anti-government", as well as incentives motivating government officials to raise funds, led to frequent use of these regulations to expropriate private property. In Hubei province alone, one hundred sixty-five cases of confiscation were recorded, causing a considerable amount of capital flight from nervous merchants, with twenty-seven million *yuan* worth of assets transmitted from Hubei to Dalian alone; undoubtedly considerably more assets flowed outward to escape confiscation, although estimates are difficult to obtain. Nonetheless, the result was clear—massive capital shortages in local banks and amongst merchant groups led to considerable declines in investment and a freezing of financing of business ventures.

In this instance, the ensuing social outrage that occurred forced Guomindang Party to take some action, instituting review process of some cases, resulting in the return of a small portion of assets as wrongful confiscation; however, the return process was arduous, and most of the confiscated assets were not returned (Guo 2010, Feng 2015). Government confiscation of assets under these regulations also frequently included equity shares and ownership interests in private companies. After several large shareholders of Yudahua Textile were accused by regulators from the Disposition of Traitors' Property department of being "enemies of the government", and therefore confiscated their shares in Yudahua, the company engaged in extended negotiations with the department on the shareholders' behalf, arguing that such action was against the company's Articles of Association. The company' request was denied, however, and the equity shares of the accused "counter-revolutionaries" were taken over by the government (Luo & Li 2010: 211).

Besides targeting large companies for either takeover or extorting contributions, other acts of direct takings were directed at wealthy individuals with access to significant financial assets, such as urban merchants, bankers, and business owners; their concentrated wealth and lack of independent military power to prevent such compulsory donations. Tellingly, for instance, none of the leaders of the Green Gang, whose wealth surpassed the majority of those targeted for extortion by the Guomindang regime, were targeted for such forced takings; the fact that these actors had access to considerable sources of nonstate violence that could have been directed at the state likely played into this choice. Less powerful private actors, however, faced the possibility that simply by direct order of a government actor, backed by the police power of the state, such individual private agents could be demanded to give up their property, or else face serious repercussions such as imprisonment. In 1926, for instance, after a first attempt in Guangdong at issuing five million *yuan* of bonds failed because of a lack of subscribed investors, a second attempt, for ten million *yuan*, achieved success, the result of a government programme that forced households and shops to purchase debt equal to the value of one month's rent, or one per cent of the value of their real estate (Luo 1992: 79, van de Ven 2003: 90-91).

Other examples include the previously-cited case of Rong Zongjing, forced in 1927 to buy 500,000 *yuan* of government bonds under threat of a warrant for his arrest that was only removed after the bond purchase was made. His case was not uncommon; throughout 1927, in response to weak subscriptions of the Nanjing government's thirty million *yuan* bond issuance, business owners received "military advice to subscribe, with intimations that arrests may follow failure to do so" (*New York Times* 19 May 1927). Song Hanzhang (宋漢章), the Shanghai Branch manager of Bank of China, was threatened with arrest for "obstruction of revolution" and "helping the enemy force" and forced to resign his position after initially rejected a demand by Jiang for the bank to lend one million *yuan* to fund government Treasury bonds (SMA 2012: t20120312-5694; Ji 2003:175-176). Similar threats and coercion continued to be employed by the Guomindang government to compel private banks or businesspersons to subscribe to government debt issuances. Describing the plight faced by the Chinese capitalists, Isaacs (1938: 209-210) notes, "The military authorities have ordered the reorganization of the Chinese Chamber of Commerce and other institutions with new directors... Outlawry against the better class of Chinese is rampant." Evidence of such expropriatory actions on the part of the government, including those undertaken against organisations, such as chambers of commerce, representing commercial interests, undercuts the revisionist arguments of Fewsmith (1982) or Ma (2012:15) that suggest a more cooperative and corporatist relationship between government actors and the commercial class. Likewise, the rise to power of the Guomindang in the wake of the Northern Expedition saw Party cadres in certain towns and cities use their access to levers of state coercive force to confiscate private property from wealthy individuals, typically under the justification that such wealthy individuals had accumulated their wealth through the "exploitation of the people". A 1928 *North China Daily*

News article describes the implementation of a "general campaign against the wealthy" that took place in Lianyungang, Jiangsu against ex-officials, wealthy merchants, and any others who had "turned to his own profit and amassed great wealth" (*NCDN* 19 April 1928: 4). Geisert (1984: 28) notes similar instances of Party leaders in Jiangsu who expropriated land from local elite landlords ("local bullies and evil gentry"), only to rent it back to landless farmers at market rates, thereby enriching themselves under the guise of fighting "exploitation" via land reform. Geisert (1986:682-684) does note, however, that such actions were often carried out by local Party members not necessarily acting under the command of central Party officials; in many cases, such actions towards merchants and landed elites eventually resulted in the removal of local party members and installation of new local officials more sympathetic to the interests of local gentry and merchant classes, a phenomenon Geisert describes as "de-revolutionising" the Guomindang at the local level, bringing about a reorientation of local party interests to become more aligned with local elites.

The examples of extreme violations of private property rights undertaken by state actors were a function of several important factors. To begin with, although instances of these types of takings behaviours are not without precedence in all states, the authoritarian governmental form, whether that be the Qing or that of the Republic, helped facilitate state actors' ability to expropriate private property. Autocratic governments, given that they are less directly accountable to an electorate of property holders, are more likely to engage in expropriatory behaviour, given the more complete control over the levels of coercive authority state leadership holds, as well as the less severe consequences that state actors face from private economic actors when they engage in such behaviour; unlike in open-access states, where effective credible commitment mechanisms such as an independent judiciary or open and fair elections can lead to the removal of state actors from office were they to violate the legal protections of property holders, leadership in authoritarian states are unconstrained by such mechanisms, with private actors possessing no formal mechanisms to check governmental power, other than internal revolt. Given coordination problems, however, this dispersed power is difficult to enact and only serves as a weak deterrent on state behaviour until coordination is enabled (such as with the Communist Party's mobilisation of primarily dissatisfied rural citizenry).

Second, as Weingast and his Violence Trap co-authors have shown, limited-access authoritarian states frequently are defined by high levels of political violence that signify serious existential threats to the regime in power. Certainly, that was indeed the case with the domestic governments of the late-imperial and republican period. Further, as we have shown via the "low credibility trap" argument, the extreme levels of political violence and the existence of existential threats to state survival characterising the late-imperial and republican era, resulting from a lack of monopoly on violence, implied that state actors were neither incentivised nor able to create credible checks on state power from violating private property rights. Further, faced with continual threats of loss of power by violent overthrow, long-term goals—such as improving institutional conditions to foster long-run economic growth, or the ability to obtain capital cheaply in the future—were subordinated in order to meet the immediate goal of holding on to power by decreasing the probability of violent overthrow in the short-term. Thus, state actors were willing to take extraordinary actions that involved taking as much resources as possible in the immediate term, including actions that violated private actors' property rights, such as confiscation of property from private actors. It is not surprising in such an environment, especially under authoritarian conditions where there exist few limits on state actors from exercising the full power of government authority to take whatever they wanted in the immediate, state actors utilised the tools of government authority to undertake such relatively extreme forms of takings.

7.3. State-sponsored Violence Against Private Agents

Beyond the litany of examples referenced above regarding state takings of private actors' properties, there also occurred numerous instances of the most egregious violation against private actors' property rights, that of takings of private actors' lives. Violence directed against the state's own citizens represents an attack on the most fundamental property that private agents possess, life itself. Defining the primary role of the state as to provide protection of life, liberty and property, there can no greater failing of a state that not only fails to provide citizens protection from other nonstate actors able to use force to deprive private citizens of their life, liberty or property, but also functions so as to permit government actors themselves continually able to undertake actions depriving the citizenry of that which the primary purpose of the state is to protect.

While there exist examples of state violence directed against citizens during the late-Qing (Wong 2009), especially towards those suspected of advocating an end to imperial rule, the lack of rule of law that came to dominate the republican era fostered ever greater violations of state power in this manner. State actors were generally unrestrained by rule of law. This was exacerbated by the fact that the authoritarian republican-era governments were characterised by military control of government, further diminishing the ability for civil society to exert control over the exercise of government power.

For instance, during the Beiyang period, broad powers under the so-called "Anti-Banditry Regulations" were initially promulgated by Yuan Shikai's government. According to the *Yi Shih Pao* newspaper (1931: 16), "These anti-Banditry regulations... degenerated into an instrument with which to deprive the people of their liberties. It was Yuan Shih-Kai who invented the Provisional Regulations for the Punishment of Bandits with a view to limiting the freedom of speech and the liberty of action of the Chinese intellectuals in the political sphere... It is true, unfortunately, that they provided a convenient pretext to the Northern militarists for doing away with political enemies, for violating the judicial system. How many innocent people were victimised during these two decades as a result of the abuse of those regulations we cannot know." Similar abuses were conducted by the Guomintang government, especially after enactment of the 1931 National Emergency Act allowing the government to arrest and execute private citizens without provision of civil trial, for a broad array of infractions that could be deemed to lead to "disturbing the public peace" (Article I); "inciting other to disturb the peace", or "carrying on seditious propaganda by writings, pictures, or word of mouth" (Article II); or even "organis[ing] associations or meetings, or propagates doctrines incompatible with the Three People's Principles" (Article VI). Nor were private citizens accused under this act afforded the right to civil trial, but rather subject to military courts: "the highest local military organ shall be responsible for the trial of persons charged with crimes enumerated in this law" (Article VII).

State-sponsored violence included violent suppression of labour unions and suspected members of the Communist Party through arrests and executions, including the 12 April 1927 Incident, when troops and gangsters suddenly attacked various headquarters of labour unions throughout Shanghai, killing hundreds of workers (*Time* 25 June 1928). Following the incident, Jiang carried out a full-scale purge of Communists from within the Guomintang Party, and suppressed several violent uprisings in a period known as the "White Terror." An estimated twelve thousand Communists were killed within a three-week period after the 12 April Incident (Rummel 1997: 125), initiating the formal start of a civil war by the Guomintang against the Communist Party.

The state leadership also often employed the coercive power of state violence to force desired economic behaviours from private actors, such as threatening imprisoning of those who refused to purchase government bonds or provide "donations" to the Party. Writing in

reference to the frequency of forced loans placed on Shanghai's business leaders, Issacs (1938: 209)'s contemporaneous observation is indicative of the way an intrusive state tried to control private business activity: "The plight of the Chinese merchant in Shanghai is pitiable. At the mercy of General Chiang Kai-Shek's dictatorship, the merchants do not know what the next day will bring—confiscations, compulsory loans, exile, or possible execution."

Indeed, perhaps the most odious examples of state-sponsored terror included instances of assassinations of private actors by state agents. Beyond the state's silent acquiescence to the violence perpetrated on private citizens by local favoured criminal organisations such as Shanghai's Green Gang, incidents of state-sponsored assassination of ordinary civilians who advocated the end of authoritarian military rule. A particularly noteworthy case of political assassination was the death of Shi Liangcai (史量才). Shi was the publisher of *Shun Pao*, Shanghai's most respected Chinese-language daily newspaper. In the 1930s, coverage of Guomindang policies turned fairly critical, especially regarding issues surrounding the persecution of human rights advocates. The political assassination of Yang Xinfo in 1933, who had served as Executive Director of the Preparatory Committee of the China League for Civil Rights, and had been an outspoken advocate of China's democratic movement and prominent critic of Guomindang policies, led to a series of articles highlighting the government's role in the assassination (Lean 2007; Jia 2010:4). According to Wakeman (1996: 257), it was *Shun Pao*'s coverage of the assassination of Yang and continuing public criticism of the Guomindang Party that led Jiang to personally order Shi to be assassinated. †

This episode underscores the persuasive lack of rule of law and a government structure inimical to protection of private property rights, the most fundamental property being life itself. Shi was one of Shanghai's wealthiest and most respected citizens; yet his life and liberty were taken, without consequence, at the whim of state leadership. Such examples of politically-sponsored unlawful assassination, carried out on private citizens by state actors employing the government police apparatus—the very institution supposedly responsible for upholding the rule of law and preventing assassination—underscores the fact that private property rights, and the rule of law, were severely compromised during the period.

As demonstrated, state actors continually utilised the levers of state power to inflict violence against private individuals—communist sympathisers, critics of the government, those attempting to resist government takings—via coercion, imprisonment, or assassination. Such actions further undermining the rule of law, served also to undermine the ability of the state to create commitment mechanisms that could appear credible to private actors, or to change private actor perceptions of the institutional environment surrounding the enforcement of private property rights. Quite conversely, it was easily observable that state actors were quite willing not only to break previous commitments to protect property rights, but also to act to violate the property of private actors, including even their very personal safety.

† Wakeman (1996:258) describes the assassination in graphic detail: "Chiang [Jiang Jieshi] commanded Dai Li [head of the Guomindang Army police] to assassinate Shi, who was then serving in one of the most prominent public positions in Shanghai as head of the Chinese Municipal Council. Dai Li originally planned to carry out the operation against Shi in Shanghai, but the editor lived in the International Settlement where police protection was difficult to circumvent... On November 13, 1934, Shi Liang-cai and his family wound up their holidays and prepared to return to their Shanghai residence by automobile. Shi's party—his wife Shen Qiushui, son Shi Yonggeng, niece Shen Lijuan, and son's classmate Deng Zuxun—took the Hu-Hang highway. When the car drew near Boai zhen, not far from the harbor of Wenjia in Haining county, they came across another automobile drawn across the highway. As Shi's chauffeur slowed down, the doors of the other car opened and the assassins jumped out with drawn guns. In the first hail of bullets the chauffeur and school-chum were shot down dead... Mrs. Shi was hit and fell wounded, as did her niece Shen Lijuan. Shi Yonggeng, the son, managed to run to safety. But Shi Liangcai was killed on the spot, and his body was dropped into a dry cistern."

7.4. Growth of the Leviathan—The State and Civil Society

One of the great debates in liberal thought has been in regard to the proper role of the state in relation to civil society. The state at its core is an organisation of individuals who are imbued with authority over others by way of the power they obtain via the coordination and collectivisation of their resources in comparison to the more dispersed, individualised power of uncoordinated private individuals. Under classical liberalism, the purpose of government is to secure liberty. Philosophical issues shape the definitions of liberty—Klein & Clark (2010:42) refer to "positive" and "negative" liberty that depend upon views of the configuration of ownership—and in the identification of the appropriate balance between protections on individual liberty, versus the justifiable suppression of that individual liberty for the betterment of a "collective good"; that is, sufficiently liberty-enhancing in the aggregate, whether in the immediate or the future, to justify the limiting of liberty in the immediate. From a theoretical standpoint, it is difficult to find consistent parameters as to when limits on individual freedoms are outweighed by collective concerns, and how to prevent a tyranny of the majority from transgressing upon the rights of the minority.

Philosophical concerns aside, in application, the problem is more sharply delineated given that state actors, imbued with the coercive power of the state apparatus, can find it easy to advance their own private interests by violating the individual freedoms of civil actors, often under the guise of doing so by equating the "collective good" with the maintenance of stable governance; i.e., a continuance of state actors remaining in power. Further, as the power of the state grows vis-a-vis individual private actors, state actors can find it of increasing advantage to use such power to extend state control over areas previously the purview of private concerns private matters into the public domain.

In general, China's authoritarian domestic state leadership, over the late-imperial and republican period, undertook actions to control an increasing range of aspects and behaviours that were previously solely the domain of private civil society. The impetus for such actions on the part of state actors was to secure the primacy of the Party, and hence the Party's—and state actors'—hold on political power. The desire for state actors seeking to implement policies designed to control increasingly greater facets of common citizens' daily lives can be best understood by the ways that such controls limited threats to state leadership's hold on power, given such controls sought to limit the ability of free expression of ideas counter to the permanence of Party rule, or the ability of free association for individuals to join together in organisations that advance their interests in ways that might threaten the power, benefits or permanence of rule of the Party leadership.

7.4.1. Growth of the Leviathan—Education System and Propaganda

The growth in the role of the state can be observed in the field of education. For nearly the entirety of the Qing era, education was not a government provision. Nonetheless, education was a service heavily demanded by the populace, and as such, private entrepreneurs met the need by operating small private schools. As Lee (1914: 215) describes the system at the time, "Schools in China are generally kept by private gentlemen. The Government provides for advanced scholars only. But... schools are to be found everywhere, in small hamlets as in large towns, although the Government appropriates no funds for the establishment of common schools; and although no such thing is known as 'compulsory education,' there is a general desire, even among the poorer classes, to give their children 'a little schooling.'" As part of larger reform efforts implemented to create more responsive government institutions, the Court took several nascent steps to create formal national education system, including the development of a national university system and national curriculum. The transition to a republican form of government brought about a more manifest shift amongst state policymakers to move from an elite-based to a mass-based education system. Providing public education, especially at an elementary school level, became viewed as the state's purview (Schulte 2013: 231).

While education was deemed important for producing a workforce able to lead the drive for economic growth, government leaders also viewed the education system as a tool for the promotion of nationalism and patriotism. Even before the institution of compulsory elementary school education under the Republic, Qing-era educational directives in the early part of the twentieth century had begun to utilise newly-established schools opened by local magistrates that were designed to engender loyalty and patriotism within the educated populace. For instance, as Harrison (2001: 92) relates, "One of the primary-school textbooks issued at the time, which closely reflects the government's ideas, has a lesson that reads, 'Two brothers sing a song together. First they sing of loyalty to the monarch. Then they sing of love of country.' The teacher's manual explains that the image of the brothers singing together is supposed to suggest the close relationship between loyalty and patriotism, which is the base of education for citizenship. The manual provides an explanation the teacher can give to the students for the words 'love', 'loyalty', 'country', and 'monarch': 'He who loves the country must be loyal to the monarch. He who is loyal to the monarch must love the country. When one knows the close links between the monarch and country, then loyalty to the monarch and love of country cannot be separated.'"

State control over the education process had all schools falling under direct control of the Ministry of Education (*China Year Book* 1916: 413). The emphasis of the education system as a vehicle for the development of a citizenry loyal to the state was particularly pronounced during the Guomindang period, where education was to serve as an extension of nationalist ideology (Chen 1976: 180). All aspects of the education system, including curriculum, were under Party authority (Peake 1932, Yeh 1990). Guomindang government officials instituted a set of educational reforms designed to ensure a "participation of education" (Chen 1976: 184). To accomplish this goal, the head of the Ministry of Education, Cai Yuan-Pei (蔡元培), a respected scholar, was soon replaced with Dai Ji-Tao (戴季陶), a party bureaucrat. Dai oversaw policies such as the creation of 'political education' departments on university campuses, with the Ministry using the threat of withholding accreditation to compel both public and private institutions complied with mandates on textbook selection, budgeting, and hiring and retention of faculty and administration. As under the Qing, the goal of such 'participation' of the education system, as well as other social institutions, was to ensure a nationalist ideology amongst the populace to foster a love for country (patriotism) and simultaneously equate the Party (monarch) and state (country) as one and the same.

7.4.2. Growth of the Leviathan—Censorship and Propaganda

The state also took on an active role in controlling information dissemination. Conceptually, censorship was not a new idea to state actors. Alford (1995:13) details early instances of the state seeking to control the publication of materials dating back to the Tang era, with imperial edicts prohibiting the publication and distribution of documents such as almanacs or calendars that might be used for prognostication, so as to control the potential use of such tools as a way to forecast events unfavourable to the Emperor, such as bad harvests, and Tangyuenyong (2017) shows examples of the early Qing imperial state banning books for political indoctrination reasons. However, with the increase in the publication of books and newspapers, government officials began to take on a more active role in terms control and oversight of the media. Such changes were exemplified by a level of formalisation of state control of information dissemination, such as the creation of a department of censorship starting under the late Qing. The repercussions for printing "seditious" material were severe, with observers during the period noting that "the native [Chinese] press... was at the mercy of the administrative and judicial discretion of various officials who did not fail to use their privileges to strangle any semblance of free thought and opposition... any free thought regarding the monarchical form of the government in China, any slightest criticism of its function, could be interpreted as *lese-majest* and the unfortunate editor or author, and even their relatives, were liable to the penalty of death" Kotenev (1927: 74).

Under the Qing, there was no formal legal code designed to protect or restrict the press, with censorship and punishments meted by the arbitrary decisions of local magistrates. It was only in 1906, after the implementation of a national education curriculum, that the Ministry of Education decreed that all educational textbooks were to be reviewed by Ministry officials prior to publication. This policy resulted in the banning in 1908 of the primary school textbook 初等女子小學國文 for its use of the phrase 平等 ("equality") (Wang 2007: viii). During the republican period, enacted laws regarding expression by the press were mostly decried for their draconian nature, beginning with the enactment of the 1914 "Provisional Regulations for the Punishment of Bandits". While ostensibly designed to combat the issue of banditry, these regulations were also used by the state to suppress freedom of expression. According to the newspaper *Yi Shih Pao* (1931: 16), "These anti-Banditry regulations... degenerated into an instrument with which to deprive the people of their liberties. It was Yuan Shih-Kai who invented the Regulations with a view to limiting the freedom of speech and liberty of action of the Chinese intellectuals in the political sphere"

Strict censorship and control over the press continued under the Guomindang, with even greater resources devoted to an expanded Department of Censorship. For instance, all books had to be reviewed by state bureaucrats prior to publication. Moreover, the pre-existing Censorship Law was replaced at the start of 1931 by an even stricter Publications Law that T'ang (1931: 5) for instance harshly criticises as allowing for nearly any seemingly negative printed comments regarding the Party to result in imprisonment of their author and publisher. The promulgation in February 1931 of the National Emergency Law soon followed. Together, these two laws were employed as tools by the state bureaucracy to suppress the publication of materials viewed as not providing the proper veneration towards the Party. Specifically, the National Emergency Law's six articles mandated those engaged in "disturbing the public peace, with Intent to subvert the Republic" would be "punished with death"; so too criminalised was "carrying on seditious propaganda by writings, pictures, or word of mouth", with punishments also directed towards the editors or publishers of such materials. The law included not only prohibitions on the printing and dissemination of "seditious" materials, but even those criticising the ideals of the Guomindang Party, with Article VI defining it illegal to "propagate doctrines incompatible with the Three People's Principles" (National Emergency Law 1931: Articles I-VI).

The law was criticised by observers at the time for its "Its vague wording, its administration by local military and administrative authorities instead of by the regular Courts of Law" (*Peoples Tribune* 1931: 11). Employing more bombastic rhetoric, T'ang (1931: 1) complains "the so-called Emergency Law...renders anyone who says or does something short of fulsome flattery or abject submission to those in authority, liable to capital punishment or life-imprisonment."

An editorial in *Yi Shih Pao* (1931: 16-19) found Article VI to be particularly problematic, arguing, "No political doctrine other than the Three People's Doctrine may thus be used as material for publication, translation or speech, on pain of imprisonment for five to fifteen years. Is this not ridiculous... And what do the gentlemen of the Central Party, who regard themselves as Orthodox, really consider 'compatible with the Three People's Principles'? The absence of any clear definition, if such were possible, inevitably leads to the creation of abuses, and in view of the large discretionary powers of local administrative officials, a free press must remain an illusion and a dream. As any writing of a political or sociological nature may be declared 'incompatible with the Three People's Principles,' it is now of course out of the question to oppose the policy of the Government, but even sympathetic criticism will soon become impossible as being liable to be misunderstood or misinterpreted."

It is noteworthy that the *Yi Shih Pao* editors appear quite content to accept a good degree of censorship over the press, stating that "In the so-called period of tutelage it may be justifiable to suppress theories as affecting the question of party monopoly... [and that] It may be granted that those who are opposed to the Three People's Principles must be suppressed, but those who are merely discontented with the Government should be treated differently", underscoring that even those not committed to absolute freedom of the press objected to the limits on free expression imposed by the Emergency Law, and the arbitrary nature of the application of such limits.

While the majority of censorship activities were directed towards domestic publishers of Chinese language materials, the foreign press was also targeted by government censorship efforts under the Guomindang. The *North-China Daily News* repeatedly drew responses by the state actors in the Department of Censorship and related organs, such as when the Standing Committee of the Central Executive Committee of the Guomindang Party (the highest body in China's national government), enacted a resolution effective 18 April 1929 suspending mail services for the *Daily News*. While the paper itself was published inside the International Settlement, and hence technically out of the jurisdiction of the domestic government's ability to suspend its publication, the Committee issued orders for the Chinese Post Office to refuse transmission via the mail service of the *Daily News*, and for the Chinese Maritime Customs to detain copies of the newspaper. The second component of the same resolution ordered the deportation from China of Mr. George Sokolsky, an American citizen who served as an editor of the *Daily News*. The rationale for the resolution, as given by Mr. Yeh Chu-tang, chief of the Publicity Division of the Guomindang Central Headquarters, was that the *Daily News* "had made ridiculous statement [*sic*] in its columns, creating baseless sensation... [that was] detrimental to the interests of the Chinese nation and causing unwarranted consternation among foreigners and Chinese."

An article posted by Reuters news service on 20 April 1929 notes that the *North-China Daily News* had been singled out by members of the Guomindang Third National Congress for having "repeatedly and maliciously attacked the national government and the Kuomintang." The proposal stated that, "While the Government is keeping a strict censorship over Chinese publications, it has paid comparatively little attention to the foreign press. A number of the foreign newspapers and magazines in China are maliciously attacking our Government and the Party. ...Severe disciplinary action should be taken against such reactionary publications to uphold the prestige of the Central Government and the Party." Another one of Shanghai's daily newspapers, *Sin Wan Pao*, quotes in its 23 April 1929 issue China's Commissioner of Foreign Affairs, King Wun-sz, as justifying the resolution since the *Daily News* "often published false statements and unfavourable criticism, evidently with the aim of undermining confidence and respect of the general public in the national Government." The story by Reuters noted that the discord leading to the suspension of mail service for the *Daily News* was long-seated, with the official statement claiming that the paper was a source of "constant fault-finding and criticism of conditions under the National government", citing, for instance that "Prior to the occupation of Shanghai and the Yangtsze Valley by the Nationalist forces, the *North-China Daily News* constantly published reports and editorials alleging the impregnability of the Northern militarists previously in control of this area."

The use of state bureaucratic tools such as censorship, legal regulations on the media, and the education system to indoctrinate the population was symptomatic of the authoritarian nature of the late imperial and republican domestic state. By the time the Guomindang Party came to power, however, an even greater degree of bureaucratic resources were invested in attempts to control civil society, with not just a Department of Censorship, but also a dedicated Department of Propaganda created for the expressed purpose of controlling and directing public sentiment in support of the Party.

7.4.3. Growth of the Leviathan—Mass Control and Propaganda: The New Life Movement

A significant representative example of the scale of state-sponsored propaganda is reflected by the New Life Movement. Inaugurated in February 1934 in Jianxi, this movement did not begin organically, but rather was a top-down, Party-driven state-sponsored mass mobilisation effort explicitly designed to indoctrinate the public and modify behaviour in support of Party objectives. A considerable amount of state resources went into the promotion of this movement, its importance highlighted by the fact that Jiang appointed himself the formal leader of the National Association for the New Life Movement. Local counties were ordered to create their own branches, and by the start of 1937, branches existed in 1355 counties across 24 provinces (Lin 1995).

The power of the state was directed towards enforcing promotion of the New Life Movement. Business organisations, such as industrial groups, unions, and professional and business associations, as well as private civil organisations, such as religious groups including the YMCA and the National Christian Council of China, were compelled by state officials with regulatory and funding authority over these organisations, to institute "study groups" and hold rallies promoting the Movement's ideals (Wen & Li 2006, Felanti 2010: 972-977). Likewise, state education officials were involved in incorporating the Movement's indoctrination techniques throughout the national education system (Averill 1981), including those directed specifically towards university students (Huang 1996: 78).

Ostensibly, the New Life Movement was a reactionary social movement, designated by Jiang as a way to resurrect traditional Chinese morality, thereby restoring China to its former glory that had existed prior to the imposition of foreign imperialism. The operationalisation of this restoration was to occur via the modification of behaviour amongst common citizenry in regard to manners and hygiene, becoming more that of a gentleman." An early introduction to the movement presented in the *North China Herald* describes the movement prescribing "the fundamental way of bringing about the nation's recovery lies in the improvement of the daily life of the people. In the matter of clothing, food, and housing, the people must cultivate the habit of the order, cleanliness, simplicity and frugality. Furthermore, the people must respect the qualities of a gentleman, as they were taught many centuries ago by Confucius, which include: 'Li, Yi, Lien, Chih.' These four characters stand for:" Good manners, chivalry, honesty and consciousness" (NCH 21 March 1934:)

In reality, the essence of the New Life Movement was to foster support of authoritarianism amongst the population. The conception of the relationship between private individuals and the government was to be one of subservience, with documents published in 1936 in the Outline of the New Life Movement highlighting the dependent nature of civil society to the state: "People depend upon the government... for a satisfactory life" (quoted in Li 1986: 29). More explicitly, the alumni association of the Whampoa Military Academy published in its weekly journal the Moral Endeavour in 1934 an article starting that "if the government used political power to improve the material condition of people's lives, then it was entitled to discipline the people using coercive power to ensure they fit into these new living conditions" (quoted in Liu 2013: 44). In the same publication, Gong (1934: 3) openly states that individual rights are to be subordinate to those of the state, declaring, "We should give up individual freedom to pursue the freedom of the nation."

The Movement fit in well with the larger drive by state leadership to impose ever-greater control over and "correct" individual private behaviour. As Wakeman (1997: 431) describes, much of the Movement's focus included restrictions on smoking, dancing, and the wearing of western clothing. Also included was an anti-opium smoking initiative (Li 1987: 30), one that must be considered ironic given the well-known linkages between the Guomindang

regime leadership and the opium smuggling monopoly previously described. The 1935 annual report of the New Life Movement Association listed detailed procedures that businesses and public organisations were to follow, including the "proper behaviour" for workers, servants, hotels and restaurants staff, the use of toilet facilities, and social group participation (NLMA 1935: 272). Many of these directives were centred on concepts of orderliness, or what Felanti (2010: 981) labels as 'hygienic modernity': "The NLM [New Life Movement] was launched within administrative organs, public places, shops, public toilets, factories, guild halls, and labour unions and promoted the improvement of the city appearance (city building facades as well as dykes were to be cleaned up and advertisement displays tightly regulated) and changes in etiquette and customs (for wedding, funerals and the like)."

Such guidelines reflected a degree of fastidiousness in the desire for order and specificity in behaviour over a broad array of private activities. Even activity within the organisation was highly regimented. For instance, Felanti (2010:988) relates that "meetings of the students, even for small groups (e.g. five to ten), were tightly regulated. The students had to stand up and sing the party's anthem and then read Sun Yat-sen's will. Afterwards they had to discuss and criticise their work of the past week and plan activities for the following week. They adjourned the meeting by singing the corps' anthem. If the meeting involved the whole student body, the corps would both sing the party anthem and bow three times in the direction of the party and national flag and Sun Yat-sen's portrait."

While couched in the terminology of a movement based on popular participation, the New Life Movement was clearly driven from above; Dirlik (1975: 947) finds that "Its basic intention was to substitute 'political mobilization' for social mobilization, thus replacing revolutionary change from the bottom (which threatened the social structure) with closely supervised change orchestrated from the top." Taylor (1936:404) notes New Life and similar state-sponsored mass-mobilisation movements under the Guomindang "had their origins in military circles, [and] a strong authoritarian conception of the State lies behind the movements." The focus on authoritarian values was not by accident, with Wen (2003) finding the New Life's goals to be regime legitimisation, based on fascist-styled methods of indoctrination and propaganda. Wakeman (1997) identifies the explicit use of a fascist blueprint for the construction of the Movement, and Eastman (1972) notes much of the movement's organisation and recruitment strategies purposely emulated similar movements created contemporaneously in Nazi Germany and Imperial Japan, especially in regard to the use of secret societies. Regarding recruitment, Wang (1998:57-58) and Felanti (2010: 987) both note the emphasis on adopting the fascist strategy used in Germany of recruiting younger generation members, as they were viewed most impressionable and more easily subject to indoctrination, reflected in the Movement's the activities designed to enrol elementary schoolchildren. Huang (1993) finds a similar dynamic operating behind the formation of the Three People's Principles Youth Corp (三民主义青年团) in 1938.

The New Life Movement represented just one of several efforts by the Guomindang designed to promote Soviet-style 'controlled mobilisation' to foster patriotism and party loyalty through 'training sessions' (Edmonds 1997: 257). Such efforts dovetailed with the "Partyfication" strategies undertaken through the enforcement of propaganda tools to support the Guomindang party in the education system and through its censorship policies (Kirby 1997, Strauss 1997). These efforts included large political rallies and mass mobilisation events were directed and controlled by state authorities, designed, "from the top down: part of a larger plan, drawn from Sun Yat-sen's testament for national reconstruction... These symbolic events, however, were ultimately corporatist occasions, arranged and led by party and police agents" (Wakeman 1995b: 20).

An extreme use of state authority was employed to enforce this control over private space. As Wakeman (1995a: 165) describes, Guomindang police actively engaged not only in law enforcement, but also "order maintenance"—a purposely broad concept comprising nearly all aspects of social life, further diminishing the division between private and public life. "The police... sought to regulate every aspect of popular culture, from movies and funeral arrangements to astrologers, fortune tellers, and even neighborhood gossips" (92). With greater authoritarian control backed by the coercive power of the state, the autonomy of private economic agents was continually limited as behaviours traditionally under the purview of private civil society were placed under state control. This continued the trend begun in the late Qing, of a limited, distant state becoming a more powerful, authoritarian and pervasive presence overseeing the daily activities of ordinary citizens, elevating the primacy of the public state-dominated realm at the expense of that of the private individual.

7.4.4. Growth of the Leviathan—Increasing Employment of Nationalist Propaganda

Not surprisingly, similar to other fascist and authoritarian movements, the tone of the New Life and other Party-sponsored mass mobilisation and propaganda movements was openly nativist and nationalist. For instance, Jiang Jieshi delivered a well-publicised speech in September 1933 stressing that China's citizens needed a "national self-confidence (*zixin*) [that] necessarily believes that his own nation is 'best of all' (*zui youxiu*), with the most glorious history and superior culture of any country" (Wakeman 1997: 424). Such nationalist rhetoric was also evident in state actions noted previously in Section 3.2 in cases such as the Salt Inspectorate or Postal Service, whereby domestic political leaders sought to depict joint foreign leadership of these organisations as symbolic of foreign exploitation of Chinese citizens so as to take control of these organisations so as to use them for their own benefit, ironically thereby effectively exploiting domestic private nonstate actors all the more. Indeed, stoking nationalist nativist flames amongst the populace is often viewed as a useful distractionary technique by authoritarian leaders.

This dynamic was similarly observed when the Ministry of Finance in the mid-1930s sought to monopolise the power of currency issuance, so as to obtain control over the money supply and allow for greater levels of government spending via a currency debasement strategy at the expense of domestic private savers. Notably, domestic state leaders once again turned to the strategy of employing ideological calls to nationalism for an end to the "exploitative" practise of foreign banks from issuing currency. Thus, a blatant attempt by state actors to prevent domestic private economic agents the ability to exercise choice amongst currency issuers outside of government control was presented as a patriotic matter—only state-sanctioned entities under the direction of state actors should have the right to issue currency in China. Such nationalistic arguments were directed throughout society, to be found even in officially-sanctioned Guomindang Ministry of Education publications—as claimed in a beginning-level reading textbook, the reason that only the domestic state should be able to issue currency was to end the exploitation of the Chinese people: "Foreign banks are an additional form of economic oppression. They print banknotes in order to take our supply of hard currency and goods in return for worthless paper. They also cheat us with their exchange commissions. Yet those of us who have money still deposit it in foreign banks, totalling hundreds of millions of yuan. Even if foreign banks do lend money to our modest businessmen, they charge high interest rates, and so every year they make profits of a hundred million dollars off of us Chinese" (三民主義千字課 1928: 34). (It might be noted that the use of the terminology "worthless paper" reads ironic given the fall in value of the Guomindang government's paper currency that occurred in the 1940s after state actors had monopolised the power to issue currency, and subsequently used such power to exploit private domestic economic actors via seigniorage.)

Whether developed organically or through effective use of persuasive state propaganda, many Chinese exhibited a sense of patriotism that found foreign intrusions on Chinese sovereignty an affront "dishonouring the dignity of the nation." Thus, for instance, Su & Barber (1936:115), writing in the economic trade journal *Far Eastern Review*, refer to the Guomindang government's securing of the ability to increase tariff rates "a point of national honor", as opposed to consideration of the economic hardships imposed on ordinary Chinese private citizens as they were forced to pay higher prices on imported goods. Similarly, calls to end foreign presence or for an end to extraterritoriality came from throughout society. The popular press, politicians, and legal scholars all made effective and passionate cases for why it should be abolished. T'ang (1931: 5) is exemplary of this sentiment when stating, "Extraterritoriality... is at present of little practical value to the foreigner, but being derogatory to Chinese national dignity, its total abolition is imperative."

Yet, ironically, T'ang's view is also exemplary in the sense that such a call for the abolition of extraterritoriality comes in an essay regarding the blatant and arbitrary unjustness facing society owing to the enactment by the Guomindang Party of the Publications Law and the National Emergency Act, both of which granted the government police apparatus the right to imprison or mandate capital punishment for anyone deemed to have acting the Party, with trial and judgement to be determined in military not civilian court; further, he complains of continued behaviour by "corrupt and greedy officials" who frequently levy illegal taxes yet escape punishment because of a weak and ineffective legal system. While the sentiments expressed by T'ang calling for the end of extraterritoriality were not unique, they nonetheless appear to lack a consistency of logical reasoning—demanding as they are for an end to a legal system that while not ideal, was absent the type of arbitrariness and lack of protections afforded the civil population due to a basic lack of rule of law—simply on the grounds of perceived affronts to "national dignity". Likewise, it seems somewhat further ironic that T'ang published his critique of the Guomindang laws and legal system in a domestically-owned publication that was distributed by a company, The French Bookstore, operating out of Tienjin's foreign concession area, where it was protected by the extraterritorial legal system from the very censorship laws he attacks in his publication.

Yet, perhaps the expression of patriotic and nationalistic sentiments throughout Chinese society at the time—or perhaps within any society at any time—should not be unexpected. The lessons described above in Qing elementary school textbooks, and the teachings of the New Life Movement, and in speeches given by the country's supreme leader Jiang, reflect the kind of language often promulgated via state instruments in nearly all governments. Such language is often designed to distract the populace with populist claims of economically liberal policies as representing "humiliations" imposed by "outsiders", while domestic state actors seek to enact ever-greater control over ever-more aspects of economic and civil society. Tolstoy (1893:5) refers to such strategies of "hypnotising the people" as the employment of state resources designed to spread "the savage superstition of patriotism, and the same pretended obedience to the governing authorities. The patriotic superstition is encouraged by the creation—with money taken from the people—of national fetes, spectacles, monuments, and festivals to dispose people to attach importance to their own nation, and to the aggrandisement of the state and its rulers, and to feel antagonism and even hatred towards other nations."

Part III. **Shanghai's Parallel Institutional Environments**

The chapters in Part II provided an in-depth description of the nature of China's overall domestic institutional environment; in Part III, we turn our attention to consider more specifically the particular institutional environments found within Shanghai itself, attempting to undertake an analogous analysis of the city's parallel dualistic institutional environment. Late-imperial and early republican Shanghai presents a unique opportunity to consider the impacts of institutional differences on economic outcomes, given that this singular city comprised both a domestically-controlled municipality, and extraterritorial settlements, each of which were defined by differing institutional environments, nonetheless housed a similar set of economic agents, and were influenced by the same economic forces within the same geographic physical space and same temporal time frame. Thus, differences between the two sections of the city primarily were of a political, legal and social institutional nature.

In Chapter Eight, we present an overview of the domestic institutional environment as it existed within the domestically-controlled sections of Shanghai. Relatively abbreviated in length, this chapter focusses fairly specifically on those unique aspects of the institutional environment and historical events that differed from the broader Chinese environment. However, given the authoritarian, hierarchical and unitary nature of the domestic political system, limited control was provided to local governance mechanisms. As such, the institutional environment in Shanghai was predominantly defined by the broader domestic institutional environment described in detail in Part II. From a methodological standpoint, this fact proves advantageous in regard to our study; as shall be discussed in Part IV, the similarity between the overall national domestic institutional environment and the more specific domestic municipal institutional environment allows us to use a comparative analysis between institutional environments of domestic Shanghai and extraterritorial Shanghai to make broader claims about the broader domestic environment.

In that regard, the focus of Chapter Nine is to provide a detailed qualitative consideration of the extraterritorial institutional environment. As noted in the text, although Shanghai extraterritorial settlements came to comprise two separate partitions, of the International Settlement and the French Concession, our focus is primarily upon the International Settlement, mostly taken for parsimonious reasons.

Similar to that described for Shanghai's domestic institutional environment, the nature of Shanghai's extraterritorial institutional environment, far from being uniform or time invariant, was defined by multidimensional complexity, and experienced considerable variation throughout the lifespan of the system of extraterritoriality.

Chapter Eight.

Perceptions of Institutional Quality in Shanghai's Domestic Municipality

Following a brief introductory Section 8.1, Section 8.2 presents the domestic political state structure apparatus that defined the domestically-controlled Shanghai municipality. Section 8.3 considers a few specific features of municipal bureaucratic capacity that allowed state actors to plan and implement economic and social policies, in large part deterministically proscribed by central government directives and control structures. Section 8.4 describes the ability of the domestic municipality, protected as it was by central government military apparatuses, to enforce a monopoly on violence within its sovereign territory. Section 8.5 briefly summarises.

8.1. Historical Background

As described in Chapter One, no mere "sleepy fishing village", Shanghai was a relatively thriving trading port well before the Treaty of Nanjing led to the arrival of foreign merchants in significant numbers and the city's designation as a Treaty Port. Even prior to the arrival of foreign merchants, Shanghai was already a city of immigrants. The allure of economic growth brought about considerable internal migration as domestic merchants flocked to the city from areas throughout China, helping drive the city's growth. As a result, the population was relatively diverse in terms of ethnic and regional background of its residents. Du (1983:7-8) finds over twenty-six native-place and associated merchant guild associations to have existed in the city already by the start of the nineteenth century.

The subsequent opening of Shanghai as a treaty port brought to Shanghai not only scores of foreign merchants—and the attendant warships of foreign powers docked along the Huangpu River to guard the interests of these merchants—but also foreign legal and political institutions that was able to operate within the construct of extraterritoriality. Simultaneously, however, within the domestically-controlled areas of Shanghai, the same form and administration of the domestic Chinese legal and political institutional system existed for the most part as found throughout the rest of China.

8.2. State Structure of Shanghai's Domestic Municipality

Overall, as indicated, the institutional framework as operating within domestically-controlled Shanghai was simply reflective of the broader domestic institutional environment. This included in the areas of administration of justice through either magisterial or "modern" court and judicial systems, which underwent changes that were instituted at the national level. Nonetheless, given the difference in state administrative level of municipal versus national, there existed obvious specific political state structural differences between the domestic municipal and national government state structures, with Shanghai's domestic municipal structure experiencing evolutions concomitant with those occurring at the national level of government. Administratively, Shanghai historically had been considered part of Jiangsu province, with responsibility for its municipal administration therefore falling under the purview of the provincial leadership. While this remained mostly true during the late-imperial period, the ensuing political instability of the republican era, combined with Shanghai's ever-increasing population and economic output, led political forces in neighbouring provinces to seek control over the city via annexation, or for others to push for greater autonomy for the city.

8.2.1. Domestic Municipal State Structures under the Qing

Throughout the entirety of the late-Qing era, Shanghai administratively remained part of Jiangsu province. Shanghai was designated as a *xian* (上海縣), a county reporting to the Songjiang fu (松江府) prefecture, which operated under the Susong Tai Dao (蘇松太道) circuit level, which in turn reported to the Jiangsu provincial government. Appointed by the emperor, the local magistrate functioned as the municipal executive head, responsible for the maintenance of peace and order, collection of tax revenue, and also serving as the local highest judicial and prosecutorial authority (Wang 1890). As an important city, the circuit-level office of the *dao* was located in Shanghai, and thus effectively the *daotai* acted in direct control of the local magistrate. Given the physical presence of the circuit office stationed within the city, the officeholder was often referred to as the "Shanghai *daotai*" (Leung 1991).

During the Qing period, the official domestic Shanghai city initially consisted solely of the old walled city, referred to as Nanshi. As the attraction of economic opportunity brought about significant population growth, so too did the informal settlements and neighbourhoods surrounding the walled city grow in scale. Soon these became more formally-recognised sections of the domestic city, including Hu-nan, or Nan-tao, formed to the south of the walled city, and Hu-pei, or Cha-pei [Zhabei], located to the north of the International Settlement. At this time, however, these separate areas cannot aptly be described as districts in the modern sense, as each section was separately administered by minor officials while a single Qing Court-appointed magistrate and his staff of officials comprised the official leadership over the proper walled city within Nan-shi.

Near the end of the Qing period, pressure from business groups in some of these neighbourhoods began to push for greater control over local spending and financing decisions. Combined with official acceptance of such efforts as a result of the reform-minded Self-Governance Movement (地方自治運動), organic efforts for privately-funded public works appeared, with nascent elected municipal governance councils created to manage the administration of local laws and regulations. Nevertheless, the Shanghai magistrate exercised ultimate authority given he possessed the power to accept or nullify any decision made by such councils (Tung 1964, Elvin 1996).

8.2.2. Domestic Municipal State Structures under the Beiyang

The initial Wuchang Uprising occurring in October 1911 that led to the Xinhai Revolution spawned numerous other major uprisings in cities across China, including also in Shanghai. Taking place in November 1911, the Shanghai Uprising comprised several small groups who took up arms, led primarily by Chen Qimei and the Guangfu Association, and members of the Tongmenghui Party. Establishing the Shanghai Revolutionary Army on 8 November, the rebellion first captured the Jiangnan Arsenal, and then overthrew the Shanghai Daotai and other Qing city officials, declaring Shanghai city independent from Qing authority (Fu 2016). One week later, sixty civic leaders comprised of members of the city's business association (商務總會) and representatives of the Shanghai Self-Governance Council (上海城自治公所) declared the founding of the Shanghai Military Government (滬軍都督府). Simultaneously, other areas of the municipal region, including the Baoshan and Qingpu neighbourhoods, as well as surrounding counties including Chongming and Songjiang, soon also declared autonomous independence from Qing rule. In Baoshan, for instance, local civic leaders pushed the wealthy landowner Qian Gan (錢淦) to serve as the effective leader of a Baoshan municipality (寶山縣民政). While Wang (2007) notes the relative indifference the majority of the city's populace took to the political happenings in the wake of the Uprising and overthrow of its Qing leadership, the events leading to the formation of the new government were not entirely bloodless, with violence marking the overtaking of the Jiangnan Arsenal, along with reports of civilian casualties and destroyed private homes (Schroder 1912).

With the ascension of Yuan Shikai to the presidency of the new republic, Yuan's allies in Jiangsu sought to reconstitute Shanghai back under the authority of the province. This was driven primarily by Shanghai's fiscal importance to the province—as the local trading centre, revenue from goods and transit taxes, especially on opium shipments, represented lucrative sources of income provincial leaders wished to reclaim (Feng 2004:56). Seeking to solidify support amongst his allies by providing them access to the desirable financial benefits control of Shanghai represented, Yuan sanctioned the actions of General Cheng Dequan, the military governor of Jiangsu, to enforce the removal of the Shanghai Military Government (Henriot 2010). The Shanghai Military Governor's Office was abolished 31 July, and reconstituted as the Office of Jiangsu Municipal Supervision (江蘇都督行轅) (STCC 2005). General Chen Qimei, assuming the post of Military Governor of the Shanghai region in the same year, created the Office of Municipal Affairs (市政特別辦公室) to administer Shanghai.

As one of the first attempts at centralising control over the entirety of the domestic Shanghai municipal areas, Chen's efforts via the Special Office of Municipal Affairs yielded relatively minimal administrative and bureaucratic changes, with Woodhead (1933: 661) suggesting progress in this regard over much of the Beiyang period to have been "practically nil". Such subjective critical depictions aside, there were a series of steps taken by Beiyang-appointed administrators to modify much of the city's municipal bureaucracy. With the end of the Qing bringing with it an end to the old magistrate adjudication system, new legal frameworks in the form of formal courts with judges trained in the law were installed to replace the traditional magistrate-administered system. However, aspects of the old magistrate system remained. While in Shanghai the formal offices of the Songjiang fu prefecture and Shanghai Daotai were formally abolished on 1 January 1912, twelve months later in January 1913 the Beiyang government issued a proclamation (劃一現行各省地方行政官廳組織令) reinstating the position of the Daotai, albeit under the new officeholder title of County Administrator (察使).

In January 1914, Yang Sheng (楊晟) was appointed as the first Shanghai Administrator (上海觀察使). More administrative changes in municipal structure followed, however. In May of 1914, by decree of the central Beiyang government, the Shanghai Administrator position was reorganised back to the dao (道) level, with the creation of the Shanghai County Level Office (滬海道署), under which twelve towns were designated, including Shanghai city. Yang sheng was retained as County leader. The following month, a further reorganisation took place as the County Office became the Office of Public Administration (道尹公署) (STCC 2005).

In May 1924, efforts to create an autonomously-governed Shanghai County were partially realised with a promulgation by Beiyang authorities designating the County as a special urban district under the direct administration of the central government. As Fei (1991) and Feng (2000) explore, these efforts were primarily driven by local private merchant groups concerned that the threat of war between Jiangsu and Zhejiang in the early 1920s presented risk of disruption to economic activity and destruction to private assets. Contemporaneous reports in *Shun Pao* (18, 19 April 1922) describe extensive efforts by local Chambers of Commerce to procure assurances from provincial military leaders to avoid warfare; such efforts were successful in obtaining a signed peace treaty between the military leaders of Jiangsu and Zhenjiang. As Feng (2004: 58) notes, however, the failure of the peace treaty to prevent a war for control Shanghai between Jiangsu and Zhejiang led to the development of a more serious self-determination movement by civic and business leaders. Although success was achieved in so far as in June 1924 Sun Baoqi was appointed the first superintendent of the new Self-Government of Shanghai Special City, success was fleeting, as this government was shortly abolished in 1925 by the actions of Marshal Qi Xieyuan, the military-governor of Jiangsu province, who desired control over Shanghai's fiscal resources for the purposes of funding his provincial warlord armies. Yet by late January 1925, Qi had fled to Japan after losing control over Shanghai to Zhang Zongchang's Fengxi army, who then subsequently lost control of the city to Sun Chuanfang's army by autumn of the same year.

Throughout these myriad administrative changes, the uncoordinated nature of municipal structure remained. The domestic city's various neighbourhoods, which included Nanshi and Nantao to the south, and Zhabei, Baoshan and Wusong to the north, had grown in an unplanned and organic fashion, and administratively the domestic city continued to operate with little overarching coordination in planning or management across the various sections. However, Sun Chuanfang's rule brought with it an attempt to institute centralised municipal control, with a unified position of Directorate-General of the Port of Shanghai and Wusong created in June 1926. Although this bureaucratic office lasted only nine months before Sun's ouster from power by the incoming Guomindang army, the office of the Directorate-General served as a precursor to the formal role of mayor (Woodhead 1933: 661).

Interestingly, it was during the weakened central authority periods of the end of the Qing and the Beiyang that domestic Shanghai experienced some of its most dynamic localised governance structures. The decentralised domestic administrative structure led to organic experimentation with local-driven funding and business-municipal relations. For instance, as to be explored further in Chapter Eleven, local business groups in several domestic neighbourhoods formed spontaneously, and initiated the incorporation of either privately-funded or public-private enterprises responsible for public works projects that the business community felt useful, such as road construction; in Nan-shi, for instance, an extension of the foreign Bund was financed by the issuance of bonds by a public-private joint public works enterprise, while a similar road-building project was undertaken by a purely private venture initiated by a business association in Zhabei. Structures that were successful were in turn copied and modified by business associations in some of the domestic city's other neighbourhoods, such as Nan-tou. Thus, this period was partly exemplified on the local level by municipal public administration moderately characterised by the type of polycentricism identified in general form by Polanyi (1951) and applied more specifically to municipal governance in Ostrom *et al.* (1961), with examples of multiple independent decision-making centres overcoming problems of funding, or whether and where to build public works, taking place locally rather than within a single, centralised administrative body.

8.2.3. Domestic Municipal State Structures under the Guomindang

The end of Beiyang control over domestic Shanghai formally arrived in March 1927, when Guomindang Northern Expedition troops entered the city. Their arrival led to the defeat and subsequent flight of troops loyal to Sun Chuanfang, leading also to an immediate dissolution of the Port of Shanghai and Wusong Directorate municipal structure. In its place, local workers militia forces and allied Communist Party members attempted to institute a new municipal government, but relative disorganisation and lack of elite support meant it was relatively weak, falling after the so-called April 12 Massacre ordered by Jiang Jieshi that led to the death and arrest of hundreds of Communist Party members and sympathisers (Henriot 2010: 299). By 7 July, a new formal municipal administrative structure of domestic Shanghai had been instituted. This reorganised single administrative unit was referred to as the City Government of Greater Shanghai (Borg 1939: 192). The new administrative structure was explicitly monocentrist in nature—the areas of Nantao and Nanshi were aggregated into the Nantao district, and Zhabei, Baoshan and Wusong were amalgamated into the Zhabei district, all under the centralised control of a single administrative structure. Given the importance of the Shanghai, by proclamation of the Organic Law of 14 July 1927, the city government was classified as a Special Municipality, and elevated to the level of *sheng*, or province, reporting directly to the central Nanjing government. The municipal administration operated under control of a mayor, who was appointed directly by the central government. Underscoring the nature of military influence and control over civilian affairs, the first four of the five men who served as mayor of the domestic municipality after 1927 before its fall in 1937 were Guomindang Army generals.

General Huang Fu (黃郛) was appointed mayor in early 1927; Wakeman (1995: 44) notes Jiang Jieshi personally attended Huang's mayoral inauguration service and proclaimed that, "The Shanghai Special Municipality cannot be compared to an ordinary city", emphasising the importance of Shanghai to the success of the new government. Poor health saw Huang shortly succeeded less than six months later by General Zhang Dingfan (张定璠) in August 1927. Zhang ruled until March of 1929, when he was replaced in April by Zhang Qun (張羣), the Vice-Minister of Military Affairs and Director of the Jiangnan Arsenal. Zhang resigned from office in light of his inability to control mounting student demonstrations coming in response to the Shenyang Incident in September 1931. General Wu Tiecheng (吳鐵城) was simultaneously appointed mayor and Wusong Garrison Commander in January 1932, immediately prior to the outbreak of war with the Japanese military, remaining in power through April 1937, at which time he was appointed to chairman of Guangdong Province (Tan 2016: 68). Wu was succeeded by Yu Hongjun (俞鴻鈞) later in April 1937, but only remained in office for less than a year before the Japanese military invasion in August of that year led to the overthrow from power of the Guomindang Nanjing government, including effectively ending its control over non-extraterritorial Shanghai by November.

Municipal governance throughout the period remained authoritarian in nature over the course of the Guomindang regime. However, a limited degree of representative rule was attempted with the creation of a directly-elected municipal assembly. As designated under the Provisional Constitution such municipal councils were to be responsible for deliberating on municipal matters, including budgeting, and rules and regulations. In practice, however, these assemblies remained provisional in nature. More important, assembly membership was constituted via appointment by the mayor for limited terms (Tung 1964: 147-148). As such, these assemblies, including the one operating in Shanghai, failed to function in the role of an accountable representative legislative or oversight body on executive power. Further, in keeping with the fundamentally non-representative nature of the government structure that characterised domestic municipal administration under the Guomindang, not only was the city mayor directly appointed by the central government in Nanjing, but so was the city's chief secretary, who operated directly under the mayor, and each of the heads every administrative municipal department (Crow 1933: 143).

Overall, the most salient factor in regard to municipal state structure as it applied specifically to Shanghai is that for entirety of the time frame covering the late-Qing through early-republican era, all principal domestic municipal government officials were appointed by the ruling central government. Government authority remained centralised—while municipalities were administered locally by local officials, such officials were appointed by, and received their authority from, the central government. Indeed, even the concept of a "national" or "central" government was somewhat redundant, in that all governmental structures were centrally controlled. Thus, whether embodied by the Shanghai Daotai, who was appointed by the Qing imperial court as the local representative of the central government; or the military municipal administrators of the Nantao and Zhabei sections of Shanghai, respectively, appointed by the Beijing-based Beiyang government; or the Mayor and associated heads of administrative departments of the Municipality of Greater Shanghai as appointed by the Guomindang government in Nanjing—all local municipal officials were direct representatives of the central state. As such, it is more apt to characterise their primary constituencies as located in the ruling central government's capital, rather than residing or conducting business within the domestic sections of Shanghai.

Further, and in line with incentive structure frameworks outlined by Ostrom & Ostrom (1971) and Ostrom (1972), rent-seeking activity (Li 2018) and administrative corruption, especially within the police (Martin 1991), increased with the installation of a more explicitly monocentric municipal governance structure, as the quasi-market structures of

competition between multiple decision centres across the domestic municipality that had been developed under the organic polycentricity of the end of the Qing and Beiyang era essentially disappeared. The explicitly hierarchical organisation of the Guomindang Party design, structured along Leninist lines, and committed to a strict obedience of Party goals under its "*partyfication*" strategy of all government offices, reflected a style of governance focussed on obedience to mandated policies and hierarchical decision-making processes.

8.3. Bureaucratic and Administrative Domestic Municipal State Capacity

Over time, more complex domestic municipal bureaucratic structures were developed in response to growing responsibilities and fiscal requirements. The rather skeletal domestic municipal government structure up through the end of the Qing, providing few social services, slowly gave way to an increasingly complex administrative municipal bureaucratic structure. By the late Qing, several semi-public bureaus devoted to the construction of public works had already been formed. This process continued over the course of the Beiyang, albeit haltingly given the political chaos that dominated much of the period.

The formal institution of the Nanjing-based Guomindang government in 1928 brought with it a more formalised bureaucratic administration. Separate departments for health, public works, education, and police were delineated, with the semi-public bureaus responsible for administration of infrastructure construction projects becoming incorporated into formal municipal government departments. The Organic Law of 1927 that constituted Shanghai as a Special Municipality formally designated this more centralised municipal bureaucratic structure, with the Mayoral executive office supported by a Secretariat and Counsellor's Office, as well as ten administrative departments: (i) finance, (ii) public works, (iii) public safety, (iv) public health, (v) public utilities, (vi) education, (vii) land administration, (viii) harbour administration, (ix) public welfare, and (x) agriculture, labour and commerce. The revised Organic Law of May 1931 led to a new administrative municipal structure for cities of Shanghai's size that partly streamlined municipal bureaucratic structure down to eight administrative departments (Woodhead 1933: 661).

In sharp contrast to the rather limited and less defined responsibilities assigned to city administrators under the Qing and Beiyang administrative periods, Article 7 of the 1927 Charter of the City Government of Greater Shanghai laid out twenty-four specific enumerated powers of the municipal government, including responsibilities such as conservation of food supplies; educational and cultural undertakings; erection and maintenance of public buildings, parks, recreational buildings, and cemeteries; fire prevention; care of children, old people and the poor, regulation of private construction works; construction and maintenance of roads, bridges, canals and other public works. These municipal duties were to be exercised "in the absence of conflict with the laws and ordinances of the Central Government" (Tyua : 374).

The effectiveness and efficiency of these new bureaucratic structures in regard to their ability to deliver the kinds of municipal services desired by the domestic municipality's residents appear to have been somewhat uneven. The mixed success in regard to bureaucratic municipal state capacity is partly reflected by that of the experiences of the administration of General Wu Tiecheng, the fourth mayor of Shanghai. Coming to power just prior to the onset of open military conflict with Japanese military in January 1932, Wu's administration faced a serious set of economic, civil and social development issues, particularly in the war-devastated district of Zhabei.

Numerous policy goals appear to have been achieved over the course of Wu's mayoral domestic administration. Henriot (1993: 234-235) notes that under Wu's tenure provision of domestic services related to public utilities improved substantially, which he suggests was achieved by refining regulations regarding private utility providers infrastructure requirements, as well as overseeing the amalgamation of eight of Nanshi District's older electric power plants into two newer modern ones. Wu's administration also directed the formation of a new water purification facility located in the Pudong district whose construction was funded by private domestic investors. Wakeman (1995:289-292) is somewhat less generous of the performance of Wu as Mayor, arguing that his municipal administration ultimately failed to accomplish a majority of its stated goals, particularly in the area of crime reduction, with violent crime rates remaining especially high the Nanshi District, as did petty offences such as the activities of unregistered impermanent vendors who blocked both pedestrian and motorised traffic flows on the city's sidewalks and streets. Moreover, Henriot (2016) documents the city's continual inability to secure sufficient land and construction resources to accommodate the demand for necessary cemetery facilities. Further, both Henriot and Wakeman note Wu was unable realise the municipality's largest policy goal, that being relocating Shanghai's business centre out of the foreign settlements northward into the Wusong area. This unrealised goal was to be accomplished by erecting modern port facilities at the mouth of the Huangpu further upstream of those wharfs operated primarily by foreign-registered companies along the riverbank of the International Settlement and in Pudong directly across (Henriot 1993: 179-182). As implied by the institutional arguments presented throughout this dissertation, whether changes in port infrastructure could have overcome serious deficiencies in terms of the structure of domestic private property and contract rights protections can be argued to have been unlikely, given that the revealed preferences of domestic entrepreneurs and investors continually indicated their desire to utilise extraterritorial as opposed to domestic institutional protections when choosing where to locate their business and financial assets.

8.3.1. Bureaucratic Municipal State Capacity: Taxation and Revenue-Raising Capabilities

Concomitant with the increase, formalisation, and specification of municipal government responsibilities laid out in the Organic Law of 1927 and revisions in 1930 and 1931, so too were the types of tax revenue sources more systematically delineated. Article 9 of the Revised Law of 1930, for instance, specified that seven specific taxes were defined as comprising the revenue for municipal governments; (i) Land tax, (ii) House tax, (iii) Business tax, (iv) License fees, (v) outdoor adverts fees, (vi) income from public lands, (vii) income from municipally-owned business (Tyua : 375).

Prior to the Guomindang period of municipal administration, supervision over the assessment and collection of tax matters was handled separately within separate sections of the domestic city; two such offices were the Nantao Municipal Office, and the Zhabei Works and Tax Bureau. As a result, different tax structures and effective tax rates existed across these areas; for instance, while a monthly-collected public welfare tax of five per cent on residences (twelve per cent for homes along the banks of the Huangpu), and seven per cent on small business shops, was levied in Nantao, a quarterly-collected general tax of six per cent on residential units (twelve per cent on houses located along Suzhou Creek), and ten per cent on small business shops, was in place in Zhabei; the district government of Shanghai also imposed a fifteen per cent tax on residential units (Woodhead 1933: 663). In keeping with the drive for coordinated control, these separate divisions were abolished and their functions consolidated under various departments of the Greater Shanghai domestic municipal bureaucratic structure, eventually becoming centralised within the Bureau of Finance, which ultimately instituted a per-unit based house tax standardised across the entire domestic municipality, in line with rates the Zhabei office had earlier imposed.

The inability of Beiyang-era local governments to raise significant levels of capital is highlighted by Woodhead (1933: 663), who notes that local taxes "were not usually paid in full. Some influential personal contrived to be practically exempt from such payment, less influential personals made it a rule to pay only one-half or less than one-half of the stated amount." As a result, total tax receipts were relatively low. Moreover, corruption was a significant feature of the tax collection procedure, owing partly to the practise of tax farming which had taxes collected through an array of commercial ventures and merchant groups that often found it more in their interest to keep significant portions of actual collected tax amounts as opposed to passing along to government officials, often by assessing below-value taxes while collecting amounts in excess of assessed amounts.

Significant attempts were undertaken by the Guomindang administration to standardise tax collection policies with the intent to increase tax receipts. To begin with, tax farming was curtailed, with tax collection directly administered by Bureau of Finance officials. Municipality administrators also worked to increase tax receipts by increasing the number of taxes that were designated as municipal revenues as opposed to provincial; for instance, Mayor Zhang Dingfan was able to transfer control over the proceeds of the tax on horse-racing betting and operations from the province-level to the municipal level, and after securing control over these tax revenues, immediately proceeded to increasing the rate from one and a half per cent up to five per cent in 1928, increasing municipal tax revenues by nearly half a million yuan per annum (Woodhead 1933: 664).

Beyond tax collection, municipal revenues were also derived from the sale and rental of municipal lands, as well as from business revenue of municipality-owned ventures. As at the national level, the degree of government control and ownership over productive assets at the local level experienced substantial increases during the Guomindang time period. This can be observed from the drastic increases in tax receipts received from such properties and assets. For instance, revenues from municipal-owned properties increased from 79,105 *yuan* in 1927 to 525,158 *yuan* by 1931, while revenues from public and municipal businesses and industrial undertakings increased from 68,270 in 1927 to 704,570 *yuan* by 1931 (Woodhead 1933: 665); such increases were on the scale of five hundred and sixty-four per cent, and nine hundred and thirty-two per cent, respectively.

Shanghai's municipal governments also generated income from the sale of municipal bonds. As explored in detail in Part IV of the dissertation, the success of Shanghai's domestic municipal governments raising capital via the flotation of such bonds was decidedly mixed. For the majority of the period, only relatively small and sporadic amounts were able to be floated on local markets given investors' consistent hesitancy to take on significant levels of debt backed by the pledge of municipal government officials to repay loans collateralised by locally-managed tax receipts. As at the national level, continual default events occurred, with missed coupon payments or outright stoppage of debt repayment. It was only well into the middle of the Guomindang period that a domestic Shanghai government proved able to raise a significant amount of funds from investors. Both the 1932 and 1934 flotations issued by the City Government of Greater Shanghai were fully subscribed, and proceeded to be priced as valuable and viable financial securities on the city's secondary bond markets. The income generated by these bonds for the domestic city government was considerable, contributing extraordinary income of 4.8 and 3.3 million *yuan*, respectively, to municipal budgets with ordinary revenue receipts of 8.8 and 11.7 million *yuan*, respectively. However, while both issuances initially proved successful and were well-received by investors, the inability of the domestic state at the national and local level to maintain a monopoly on internal violence ultimately resulted in both of these bond issuances falling into complete default after late 1937, in the wake of the Japanese military invasion and subsequent overthrow of the Nanjing-based Guomindang central government, and the accompanying overthrow of Shanghai's Guomindang regime-backed domestic municipal government.

8.3.2. Bureaucratic Municipal State Capacity: Fiscal Expenditures Policies

Concomitant with the above-described increases in tax receipts during the Guomintang period, so too did municipal spending outlays increase. Much of this increase in spending came about as a result of significant increases in the assumption of the provision of social and civil services by the domestic municipal administration. Part of the change in the fiscal outlay process was procedural in nature. Prior to the Guomintang administration, fiscal outlays at the local level were undertaken primarily on an *ad-hoc* basis, with local municipal departments undertaking neither financial forecasting nor the budgeting of definitive allocated appropriations over set time periods. Beyond such new bureaucratic procedural norms, also introduced under the Guomintang-backed municipal government was the practise of standardised financial reports for municipal departments. So, too, was a complicated system of fund disbursement, embarked upon in an attempt to minimise spending outside of budgeted limits and uses: "Standard stationary forms are in use for depositing and withdrawing authorized funds. These forms are required to be filled out in triplicate, sometimes in quadruplicate, and to bear the official seals of the competent functionaries before they will be deemed valid or honoured" (Woodhead 1933: 664). Woodhead approvingly refers to such procedures as "scientific", utilising terminology used by advocates of the time period's modern accounting techniques (Morgan 2003).

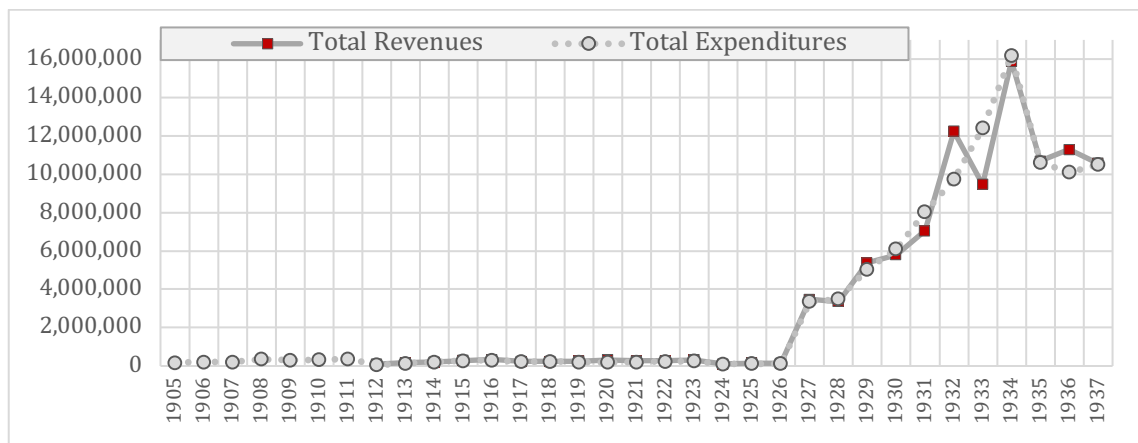
Yet employment of "scientific" budgeting methods did not imply more efficient or effective municipal bureaucracy. Reforms centring upon increasing the number of rote, bureaucratic procedures—such as requiring government officials to fill forms out in triplicate, or even in quadruplicate—failed to solve issues of corruption in spending or allocating, nor did it imply efficiency or usefulness in application of expenditures, nor incentivise the overall economising of spending levels. In fact, municipal spending levels increased nearly fivefold over the course of the decade of Guomintang municipal control of the Shanghai municipal government from 1927 through 1937, with budgeted outlays rising from approximately three and a half million *yuan* up to over thirteen and a half million. Increases in spending, whether documented in triple or quadruplicate, could be argued to have been an outgrowth of a leviathan state structure that continually extracted greater amounts of tax revenue from private actors so as to be utilised in ways that state actors desired.

The inclination by domestic municipal officials to spend significant sums of taxpayer money was exemplified by actions during the Wu administration. While Henriot (1993, 2016) and Wakeman (1995) write critically of the administration's ability to effectively deliver public services, it did at least prove adept at spending, especially on ostentatious projects designed to project state power. For instance, the administration oversaw the opening of a new City Hall (市政廳) in October 1933 in the Zhabei district. Built in the aftermath of the 1932 hostilities with the Japanese military that destroyed much of the northern districts, the cost of this new facility housing the municipal government was considerable, estimated by Borg (1939: 192) to have totalled twenty-five million *yuan*. Beyond the new city hall structure, other municipal building projects were undertaken, including a new municipal library, city museum, and sports facility, all completed in 1937 (Henriot 1993: 181). It is debateable whether expenditures of scarce public resources on these large government-owned facilities represented those that best addressed the concerns of the majority of the domestic municipality's residents, especially given the multitude of serious issues that for the most part remained unresolved—many of which were highlighted by a public address Wu himself in December 1932 in which he noted, "we are seriously handicapped by a system of roads, or rather the lack of a system, which even at its best is a makeshift, grown out of a maze of old roads hap-hazardly laid out without an eye to the future. No human power can render these roads adequate in taking care of the ever growing traffic. Shanghai is rated as the third largest city in the world. Its harbour accommodates tens of millions of tons of cargo in shipping. Yet it takes more than an hour for any individual steamer to come up to its berth

or mooring. In many cases passengers are obliged to take to lighters of tenders to reach the shore. The value of this unnecessary waste of time and cost is incalculable" (Woodhead 1933: 672). Given such pressing need for infrastructural facilities for economic expansion, it is telling that municipal leaders chose to prioritise the construction of a new government office building to serve as their workspace, as opposed to utilising fiscal resources on projects that would more directly lead to municipal economic development and therefore improvement in the quality of the daily lives of the majority of the municipality's residents.

The scale of the increase in overall levels of domestic spending and tax extraction that occurred under Guomindang administration can be observed from data presented in Figure 8.1, which graphs total revenues and outlays made by domestic municipal authorities during periods of late-Qing, Beiyang, and early Guomindang control over governance of the domestic city, adjusted for inflation. Several aspects of domestic municipal fiscal matters are immediately clear from the chart. To begin with, deficit spending was kept to a relative minimum, with revenues and expenditures approximately equal throughout the time period. Revenues exceeded expenditures in 1932 when the city successfully floated 4.8 million *yuan* worth of new municipal bonds, although this difference was nearly equally reversed to the opposite the following year once municipal officials allocated the new monies. The high revenue and spending mark occurring in 1934 also coincides with that year's issuance of another municipal bond netting the city 3.5 million *yuan*.

Figure 8.1. Shanghai's Domestic Municipal Fiscal Position, in constant 1937-*yuan*, 1905-1937



sources: Shanghai Finance and Taxation Committee (1995: 61-62, 100-101, 151-154); inflation data from He (1927), Shanghai Institute of Economics (1958: 126-143, 163-170).

On a more fundamental level, the shape of the graph clearly demonstrates the difference in the scale of provision of social services at the municipal level during different governmental periods. During the late-imperial and Beiyang periods, the administration of the city was not conducted by a formal municipal authority overseeing a standardised budget responsible for the supply and maintenance of social services; instead, most such services were either absent, or supplied privately or by quasi-public bureaus whose creation were often initiated by private concerns but received official government sponsorship or authorisation. As the figure plainly shows, however, a marked change in the scale of municipal-level taxation and spending occurred at the start of the Guomindang period—not only do the levels of both indicators immediately sharply rise in 1927, but they then both exhibit a distinct upward trend throughout the rest of the time period. Obviously, then, these data suggest that the general trend of an increasing role of the domestic state in the economy and economic actors' daily lives during the Guomindang period that occurred on a larger national scale, as described throughout Part II, was also reflected in the size of Shanghai's domestic municipal governance structure under the Guomindang.

8.4. Domestic Municipal State Capacity: Maintaining a Monopoly on Violence

As extensively detailed in Chapter Six, from the late-Qing period and throughout the course of the Republic, China was wracked by continuous episodes of social strife, political violence, and internal and external warfare. Overall, as to be described, while certainly experiencing its share of social violence, in the aftermath of the Taiping and Small Swords Rebellions, comparatively speaking, Shanghai avoided much of the civil violence that characterised China throughout the end of the Qing and the Beiyang's so-called warlord period. This was due in part to an implicit protective influence exerted by the presence of the extraterritorial settlements and their attendant foreign gunboats that provided the settlements military protection. In this way, the foreign gunboats parked along Huangpu's harbours represented both a potential threat to the city's sovereignty, yet also provided the domestic municipality with implicit protection, given its proximate position to the extraterritorial settlements.

8.4.1. Domestic Shanghai: Maintenance of Monopoly on Violence under the Qing

Shanghai did not entirely avoid the wave of social unrest and internal rebellions that defined that late-Qing period, including that related to the Taiping Rebellion. The city was besieged 7 September 1853 by members of the Small Swords Society (小刀會) (also referred to as Short Swords; Cranston 1936: 152), a secret society originating in the southern city of Xiamen (Amoy) and brought to Shanghai by Fujianese migrants. While not formally part of the Taiping, with its members more closely aligned with Triad organised crime elements from Fujian, for citizens dissatisfied with the Qing rule, the Small Swords presented a similar appeal as that of the Taiping in their advocacy of overthrow of the Manchus and attacks against corrupt officials. The weak support for Qing municipal officials is underscored by the Small Swords' capture of the domestically-controlled formal Shanghai city centre of Nanshi—at the time, a city with over 200,000 domestic residents—with a force of but approximately three thousand (de Jesus 1909: 59-63). The rebels succeeded in defeating those Qing imperial troops stationed at Shanghai, killed the municipal magistrate and took the *daotai* prisoner, within the course of only a few days (Pott 1928: 58). The *daotai* at the time, Wu Jianzhang (吳健彰), was a former Cantonese merchant who had purchased his title, and remained heavily involved in trade with the American firm Russell & Co. in Shanghai. Wu was rescued through the efforts of his American supporters at Russell & Co., afterwards seeking protection from the rebel forces by fleeing to the safety of the American Settlement. The Small Swords rebels initially maintained some public support by issuing a cessation on tax collection shortly after taking power (*NCH* 15 October 1853); once in power, however, the rebel leadership reneged on an earlier set of promises to halt taxes on rural peasantry, who had fought in support of the rebel movement outside the city walls against the Qing soldiers (Perry 1985:91). This policy reversal helped eventually turn enough of the rural population against the rebel cause so as to allow Qing soldiers to retake the walled city in February 1855, a year and a half after it had been lost, with the assistance of French troops.

Shanghai was again besieged several years later when in December 1861 a battalion of Taiping rebel forces advanced toward Shanghai from their Nanjing capital stronghold. Li Xiucheng, the Taiping general, mistakenly anticipated little resistance to taking Shanghai, given the overall weakness of the Qing forces in the area, and the general's (mistaken) understanding that foreign military forces in extraterritorial Shanghai would welcome the defeat of the Qing imperial officials overseeing the domestic sections of the city (Lindley 1866: 268-274). However, given reports of destruction and atrocities that frequently accompanied the seizure of cities by Taiping rebels, the leadership of the extraterritorial settlements appeared loath to allow the rebels free access into Shanghai, which they believed would likely bring about a huge disruption to trade. Perhaps more salient to their misgivings of potential Taiping rule was the rebellion's ban on the opium trade, which threatened to cut off a sizeable revenue stream for many of the city's foreign merchants. In any event, when the first battalion of the Taiping army advanced upon the city, foreign

military forces fired upon and soundly defeated them. General Li returned again later that summer, however, with a larger rebel army, and besieged Shanghai. Known as the Taiping Battle of Shanghai (太平軍二攻上海), the siege lasted nearly one year, involving over 100,000 soldiers on each side. With assistance from the bombing of rebel positions by British and French naval forces, Qing Imperial army forces under the leadership of Li Hongzhang, who had been promoted to General, drove the Taiping rebel forces away from the city, and restored the municipal governance run by Qing-appointed officials. A contemporaneous accounting of the Taiping army's attempt to take Shanghai is provided by Frederick Lindley, a former British Navy officer who became a Taiping army commander, in his monograph in published in London in 1866 under his Chinese name "Lin-Le" (Lindley 1866).

In the years after the Taiping, while the Qing state as a whole faced a series of serious internal rebellions and external military threats, Shanghai remained relatively insulated from these series of violent episodes. The battles fought between the Chinese and Japanese navies during the First Sino-Japanese War of 1894, for instance, stayed far from Shanghai's harbours; the violence that characterised the Boxer Rebellion and the severe military response of the Eight-Nation Alliance did not impact the city. With the outbreak of the Wuchang Uprising and Xinhai Revolution in 1911, however, the stability characterising the vast majority of the time frame of Qing rule over domestic Shanghai came to a sudden end.

8.4.2. Domestic Shanghai: Maintenance of Monopoly on Violence under the Beiyang

A brief consideration of the situation Shanghai experienced during the Beiyang time period helps illuminate how political chaos on the national stage impacted the level of political violence in regard to control over the city itself. In the wake of the Xinhai Revolution, a local military commander, General Chen Qimei, with the backing of his battalion of troops, took control over Shanghai, and assumed authority as governor of the city and surrounding region. His leadership, however, lasted only a few years. After the ascendancy of the authoritarian military Beiyang regime under General Yuan Shikai in 1912, Chen, who was aligned with Sun Zhongshan and supported Sun's attempted Second Revolution in 1913, was forced to flee Shanghai in wake of the revolt's failure. Chen went to Japan to work with Sun Zhongshan's provisional government in exile. Upon his return to Shanghai in 1916, Chen was assassinated, mostly likely by agents loyal to Yuan (Bergere 1998: 268).

After Chen's initial abscondence, the domestic sections of Shanghai fell under the leadership of a revolving succession of military commanders that were either installed by the current central Beiyang regime, or by local warlords desiring control of the economically vital region, and sought to do so by installing a friendly representative to oversee the city's municipal leadership. As suggested by Chen's fate, the ongoing political turmoil experienced on the national level also greatly shaped control of the Shanghai municipal region during the Beiyang period. For instance, Chen's immediate successor, Zheng Rucheng (鄭汝成), was installed as military commander over Shanghai by region by Feng Guozhang, the Zhili warlord leader controlling Jiangsu at the time, and also aligned with the Feng warlord group. Zheng's time as military commander over Shanghai was cut short when he was assassinated in November 1915 as his motorcade crossed Shanghai's Waibaidu Bridge (Qiao 2013:B1). Evidence suggests that the son of powerful Zhejiang warlord Lu Yongxiang (盧永祥) had arranged the action (STCC 2005); Lu was aligned with the Anhui militarist group, which sought to control access to the lucrative tax- and trade-related revenues Shanghai generated, particularly those associated with the opium trade.

In Zheng's place, Yuan Shikai installed Yang Shande (楊善德), a senior Anhui militarist; after Yang assumed the military-governorship of Zhejiang, Lu replaced Yang as Shanghai military commander (Feng 2004: 56). After Yang died in August 1919, Lu once again assumed Yang's former role, becoming military-governor of Zhejiang, and backing the installation of He

Fenglin (何豐林) as Shanghai military commander (淞滬護軍使). Beholden to Lu for his political position, He ceded control over domestic municipality fiscal revenues to Lu's surrogates, which included a partnership with Du Yuesheng, leader of the Green Gang organised criminal organisation, to assure control over the city's lucrative, albeit illicit, opium trade.

However, the ascension of Qi Xieyuan (齊燮元) as military leader of Jiangsu in October 1920 saw an increased effort by the Zhili clique to reassert control over Shanghai. Qi declared Shanghai to be rightfully part of Jiangsu, to which Lu responded by vowing to retain control over Shanghai (STCC 2005). Tensions over control of Shanghai remained high between the two warlords; while a peace treaty was brokered at the urging of local business leaders (*Shunpao* 19 April 1922), and eventually signed in August of 1923, subsequent events led to an outbreak of open warfare by September of the following year. After the military leader of the Zhili clique, General Cao Kun, assumed the national presidency by forcing the resignations of Xu Shichang and Li Yuanhong, Lu declared Zhejiang would no longer submit to the authority of the national government, sparking an end to the peace treaty, and the start of the Jiangsu-Zhejiang War (江浙戰爭), which served as the precursor to the outbreak of the Second Zhili-Fengtian War on a national scale.

Although the Jiangsu-Zhejiang War lasted but little more than one month, the damage to Shanghai and its surrounding environs was considerable. Civilian non-combatants were frequently conscripted into battle, or forced to provide services for the battling warlord armies. From an economic standpoint, the war was equally devastating, with complete disruption to trade and the closure of markets. The attendant breakdown of law and order also led to numerous instances of business forced to contribute funds to warlord armies, with kidnappings undertaken to ensure compliance (Feng 2004). In mid-October, with the forces of the two sides seemingly at a military deadlock, Sun Chuanfang (孫傳芳), the powerful Fujian military-governor, an ally of Sun Zhongshan and also aligned with the Zhili clique, suddenly entered the battle, sending his army northward to attack Lu's southern flank. As a result, Lu and He's forces are defeated, sending both leaders to first flee to Shanghai's extraterritorial settlements, before both leaving the country to seek refuge in Japan. Sun thus assumed control over Zhejiang, leaving Qi's forces to take control of the domestic areas of Shanghai (Kotenev 1927). President Cao there forth declared Marshal Qi Xieyuan, as military-governor of Jiangsu province, to possess complete control over the domestic Shanghai municipality.

Qi's control over Shanghai was to be short-lived, however, once Feng Yuxiang successfully implemented his coup in Beijing on 22 October 1924, overthrowing the Zhili leader Cao (NYT 4 November 1924). The newly-installed president, General Huang Fu, revoked Qi's formal control over Jiangsu, and Feng sent his National Army (國民軍) on the so-called Anhui-Fengxi expedition to re-commandeer Shanghai's domestic districts. This action led to a series of battles for control over domestic Shanghai that took place throughout the end of 1924 and the start of 1925 between various warlord powers for the control of Shanghai. General Sun Chuanfang, sent a battalion of troops that captured Songjiang. This action brought about a military response by the Generals Lu Yongxiang and Chen Yaosan, both of whom had previously fled to Japan, but had returned as allies of the new Beijing government. By January 1925, four thousand troops under the command of Chen Yaosan reached the outskirts of Shanghai. However, General Sun Chuanfang and Marshal Qi repositioned troops stationed at nearby Nanjing into the Shanghai area, securing the Jiangnan Arsenal and defeating Chen's and Lu's troops. With this victory secured, Qi declared the formation of a new municipal government in Zhabei; this "Shanghai Citizen's Government" was to be no longer subject to the orders of the new regime in Beijing (Kotenev 1927: 117). In response, the new Beijing government, now led by President Duan Qirui, sent General Zhang Zongchang, who had amassed 10,000 troops, along with support of Russian troops, to retake Zhabei, which they successfully did, after which Qi himself fled to Japan (SMC 1925: 59).

This brief overview of the politics of the domestic sections of Shanghai over this period underscores that political control over Shanghai was one accomplished by way of force, as opposed to a peaceful maintenance or transfer of power. Removal of municipal leaders from power was not accomplished by election or other peaceful means, but rather through direct appointment by military commanders, and frequently via armed conflict, forcing the losing to flee and perhaps face assassination upon return. Clearly, then, not only on a national scale, but so too on local municipal levels, we find the political situation to have been one exemplifying that of a political structure defined by violence, as opposed to rule of law.

Not surprisingly, the effects of these military actions had profoundly negative impacts on business and trading activities. Throughout the period, newspaper reports sounded the constant theme of uncertainty and disruption, with one example among the many being the nearly four per cent drop in the price of silver on 9 October 1926 was blamed on "incessant and widespread civil wars that has trade hampered enormously and silver supplies cannot freely be moved throughout the country" (*NCH* 16 October 1926: 119).

8.4.3. Domestic Shanghai: Maintenance of Monopoly on Violence under the Guomintang

The arrival of Guomintang troops outside the city limits in March of 1927, part of the Northern Expedition military drive, in many ways can be seen as representing just another in a string of serious existential threats to the existing regime controlling the Shanghai domestic municipality. Controlled at the time by the forces of the militarist leader Sun Chuanfang, the domestic sections of the city had been administratively and bureaucratically consolidated under a single municipal governance structure of the Shanghai-Wusong Port Directorate. As described in a series of daily articles published in the *ShunPao* (21,22,23 March 1927), brief but intense fighting took place between Sun's forces and the incoming Guomintang army, supported by small groups of local workers militias aligned with the Communist Party. Although brief, the damage caused by the fighting was significant, given it took place in the middle of the roads and business district of the Zhabei neighbourhood. As such, those suffering the most damage proved to be the owners of private residential and business properties, especially once large-scale fires broke out (關北大火) that ultimately caused an estimated five million *yuan* worth of property damage, and destroying nearly two thousand private residential houses, helping to account for approximately one hundred and fifty civilian deaths (*ShunPao* 22, 25 March 1927).

The lack of sufficient state capacity to enable the domestic state to enforce a monopoly over internal coercive force, allowing nonstate actors to engage in unsanctioned violence that resulted in the destruction or takings of private economic actors' properties and assets, continued throughout the Guomintang period on the municipal level in domestic Shanghai. Crime was a serious problem in the domestically-run sections of the city, with serious crimes such as kidnappings, burglaries, and robberies rising from 205 cases reported in 1927, to 288 by 1930 (Woodhead 1933: 672). One of the most significant and constant forms of violence experienced within the domestic city came from the multitude of illegal and violent activities perpetrated by the Green Gang. As detailed in Chapter Six, domestic state police forces were not only unable to prevent this criminal organisation from engaging in such activities, but in fact in many instances tacitly turned a blind eye to such actions, or even actively provided support. Yet as violent crime levels increased, so too did police actions directed toward control over the city's domestic residents, with Woodhead (1933: 672) reporting the total number of arrests or citations for offences against city ordinances rising nearly tenfold, from 4,652 in 1927, to 40,231 in 1930. As discussed in Chapter Seven, the Guomintang government became increasingly involved in matters previously left to the private sphere, and we find that many of these infractions—over one-quarter, in fact—were

those classified as violations of "public duty" and "public morals". Thus, while violent crimes were increasing, much of policing activity seemed more centred upon stricter control over residents' activities previously considered private actions not subject to state oversight.

Beyond the high level of criminal activity that existed within the city resulting in violence and resultant loss of property and life, Shanghai also suffered from two significant and horrific outbreaks of open warfare, initiated by the Japanese military and directed primarily against the private resident populations of the domestic Shanghai municipality. The first of these incidents occurred at the start of 1932. The invasion and annexation of Manchuria in September 1931 by the Japanese military led to mass public protests and boycotting of Japanese goods, especially in Shanghai, where much of the anti-Japanese movement was concentrated. As a treaty port, Shanghai attracted a large amount of Japanese capital, much of it going into cotton and textile factories that Japanese manufacturers opened in the countryside surrounding the city. In the three-month period after the Mukden Incident, 138 anti-Japanese protests were held in Shanghai alone (上海通史 1999b: 268). Fears of an outbreak of serious violence were to be realised when in January 1932 a clash involving five right-wing Japanese monks and nationalistic Chinese factory workers ended in the deaths of Chinese policeman and a Japanese monk. While reflective of the heightened politically charged atmosphere, Wakeman (2006: 187–194) notes that this incident was initiated by a Japanese intelligence officer who had paid the Chinese workers to attack the monks, seeking to provide justification to increase Japanese military presence in the city.

In response to the incident, a Japanese Admiral in charge of Japanese military forces in Shanghai demanded an apology from the domestic municipality Mayor Zhang Qun, plus reparations for the death of the monk, and suppression of further anti-Japanese demonstrations (FRUS 793.94/3970. 30 January 1932). Despite the mayor's agreement to comply with the demands, Japanese troops attacked domestically-controlled sections of the city without warning in the following night, forcibly seizing Zhabei, home to the Chinese municipality administration. In the process, the then-newly constructed three million *yuan* domestic municipal administration building was destroyed, with multiple reports of fleeing Chinese residents gunned down by Japanese military personnel (*China Weekly Herald* 27 February 1932). Although initially blamed as random acts of violence by untrained *ronin* reservists, attacks by the Japanese military directed on the Chinese civilian population and residential communities appear to have been well-coordinated (Henriot 2010:297-304).

In a well-publicised first-hand newspaper account, Walter Brown, a correspondent with the United Press in Shanghai during the attack, described the War's impact on the Chinese sections of the city: "I watched last Friday the aerial bombardment, without warning, of an open and defenceless city, and saw how Japanese spectators on the same roof with me capered in joy, shouting, "Banzai" (hurrah) and embracing each other as explosions spread fire and death in Chinese territory. It was a terrible sight, this dropping of bombs on a crowded territory far down below, death and mangling were the fate of many Chinese, caught without a chance... An uncounted number of Chinese were killed or maimed by the bombardment and the ground fighting. Women and children suffered... many in hospitals and others left to fill unmarked graves... [Bombers] swarmed over the new works of the Commercial Press, China's latest educational publishing institution, and let off some incendiary bombs. The plant soon was all afire. It doesn't take many bombs to tear up a railroad station, and smash down a lot of houses, and kill off residents. And once the bombs have started a fire in such a spot as Chapei, they have done their job. This was the case last Friday. It was just as though somebody with a big torch had come down out of the air. The Commercial Press burned fast. The wind off the Whangpoo River spread the fire westward. Nothing could stop it. The less substantially built houses went up like kindling on a stove. Poor families ran out in a panic. I can't tell you of the tragedy of these swarms. They grabbed what they could bear, mattresses, a handful of clothes, sometimes a bird cage, and with their

loads on their backs and in wheelbarrows set out in a daze to find a shelter where bombs and fire would not follow them. Many of them went into the International Settlement, dumbly pleading for a corner to set down their humble belongings and shield themselves from the invader" (*United Press* 2 February 1932). As Brown's account suggests, airstrikes and fighting were mostly concentrated in Zhabei, and hence the majority of the damage on life and property was to the Chinese section of the city, with the extraterritorial settlements mostly unaffected. In the three weeks of fighting, domestic Chinese residents in Shanghai suffered over 14,000 casualties, with 10,000 or more civilian deaths (Mitter 2013: 57).

The negative impact from the political instability was felt across Shanghai's economy. The *North China Daily News* published a continual stream of reports of disruptions to business activities, as the uncertainty of the political situation caused weakness in commodity markets in 1933: "Shanghai millers have adopted a waiting attitude which possible is principally due to the uncertainty regarding the northern situation, and little business has been done... All the telegraph and post office in the Northern region had been destroyed by bombs dropped by Japanese aeroplanes. Severe fighting was raging..." (*NCH* 22 February 1933: 302). Two weeks later, a similar report noted, "the political situation in the north has cast a heavy shadow over the local markets during the past week, and there has been little doing... all prices have fallen... the local market has been inactive and no business has been reported, buyers preferring to wait until the political situation clears. Similarly, importers do not desire to increase their commitments under present conditions" (*NCH* 4 March 1933: 382). Likewise, activity on the city's financial markets, initially closed during the worst of the hostilities, was mostly moribund after their reopen.

The second major outbreak of warfare within Shanghai in August 1937 proved to be of a more devastating scale than even that which had occurred in 1932. In the wake of the Lugou Bridge Incident on 7 July, and subsequent skirmishes between Japanese and Chinese forces, the following month Generalissimo Jiang Jieshi initiated a major military attack on Japanese naval forces in Shanghai. As a result, for the following three months, Shanghai became a battlefield, with combat aircrafts flying overhead and bombs being dropped. The war caused unprecedented devastation to Shanghai's economy, with vast areas of the city destroyed and hundreds of thousands of civilians made homeless. Refugees once again poured into the extraterritorial settlements to seek shelter, swelling their population from 1.5 million to four million within a few weeks. The number of factories destroyed was estimated to be 5,255. In different areas of the city, anywhere from seventy to nearly one hundred per cent of industrial enterprise was destroyed, and total property damage was estimated to be over three billion *yuan* (Hanwell 1938). Additionally, the war caused a loss of approximately US \$800 million in foreign investments to the country (Wakeman 1996: 6-7; 280-281).

An American businessman living in Shanghai at the time described the damage and ensuing economic stagnation in stark terms, noting, "The settlements are packed with hundreds of thousands of destitute refugees. Normal trade and industrial activities were brought almost to a standstill during the fighting and the financial structure of the community was frozen in large degree... Early in October it was estimated that only 15,000 out of 175,000 workers regularly employed in the Settlement were at work. Withdrawals from Chinese banks were limited to 5 per cent or no more than \$150 a week. Most of Shanghai's wharves were in the fighting zone, and insurance rates rose to prohibitive levels. For the first time in history Shanghai's trade contacts with virtually all interior districts were cut off, except as they could be maintained by indirect routings making use of coastal steamers. Exports dropped 47 per cent and imports 91 per cent between July and September" (Lockwood 1937: 278).

For the majority of Chinese citizens in Shanghai, the destruction of homes and businesses brought about increased economic hardship and greater uncertainty. Shanghai's Chinese businesses suffered outright pillaging, and those that managed to remain were forced to

take on Japanese partners to remain viable. Henriot (2004: 31) recorded activities by the Japanese invading force that constituted textbook roving bandit behaviour—after open hostilities ceased, the Japanese army barred the Chinese population from entering the areas under its control, so as to provide Japanese military personnel enough time to survey the remaining factories and to remove undamaged stocks and the machinery that could be used for military purposes or by Japanese firms. Subsequently, Chinese industrialists were forced to either work in collaboration with Japanese firms, or have their factories confiscated. By May 1939, for instance, forty Chinese cotton mills were under Japanese control, and by 1940, the Japanese seized more than two hundred enterprises in Shanghai.

From an administrative side, the loss of power by the Nanjing-based Guomindang led to the domestic municipal government structure of the City Government of Greater Shanghai replaced by the Dadao Municipal Government of Shanghai, a Japanese-military sanctioned regime established in December 1937 in Pudong. While domestic municipal bureaucratic organisations still operated, they exercised limited autonomy, as Japanese military personnel were appointed as heads of each bureaucratic division. Thus, for instance, while there still technically existed a domestic municipal police force to enforce rule of law in the domestic sections of Shanghai, now administered under Japanese control, Japanese military officers were appointed as the forces' commanding officers. Moreover, Japanese military law was enforced within the city by Japanese military troops, who by legal right and military might outranked and outnumbered the domestic police force.

8.4.4. Domestic Shanghai: Monopoly on Violence—Comparisons with National Experience

As demonstrated by the previous three sub-sections of text, the degree of political strife and violence experienced by the domestic sections of Shanghai throughout the late-imperial and republican periods was significant. To create a rough comparison with level of political discord experienced at the central government level, we look to construct a simple measure of local municipal-level occurrences of violent political regime change, in line with the similar measure designed by Cox *et al.* (2013, 2017) to capture political violence on a national-level scale that results in the violent overthrow of the country's ultimate sovereign power. As a local municipality under a series of unitary authoritarian governments, Shanghai's domestic municipal governments did not exercise autonomous political power. However, we believe this exercise is useful as a comparative analysis tool, both against the similar measure at the national level previously presented in Table 6.1 in Chapter Six, as well as with the neighbouring extraterritorial settlements to be discussed in the proceeding chapter.

The data presented in Table 8.1 indicate a story somewhat similar as that found in Table 6.1. As on the national level, the total number of violent transitions of power are similar; thirteen over the same period at the national level compared to twelve at the local level. Also similar is the highly skewed nature of these occurrences, albeit of an even more extreme nature than during the national period. During the Qing, there was only one instance of violent transition of power from one municipal government, represented when the Small Swords insurgency took hold of the domestic city for nearly two years. While there was an early instance of change of power by way of assassination at the start of the Beiyang period, relative to the turmoil experienced throughout the rest of the country, domestic Shanghai remained well removed from the political violence that so significantly affected the majority of the middle Beiyang period. The situation however changed quite drastically with the start of the Jiangsu-Zhejiang War in October 1924, which led to five violent municipal regime changes over the next year. As at the national level, the Guomindang "Nanjing Decade" period was characterised by stability, with no forced regime changes at the municipal level occurring until the overthrow of the Guomindang Nanjing-based regime in the wake of the outbreak of war with Japan in late 1937.

Table 8.1. Number of Forced Political Leadership Transitions, Shanghai, 1840–1941

Count	Date	Outgoing Government	Incoming Government	Mode of Change
1	Sep 1853	Qing Imperial Government	Small Swords Society	Insurgency
2	Feb 1855	Small Swords Society	Qing Imperial Government	Central Govt Military Action
3	Nov 1911	Qing Imperial Government	Jiangsu Province (Gen. Chen Qimei)	Rebellion: Xinhai Revolution
4	Sep 1913	Jiangsu Province (Gen. Chen Qimei)	Jiangsu Province (Gen. Zheng Rucheng)	Civil War: Second Revolution
5	Nov 1915	Jiangsu Province (Gen. Zheng Rucheng)	Zhejiang Province (Gen. Yang Shande)	Assassination
6	Oct 1924	Shanghai Self-Govt (Sun Baoqi)	Jiangsu Province (Marshal Qi Xieyuan)	Civil War: Jiangsu-Zhejiang War
7	Dec 1924	Jiangsu Province (Marshal Qi Xieyuan)	Republic of China, Beijing (Gen Chen Yaosan)	Civil War: Fengxi Clique
8	Jan 1925	Republic of China, Beijing (Gen Chen Yaosan)	Shanghai Citizen's Govt (Marshal Qi Xieyuan)	Civil War: Zhili Clique
9	Jan 1925	Shanghai Citizen's Govt (Marshal Qi Xieyuan)	Republic of China, Beijing (Gen Zhang Zongchang)	Civil War: Fengxi Clique
10	Oct 1925	Republic of China, Beijing (Gen. Zhang Zongchang)	Port of Shanghai & Wusong (Gen. Sun Chuanfang)	Civil War: Zhili Clique
11	Mar 1927	Port of Shanghai & Wusong (Gen. Sun Chuanfang)	City Government of Greater Shanghai	Civil War: National Army
12	Dec 1937	City Government of Greater Shanghai	Dadao Municipal Govt of Shanghai	War: Japanese military invasion

sources: please refer to discussion presented in Sections 8.2 and 8.4.

Yet also as is the case with the national level situation, the measure devised by Cox *et al.* (2013, 2017), while instructive, fails to capture an important component of political strife. The siege that occurred on the domestic sections of Shanghai during the Taiping Battle of Shanghai in 1861 through 1863, for instance, was enormous in the scale of military battles, with the imperialist Qing and rebellion Taiping armies each committing over one hundred thousand combatants to the battle, which was enormous also in cost, both in terms of human life and economic assets. Although the formal government housed within the walled city itself did not fall, nearly all of the surrounding neighbourhoods—where the majority of the domestic population lived—were devastated during the course of the war, with numerous disturbing atrocities and examples of violations of property rights and human dignity committed by the armies of both sides documented by several contemporaneous and later historical accounts (*Blue Book* 1862, Lindley 1866: 498-538, de Jesus 1909). Similarly, while the Japanese military incursions on domestic Shanghai did not result in a forced change in political leadership of the domestic municipality, it nonetheless extracted a huge set of costs on the city and its domestic populace. As Woodhead (1933: 670-671) documents, the economic cost of the war totalled nearly two hundred million *yuan*, with over twenty-five thousand workers unemployed after their places of business were destroyed or otherwise reduced employees in the wake of hostilities. Of the total losses, twenty-five per cent was attributed to damage or destruction of private civilian residences, another quarter to private small businesses, and approximately thirty per cent to privately-owned domestic factories; government properties, schools, and temples accounted for the remaining twenty per cent. Beyond direct economic costs, nearly three thousand domestic civilian deaths were recorded. Yet for all their destructive economic and human costs, the two wars of the Taiping Battle of Shanghai and the 1932 Japanese military attack on domestic residential neighbourhoods of Shanghai are not captured by the Cox *et al.* political violence measure. Also not captured is the degree of political violence caused by non-military factors, such as the activities of the Green Gang or other organised criminal elements in the city.

Nonetheless, after the conclusion of the Taiping Battle of Shanghai in the early 1860s, and until the military attacks on the city in 1932, domestic Shanghai was relatively spared the scale of military violence that characterised so much of the rest of domestic China. Even the Jiangsu-Zhejiang War in 1924 and its derivative battles over the next two years were fought on the outskirts of the domestic city. Compared to the political discord and associated violence that affected so much of the rest of the domestic institutional environment, domestic Shanghai remained relatively unaffected. This relative level of political stability was due to a kind of "halo effect" (or, what Henriot 2006: 216 refers to as part of a "*pax occidentalia*") due to the proximity of the extraterritorial settlements, which as discussed in the following chapter, the governments of which were able to maintain a general monopoly on violence, due in large part to the implicit backing of superior foreign military force.

The level of political violence plays an important role in the Violence Trap argument of Weingast and his co-authors, and in our argument of a "low-credibility trap", insofar that pervasive and constant occurrences of political violence affect the incentives and the ability of state actors to create credible commitment mechanisms that can serve to generate strong protections on private property and contract rights. While the values of the measure of political violence via forced leadership transition devised by Cox *et al.* are similar across both the domestic national level and Shanghai municipal level, at thirteen and twelve, respectively, there were significant differences in the overall lower level of political violence that directly impacted the domestic municipal setting of Shanghai. This difference is significant for the purposes of our study, given our use of Shanghai's domestic institutional environment as a proxy for the broader national-level institutional environment. In this regard, therefore, the lower levels of political violence imply that, at least along the political violence vector, differentials between the domestic and extraterritorial institutional environments at the municipal level are less divergent than would be between the extraterritorial and domestic national level. This further implies, therefore, that in terms of a comparative analysis between the domestic and extraterritorial environments, the Shanghai domestic municipal environment represents one more favourable than the domestic national-level environment. Hence use of the domestic Shanghai municipal institutional environment as a proxy for the national Chinese institutional environment in our comparative analysis safely represents a lower bound in terms of economic actor and investor perceptions of differentials between domestic and extraterritorial environments.

8.5 Conclusions

Given the importance that Shanghai played in terms of economic and sociopolitical landscape of China, many of the examples regarding the development and perception of the domestic institutional environment already noted in Part II pertain also to Shanghai. For instance, some of the earliest state-owned enterprises created under the auspices of the Self-Strengthening Movement were founded in Shanghai. Jiangnan Arsenal was formed in Shanghai in 1865 to manufacture weapons and warships; and China Merchants Steamship Navigation was formed in Shanghai in 1873 as a shipping concern designed to provide commercial services while supplementing the development of a military steamship fleet. Further, the examples of the domestic state's inability to enforce a monopoly over internal coercive force was exemplified by its complex relationship with the Green Gang organised crime outfit and its leader Du Yuesheng. Likewise, in analysing the impact on judicial independence played by the "partyising the judiciary" strategy, we highlighted the removal from power in 1927 of domestic Chief Justice Lu of the Provisional Court, after he refused to sanction the issuance of extradition orders for suspects residing within the International Settlement, replaced by a judge incentivised to "carry out party principles" (Xu 1997:12).

Interestingly, in each of these instances, the relationship between the extraterritorial settlements and the domestic administration played an important role. The modern factories and industry in centred in Shanghai, many foreign in origin, were viewed by those in the Self-Strengthening Movement as a model for the creation of state-owned enterprises; in the summer of 1883, at the invitation of the American Consul-General, Li Hongzhang travelled to Shanghai for the express purpose to examine several of the city's foreign-owned factories (*NCH* 6 July 1883). The Green Gang, while in origin a domestic criminal organisation, operated throughout the entirety of the city of Shanghai, in areas both domestic and extraterritorial. As Martin (1991) describes, in fact, much of the organisation's base of operations—as well as Du Yuesheng's personal residence—was located in the French Concession, purposely done so as a way to shield the organisation and its leadership from domestic police and prosecution. For Chief Justice Lu, his failure came out of his respecting the rule of law, as it pertained to the issue of extraterritoriality, over "party principles."

All of these examples underscore the rather complicated relationship that existed between the domestic institutions that operated within the domestically-controlled sections of Shanghai with the extraterritorial settlements located in the city's midst. While often viewed as an affront to China's sovereignty, the city also received economic benefits from the existence of the settlements, as well as a level of increased security from general political and civil strife owing to the proximate nature of the extraterritorial settlements and domestic municipality. This complicated relationship is perhaps signified by the way in which domestic government officials were some of the most active participants in the cross pollination of life across the boundaries. Officials of the domestic municipal government often chose to make their residence inside the boundaries of the extraterritorial settlements—an example where contemporaneous actors exhibited a preference for the extraterritorial over the parallel domestic institutional environment. As Henriot (1993: 75-110) makes note of, this could lead to ironic situations, such as during the mayoral term of General Zhang Dingfan when the domestic Shanghai municipal government drafted resolutions requesting the national government enact prohibitions on Party members from residing within the settlements, even while the majority of local senior Party officials—including Mayor Zhang himself—chose to reside within their boundaries.

Overall, relations between the domestic and extraterritorial administrations vacillated between positive and adversarial, depending both on larger national directives, as well as issue-by-issue. Overall, however, especially by the latter half of the Guomindang period, had a positive working relationship between the two municipal governments, symbolised in part by the mutual praise exchanged in the comments made by the extraterritorial Shanghai Municipal Council and the domestic municipal leadership upon the resignation of the domestic Mayor Wu in April 1937. "On his appointment as Chairman of the Kwangtung [Guangdong] Provincial Government, the Council expressed to General Wu Te-chen, Mayor of the City Government., its congratulations and its regret at his departure from Shanghai. General Wu Te-chen, in replying, spoke of his happy relations with the Settlement authorities and the ready co-operation which had always been extended. Later in the year, the Council, in congratulating Mr. Yui on his appointment as Mayor of the City Government, expressed confidence that the same happy relations would also mark his term of office, and Mr. Yui, in reply, said it would always be his endeavour to work for harmony and peace among the peoples of many nationalities residing in Shanghai" (SMC 1937: 20). In the following chapter, we turn to a more explicit consideration of the extraterritorial settlements and the way in which they developed internal and external mechanisms that created formal and informal linkages between the parallel municipal governments, as well as those which formed the basis for the overall extraterritorial institutional framework.

Chapter Nine.

Perceptions of Institutional Quality in Shanghai's International Settlement

The focus of this chapter is twofold. First, after a brief review of the historical setting in section 9.1, we seek to provide in Section 9.2 the way in which the institutional framework of Shanghai's extraterritorial settlements is typically viewed and discussed within the economic history literature. In general, unlike in the case of China's domestic institutional environment and state capacity, there appears less debate in the literature regarding the overall nature of institutional quality of the extraterritorial settlements. In particular, the presumption typically presented is that the extraterritorial institutional environment provided relatively strong protections of private property and contract rights in accordance with similar safeguards found within the liberal republican states whose governments had helped to create and support the extraterritoriality system, and founded associated settlements within Shanghai. Unfortunately, however, similar to much of the mainstream literature that attempts to link the impacts of China's pre-war domestic institutional environment on attendant economic outcomes, there exists a tendency within the literature to make inferences about the impact of extraterritorial institutions on aspects of economic activity occurring within the settlements, by simply positing a monolithic and immutable institutional quality of the extraterritorial environment. As to be described, however, the nature of the extraterritorial institutional environment, and the level of protection provided to private economic actors' property, was neither time invariant, nor consistently effected across institutional constructs; further, the nature of institutional protection afforded to private economic actors often differed across differing population sub-groups, such as between foreign and domestic residents.

Second, this chapter additionally describes and analyses the factors shaping Shanghai's contemporaneous economic agents' perceptions of the extraterritorial institutional environment, including an explicit focus on the way in which agents viewed protections on private property rights and contract enforcement. Given the relative lack of explicit focus in the literature on extraterritorial institutions, our analysis primarily employs the use of contemporaneous sources to conduct our analysis. In general, we follow the approach adopted in Part II analysing the domestic institutional environment, and discuss the primary facets of the efficacy and capacity of state institutions involved in the production of institutional protections on private property and contract rights.

Such institutional constructs include the ability of the extraterritorial state apparatus to develop state capacity and create credible commitment mechanisms. Section 9.3 discusses how the extraterritorial political, legal, and judicial systems operated in ways that either limited or fostered the ability of state actors to engage in government expropriation of individual private property. Section 9.4 considers the development of state bureaucratic capacity that allowed state actors to plan and implement economic and social policies that defined the state-private agent relationship and either created space and ability for private economic activity to flourish or be constricted by government action. Such policies included those on taxation, business regulations, provision of infrastructure, as well as social policy such as provision of education and public health services. Section 9.5 describes the structures in place and ability of the Settlement to enforce a monopoly on coercive force within its sovereign territory through the establishment of internal police and external military forces. Section 9.6 analyses the degree to which credible commitment mechanisms created private property rights protections, as well as the impact of attempts by the state to control private actors in areas such as censorship of free expression that shaped the openness of civil society. Finally, a brief summary in section 9.7 concludes the discussion.

9.1. Introduction: Historical Setting

Shanghai's famous waterfront promenade, the Bund, stretches one and a half kilometres along the west bank of the Huangpu River. Representing some of the world's most expensive real estate, the cluster of fifty-two historical buildings along the Bund exhibit a mixture of Gothic, Neo-Classic, and Art Deco architectural styles, and provide a popular backdrop for tourist photos. Yet while the Bund is regarded as an important symbol of Shanghai, it elicits mixed feelings for many residents as an incongruous sight in a Chinese city, and harkens back to a period that saw western governments' partial usurpation of Chinese sovereignty. In fact, however, much of the capital and enterprise that drove the construction of the buildings lining this architecturally impressive promenade was Chinese in origin. As such, the Bund, and as by extension the entirety of Shanghai's early extraterritorial settlements, signify the amalgamation of both foreign and Chinese physical, financial, and human capital.

When a young Englishman, George Balfour, arrived in Shanghai aboard the steamship *Medusa* one hundred and seventy-five years ago, on 8 November 1843, the area that would become the Bund appeared considerably different. Stepping off the boat and onto a muddy narrow lane at the southwest corner of where the Wusong (Soochow Creek) and Huangpu (Whangpoo) Rivers met, Balfour was greeted only by the marshland lying north of the old walled city of Shanghai, dotted with reeds and wild birds. Yet within a mere fifty years, the landscape would be transformed into one of Asia's leading financial centres.

Balfour had come to Shanghai following the conclusion of the Opium War and subsequent signing of the Treaty of Nanjing, Article II of which compelled the Qing government to allow British citizens access to five Chinese cities "for the purpose of carrying on their Mercantile pursuits." Balfour, representing the vanguard of British political and commercial interests, had been selected to serve as the first British Consul of Shanghai, and tasked by Sir Henry Pottinger, the first Governor of Hongkong and one of the original negotiators of the Treaty of Nanjing, to create a viable and successful treaty port from which British merchants could operate. The Treaty defined treaty ports as places where "British Subjects, with their families and establishments... [be] allowed to reside, with the purpose of carrying on their Mercantile pursuits, without molestation or restraint" (Treaty of Nanjing 1842: Art. II).

The International Settlement in Shanghai traces its origin to 1845, when Balfour was able to strike an agreement with the ranking local Chinese official, the *Daotai* (道臺), for access to a stretch of undeveloped land north of the walled city for residences of British merchants, in accordance with the provisions of the Treaty. The stipulations of the Land Regulations first drawn up in 1845 (later revised in 1854, 1869, and 1898) served as the basis of a municipal constitution for the British (and later International) Settlement. With such an agreement in place, Balfour set about overseeing the construction of the British Consulate General's office along the bank of the Huangpu River. Thirty-Three the Bund was the starting point of the development of the British Settlement, originally referred to as simply 十裏洋場 (or, "ten *li* of foreign territory"). Although the original structure completed in 1849 was destroyed by fire in December 1870, the Consulate building was reconstructed in 1873 as a two-floor neo-Renaissance building, and currently still stands on the site.

The nature of the agreement that Balfour negotiated—a perpetual lease of land to British residents—stipulated no forfeit of Chinese soil; while designated for use by the British, "fair and equitable" rent was to be paid to the Chinese government (Hsia 1929: 40). Under the Land Regulations, British citizens living in the Settlement would pay rent directly to the Chinese government (albeit collected and transferred via the British consul office). Nonetheless, the right to rent the land was granted "in perpetuity", and hence effective control of the land, although technically still Chinese soil, was ceded to the British. Therefore,

despite Article 28 unequivocally stating that "the land encompassed in the territory remains Chinese territory, subject to China's sovereign rights," the British Settlement obtained what legal experts at the time called "a delegated power of municipal administration... equipped to deal with these matters in an area where the large majority of the foreigners dwell" (Fraser 1939: 45).

As greater numbers of foreign merchants arrived in the treaty port in search of business opportunities, settlements for other foreign merchant communities (American, German, Italian, and Dutch) were formed, negotiated under similar arrangements between their respective governments and Qing officials. Given perceived common interests and wishing to cut administrative costs, the American Settlement officially merged with the British Settlement in 1863 to form the International Settlement, with the Shanghai Municipal Council as its governing body (*NCH* 8 July 1854: 194-195). Foreign settlements of other nations, considerably smaller in size and scope, soon also subsumed their separate administrations under the general umbrella of the International Settlement. Undergoing several expansions, the original Settlement increased from just 138 acres in 1846 to 5,583 acres by the end of the nineteenth century (*Chronicle* 1906: 676; Jones 1940: 1).

Of exception was the French settlement. Having withdrawn from the Land Regulations in 1855, the French Concession was officially established comparatively late, in May 1862, under an agreement negotiated with the Qing government by the French consular agent Charles de Montigny. The French Concession was of a slightly different form of agreement than that which represented the settlements run by the other foreign nations, as it more explicitly represented a grant of land (a "concession") by the Chinese government to the French government, although this grant also was in the form of a perpetual lease. Technically, however, the French government formally controlled the land, and could therefore act as landlord by sub-leasing the plots to individuals, either foreign or Chinese (Johnstone 1937: 942-943).

With the arrival of European mercantile houses and foreign banks into the settlements, along with attendant foreign and Chinese workers, traders and entrepreneurs, the foreign settlements and the entire city of Shanghai continued to grow in population and territory. Figure 9.1 provides depictions of the city in 1862, 1900, and 1933, respectively. The map of the city in 1862 indicates the walled domestic-government administered section of the city bordered to the north by the French, British and American settlements, with the relative sizes of the foreign settlements to the domestic walled city approximately equal in area. By the turn of the century, the foreign settlements—in particular the amalgamated International Settlement—had expanded in size to surpass that of the original Chinese city. The 1933 map illustrates the growth of the domestic municipality; while both foreign settlements encircled in bold lines, and the location of the original walled city—albeit by that time no physical walls remained—are clearly evident, their relative sizes are now dwarfed in scale by the overall size of the total land area controlled by the Shanghai domestic municipality.

Already by 1850, Shanghai came to displace the other treaty ports to serve as the leading seaport for international trade in China. Opium boats, which used to dock mainly in Guangzhou, now mostly congregated along the Wusong wharves. From 1847 onward, nearly half of the opium imported into China was via Shanghai (Morse 1910: 541). In 1859, the Qing government moved the office of the Minister of Trade in charge of the five treaty ports from Guangzhou to Shanghai. Over the next half century, the city would continue to grow such that by 1930, over thirty thousand foreigners from fourteen countries called Shanghai their home, having built their lives and businesses within the confines of foreign settlements, governed by locally-elected councils under extraterritorial legal systems.

Figure 9.1. Maps of Shanghai, c. 1886 and 1933



Sources: *Encyclopædia Britannica*, 1886; General Staff No. 3956 U.S. Army War Office 1935

9.2. Brief Review of the Literature: A Presumption of Strength

Unlike the debate in the economic history literature regarding the institutional quality defining the domestic the late-Qing and early Republican Chinese state described in detail in Part II, considerably more agreement exists in the literature in regard to depictions of the overall institutional quality that characterised Shanghai's extraterritorial settlements.

Such lack of debate is partly due to a general dearth of detailed researches focussed on the extraterritorial settlements themselves. Compared to the wealth of research undertaken regarding the economic history and institutional framework defining late-imperial and republican domestic state capacity, considerably less analogous attention has been paid in regard to Shanghai's extraterritorial settlements. According to Bickers (2013: 162, 167), "On the whole they are mostly ignored in English [language literature]", while within the comparable Chinese-language literature, "the International Settlement and French Concession administrations have attracted in fact little by way of direct analysis up to now, aside from consideration of their political impact in the turmoil of the mid-1920s."

That said, several significant exceptions exist to the literature's general omission, with research by Bickers (1998, 1999, 2003, 2004, 2016) providing some of the most notable. In particular, his work focusses on the lives and attitudes of the British merchants and opportunity-seekers who largely dominated the population of the International Settlement. His research also stresses the way in which official British interests began to diverge with those of the residents of the Settlement, resulting in increasing levels of discord between the Shanghai Municipal Council leadership and the British Foreign Office over time. Bickers' focus on the lives and personalities of expatriate individuals comprising the Settlement, and his discussion on the workings of many of the institutions that defined extraterritorial International Settlement, including the Mixed Court and Shanghai Municipal Council, provide a generalised consideration of the institutional make-up of the extraterritorial community, albeit one coming from a primarily personality-driven narrative.

Jackson (2017) provides a more detailed historical examination of the ways in which the Council and related institutions governed the International Settlement, describing the transformation of the Council from a rather modest governing construct into a complex bureaucratic structure as it increased its authority and scope over the lives of the Settlement's residents, while simultaneously attempting to maintain its independence of rule from control by the domestic Chinese state leadership. Jackson contends that at its core, the Council was a colonial institution, even if its leadership was occasionally at odds with that of the interests of Britain and the United States. Referring to the Municipal Council as operating a system of "freelance colonialism", Jackson ultimately regards it to have served as an arm of foreign imperialism in China.

Whewell (2015) focusses her research on the institution of British extraterritoriality itself as it operated in the treaty ports of China, with special attention paid to Shanghai. For Whewell, British extraterritoriality represented a symbol of British imperialism in China, and central to her investigation are the similarities and linkages of extraterritorial law in China to that of more formal British colonial legal systems. Whewell further emphasises the role played by extraterritorial law insofar that it "supported, regulated and protected trading and property rights [for British merchants and entrepreneurs]" (2).

Several additional researches focus on other specific institutional features of the settlements. Stephens (1992), Ruskola (2003), and Yang (2006) concentrate solely on the extraterritorial judicial institution of the Mixed Court. As the Mixed Court was a western legal construct designed to implement Chinese law, Stephens presents a comparative examination of the philosophical differences between Chinese and western law, arguing that "true" adjudicative law as defined by western legal traditions depends upon adherence to the principles of application of rule of law: "rigid, universal, specific" legal objectives applied equally to all; conversely, Chinese law operates on the disciplinary model, and thus is necessarily arbitrary, with: "predetermined, rigid, universal imperatives governing conduct and imposing order from without not to be found" (4,8). Noting the Mixed Court had at best dubious legal status, with its legitimacy not explicitly recognised under extraterritorial, international, or domestic Chinese law, the Mixed Court system nonetheless worked well because, according to Stephens, issues of legitimacy were not problematic to most Chinese subject to its rule, given that Chinese culture and legal understanding was based on the disciplinary model of law, where arbitrary rules are applied by those holding the power to make the rules; i.e., a "might makes right" conceptualisation of legal reasoning. Yang makes a similar case, arguing that Chinese citizens historically looked to government magistrates as paternalistic figures whose role was to help resolve what would be termed legal civil disputes, and that the Mixed Court was designed to take over this role for the settlements' Chinese residents. Ruskola (2003: 2) suggests, however, that the Mixed Court was doomed to fail in its application of Chinese law given that he views Chinese law as "congenitally lawless," with the Court struggling to combine Chinese and western legal precepts. Lee (1994: 193), meanwhile, presents an implicit critique of such dichotomist analyses, noting that in many respects, the actual operation of the Mixed Court "seems to fit better with the adjudicative than with the disciplinary model." Lee also draws attention to instances where the Chinese public actively opposed Mixed Court decisions, thus implying it was unlikely that Court's foreign judges were uniformly viewed as "figures of paternalistic authority in the eyes of the court's Chinese subjects," as implied by Stephens and Yang. Law (2015) also considers the extraterritorial legal system, but during the Guomindang era, after the abolishment of the Mixed Court.

In other work, Jackson (2012) provides a detailed consideration of the structure of the Shanghai Municipal Police, and outlines its role as an important institution in maintaining internal peace and order in the International Settlement in accordance with the norms and interests of the Settlement's business and political elites whose interests were represented by the Council and Settlement business owners. Martin (1991, 1995, 1996) and Wakeman (1995a) also contribute to an understanding of law enforcement mechanisms within the settlements and larger Shanghai in research on the operations of the Green Gang organised crime syndicate. Their work underscore some of the inherent weaknesses of the institutional structures of the settlements in maintaining law and order, a story that seems to be in sharp contrast to the overly positive descriptions of the legal and order of the Settlement that is generally assumed by the economic historical literature. Also consistent throughout the literature is the perception that the byzantine nature of legal jurisdictions operating throughout Shanghai created opportunities for lawlessness. Scully (1998: 858)'s description of the implications of multiple jurisdictions is typical: "the division of Shanghai into Anglo-American, French and Chinese sectors with different municipal regulations complicated questions of law and order helped anyone on the margins of society to resist authority." Similar sentiments are expressed, amongst others, by Martin (1996) in his description of the operations of the Green Gang, Ma (2008) in his look at industrialisation and economic growth rates in the Lower Yangzi, and by Whewell (2015) in her description of the complexities in the application of extraterritorial law.

Numerous additional studies on various aspects of social institutions and constructs defining life in the extraterritorial settlements exist, such as those debating the degree to which Shanghai's private sector-based commercial culture was dependent upon the foreign settlements (Chan 1999), the role played by small business owners (Lu 1995), spatial construction effects on Bund-based businesses (Taylor 2002), the impact of corporate culture on the lives of domestic Chinese employees of the Settlement's modern commercial enterprises such as banks, publishers and department stores (Yeh 2007), and the social and racial dynamics reflected in the practice of prostitution in the settlements (Hershatter 1997, Scully 1998). Harris (2018) considers the impact on the development of administrative capacity provided via the creation of a local postal office by the Shanghai Municipal Council in 1863. However, while these and previously-cited literatures provide valuable archive-based contributions to a historical understanding of Shanghai's extraterritorial settlements, the overall literature lacks for the most part explicitly economic historical or economic studies on the development and evolution of Shanghai's extraterritorial institutional environment. This makes sense, as none of these authors are economists or economic historians; Bickers, Jackson, Martin, and Whewell are historians, while Stephens, Lee, Ruskola and Yang are legal historians, and Taylor an architectural scholar.

There do exist, however, several researches within the economic history literature that analyse the importance of the extraterritorial settlements to Shanghai's economic growth path and dynamics, as well as specific ways in which the settlements' institutions drove the expansion of Shanghai's financial and industrialisation process. Early on, Hao (1970) argues domestic Chinese compradors played a significant role in bringing "modern business" into the Chinese economy, by using the wealth and human capital gained from working within the extraterritorial institutional environment at the many foreign joint-stock firms operating within Chinese treaty ports such as Shanghai. More recently, Ma (2008) also stresses the important of western institutional influence—from legal structures, property rights —provided by the presence of Shanghai's foreign settlements as providing the primary spark that drove the rates of economic growth and industrialisation within the Yangzi Delta region that outstripped those found elsewhere in the Chinese economy.

These works, while important in their consideration of the way that institutional form impact economic outcomes, suffer from a criticism similarly identified with the literature that relates the domestic Chinese institutional environment with attending behaviours of domestic Chinese economic actors and accompanying economic outcomes, insofar as the overall nature of the underlying institutional environment is primarily assumed as opposed to rigorously analysed. Instead, when the institutional environment of the foreign settlements is referenced by this literature, it is typically done so in a manner that implicitly assumes the existence of strong state capacity reflecting efficient bureaucratic faculty, and a high quality institutional environment that provided good protection of private property rights; certainly, it is assumed to be superior to that found in the domestic institutional environment of either domestically-controlled Shanghai, or China as a whole.

Certainly, it is not surprising to find the contemporaneous English-language literature *parti pris*, eager to paint a self-congratulatory view of the settlements as beacons of modernity and home to efficient and strong institutions, effective in their protection of private property rights. Accordingly, Feetham (1931: I,317), in poetically describing the towering buildings of Shanghai's banking sector along the Bund as symbols not only of the Settlement's wealth and economic success, but more importantly, as possessing "a deeper economic significance than this; they are the first conspicuous signs and symbols of the sanctity of the rights of private property as recognized and safeguarded in the Settlement". Gundry (1920:59) boasts that "It has been said, indeed, that the Shanghai Municipal Council

are the best missionaries in China, as they offer to the myriads of Chinese who pass through the Settlement an example of what orderly and good government may mean." Crow (1933: 143), meanwhile, adopting the "model settlement" terminology, claims that "under the long and honourable administration of the Council, this section of Shanghai has become known the world over as 'The Model Settlement.' Its modern buildings, clean, paved streets, and its prosperous air of business activity usually surprise the visitor who expects to find a Chinese city rather than one which has all the aspects of a Continental metropolis."

More recent literature appears equally ready to pronounce Shanghai's extraterritorial settlements home to effective, and superior, institutions. Lee (1995:5), for instance, first posits that "the foreign laws promised a reasonably objective and impartial standard for managing private affairs," before proceeding with analyses of business relations in the settlements based on that assumption of impartiality for private business activities. Yet Lee's supposition of the construction and application of foreign laws in an impartial manner are not supported by in-depth study or citation of such a study; rather, there seems to be an implicit assumption that the fact that these laws were foreign, and adjudicated in foreign-run (extraterritorial) courts must imply they were impartial; or, certainly more impartial than that which agents could expect from the domestic legal environment.

Similarly, prior to ascribing the superior growth of the lower Yangzi to capitalists operating out of an improved institutional environment that owed its existence to extraterritorial Shanghai, Ma claims, "The [Shanghai Municipal] Council was remarkably corruption free" (2006:19); and that "[i]n comparison with the Chinese quarter governed by the local Qing government, the business-dominated council was far more efficient in the provision of public goods including the maintenance and improvement of city roads, transportation and communication infrastructures, public utilities, and port facilities" (2008: 373).

The reasons for this implicit assumption of superior institutional quality are rather clear for contemporaneous actors, who undoubtedly found it in their interests to assert such superiority to use as an implicit (and frequently, explicit) justification for the continuation of the extraterritoriality system. More recent examples are more likely owing to the fact that the settlements' institutional framework, as derivative European institutions, are viewed from Northian assumptions that it was "European exceptionalism" that created the unique institutional frameworks capable of effectively protecting private property rights and contract enforcement.

However, as noted in previous discussions regarding assumptions presented in the literature on the domestic Chinese institutional environment, without more rigorous and disinterested methodologies employed to analyse the quality of these institutional environments, we risk arriving at conclusions that ascribe varying observed economic outcomes—growth rates, industrialisation levels, formation of joint-stock companies, or financial market development—to an assumed and constant institutional framework that exists only as a banal typecast but not to be found in historical reality.

In this respect, our approach going forward is to look to present a detailed qualitative analysis of the institutional environment of the extraterritorial settlements, one that attempts to understand their construct from the point of view of the perspective of the settlements' resident economic actors, whether domestic Chinese or expatriate. Further, we highlight both the undulating nature of the institutional environment over the late-imperial and early-republican time frame, as well as the myriad inconsistencies and contradictions that shaped the way contemporaneous actors perceived the quality of private property protections and overall institutions operating within the extraterritorial settlements.

9.3 State Capacity: Protecting Private Property and Contract Rights via Effective Institutions within the International Settlement

Before starting our analysis of the nature of perceived institutional quality within the foreign settlements, we note that the following discussion shall primarily focus attention on factors shaping the property rights environment of the International Settlement, with considerably less attention paid to the French Concession. Admittedly, some loss of specificity and consideration of the diversity between these two foreign-run environments is lost, given the existence of several substantive differences in administration of these municipalities.[§] Overall, however, the nature of the institutional differences between the two foreign settlements can be defined as one of scale, as opposed to one of form for the types of differences existing between the domestic Chinese controlled areas of Shanghai, and those of the two extraterritorial settlements.

9.3.1 Credible Commitment Mechanisms: State Structure

Clear differences existed across Shanghai's domestic and extraterritorial-administered municipal governments in terms of their ability to create credible commitment mechanisms that fostered the perception amongst relevant actors that the government was competent in creating an effective private property framework, and that expropriation of private property by the state was of relatively low likelihood.

Of the most important form was the government structure. The domestic municipal governments were run by officials appointed, successively, by the Qing Court, the Beiyang central government, and the Guomindang party. Conversely, moderately representative municipal councils governed the foreign settlements. Soon after the founding of the British Settlement in 1845, and with the implementation of the Land Regulations, several of the largest land renters began meeting to discuss ways to improve the services for residents of the Settlement.

Soon thereafter, the Committee of Roads and Jetties was formed and tasked with coordinating the construction of roads, canals, jetties and other public works. In July 1854, the first official meeting of "Land Renters" (later referred to as "ratepayers") was held by the organisation that would later become the Shanghai Municipal Council. At the meeting, the ratepayers agreed to a set of rules and guidelines for self-governance, including the formation of a formal governing council to be run by members elected from ratepayers. This council was granted the power to create regulations and levy taxes on the ratepayer body as a whole in order to raise funds necessary to provide services and public facilities to the International Settlement residents (*NCH* 8 July 1854: 194-195, *NCH* 22 July 1854: 202-203). This first meeting, and the early meetings that followed it, were the first steps in creating and entering into the constitutional agreement that would govern the Settlement. Such a process might well be viewed as a practical application of the theoretical framework Buchanan & Tullock (1962) lay out in their seminal work *The Calculus of Consent* regarding constitution construction as deciding on the decision rules that will determine self-governance.

[§] Bergère (2002 [2009]) provides a useful comparative examination of the French Concession with the International Settlement, contrasting many of the important ways in which the two foreign settlements differed. Overall, the French municipality was much more an explicitly colonial structure, with absolute power residing in Paris, whereas the International Settlement was governed locally and not beholden to a foreign government's policies.

By the time the British and American Settlements had merged to form the International Settlement, much of the authority originally bestowed onto the British or American Consuls had been appropriated by the Shanghai Municipal Council. The early community actively sought to seize authority and consular control from western foreign-government-appointed Consuls based in Beijing. A statement by a member of the Council, Mr Robson, at the Annual Ratepayers Meeting in 1881, is telling: "I simply wish to deprive Consuls of any power except as judges. We are more capable of governing ourselves than the Consuls are of governing us. That is the idea I want to express, and that idea is not inconsistent with the regulations as drawn. I propose to withdraw from the Consuls all unnecessary authority which these regulations give them. They ought to be our servants" (de Jesus 1909 :226). In many respects, the autonomy of the Council came partly from ambiguity surrounding to whom it was ultimately answerable. As Pott (1928: 68) notes, neither the British nor United States ambassadors to China in Beijing had authority over the Council, lacking ability to command its members to obey directives from their governments. Essentially, the authority of the Council derived from its construction; formed by an agreement of the governed, its members were directly elected by the governed—or, at least, a portion of them.

In reality, the ratepayers represented only a small fraction of the actual number of residents comprising the International Settlement's population. The Shanghai Municipal Council was annually elected based on a property-based franchise, with only foreign ratepayers either owning land of a minimum value of 500 *taels* or paying annual rental fees of 10 *taels* entitled to vote; further, renters were only qualified to run for council positions if rental payments were a minimum of 50 *taels* per annum (Lockwood 1934: 1032-1033). While formal mechanisms in the Land Regulations—such as the elected nature of the Council, or mandating that budgeting and other substantive issues put forward by the Council or by other ratepayers required majority voted approval at annual or extraordinary ratepayers meetings—helped provide an important check on the Council's taxation and regulatory powers, the qualifications on voting and electability requirements implied the vast majority of residents were unqualified to either vote or run for Council membership positions. Prior to the late 1930s, less than one-sixth of the British community had voting right in the Shanghai Municipal Council elections (Bickers 1998: 168; Bergere 2002[2009]: 97). Even by 1934, the total number of eligible foreign voters in the Settlement was approximately 3,500 ratepayers out of a total foreign population of over 27,000, meaning therefore only approximately thirteen per cent of the Settlement's foreign population was eligible to vote in Council elections (*NCH* 28 March 1934: 489).

For the majority of its existence, the most glaring omission in the Council's composition was its lack of domestic Chinese membership. By 1927, the International Settlement population nearly topped 850,000 residents, comprised of approximately 7,000 British, 13,000 Japanese, 2,000 Americans, 3,000 Russians, and 5,000 nationals of other treaty powers—all far outweighed by a Chinese population of approximately 810,000, representing ninety-seven per cent of the population, and two-thirds of the taxpayers (SMC 1927: 80-81). Figure 1.2 presented earlier in Chapter One displays the relative population within the Settlement graphically. The International Settlement was clearly a Chinese city, albeit one with a colonial feel given the determinedly foreign political leadership and their outsized control of socio-political power.

As early as 1925, representatives of the Guomindang Party were increasingly and stridently calling on the Council to include Chinese participation in its rule; these calls grew increasingly more strident in following increased anti-foreigner sentiment the wake of the May Thirtieth Movement. While similar pressure exerted by Beiyang central government actors on the International Settlement leadership was not immediately successful in ending the extraterritoriality system, these efforts had important impacts on the structure of governance and responsiveness by the Shanghai Municipal Council.

Historically, Shanghai Municipal Council membership had only comprised British and American nationals, with two seats later allocated to Japanese representatives in the early 1920s, as the Japanese population—and business and political clout—had dramatically increased in the International Settlement (*Contemporary Japan* 1936: 449-456). By 1928, Council membership comprised of five British, two Americans and two Japanese, with Chairmanships having been held exclusively by either British or American nationals.

The 1926 Annual Ratepayers Meeting vote granting three seats to Chinese members on the Council, as per an initial request by the Chinese Ratepayers Association, represented a belated effort by the Council to diversify its membership. However, although the proposal was approved by the Beiyang government, before the election took place in 1927, more strident members of the Chinese community expressed dissatisfaction with the plan, arguing that three members were too few given the community's size and contributions to the Settlement, and demanded nine seats for Chinese, to equal the total number of seats held by foreign members (SMC 1927: 80). Considerable pushback was forthcoming from the foreign community, however, with editorials in English-language periodicals pointedly questioning why both Chinese Settlement residents and the domestic Guomindang government could so strongly demand representative rights for Chinese Settlement residents when all Chinese citizens lacked such rights under the authoritarian military-led Guomindang regime, with Kotenev (1926:7) defensively noting that "Chinese living in the native sections of Shanghai have certainly no more representation or voice in their local municipal government than those living nearby in the foreign settlements, with both equally disenfranchised."

In 1928, for the first time, three Chinese Council members were appointed to the Council, selected by members of the Chinese Ratepayers Association and the Shanghai, Nantao and Zhabei Chambers of Commerce. Further resolutions were passed to increase Chinese appointments to more senior positions within the Council and administrative structure (*Pacific Relations* 1934: 1-2). Whilst representation on the Council by Chinese members was an important step in rationalising and increasing the legitimacy of the Council at a time of increasing calls for an end to extraterritoriality, although dissatisfaction amongst many Chinese residents remained. After an embarrassing failure to pass a resolution at the annual ratepayers meeting in April 1930 to increase the number of Chinese representatives, a month later the Council called a Special Meeting of the ratepayers which saw a successful vote on a similar resolution to add two more Chinese members to the Council (SMC 1930: 32-56), increasing the number of elected Chinese members on the Council to five. This structure remained in place until the dismantling of the International Settlement in 1942, when the population of the Settlement had reached over 1,600,000, of whom all but approximately 125,000 residents were Chinese nationals (Woodhead 1945: 301).

The impact of increased representation certainly yielded some increases in the responsiveness of the state apparatus to the needs of a greater percentage of the Settlement's population; it is no surprise, for instance, that after admittance of the Chinese members to the Council in 1928, it was later in the same year that Chinese were admitted to freely utilise the Settlement's public parks, long a point of contention and humiliation for Chinese residents (Lockwood 1934: 1035). Other services, especially in the area of education, were introduced, such as a school construction program initiated in 1931 to increase the number elementary schools designated for Chinese school-aged children to reach a modest seven and one-half per cent by the start of 1938; the program however was curtailed in late 1934 after costs were deemed excessive (Lockwood 1934: 1036).

While much of the literature, both contemporaneous and modern, cite the representative nature of the International Settlement's governing structure as an important feature that helped place credible limits on government actors and contributed to the protection of private property rights from state interference, it is important to avoid overstating the degree of accountability the system produced. The Council was an institution representing

a limited set of interests within the International Settlement—an elected body, true, but one characterised as the few elected by the few. With the set of voting ratepayers remaining limited to wealthy expatriate landowners—and, eventually, equally exclusive Chinese Ratepayers associations—it was evident that the interests represented on the Council were those of the Settlement's business elite. Representatives to the Council selected by the Chinese community were done so less directly than in the western foreign community, with the board of directors of the Chinese Ratepayers' Association electing the Chinese members of the Municipal Council. One-third of board membership was determined by the votes of eligible domestic Chinese residents of the Settlement, which in 1930 came to a total of only 2,011 voters out of a total Settlement Chinese population of the of 971,397, representing just 0.2 per cent; the remaining two-thirds of board members were chosen by local domestic commercial organisations and resident guilds (*NCH* 30 March 1934: 523).

The limited accountability and responsiveness to the broader community of Settlement did not exist without contemporaneous critique. Observations such as those by de Jesus (1909: 249-250) were not uncommon, expressing frustration with the lack of transparency and limited voting pool, describing the Settlement as "at once a republic and oligarchy, whose council holds its meetings behind closed doors, the proceedings, howsoever important, being sparingly, tardily reported to the press. The ratepayers are powerless to carry-out their pet schemes however popular, if opposed by the council with its influential clique, with plural votes and proxies of ever-absent landlords to turn the voting of ratepayers into a mere farce." de Jesus continues his criticism by claiming there is "lavish expenditure if not actual waste of public funds." Writing several decades later, Lockwood (1934: 1036) critiques the governing structure in similar terms, noting that "Council membership, foreign and Chinese, is drawn very largely from the ranks of big business. ...Thus, despite the significant admission of Chinese to a share in the responsibility of government, the municipal regime as at present constituted remains highly oligarchical in character."

The degree to which appraisals such as de Jesus' and Lockwood's criticisms had merit are difficult to accurately assess; what some may call wasteful spending, others might well characterise as the provision of necessary social services. Further, attempts at increasing the transparency of Council actions do appear to have improved over time; by the start of the 1900s, the Council published a "Municipal Gazette" which provided residents updates and announcements regarding Council news, including regulations, announcements of ratepayers meetings and the results thereof, licensing and fee increases, and bond sale and redemption notices, amongst other news. Further, what we may observe is that such open criticisms in the local press with calls for greater transparency, reductions in government spending, or even accusations of corruption and wastefulness were partly indicative of the type of healthy debate of state power that Weingast and his co-authors identify as useful and necessary in an open society to assist in curbing the excesses of government overreach.

Nonetheless, the aforementioned weaknesses of the Settlement's representative governing system in terms of institutional mechanisms relating to transparency, accountability and responsiveness, relatively speaking, in both objective scale and by indication from the observed behaviours of contemporaneous actors, paled in comparison to those defining the domestic municipal government. Throughout the entirety of the late-Qing through republican era, Shanghai's domestic municipal government officials were appointed by the ruling central government. All local municipal officials—whether the Shanghai *Daotai*, appointed by the Qing imperial court as local representative of the central government; or the chief municipal administrators of the Nantao and Zhabei districts, appointed by the Beiyang government; or the Mayor and associated administrative department heads of the Municipality of Greater Shanghai, appointed by the Guomindang government—were direct representatives of the central state (Crow 1933:143). As such, such municipal government officials' ultimate constituencies would be more accurately portrayed as having been located in the central government's capital than in the domestic sections of Shanghai.

9.3.2 Credible Commitment Mechanisms: Extraterritorial Legal and Judicial System

9.3.2.1. Extraterritoriality and Protection of Legal Rights of Foreign Citizens

The original language found in the Qing Code specified that foreign citizens who committed crimes within China would be treated solely under its own domestic laws, with Section 34 of the Penal Code stating, "In general, all foreigners who come to submit themselves to the government of the Empire (*C), shall, when guilty of offences, be tried and sentenced according to the established laws" (cited in Liu 1925: 38). Prior to the Opium War, various efforts had already been unilaterally undertaken by Britain to try to effect jurisdiction over British citizens in China, typically under the justification that Chinese criminal laws were "barbaric." For instance, on 28 August 1833, the British Parliament passed "An Act to Regulate the Trade to China and India," of which Article 6 authorised the establishment of a British court of justice with criminal and admiralty jurisdiction for the trial of offenses committed by British subjects in China (State Papers 1833: 260-262). A subsequent bill introduced by Lord Palmerston in 1838 sought to establish a court in China to oversee all civil as well as criminal and admiralty matters (Journal of House of Commons 1838: 476). However, the powers passed under such legislation were not exercised, due partly to the anticipated resistance of Chinese authorities, and partly to the concern on the British side that such reach of legal power would not be in accord with the rules of international law (Hansard Parliamentary Debates 1842: 751-752).

One of the goals of the British negotiators in the Treaty of Nanjing was to ensure that British law, rather than domestic Chinese law, be applied to its subjects in China. With the signing of the Treaty, and later, the General Regulations of Trade, published 22 July 1843, extraterritoriality was granted to British citizens in China. Over the next few years China concluded a series of similar treaties granting similar extraterritorial rights to foreign citizens of other nations, including in 1844 the Treaty of Whampoa with France and the Treaty of Wanghia with the United States (Wu 1930: 185).

While much of the focus of extraterritoriality was on exempting British residents in China from prosecution in Chinese criminal courts to instead face trial and punishment from British-run courts under British criminal law, the desire to secure the protection of the trade interests of British merchants was also present (Koo 1912: 260-265). Indeed, early attempts to push open trade and utilise British laws to govern trade relations are found throughout British government officials' internal communiques in the *British and Foreign Papers* from this period (State Papers 1833: 1241-1244).

The 1858 Treaty of Tianjin between China and the United Kingdom subsequently further expanded the power of extraterritoriality, and more specifically included explicit clauses prohibiting the involvement of the imperial Chinese government in private business dealings regarding British merchants. Much of the Treaty's language dealt with ensuring that British merchants had the right to conduct business within China. For instance, Article XII of the Treaty specified that British subjects had the right to rent land for business purposes, "at the rates prevailing among the people, equitably and without extraction on either side." Likewise, Article XIV stated "British subjects may hire whatever boats they please for the transport of Goods or Passengers, and the sum to be paid for such boats shall be settled between the parties themselves without the interference of the Chinese Government." The Article further noted however, that if the British subjects are found to be smuggling goods, however, "the offenders will of course be punished according to [British] Law." While Article XV clearly stated, "All questions in regard to rights, whether of property or person, arising between British subjects, shall be subject to the jurisdiction of the British authorities," other articles in the Treaty that attempted to specify legal matters pertaining

to business did not do so by seeking to further expand the application of British law in China as much as require that Chinese law be used to protect British merchants' interests. For instance, Article XVII required Chinese authorities to provide full protection to the person and property of British subjects; Article XIX required Chinese authorities to protect British merchant vessels against robbery and piracy; and Articles XXII and XXIII required Chinese authorities to arrest Chinese subjects failing to discharge debts and enforce the recovery of debts owed to British subjects. Similar treaties were also signed at the same time in Tianjin between China, Russia, France, and the United States. In general, the role of extraterritoriality in commercial dealings was designed to ensure the protection of foreign merchants' property rights, as opposed to providing explicit advantages to foreign merchants.[§]

Subsequent additional treaties expanded upon the rights of extraterritoriality, and, as a result, Western merchants obtained a set of independent legal, judicial, policing, and taxation systems within the treaty ports, including Shanghai. By the early 1900s it was well accepted that a key function of extraterritoriality was to provide "a means for the protection and furtherance of the interest of trade" (Wu 1930: 182). Nations enjoying extraterritorial rights included Britain, the US, France, Italy, Japan, Belgium, Norway, Brazil, Denmark, and Sweden; although later as a result of the First World War, Germany, Austria, Hungary and Russia lost their extraterritorial rights and their citizens and companies were subject to domestic Chinese law (Helmick 1945: 252).

That foreign-operated business was able to operate under the purview of foreign commercial law had significant effects on the business organisation and financing of such firms that were founded in China. Firms founded under British law, for instance were able to utilise the British 1844 and 1856 Joint Stock Companies Acts, and later the consolidated 1862 Companies Act, which created a streamlined process for company incorporation with limited liability shareholders. Under the 1862 Companies Act, companies could be registered under British law if incorporating in any British colony, including Hongkong, and for much of the late Qing and early Beiyang period the majority of British-owned Shanghai firms were incorporated out of Hongkong. Companies owned primarily by citizens of other Western nations or by Japan typically would incorporate firms under the ordinances of their home countries. Subsequently, the 1915 Ordinance created a Companies Registry in Shanghai under the jurisdiction of the Supreme Court of the International Settlement, which allowed companies incorporating in Shanghai to be protected under British law.

The ability for foreign companies to open manufacturing concerns within China was another important step; the 1895 Treaty of Shimonoseki between China and Japan expanded legal protections and property rights of Japanese-incorporated businesses, and allowed Japanese-incorporated manufacturing companies to open and operate factories inside China proper. Other treaty nations immediately thereafter amended their agreements with China to include similar language and rights.

§ While the treaties between China and foreign powers are frequently referred to using the terminology "unequal treaties," this reflects their signing to have come at the conclusion of China's military defeat, and thus China entered the treaty as an unequal and unwilling partner; furthermore, these treaties frequently imposed onerous reparations upon the Qing government. However, for the most part, the language of the treaties did not impose "inequalities" in regard to commercial dealings between foreign and domestic economic actors (e.g., tax rates were never specified in any of these treaties along the lines of, "foreign merchants to pay *X* per cent lower than tax rates applied to domestic merchants"). In this important sense, domestic merchants were not *per se* placed at a disadvantage to foreign merchants due to the provisions of these treaties. However, as discussed in earlier chapters in regard to the *lijin* tax system, in application, domestic merchants faced punitive tax rates imposed by domestic state actors from which foreign merchants were effectively exempt.

Perhaps the most important way extraterritoriality was applied in Shanghai's foreign settlements was via the court systems. In essence, extraterritoriality created a system of foreign courts administered by foreign justices administering foreign laws. Foreign residents and foreign-incorporated companies in treaty port cities were subject to the legal jurisdiction of their home countries under consular authorities, rather than that of the domestic Chinese legal system. Owing to its international structure, within Shanghai's International Settlement there operated a multitude of jurisdiction-specific courts. Britain, for instance, established the British Supreme Court for China and Japan. In 1906, the U.S. Congress passed legislation creating the United States Court for China in Shanghai, which exercised extraterritorial jurisdiction over U.S. citizens and U.S.-registered companies in Shanghai regarding both civil and criminal matters from 1906 to 1943. Other treaty countries that utilised the International Settlement structure also operated their own consular courts within which their citizens could receive the legal protections offered by their home country's particular legal system.

The rights of these non-Chinese courts to adjudicate under foreign laws was consistently affirmed and expanded. For instance, in 1904 several rulings were made by the British Court to clarify that such jurisdiction covered British subjects, including British protected persons, the property and all rights and liabilities of British subjects, British ships, and all persons and property on board, within 100 nautical miles of the Coast, including the administration or control of the property or persons of British subjects (*London Gazette* 28 October 1904: 6887-6909).

This separate set of court systems provided an institutional framework for legal resolution of disputes and an application of the rule of law that accorded with the expectations of foreign nationals in Shanghai, including business managers and investors. Foreign-incorporated companies—including joint-stock companies whose stock and bond issuances traded on the city's local foreign-operated stock exchange—operated under foreign law, and hence disputes regarding their business activities or issues concerning shareholder rights were governed by applicable foreign law. This situation differed from companies and shareholders of domestic Chinese joint-stock companies incorporated under domestic law, particularly prior to the period of the passage of codified or formalised company law.

Milton Helmick, who served on the United States Court for China from 1934 until 1941, describes a relatively effective legal system operating in the Settlement, despite the multitude of different nations' courts in simultaneous operation. Helmick (1945: 252) notes, "There was not nearly so much confusion as one would think. If a Chinese had a claim against an American, he sued in the American court; if an American had a cause of action against a Briton, he filed in the British Court; if a Frenchman had been wronged by a Swiss he sought damages in the Swiss Court". While Lockwood (1934: 1038) is slightly less sanguine regarding the complexities the extraterritorial court system brought, he too accords with Helmick, commenting that whatever "confusion and uncertainty in judicial arrangements" there existed, it was at least "less perhaps than the clumsiness of the system might lead one to expect."

Nonetheless, issues of inadequacy in this somewhat contrived legal system existed, including in terms of commercial law. As Hinckley (1912: 105-106) notes, the United State Court for China lacked formal jurisdiction to enforce the federal U.S. bankruptcy law, restricted as it was to application in federal courts. As a result, American judges on the Court would frequently resort to performing more in the role of an arbitrator than an adjudicator in circumstances involving bankruptcies, as Hinckley describes the actions of involving chief justice Rufus Thayer in a complex bankruptcy case that came before the Court in 1908.

As typical of many of those who participated in constructing and implementing the Settlement's legal institutional framework, Helmick (1945: 255) expresses the goal of the system to have been the application of "impartial" justice, as opposed to providing special protection to foreigners: "One is likely to think of extraterritoriality and the [U.S.] Court in terms of protection to American citizens, forgetting that the duty of the Court to protect Americans was no higher than its obligation to afford just remedies to four hundred million potential plaintiffs. The majority of the plaintiffs were not Americans but Chinese, British, Russian, Portuguese and every other nationality." Such positive characterisations of the extraterritorial legal system, however, need be tempered by the fact that Helmick's perception of the system was necessarily heavily coloured by his very embeddedness within the extraterritorial system itself.

9.3.2.2. Legal Protections Afforded Chinese Citizens in the International Settlement

While extraterritorial rights covered citizens of applicable countries, the vast majority of the International Settlement population was comprised of Chinese citizens. As such, many commercial legal disputes involved issues between Chinese citizens themselves, or with citizens of other nations. Accordingly, a unique legal structure of the appellation the "Mixed Court" was established in 1864. Mixed Court cases were presided both by a Chinese magistrate and a foreign assessor, both of whom needed to agree before judgement could be rendered (anon. 1927: 87). The authority of the Mixed Court derived from the fact that within the Settlement, Chinese legal authority was limited.

Stephens (1992) controversially claims that since there was no actual "Chinese law"—defining the term narrowly along the lines of Hadfield & Weingast (2012) to reject the application of the Chinese legal system as applied by Chinese magistrates solely represented a "disciplinary system", meaning decisions were made according not to defined, established law, but rather an individual assessor's own (potentially arbitrary) opinion and reasoning—instead, the actual law as implemented by the Mixed Court was in fact based upon underlying legal principals underlying the legal traditions of the foreign (Western) legal assessors, a claim earlier supported by Gundry (1920: 53).

For Chinese citizens residing or conducting business within the foreign settlements, this unique legal structure created a partial layer of legal authority between Chinese citizens and the power of the Chinese state. As Jernigan (1904: 222-223) details, "The settlements are further protected from the authority of China to the extent that, if China should wish to arrest one of her own subjects residing in a settlement, such subject could not be arrested until the warrant for the arrest had been resent to the senior consular representative and countersigned by him. ...And after China had conformed to the above requirements, the arrested Chinese would still have the accusation against him heard and passed upon under the supervision of a foreign consular officer in a tribunal known as the Mixed Court." This procedure was reiterated numerous times by official Shanghai Municipal Council documentation, including, for instance, the 1899 Shanghai Municipal Council Annual Report which noted, "in all cases of warrants for the arrest of native residents in the Settlement, a preliminary inquiry must always be held at the Mixed Court, for verification of the facts, prior to removal of the prisoner beyond Settlement limits" (SMC 1899: 70).

Lee (1993:1354-1356) argues the Settlement's Mixed and foreign court system was accessible to Chinese litigants, with low fees and filing procedures that did not require attorneys; she further cites instances of the Shanghai Municipal Police encouraging aggrieved Chinese victims to file civil cases in the Mixed Court. The willingness of Chinese residents to utilise the Mixed Court apparatus is supported by a general reading of case records that consistently finds commercial cases brought by Chinese applicants, many

decided in favour of Chinese litigants over those foreign. For instance, a Mixed Court case between plaintiffs F. Bartley and W. Sauer against Li Yuen of the Li Shang Trading Company as defendant involved the plaintiffs making a claim of 18,340 *taels* because they had received a lower price than they had wanted on the sale of stocks. Assessor E. Mead decided 5 July 1923 in favour of the Chinese defendant, noting defendant acted solely as a broker and was not at fault the defendants received a lower price than they wished; the judgement specifically cites the contract made and signed between the defendant and plaintiffs, with the judgement upholding the intent of the contract as implied in its wording (Shanghai Municipal Archives 6.317-1-46).

In another Mixed Court case decided two weeks prior on 22 June 1923, a Chinese plaintiff Wong Vung Dah sued the Chinese domestic-owned Chartered Stock and Produce Exchange for 158,380 *yuan*. Wong claimed that under the terms of the contract, in the event that a valid trade was entered into according to the regulations of the Exchange, if the Exchange was unable to later complete the transaction as agreed upon, the Exchange was required to refund the shares and pay a five per cent penalty. The Exchange had not done so after a trade had been nullified, and Wong was suing for his shares and the penalty. The Court found in favour of the plaintiff and ordered the Exchange to deliver to Wong the shares due him as well as to pay five per cent damages as pursuant to the contract (Shanghai Municipal Archives 6.317-1-20).

These two example cases are informative in two regards. First, in both decisions, the wording of the judgements clearly held the existing contracts between the parties as the determining factor in their judgement methodology, underscoring the weight that protection of contracts was given under the foreign-jurisdiction system of the Mixed Court. Second, it appears that Chinese litigants utilised the Mixed Court even in instances such as *Wong v. Chartered Stock and Produce Exchange*, when both parties were domestic residents or companies. In this case, we might presume Wong chose to bring his claim to the Mixed Court alleging violation of contract because he was aware of the strong adherence to and protection of contract rights provided under the jurisdiction of the Mixed Court system. As noted by Helmick (1945: 253), subsequent to the dissolution of the Mixed Court in 1927, the Settlement's domestic Chinese population continued to heavily utilise the jurisdiction-specific extraterritorial courts.

Lee (1994: 193) centres her discussion of the Mixed Court from the point of view of the Settlements' domestic Chinese end-users, in particular in their choice to adjudicate civil cases under the Mixed Court system: "The hundreds of thousands of civil cases and judgments at the court, for instance, may fit less easily into the disciplinary model than do the court's criminal cases. The civil side of the court was service-oriented and competed with other courts for business." This concept of competition underscores the fact that, at least for civil cases, domestic Chinese nationals had some amount of choice whether to utilise the Mixed Court system, and the relatively large amount of cases tried under the system is indicative of a "revealed preference" for this legal form that, "at least in commercial cases", Gundry (1920: 54) claims, the Mixed Court would "base its decisions more and more upon principles of Western jurisprudence."

Beyond the formal court system, extraterritoriality also proved partially effective at providing a partial shield to the Settlement's domestic Chinese residents from the overarching power of the domestic state in terms of economic activities. This was particularly true in regard to attempts by domestic government officials to impose domestic taxes on foreign or domestic business activities within the Settlement. The International Settlement continually asserted its immunity from the Chinese taxation system by declaring, "goods as well as other property within the limits of the said concession are under Municipal protection and without the jurisdiction of the Chinese authorities" (Commission on Extraterritorial Jurisdiction in China 1926: 109).

The assertion for the right of the Shanghai Municipal Council, and the Council alone, to levy taxes on any resident within the Settlement, foreign or domestic, can be traced back to early within British Settlement policy. The issue was partly driven by concerns for potential corruption. In regard to the handling of the Council's financing needs, at the annual Land Renter's meeting of 1861, a Mr Smith objected vigorously and repeatedly that it was problematic that the Municipal Council's Defence Committee had used the power of the Taotai to issue a proclamation to commanding all Chinese renters in the Settlement to contribute an amount equivalent to two months' rental, and were they to refuse, they would be severely punished. Smith noted that given the Council was seeking collection of 60,000 *taels*, and that were all Chinese renters to submit two months' salary the amount raised would be more than 300,000 *taels*, his concern was that the fee collectors were going engage in a "gigantic squeeze" scheme on the domestic residents. As a landlord, he was able to produce stamped receipts from many of his domestic residents who had paid the two months fee; yet he noted there was no associated accounting from the domestic collectors of total amounts collected thus far, and he forcefully expressed that granting Chinese officials the authority to collect taxes from Chinese residents in the Settlement "would lead to no end of abuse" (*NCH* 5 April 1862: 56). The Council subsequently had the proclamation by the Taotai rescinded, and instead the British Consul produced a translated notice posted declaring the contribution voluntary. In addition, this led to a more general effort by the Council to reassert its position that it alone had sole authority to levy and collect taxes within the Settlement. The Council, for practical reasons in the late 1850s, had farmed out the authority to local government officials to collect certain domestic taxes from the Settlement's domestic residents; within several years, however, reference to an *imperium in imperio* issue was cited as leading to "confusion and disorder" as these officials were exercising authority within what was, in the regard of the Council leadership, the sole domain of the Settlement's authority (*NCH* 11 April 1863: 58). Moving forward, the Council continually strove, with varying degrees of success, to reassert and maintain its sole taxing authority within the Settlement.

In addition to concerns of potential corruption opportunities for either domestic or extraterritorial municipal government officials, a secondary, perhaps more important, driving factor in exempting domestic Chinese firms and individuals from domestic Chinese taxation was economic. As continually stressed, the International Settlement was, at its core, a Chinese city, comprised of Chinese residents and Chinese businesses. As Lockwood (1934: 1039) notes, "from an early date," the Council leadership, representing local business concerns, viewed the imposition of heavy domestic "Chinese taxes on Chinese residents and firms... [as] a burden on business enterprise." More lightly taxed businesses, whether foreign- or Chinese-owned, generated greater overall economic growth. Insofar as the Settlement tax environment was more attractive, it would also serve to draw domestic Chinese entrepreneurs to open business concerns within the Settlement, further boosting overall growth.

A Mixed Court case in July 1909 illustrates an application of the attempt to provide protection to domestic merchants within the Settlement against domestic Chinese taxation. Brought before Assistant Magistrate Pao Yi, and German Assessor Mr. I. Pratt, the case concerned the attempted debt collection by the City Magistrate for the local Shang government in the Foreign Settlements. The case involved two Chinese shopkeepers (Tsun Yang-shing, and Zee Yuen-Zung) who were being summoned by the domestic City Magistrate and charged with outstanding debt. Importantly, given the two shopkeepers were residents of the Foreign Settlements, the City magistrate needed to bring suit against the defendants in the Mixed Court. However, during the course of the trial, it came to light that the debt claim was for non-payment of a *lijin* tax on fuel. Upon learning of this, the Court

was emphatic and unequivocal in declaring this to be an illegal tax: "The City Magistrate had no right to tax anyone living in the International Settlement." Zee and Tsung each produced documents showing they had been residents of the International Settlement for thirty and forty years, respectively. The city collector, Loh Yue-man, was questioned at length by the Court, and admitted he had collected taxes outside Settlement for 17 years, but sometimes also collected inside the Settlement. The Court ruled that according to Shanghai Municipal Council regulations, the defendants were to be released and tax collector held, because: "Any Chinese official or the employee of any Chinese official found levying or attempting to levy *likin*, that is duty on any goods of any kind whatsoever, will be arrested and brought before the proper authorities." While ultimately Magistrate Pao chose not to formally arrest and charge the tax collector, the defendants were successfully granted freedom from the debt (*NCH* 3 July 1909: 47).

Shanghai Municipal Council pronouncements continually emphasised that Chinese-owned and operated business activity had the right to be conducted solely under the rules and regulations of the Settlement, and not interfered with by domestic law or officials. For instance, this view is reflected in a letter the Chairman of the Council addressed to the Taotai in 1900, stressing that, "No establishments opened by Chinese subjects in the Settlement are subject to the control of the [Chinese government]" (*SMC* 1900: 69). That year's Annual Report contained additional language explicitly noting that it was the role of Settlement authorities to "protect the industries of the Chinese from the interference of their officials" (*SMC* 1900: 70). However sincere this sentiment, the actions of the Council should not be discounted, for as documented throughout Chapter Three, much of the violations of domestic economic agents' property rights came at the hand of the Chinese state apparatus. The foreign settlements, therefore, at least on paper and in pronouncement, provided partial protection of property rights through an institutional environment that while ostensibly designed for the use of foreign economic agents, could also prove beneficial to domestic Chinese economic agents and their entrepreneurial activity.

9.3.2.3. Uneven Protection Provided by the Extraterritorial System

It is important not to overstate the degree to which the system of extraterritoriality and the Settlement's legal institutions served to afford legal protection to domestic Chinese residents and businesspersons from possible domestic government expropriatory actions, or whether such protections were necessarily welcome. To begin with, it must be emphasised that widespread prejudice and ingrained bias in favour of Europeans in all aspects of social dealings vis-a-vis the domestic Chinese population permeated the foreign settlements (Wu 1991); even overall positive depictions of the settlements such as Ma (2008: 376) recognise the presence of a "systematic practice of political exclusion and racial discrimination." The extraterritorial legal system was unavoidably reflective of such prejudice. Bishop (1920: 175) criticises the foreign-run extraterritorial courts in noting that they sometimes handed down lighter sentences on foreigners convicted of crimes than on domestic citizens. While claims of impartiality and application of the law equally to all parties—foreigner or domestic—that were frequently made by Mixed Court practitioners are to be discounted as driven by motivated reasoning, the structure the Mixed Court, in which both domestic Chinese and foreign legal officials co-jointly delivered judicial rulings, nonetheless served to partially mitigate the adverse effects of racial prejudice on Chinese litigants. Yet this structure itself must be regarded as biased, as there were recorded instances of the foreign assessor enforcing his judgement over that of the domestic magistrate when there was disagreement between the two (Clark 1894: 111-112).

Second, it is evident that the International Settlement and Mixed Court apparatus proved unable to provide a complete shield against the domestic state's legal power within the Settlement over Chinese citizens. There occurred numerous examples of domestic police forces disregarding the Settlement's claimed absolute jurisdiction to arrest and adjudicate residents, foreign or domestic. For instance, the 1899 Shanghai Municipal Council Annual Report references the events of 25 October in that year when a Chinese resident of the Settlement was "arrested without any warrant and forcibly taken" out of the settlement to be imprisoned in domestically-administered Shanghai; while the Municipal Council's Chairman issued a formal letter of complaint to the district Taotai highlighting the "gravity" of the situation, and demanding the return of the prisoner to be tried in front of the Mixed Court under due process, as well as the surrender of the domestic Chinese police who ordered and conducted arrest, the Report also pointedly notes that these efforts had "produced no results" (SMC 1899: 71). Such issues persisted, and the Council found itself constantly asserting to the domestic government authorities its perceived sole sovereign right of arrest and initial judicial review for all Settlement residents, foreign or domestic.

Third, although the Mixed Court represented a collaboration between domestic and foreign legal officials, it nonetheless operated, in theory, under the common law conception of a formalistic and consistent application of legal reasoning, immune from social opinion or influence by government or business leaders. However, such an approach was not universally appreciated by some domestic economic actors, particularly those who had historically served as the primary power brokers for most merchant disputes, such as domestic Chinese business and commerce guilds who were loath to cede their authority in such matters to a different institution.

The case of *Barlow & Co. v. the Ming Sung Umbrella Factory and Yen Siao Hong* can be viewed as symbolic of the tension between the traditional, more flexible and subjective arbitration methodologies preferred by the domestic guilds, opposed to the more formulaic code-based procedures utilised by the Mixed Court and other newly-formed "modern" Chinese courts. The case received extensive attention in the local press, with the *North China Herald* publishing the Chinese magistrate's and foreign assessor's conflicting decisions in full due to the case being viewed as of "utmost importance to the business community of Shanghai" (NCH 31 July 1926: 223). The specifics of the case were indeed central to commercial dealings that took place within the city between and across Chinese and foreign merchant relationships, centred around the issue of liability of debts under partnership—under Western legal conceptualisations, which had also been adopted by formal Chinese courts, any individual partner could be liable for all debts to creditors in the event of default, regardless of the relative share of the business held of the partnership; for the leadership of the local Chinese business community (including the Chinese Shanghai Chamber of Commerce), liability was to be dependent on the individual circumstances of the particular situation, subject to the approbation of the local business community leadership. While in this particular case this called for the plaintiffs to only be able to extract outstanding debts from solvent partners in proportion to the partners' initial investment in the defaulting firm, more generally, the process was described by one of the representatives of a domestic Chinese commercial association as one of consensus, such that "if a Chinese partnership became bankrupt what happened was that there was a meeting of creditors and debtors and an arrangement come to by which a percentage of the total partnership liabilities was accepted by the creditors" (NCH 31 July 1926: 225). In their respective judgements, upon which no agreement between the two could be made, the foreign assessor found for plaintiffs by citing precedent based on prior Mixed Court and recent Chinese Supreme Court rulings that affirmed the full liability concept, while the domestic magistrate ruled for the defendants, basing his finding "in accordance with custom" (NCH 31 July 1926: 224).

Ultimately, the result of the case was viewed as a blow to the adoption of formal commercial law within Shanghai. The testimony of a member of the local rice guild was seen as particularly telling in regard to the hesitation by the domestic business community to accept legal decisions by the Chinese Supreme Court as trumping the authority of local business leaders, in which he stated, "If [a ruling by the Supreme Court] is reasonable I will obey; if it is not, I will not obey," and ultimately agreed with the sentiment that in this particular case, "What we [merchants] say is right, what the Supreme Court says is wrong, even on a matter of law" (*NCH* 31 July 1926: 225). Thus, we find that while it is accurate to depict some domestic merchants as apt to utilise the authority of the Mixed Courts, with its stricter adherence to respect for contract and investor rights, it is also clear that other domestic agents chose to utilise more traditional, relationship-based adjudication methodologies, at least in instances when they proved beneficial. Representing perhaps an earlier form of the "adjudicative/disciplinary" dichotomy outlined by Stephens (1992) regarding differences in Chinese and western law, contemporaneous observers accorded the results of the *Ming Sung* case to differing "psychologies" regarding legal matters. Writing at the time, Kotenev (1927:220) states, "a feature which is absolutely unique, a feature which recurs infallibly through all the conscious and sub-conscious mentality of the two peoples. It is an exercise of an absolute obeisance on the part of foreigners to the principles of legality and law, and of reverence and adherence to traditional customs on the part of the Chinese."

Fourth, we can observe that the relative strength of the legal protections afforded to domestic Chinese economic agents by the extraterritoriality system were not time invariant, and that in particular the ability of the foreign-administered institutional environment to impose a safeguard from potential expropriation by the domestic state declined with the ascendancy of the Guomindang government. This was particularly true in regard to taxation issues. From early on, imposition and collection of taxes by domestic government officials within Settlement borders had proved a contentious issue. While adamant in its position, the Council found itself frequently unable to fully enforce their desired policy of sole authority to levy tax within the Settlement. A description of the difficulties experienced by the Council in preventing local domestic government officials from imposing *lijin* on domestic merchants in the Settlement is provided in the 1900 Shanghai Municipal Council Annual Report, which opened with the grouse, "It would appear that no amount of correspondence, no application of Consular pressure, will ever instil into the Chinese officials the fact that the Settlement is exempt from the collection of *lekin*", noting that local officials only seemed to take this issue more seriously after the arrest of a several government tax collectors by the Municipal police (*SMC* 1900: 31). The 1916 Annual Report described similar pushback efforts by the Council after Chinese government agents began patrolling Soochow Creek (吳淞江, Wusong River) in riverboats within Settlement territorial limits, imposing *lijin* taxes on cargo transported along the river.

Overall, however, for much of the history of the Settlement, both foreign and Chinese individuals and firms were generally shielded from the imposition of arbitrary and putative taxation policies of local and national Chinese officials, especially in comparison with those imposed on firms and business operations in the domestic-controlled part of Shanghai, as well as the rest of China—Lockwood (1934: 1039) notes pointedly that "the immunity of the Settlement from taxation means chiefly the evasion of irregular levies to finance destructive civil wars and to line the pockets of Chinese warlords." Such independence from the domestic taxation system, however, suffered considerably when in 1926 the Extraterritoriality Commission submitted to the incoming Guomindang Party's demand to allow the domestic government to impose excise taxes on goods such as cement, flour, and tobacco on businesses operating within the Settlement, foreign or domestic Chinese alike. As Lockwood (1934: 1039) subsequently comments, the local business community consented to this new reality "as a matter of business and political expediency."

Such acquiescence on the part of the Council was to be the first of several contests over the authority of the new central and local municipal Guomintang governments to enforce policies within the International Settlement on Chinese residents in which the Council saw its sovereign power effectively diminished. Guomintang Party officials applied continual pressure to have domestic tax laws enforced within extraterritorial settlements. In 1927 the Guomintang government sought to impose a tax equivalent to two months' rent on domestic Chinese residents of Shanghai's foreign settlements in support the Northern Expedition, and established collection bureaus within the International Settlement. While the Shanghai Municipal Council immediately declared the tax illegal and collectors liable to arrest and punishment, and demanded the closure of the collection bureaus (*NCDN* 28 June 1927: 5), a compromise was eventually reached that allowed the Guomintang government to collect stamp duty by post, provided no police or tax collectors from an outside authority operated within the Settlement. However, by 1929 the Council had consented to the establishment of a domestic government-run office of the Stamp Tax Bureau within the International Settlement itself. In the agreement, the Council reiterated that the validity of the Chinese Stamp Tax Law within the Settlement was not recognised, and that no foreign nationals be compelled to comply with this tax; the agreement further stated that although Chinese residents of the Settlement were technically required to comply with such law, "Chinese police, or other agents of the Chinese authorities, must not, on any pretext or in any form, be used within the Settlement limits for the enforcement of, or in connection with, the Stamp Tax Law", and further stressed that the Council and its agents would not conduct inspections of books or records of domestic Chinese businesses in connection with the application of the law (*SMC* 1929: 22). Nonetheless, while the Council attempted to control the enforcement of this tax, that formal domestic tax collection bureaus operated within the Settlement for the first time since the 1850s was highly significant.

Further weakening of the Settlement's sovereignty authority in regard to the enforcement of law within its territorial borders can be reflected in the ultimate results stemming from disagreement over the legitimacy of implementation of the Guomintang government's 1929 Factory Act, which ostensibly sought to improve working conditions and prohibit child labour throughout China. After the law's passage, the central government immediately began to pressure the Council allow inspectors to enter the Settlement to enforce this law (albeit, it was not until 1934 that the Ministry of Industry's Bureau of Factory Inspection produced a five-stage plan to actually implement the law), to which the Council vigorously protested. Certainly, much of the resistance on the part of the Council derived from a general commitment to lax regulation on industry; while the Council had itself begun efforts to limit child labour and improve working conditions in the early 1920s (*SMC* 1923: 59-61), little substantive action had taken place; as the *Far Eastern Review* (20 Nov. 1935: 187) remarked, "The continuation of *laissez-faire*, as it exists in the 'model settlement' with its large and growing industrial proletariat, is without parallel outside China." However, the more fundamental issue was only tangentially related to the specific nature of regulatory control that should exist on factory owners; this fact perhaps underscored by fact that the Council's proposal to enact and enforce the exact same regulations as specified in the Factory Act was opposed by the central authorities, who remained adamant that factory activity within the Settlement was theirs to regulate, on the grounds that the Settlement was part of Chinese territory. Hence, the ultimate disagreement centred around the validity of domestic law and the enforcement mechanisms of such law within the Settlement.

Nearly two years after the law's implementation, the issue remained open. A statement on the issue by the domestic city Mayor, General Wu Techen, in May 1933 was pointed: "The International Settlement being Chinese territory, foreigners residing and doing business in the International Settlement by virtue of existing treaties can only enjoy the rights stipulated therein. Chinese citizens resident in the International Settlement have the same duty towards the Chinese Government as those who reside outside it. The natural

relationship between Chinese citizens and the Chinese Government must not be interfered with by foreigners" (NCDN 07 May 1933). In reply, Council members issued several abstruse statements indicating they intended to comply; however, the issue remained unresolved until a formal agreement on the system of factory inspection in the International Settlement was signed by the Council and the City Government in 1936 (*Far Eastern Survey* 15 July 1936: 156-157). In this instance, the ability of the Council to use the shield of extraterritoriality to limit enforcement of domestic government regulations on residents of the Settlement, after an extended period of pushback, eventually lost out as the relative power of the two parties evened. In general, an ever-increasingly powerful Guomindang bureaucracy that sought to end extraterritoriality and implement policies amenable to those in line with Party goals, including those that were occasionally inimical to the protection of domestic economic agents' private property rights, was able to reshape the legal institutional landscape of Shanghai's International Settlement to one less definitively distinct from that of the city's domestically-administered municipality, especially for domestic economic agents.

Of a similar form, Law (2015)'s research indicates that during the Guomindang era, starting as early as late 1927, weakened judicial independence of the extraterritorial legal system was manifested in the form of numerous concessions by the Shanghai Municipal Council and Municipal Police in acquiescence to Guomindang demands to curtail arrest, detainment and expedition procedures and regulations in regard to suspected communists. Over time, Law shows, legal protections designed to ensure the rights of suspects were continually eroded in a series of compromises on the part of the Settlement that effectively transferred policing and judicial authority from the extraterritorial to the domestic legal system. As Law (2015:3) observes, "the Kuomintang demanded the Shanghai Municipal Police for the simplification of arrest procedures when arresting communists hiding in the Settlement. Later, the Chinese authorities furthered requested the Shanghai Municipal Council to extradite important communist convicts immediately and to hand over communist prisoners to the Soochow reformatory." Although, as Law continues, these "demands violated the legal procedures of the Settlement", they nonetheless occurred, given that many of the leadership of the Shanghai Municipal Police believed "Violations of settlement judicial procedures and legal practices [made] arrests more effective and efficient" (7). While violations of suspects' rights is indeed likely to increase the efficiency of the ability of state police apparatuses to arrest, whether the goal of the legal system is to prioritise efficiency or justice is a question that historically within the common law legal tradition of the ascribed to by the International Settlement had been more heavily weighted towards justice, but one from which, under pressure from Guomindang political structures, the extraterritorial legal system continually seemingly abandoned.

9.3.2.4. The End of the Extraterritorial System

This reshaping of the extraterritorial legal environment from one of relative insulation from domestic political-legal intrusions, to one more adaptive and responsive, coincided with the waning in the support from Britain, France and other treaty nations to continue the extraterritorial system. As Bickers (1998) argues, in the period following the First World War, government officials in Britain and the United States had already started to seek ways to extricate themselves from the legal and diplomatic morass of the extraterritorial system; it was the "Shanghaianders"—local expatriate residents—who continually fought hard for maintenance of the extraterritoriality system, much to the consternation of the British and American foreign ministries.

The practice of extraterritoriality was regularly described in the Chinese popular press and by most Chinese government officials as an affront to Chinese sovereignty, and calls to end its existence began quite early. However, the general weakness of the Qing and Beiyang governments, coupled with a strong commitment to the system by the foreign treaty powers, led to little substantive movement on the issue beyond the commitment at the Washington Conference to "examine the issue" (*NCH* 24 April 1926: 165). The situation began to change once a more powerful and bureaucratically competent Guomindang Party secured control. To begin with, the Guomindang central government began increasing pressure on the International Settlement leadership to relinquish the right to extraterritoriality, and to prepare for the ultimate return of the International Settlement to China. Additionally, in the wake of legal reform in 1926, the Guomindang government abolished the Mixed Court system and replaced it with a provisional Chinese court comprised of a sole Chinese judge, and subsequently in 1930, by the Chinese Special Courts.

Furthermore, such increased pressure on the part of the domestic government to end extraterritoriality coincided with waning support for the system within the diplomatic corps of the two major treaty powers, Britain and the United States, as it was increasingly viewed as generating few diplomatic benefits yet causing continual disagreement with a government they increasingly saw as a potential important ally in the global battle against communism (Bickers 1999). Expatriate residents of the Settlement, conversely, continued to voraciously call for the continuance of the extraterritoriality system. In response to rising pressure by the domestic central government to end the system as early as 1932, in 1930 the Shanghai Municipal Council commissioned a report by a South African legal scholar, Judge Richard Feetham, to provide an "unbiased" report and propose a course of action. Feetham (1931)'s conclusion that extraterritoriality should be maintained at least for a few more "decades" was met with immediate rejection by the Guomindang government, and a marked distancing by the foreign treaty powers.

Pressure to rescind extraterritoriality lessened, however, after the Japanese invasion of Northern China in 1931, when the Guomindang government leadership viewed appeasing Western countries on the extraterritoriality issue to be valuable in gaining their support in combat against the Japanese military (Lockwood 1937: 277). In addition, the British position regarding extraterritoriality hardened considerably after a young Briton was secretly killed by a Chinese military commander in 1931. The subsequent cover-up and initial denials by the Guomindang government was viewed as further evidence that ending extraterritoriality would be premature (Bickers 1996).

A complete dismantling of the extraterritoriality system would not come until nearly a decade later. Concerns about the lack of independent judiciary under the Guomindang government and corruption in the Chinese legal process aside, the majority of Western powers exercised a voluntary relinquishment of extraterritorial rights shortly after the start of the Pacific War in December 1941. The decision to end extraterritoriality by the United States and Britain appeared prompted more by political expediency rather than confidence in China's judicial system. Neither country cited their satisfaction with Chinese legal development as a reason for the relinquishment; on the contrary, at least from internal discussions, China's judicial system was seen a cause for continuing concern. In a tellingly blunt assessment, Clarence Gauss, the American Ambassador to China, upon learning of the State Department's plans to abolish extraterritoriality, stated, "The unsatisfactory Chinese police, judicial and prison systems have not improved during the past decade; they have, in fact, suffered in retrograde; and unfortunately, a system of both government and Party secret services has spread throughout the country and gained extensive power and domination which seriously threatens the enjoyment of 'four freedoms' not only by Chinese people but by foreigners in this country" (US State Dept. 1942: FRUS 711.933/374).

9.4. Credible Commitment Mechanisms: Bureaucratic Capacity

The finances of the Shanghai Municipal Council were organized in a modern "fiscal state" model similar to what was deployed for municipalities in Britain at the time, where regular and ordinary expenditures for on-going services were paid for primarily from taxation, while the costs of long term capital investment projects such as public works were financed by bond issuances. Taxes were generally low—this might be partly attributable to a stated commitment to small and efficient government continually espoused by Council members; of greater import, however, were the constitutional limitations placed on the Council that prescribed the levy of taxes on business operations, allowing the Council only the right to impose real estate taxes, as well as customs dues and licensing fees. Thus, the Shanghai Municipal Council had no ability to arbitrarily raise taxes or fees on individuals or businesses without first passing municipal ordinances at public hearings during annual ratepayers meetings.

The Shanghai Municipal Council maintained a stated commitment to relative fiscal transparency. The need for keeping strong oversight on fiscal outlays was continually stressed in the press; indeed, one finds such sentiments stressed from the very onset of the formation of the Council itself: "above all, the financial economy of the Council is of primary importance. However well the various parts of the municipal machinery maybe be controlled by the body of councillors and their staff of employés, unless the revenue and expenditure be judiciously managed, affairs are certain to get into an unsatisfactory state" (*NCH* 11 April 1863: 58). External critiques in the press and by outside observers, such as de Jesus (1909: 249-250)'s previously-cited criticism of poor transparency, represented additional sources of oversight on fiscal outlays.

An important check on Council spending came from some amount of direct oversight, as budgets were subject to scrutiny by the general ratepayers. Contest of budgeted line items was not infrequent. The salaries of the Council's staff might be reviewed and discussed (SMC 1930: 7), concerns regarding the appropriateness of allocating additional taxpayer funds for a new park might be raised (SMC 1933: 18-22), and requests for increases in tax rates protested amid cries that too much prior spending was simply "squandered" (SMC 1940: 13). Hence, the annual meeting process provided a potential check on the role of the government to expropriate through taxation.

The Council also maintained a treasury system, with a Finance Committee that made recommendations to the full Council and conducted annual budget reviews, which occurred both via externally-administered audits, and in public forums at the annual ratepayers meetings. It was at these annual meetings that the Council would submit its budget to the ratepayers for review. The budget was not a simple document—the overall annual reports produced each year by the Council numbered several hundreds of pages, and included detailed line items, with sections specifying every category of spending, and explaining the full amount budgeted and spent, and reasons for such variances. However, simply ascribing importance to the length of the Annual Reports is a potentially poor indicator of state capacity. The political and fiscal administrators of the Council were incentivised, albeit indirectly, to produce work indicating the seriousness and importance of their positions, both to help ensure resources would be allocated for continual employment in their roles, as well as for personal accolades.

Nonetheless, detailed readings of these Annual Reports underscore that the tasks and role of the Settlement's municipal government continued to increase in complexity and scope over time. Further, it is evident that an attention to detail especially in regard to the financial

matters of the government structure was paramount. Monies spent on police and fire protection, education, parks and other public works were fully accounted. The 1902 Report, for instance, included several pages on a budgeting issue regarding rising school expenses due to increasing numbers of students attending public schools, and that a new policy was being put in place to charge attending children's parents 0.50 *yuan* per month for the use of school books to help defray costs. The Report provided breakdowns for previous school book costs and projected budgets based on expected increases in school children (SMC 1902: 367-369).

Although the Council leadership and other members of the Settlement community liked to reference the efficiency of governance (e.g., Gundry 1920:59), as the size of the municipal bureaucratic governance structure grew, so too did criticisms of its efficiency. For instance, the Council's response to the call for housing reform within the Settlement in the mid-1930s could be deemed inefficient; certainly, it proved ineffective. The influx of refugees from the Chinese municipality area in early 1932 in the aftermath of the Japanese bombing of Zhabei, followed by subsequent inflows of additional refugees from other parts of China in response to continuing civil strife owing to civil war and Japanese military aggressions, led to increasingly growing areas in the Northern and Eastern districts of the Settlement characterised by sub-standard housing, described in the press and contemporaneous depictions as "slum" housing. The main issue facing these areas was an extreme level of overcrowding, which combined with the lack of modern toilet provisions or water supply implied a high risk of dangers from fire or disease. In response to calls at the ratepayers annual meeting held April 1936 to address the situation (*NCH* 27 April 1936: 721), the Council created a "committee of inquiry" to study the problem, which in March of the following year issued its findings in a report, which after enumerating a host of serious issues facing the residents of such sub-standard dwellings, produced as "its chief recommendation is for the appointment of a permanent committee to further study means for reducing rents and for improvements in hygiene" (*Far Eastern Survey* 26 May 1937: 125).

Such response might well suggest reasonable critique of the bureaucratic efficiency of the Council—analogous to that levelled by Hanwell (1938:96) in regard to the reputed inefficiency of the Guomindang central government as evidenced by ably producing "paper plans" but extremely poor in implementation—as effective in creating committees but not at actual definitive action. Further, calls to improve sub-standard housing was hardly a new issue facing the Council, having been brought forward previously in the press or by advocacy groups, or even in prior Council Annual Reports highlighting similar issues; for instance, in 1907 the Report stated, "As an extension of the work of the systematic limewashing and disinfecting of Chinese dwellings, an attempt was made to improve ventilation and lighting by opening up back premises and removing overhead stages and high partitions within rooms. The overcrowding met with was deplorable; rooms large enough to provide sleeping accommodation for four persons being frequently used for as many families; the sanitary condition being rendered worse by dividing the rooms by partitions which shut out the air and make them permanently dark. The Sanitary Inspectors were brought directly and sympathetically into touch with the Chinese, facilitating the explanation of the benefits of disinfection, vaccination and other sanitary measures. Many houses thus disinfected, visited three or four months afterwards, were still found in a clean and healthy condition, but the greater number had relapsed into their former condition of oriental squalor. After a fair trial it was concluded that until there was some effective legislation against overcrowding, little lasting benefit could be expected. A rule dealing with overcrowding is recommended for inclusion among the conditions of license of native lodging houses" (SMC 1907:87). That similar or worse conditions persisted into the 1930s certainly does not preclude bureaucratic ineptitude.

However, an alternative analysis considers the underlying incentive structures behind issues such as the curbing of "slum" housing. Whether expatriate or Chinese, Council members' direct electorate constituency did not comprise residents of "slums" nor reside nearby. Meanwhile, implementing public assistance housing programs or enforcing stricter sanitation standards in the multitude of domestic resident households requiring the hiring of additional safety inspectors represented budgetary cost outlays, with few direct benefits accruing to Council members or electors; in fact, it implied less available funds for projects more readily supported by the Council's constituency, or greater debt financing implying potentially higher borrowing costs. Thus, the observed practise of committee formation coupled with an associated lack of policy implementation in at least certain instances might have reflected a lack of interest alignment more than bureaucratic inefficiency, *per se*.

Numerous other bureaucratic divisions within the Shanghai Municipal Council structure existed, increasing greatly over time in terms of diversity and size of departments. Thus, for instance, by the 1930s, the number of municipal administrative offices and divisions had grown extensively, while still including major departments such as Public Works, Health, Education, Finance, Fire, Municipal Police, and the Volunteer Corps, these were now supplemented by numerous various committees, such as the Housing Committee, the Special Education Committee, Salaries Commission, Communicable Health Committee, Meteorological Services, the Industrial Section, and the Economy Committee, among many others. Each of these often comprised of several sub-committees formed to address issues of greater specificity or for a limited time frame. Cultural initiatives, such as the Municipal Orchestra, and the Public Library, as well as parks maintenance, had continued to grow in scale over time, perhaps lending some weight to de Jesus (1909: 250)'s accusation of "wasteful public funds", although apparently well-appreciated by enough influential or self-interested ratepayers to have been continually funded throughout the time frame.

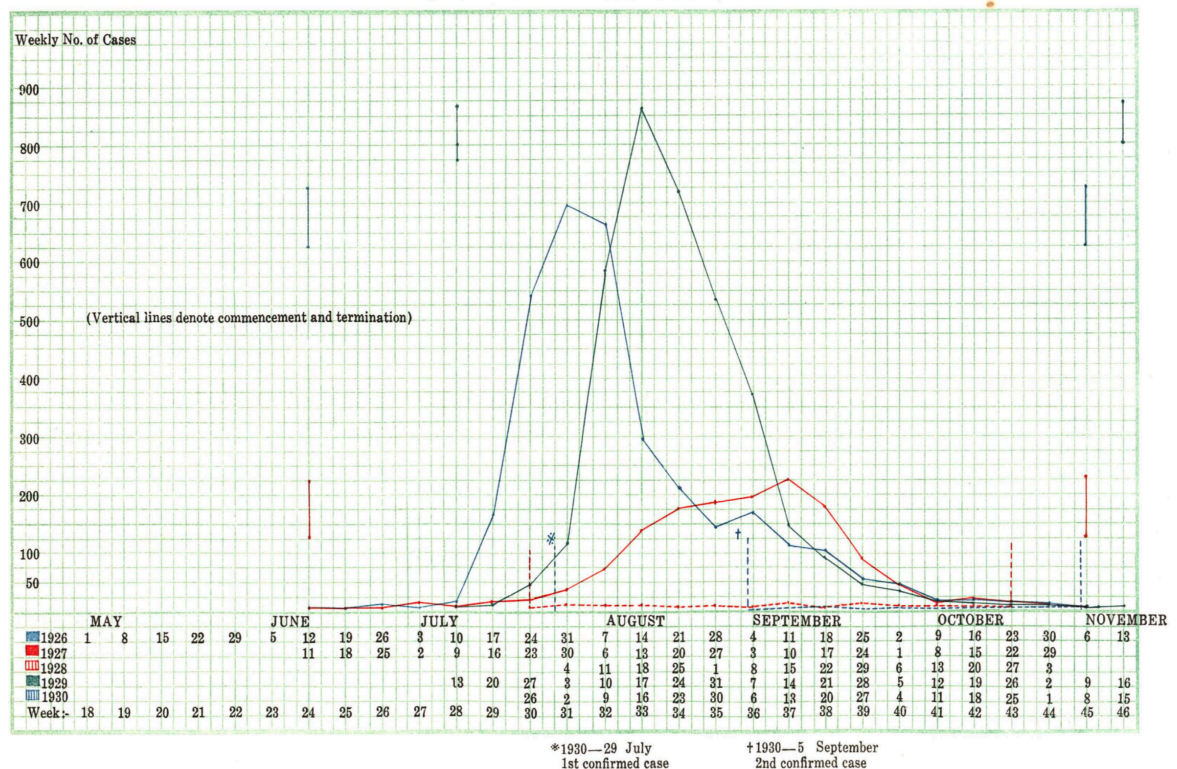
While space considerations preclude detailed descriptions of the initiatives and spending historiographies of these many municipal divisions, reporting by the local newspapers or the Council's annual reports indicate rather consistent and substantial increases in administrative complexity and budgetary resources. Several brief discussions of the administrative structures and policies of a few of the divisions can prove exemplifying. For instance, reporting statistics on the municipality's Fire Department demonstrate the growth from a small volunteer force in the late 1860s into one of the municipal government's largest administrative divisions. By the 1940s, the Municipal Fire Brigade, as it became to be called, was responsible for a complex array of services, including the maintenance of a system of hydrants and multiple fire stations throughout the Settlement, a team of fire inspectors to install and inspect fire alarms and certify Settlement commercial properties (including restaurants, hotels, factories, department stores, and apartment buildings) satisfied appropriate fire code regulations, responsibility for the issuance of permits for hazardous materials such as petrol. The Fire Brigade was also responsible for the maintenance and publication of monthly statistics on the number of fires and emergency calls, including false alarms; the monetary damages, injuries and deaths caused by fires; and the number, type, and cost of equipment used in extinguishing fires (SMC 1940: 100-111).

A brief consideration of the administrative complexity exhibited by the Health Department in 1930 is also instructive. As reported in that year's Annual Report, the department was comprised of a total of eight major sub-departments, including its administrative unit, pathological laboratory, chemical laboratory, dispensary, sanitation unit, food and dairy inspection unit, cemeteries and public mortuary division, swimming pools section, and hospitals unit. The hospitals unit itself was comprised of more than sixteen subdivisions, including administration, radiology, mental hospital, isolation hospital, isolation hospital for Chinese, sanatorium, tuberculosis sanatorium, nurse housing, ambulance services, convalescence home, police hospital for Chinese, police hospital for Indians, prison

hospitals, community outreach services including public lectures, health training for Chinese police and firemen, and a venereal disease clinic. Each year, the Council's report to the ratepayers the Health Department's detailed recording of communicable disease outbreaks. In 1930, for instance, data in table and chart form were presented for incidents of specific disease outbreaks, including smallpox, cholera, influenza, typhoid fever, tuberculosis, diphtheria, amongst others. Figure 9.2, for instance, reproduces a graph presented in the Shanghai Municipal Council's 1930 Annual Report indicating the number of cholera cases in the Settlement over a five-year period. As evidenced from the chart, the severity of this issue was considerable, with particularly serious outbreaks occurring in 1926 and 1929, with hundreds of cases reported throughout the summer months.

However, of more importance than recording the number of cases was the Department's actions to reduce outbreaks. In that year, an "Anti-cholera Inoculation Campaign" was instituted, which represented an effort led by the Settlement's Health Department across all three divisions of Shanghai (domestic, French Concession, and International Settlement) to vaccinate Shanghai's populace in order to prevent outbreaks of cholera the following year (SMC 1930: 144). Over thirty litres of the vaccine were produced in the initial year, which doubled in 1931 (with the scale of this effort prompting the establishment of a separate Vaccine Institute within the Health Department devoted to production of vaccines). Henriot (2006) provides extensive details of the preventative measures taken to reduce outbreaks of communicable diseases in the massive refugee camps that sprang up in the wake of the outbreak of war in August 1937 which led to a flood of desperate refugees into the Settlement. Notably, while the Council's Public Health Department was involved in much of the coordination efforts, as Henriot describes, the source of nearly all of the actual provision of health, housing and food services came from the donations and volunteer efforts by private charitable organisations, both extraterritorial and domestic in composition, such as the Shanghai Federation of Charity Organisations, and the Chinese Medical Association.

Figure 9.2. Reported Cases of Cholera within the International Settlement, 1926-1930



Source: Shanghai Municipal Council 1930 Annual Report: 138B.

Finally, a consideration of the many functions of the Council's Industrial Section is illustrative of the depth of bureaucratic activities engaged in by the Council apparatus. The Industrial Section was a sub-division involved in numerous outreach interactions with the business community to improve working conditions. For instance, the Section was tasked with addressing issues related to child labour in the Settlement's factories, including what was referred to as the "*mui tsai*" problem.[§] Much of the Industrial Section's work was related to improving the safety conditions in factories. The Section sponsored technical classes taught by engineers to help factory owners build appropriate safety measures for plants utilising steam power.

As a more specific example, in 1937, the Industrial Section alerted factory owners and workers through a series of announcements and visitations of the dangers from heavy metals exposure of lead and antimony, after receiving the results of a safety study it partially financed conducted in coordination with the Henry Lester Institute of Medical Research and published by the Chinese Medical Association. The same year, the Industrial Section also funded a field study by the Dr. B. S. Platt Institute on the prevention of worker malnutrition. The study found that workers who only consumed bowls of boiled white rice, a typical meal serviced to many factory workers by the in-house cafeterias of factories, led to numerous cases of "*beri-beri* disease" (thiamine deficiency), which the study attributed to the practise of washing stored white rice prior to its cooking so as to remove bacteria that grew on the outside of the dehusked rice; however, the washing process also removed the majority of the rice's nutritional value (including vitamin B1, thiamine). The study found that by storing the rice in its husk and only conducting dehusking just prior to consumption, the rice was prevented from turning rancid while stored, alleviating the need for washing, thus maintaining its nutritional value, and preventing the occurrence of cases of thiamine deficiency in the test group. The rather complex nature of the study underscores the relative sophistication of the type of activities that the Industrial Section was involved in undertaking (SMC 1937:19-36).

While ambitious in their efforts, the relative successes and failures of the various implemented policies undertaken by these various administrative departments is telling in both the complexity of the tasks the Council attempted to address, as it sought to administer to a municipality that by the start of the 1940s had a population of over one and a half million residents. For instance, as the 1930 Annual Report reports, the implementation of a program designed to increase the control over and reporting of communicable diseases in the Settlement was to be inaugurated in 1931, which represented a full eight years after it was first formulated by the Department and three years after approved by the Council: "The scheme for the Voluntary Registration of Medical Practitioners, Dentists and Surgeons, which was formulated by this Department in 1923, but held up for various reasons until formally approved by the Council in 1928, will at last become effective next year" (SMC 1930: 133). Likewise, the ambitious Anti-cholera Inoculation Campaign, designed to vaccinate the populace against cholera, could not prevent multiple serious outbreaks of cholera occurring in Shanghai, including the Settlement, in 1932, 1937, and 1938. The seeming failure of the program might be partly mitigated given these outbreaks were all precipitated by the flood of refugees into the Settlement in the aftermath of the 1932 and 1937 episodes of Japanese military aggression on residential areas of the domestic Chinese sections of Shanghai and beyond; as discussed earlier, the Settlement's bureaucratic resources struggled to handle the impacts such sudden population increases brought.

[§] This referred to the practise where underage girls were acquired for cash, either directly from their parents, or indirectly via illegal kidnapping, by wealthier families to serve as indentured maidservants, remaining in bondage until reaching marriageable age.

9.5. State Capacity: Ability to Enforce a Monopoly on Violence

As previously advanced, a fundamental role of a sovereign power is the exercise of a monopoly on force within its boundaries, thus allowing it to enforce a rule of law and consistent legal system, and prevent non-government actors, internal or external, from violating laws, or arrogating or destroying the property of its subjects. Throughout the late-imperial and republican era, domestic Chinese governments struggled fulfilling this role, as did, by extension, the local domestic municipal governments of Shanghai. The weakness of the domestic sovereign in this regard can be contrasted with a relative absence of civil strife and open warfare within the extraterritorial settlements. For the vast majority of the history of Shanghai's extraterritoriality system, there were limited disruptions to the civil peace, with the jarring exception of December 1941 when the entire extraterritorial institutional environment itself came to an abrupt and violent end after the armed takeover of the settlements by the Japanese military.

The extraterritorial municipal governments proved, in general, relatively capable of providing protection of private property from banditry or other nonstate violent actors within their borders. The leadership of these governments were clear in their mission of defence of life and property within the settlements. As Stirling Fessenden, Chairman of the Shanghai Municipal Council, remarked in 1927, "[The Council] has not only the moral but also the unquestionable legal right to defend, by force if necessary, the political and territorial integrity of the International Settlement against military or mob aggression on the part of any political or military party" (Jackson 2012: 151).

9.5.1. Credible Commitment Mechanisms: Enforcing a Monopoly on Violence via an Internal Police Force

To begin with, the International Settlement sought to maintain law and order within its territorial borders through its own police force. Formed in 1854, the role of the Municipal Police Force was to enforce the power of the state, as represented by the Shanghai Municipal Council, within the state itself, the International Settlement. The Council issued regulations binding on residents in the Settlement, and it was the function of the Municipal Police to enforce such regulations, and to maintain general civil order, and discourage, prevent and respond to outbreaks of criminal activity.

Concern over issues of internal law and order were of constant concern to the Council from the very beginning. As the Settlement rapidly expanded in the early 1860s, with population inflows of both domestic Chinese and European immigrants, quasi-xenophobic and classist arguments were frequently found expressed in the press as well as in the minutes of Council meetings. For instance, in April 1863, the Council Chairman claimed that many of the newly-arrived European immigrants were without way of earning income, and therefore, must be responsible for the uptick in reported crime. Considerable attention of the annual Land Renters meeting was paid to ways to deal with the incorporation of the eastern Hongkew [Hongkou 虹口] District into the Settlement. In the words of the chairman, a significantly increased police force was necessary as the area was home to many "dangerous elements", resulting in a relative lack of law and order, with the current police force allocated to the area insufficient to restrain "the almost reign of terror which now prevails there" (*NCH* 11 April 1863: 58).

Each year's Annual Report of the Council contained a detailed listing of crime statistics, with significant crimes such as murder, or new types of criminal activity, receiving particular attention in the annual written summary. For instance, it was reported that only two murders were reported to have occurred in the Settlement in the year 1879, in each a domestic Chinese resident having been murdered by other domestic Chinese residents; after arrest in both cases the accused were remanded to the domestic Chinese municipality for trial and punishment (SMC 1879: 55). Detailed monthly arrest statistics were reported separately for expatriate and domestic Chinese residents, with yearly totals of 383 and 6,545, respectively. Arrests were broken down by type of infraction, albeit the seven types of infractions listed for foreigners (assault, cutting and wounding, desertion, drunkenness, drunkenness and disorderly, larceny, misdemeanour), was less than half the twenty-six types listed for Chinese residents, which also included infractions such as "committing nuisance, embezzlement, firing crackers, forgery, fraud, gambling, loitering, uttering, and vagrancy, with the lattermost category by far the largest, at 3,647, more than the total of all other crimes at 2,898 (SMC 1879: 56-59). Further breakdowns were given by the age, literacy of the arrested, as well as the type and length of sentence received; vagrancy, while violators were arrested, was not a crime receiving punishment. Given population differentials, the numbers reveal fairly stark differences in crime rates within the Settlement's expatriate and domestic Chinese resident populations. Using population data from the 1880 census taken the following year, of 2,197 expatriates and 99,201 Chinese (SMC 1880: 35), we can calculate crime rates of those arrested for punishable offences as 17.4 per cent versus 2.9 per cent, respectively; including vagrancy arrests, brings up the arrest rates for the Settlement's Chinese population to 6.6 per cent, well below that of the expatriate population. While such differences appear large, these early statistics reflect reported arrest rates as opposed to actual crime rates, and thus the differences might be partly accounted for by the underreporting of crime, or the inability of victims or police in identifying the perpetrators of criminal activity, which often occurred (SMC 1900: 46).

By 1900, comparable figures had fallen to only 184 foreigners arrested, albeit for a greater variety of infractions, with arrests of Chinese for punishable offences numbering 25,221, which reflected arrest rates by population based on the 1900 census of 2.7 per cent and 7.3 per cent, a considerable fall and rise in the respective arrest rates across the population groups (SMC 1900: 49-53, 356-357). Reported statistics, however, are of considerably more detailed than in 1879, with data on district crime rates, those arrested but not charged, breakdown of types of larcenies committed, all supplied by week rather than month. In addition, details on the total number of the police force are provided, by ethnicity, along with numbers of new enlistments, resignations, dismissals, and injuries and deaths on while duty, as well as listing of the force's weaponry and other equipment (SMC 1900: 54-64). Similar reporting in the 1915 Annual Report, which now includes several more detailed crime statistics, shows general arrests of foreign and domestic residents to have been 692 and 65,359; or 3.7 and 10.5 per cents, out of populations of 18,519 and 620,401, respectively (SMC 1915: 40A).

By 1930, statistics collected included the number of fingerprints of arrestees sent to and received from police departments in other jurisdictions (in particular the French Concession police), as well as identifications made from said fingerprints. By this time the police force had grown to twelve permanent main police stations, divided into five major divisions, along with a special crimes unit, as well as three armed reserve units (SMC 1930: 102). The increase in resources for police services had accompanied an increase in the volume of violent crimes, with 105 people arrested for homicide-related crimes over the course of the year, as well as 246 for armed kidnapping or abduction, and those for armed robbery at 642 (SMC 1930: 105). Superior reporting statistics also included actual reported crimes, not solely arrest rates. The crime report identified 40 confirmed cases of murder, and 36 of armed kidnapping, for which 5 of the cases resulted in the death of the victim, 10

were rescued by police action (not including 3 additional persons kidnapped in Chinese section of the city but rescued within the Settlement by Municipal Police), 4 released after ransom paid and 2 released by kidnappers without ransom, and another 16 reportedly escaped the kidnapping unharmed. Overall, the total number of reported crimes was 14,575 in 1930, which out of a total Settlement population of 1,007,868 represented a crime rate of slightly more than 1.5 crimes per every hundred residents; of these reported cases, 7,648 resulted in conviction, slightly over half (SMC 1930: 90)

Data for 1940 indicated that, based on an estimated total population of 1,500,000 residents in the International Settlement, total crime rates (based on reported crimes) averaged slightly less than 1 per every hundred persons, with the largest proportion of those crimes falling into the category of petty larceny. The data show that the conviction rate for criminal cases sent to trial rose to slightly over 90 per cent, which the report attributed to the fact that "the high standard of efficiency in the preparation of cases has been maintained", as well as increased usages of the modern forensic techniques, such as superior fingerprinting collection methodologies and ammunition identification technologies enabling the linking of fired ammunition with specific guns (SMC 1940:120, 123). Violent crimes continued to rise, with 138 confirmed homicide-related cases investigated over the year; 131 people were arrested in connection with these cases. Total arrests for the year measured 27,876, representing a significant arrest rate of nearly two per cent of the entire Settlement population arrested over the course of the year (SMC 1940: 128-131). The report included a discussion of the impact of crime, especially serious and violent crimes, that was associated with an increase in "gangster activity" quasi-political and criminal organisations flourished within the western and eastern borders of the Settlement given what was implied to be a weakened power of the domestic municipal state in light of the deteriorating economic and political conditions prevailing throughout the Yangzi valley region (SMC 1940:120)

The police were involved in many aspects of maintain order in the daily life of the Settlement, with traffic control duties rising in importance, both in terms of maintenance of traffic flow at intersections of high usage, registration and inspection of non-motorised and later motorised vehicles and their drivers, and the handling of traffic accidents, as well as writing citations for driving infractions and even making arrests in cases of reckless (referred to as "furious") driving.

Another one of the primary functions of the municipal police force was in dealing with the actions of labour strikes. For the most part, labour strikes by workers were prohibited under company and Settlement regulations. Workers who encouraged others to strike could and were frequently arrested for breaking prohibitions on "inciting workers to strike", "labour agitation", or "creating disturbances" (SMC 1930: 96, SMC 1937: 94, SMC 1940:124). As a city that became increasingly industrial in nature, with many factories moving production facilities into the limits of the Settlement itself, factory labour unrest became a common feature of industrial relations, and yearly summaries regarding the strike actions were published by the police.

However, labour strikes and public demonstrations within the Settlement predated large-scale industrial production activities, with nearly all of these actions initiated by domestic Chinese residents over either social or labour issues that typically related to poor treatment, or perceived sociopolitical injustices. For instance, in 1897, the Council imposed an increase on vehicle (wheelbarrow) taxes; in response, riots ensued amongst domestic vehicle operators. The incident was of sufficient scale so as to lead the Council to order the Volunteer Corps deployed to quell the riots (de Jesus 1909: 244).

In 1925, one of the largest and most significant anti-imperialist mass movement protests in China began in the International Settlement of Shanghai. On 15 May, a Chinese employee of a Japanese-owned cotton factory on strike was killed in a dispute turned violent with Japanese management, resulting in the arrest of several of the workers' striking colleagues, but none of the Japanese managers ostensibly responsible for the worker's death. Initial protests by workers and students over this issue became considerably more inflamed when on 30 May eleven people were killed when the Municipal Police fired into a crowd of Chinese demonstrators (Bickers 1998: 162). Violent rioting ensued in the aftermath, and martial law was ordered by the Council.

After social order was restored and civilian law resumed several days later, an international commission was constructed to review the causes of the situation and assess blame and resolution. Notably, although the majority of the injuries and deaths precipitating the movement were domestic Chinese residents of the Settlement, the three-person international commission of judges was comprised of a Briton, an American and an Australian. The commission's findings were mixed, with the British and Australian judges finding the shootings by the police to have been justified, whereas the American judge's opinion argued the Police structure needed comprehensive reforms, including the removal of the chief of the Municipal Police force. Viewing the findings unacceptable, the May Thirtieth Movement led to a spike in anti-foreign sentiment within China, a renewed stridency in calls for an end to the extraterritoriality system, and a relatively effective nationwide boycott of foreign imported goods. Locally, many extraterritorial-owned businesses suffered in the wake of the boycott; in addition, the incident increased pressure for Chinese representation on the Shanghai Municipal Council, ultimately leading to the addition of three designated seats for Chinese representatives three years later in 1928.

The racial biases that afflicted the majority of expatriate residents were instrumental in shaping the entirety of the institutional framework of the Settlement, including the police force. The structure of the police force was that of a typical imperialist colonial-style institution, with an ingrained racist organisational structure from the start. Given the size of the foreign population compared to the Chinese population, the Council's initial intent to hire one foreign deputy supervisor for every two Chinese policemen was financially impossible, and as such early on the Municipal Police force turned to hiring Sikhs to serve as a middle layer of authority in the police structure (Jackson 2012: 1677). The hierarchy of European supervisors at the top, with Sikh constables supervising local Chinese hires, helped to reinforce the perception amongst many of its residents that the International Settlement was colonial in nature. The description of "the Chinese Policeman" in Clark (1894: 89-90) is chilling in its racist caricature of the domestic Chinese employees of the Settlement's police force.

The events triggering the May Thirtieth Movement were extreme examples of a more underlying condition of police mistreatment towards the majority Chinese population. A general reading of the contemporaneous police reports and related press reports make clear that Chinese residents received a small but disquieting level of unequal treatment by the police and authorities compared to expatriate residents, reflective of the racial inequality inherent within the Settlement. While for the most part the Municipal Police were viewed by both expatriate and domestic Chinese residents as performing their job adequately, there were reported cases of police abuse, especially of Chinese citizens at the hands of Sikh policemen, towards whom the local populace seemingly expressed more resentment against than toward the European officers (Jackson 2012: 1691).

Such events and practises help to underscore the fact that the foreign settlements were far from places of exemplary law and order. Similarly, there existed other signs that undercut the perception that the extraterritorial police forces were able to maintain an orderly and safe environment throughout the settlements. For instance, the ambiguous legal status of the extraterritorial settlements likely contributed to their use as sanctuaries by domestic Chinese agents who engaged in illegal or subversive activities seeking to escape the jurisdiction of domestic law. It is no coincidence that the founding of the Chinese Communist Party in July 1921 took place within the French Concession, outside the purview of the republican state apparatus. The organised crime syndicate the Green Gang also chose to coordinate its criminal activities out of the French Concession. The settlements were not immune from the corruptive influence and violence perpetuated by the Green Gang, which became so embedded within the socioeconomic fabric of settlements that its membership became intertwined with the those of the police forces of both the International Settlement and French Concession, including prior to his remove in 1923 the head of the Shanghai Municipal Police's domestic Chinese detective squad (Martin 1996, Hunter 2017: 114-115).

In addition, neutrality from Chinese internal politics was asserted only when it served the Settlement's purposes. During the 1920s and 1930s, for instance, support was frequently lent to the Guomindang government's efforts in purging communist supporters and suppressing student movements. In advance of the infamous "Shanghai massacre of 12 April 1927" propagated by the Jiang leadership to eliminate communist members from the Guomindang, authorities in the International Settlement and the French Concession were informed of the impending attack, and the police forces of both extraterritorial settlements actively stood by while the massacre took place (Wilbur 1983: 635, Wakeman 1995a).

These descriptions of support for lawless elements operating out of the settlements, and examples of active disregard for the rule of law on the part of the Municipal Police and other Settlement institutions in regard to due process and protection of life and liberty when involving "dangerous" social elements such as Communist Party members, should not be simply viewed as minor caveats in the larger story of the extraterritorial settlements as oases of peace and order in an otherwise chaotic domestic-administered Shanghai. Rather, these instances serve to underscore our contention that private property and contract rights, and the institutions that support them, were far from absolute in the setting of the extraterritorial settlements.

9.5.2. Credible Commitment Mechanisms: Enforcing a Monopoly on Violence via an External Militia

The governments of the extraterritorial settlements were able to maintain their territorial integrity in the face of external threats through two main institutional systems. First, as part of "gunboat diplomacy," there existed the implicit (and occasional explicit) employment of military force by European naval fleets patrolling the Shanghai harbour. The presence of these foreign naval forces, as well as accompanying stationed armed military troops, were explicitly granted to signatory foreign powers in several of the treaties signed in the wake of the Opium War and similar military defeats suffered by the Qing through the end of the nineteenth century (Wright 1930: 220). An early example of the use of force took place during the First Battle of Shanghai, fought as part of the Taiping Rebellion over the course of the summer of 1860 through the following summer. British military commanders issued a warning to the Taiping from entering the city, explicitly highlighting the concern with maintenance of a good business climate for trade as the rationale to threaten to wage war against the rebellion if they attacked Shanghai. On 26 May 1860 Frederick Bruce, the

superintendent of trade for Britain, announced by proclamation that the might of the British military would be directed to meet the oncoming Taiping army to protect property interests: "Shanghae is a port open to foreign trade, and the native dealers residing therein have large transactions with the foreigners who resort to the place to carry on their business. Were it to become the scene of attack and civil war, commerce would receive a severe blow, and the interests of those, whether foreign or native, who wish to pursue their peaceful avocations in quiet, would suffer great loss. The undersigned will therefore call upon the commanders of Her Majesty's naval and military authorities to take proper measures to prevent the inhabitants of Shanghae from being exposed to massacre and pillage, and to lend their assistance to put down any insurrectionary movements among the ill-disposed, and to protect the city against any attack" (Lindley 1866: 284). As noted in Chapter Six, the British and French military forces carried through on this proclaimed threat, using their gunboat cannons to fire upon the Taiping army based in Pudong, eventually helping lead to the withdrawal of Rebellion troops from Shanghai.

Overall, however, going forward, although most of the major treaty powers maintained small stations of soldiers in Shanghai, they were rarely engaged in military actions. The implied threat of the gunboats was, ostensibly, enough to keep most rebellion, warlord or Chinese governmental forces from seriously considering an attack on the foreign settlements. As time passed, however, with the distinct exception of Japan, the treaty powers' commitment to use military force in Shanghai noticeably decreased.

Second, the foreign settlement governments created their own militias to defend their territory from external attack. The Shanghai Volunteer Corps was formed in 1853 in response to the potential threat to the foreign settlements from the Small Swords Society's attack on Shanghai. As described in detail by Pott (1928: 60-65), the initial volunteers consisted of about 75 residents, who joined about 200 British soldiers and 100 American marines to defend the foreign settlements, both against the rebels, and against Imperial troops stationed nearby, who frequently entered the settlements to steal goods. The Corps was disbanded after the domestic section of the city was retaken by Imperial forces, but constituted again in 1861 when Shanghai was again under attack by the Taiping army. Defence of the Settlement took much of the minutes of the following year's Shanghai Municipal Council annual meeting. Nearly half of the 1862 Annual Report was concerned with issues related to additional defence fortifications, including excavating part of Soochow (Suzhou) Creek, building guard houses, and purchasing guns and uniforms for the newly constituted Shanghai Volunteer Corps (*NCDN* 5 April 1862). By 1870, the Council assumed the full responsibility of the Corps, and over time greater resources were allocated to the militia force, including cavalry. In 1906, a group of leading Chinese merchants residing in the Settlement instituted a program to facilitate the creation of a "Chinese Physical Association" of young Chinese male residents of the Settlement to later incorporate into the larger Corps. By the end of the year, a unit of Chinese volunteers had formally been merged into to Corps, labelled the "Chinese Company" (*SMC* 1906: 21-26).

By the mid-1930s, the Corps membership had risen to over 2,000, including 4 battalions, a horse cavalry and armoured car company, and active training exercises were continually conducted (*SMC* 1935: 77). Such a force represented considerable size considering that there was only slightly over 12,000 men aged 17 and above of foreign origin in the Settlement, and that about 1,800 of the Corps came from their ranks, with the over 500 British men forming the largest contingent from one country. By this time, the force did also include 243 Chinese, although, given that there were over 525,000 adult males living in the International Settlement by 1935, this figure in percentage terms was quite marginal.

The overall effectiveness of the Shanghai Volunteer Corps, combined with the implied threat of foreign powers' gunboats, served to provide fairly safe harbour for the Settlement throughout the period. The foreign settlements in Shanghai never experienced the type of attack that Tientsin (Tianjin)'s foreign concession areas suffered during the Boxer Uprising, when that treaty port's foreign-controlled areas were heavily shelled and significant loss of life occurred within (Brown 1902). The International Settlement continually claimed a right to exclude Chinese troops and police from the area, to which Chinese authorities typically begrudgingly acquiesced (SMC 1899: 71). The Settlement's military resources proved successful in preventing domestic Chinese government troops from entering the Settlement during episodes of civil war; the Council mobilised the Corps in 1913, 1924, 1925 and 1927 in response to the proximity of hostilities involving domestic troops engaged in civil wars, even disarming and interning surrendering domestic troops of various battling warlord factions into concentration camps inside the Settlement borders in 1924 and 1925 (Kotenev 1927: 116-121, Crow 1933: 142).

The International Settlement, comprised of area 8.7 square miles, along with the French Concession laying slightly to the south occupied 3.9 square miles, came to be dwarfed in size by the Guomindang government municipality of the Chinese Municipality of Greater Shanghai, which was made up approximately 320 square miles. As Chamberlain (1931: 146) notes, "There is no natural barrier between the areas; persons and goods are constantly passing back and forth from one to the other." As such, there were no city walls, no fortified defences around the Settlement. In a sense, the Settlement's lack of physical barriers was a sign of its power. The power of the Shanghai Volunteer Corps was in many aspects primarily symbolic—certainly, the actual physical guns, ammunitions and cavalry were themselves important; but it was much more the implied threat of imperialist power implicitly behind the Corps that provided its true fortification.

The International Settlement generally strove to stay uninvolved in the Chinese internal politics and repeatedly asserted neutrality when conflicts broke out between factions, and in most cases managed to stop government as well as anti-government troops from accessing its territory. Neutrality was first asserted in the Taiping Rebellion, and then subsequently in the 1911 Revolution and in the Sino-Japanese Wars. The assertion of neutrality for a leased area within a country had no true legal basis. Nevertheless, the precedent continued and was respected to a large extent by the republican governments, and later by the Japanese military to a large degree until the full breakout of the Pacific War.

Overall, the Municipal Council placed a tremendous importance on the maintenance of law and order and the protection of business property. Outlays on external and internal mechanisms to maintain order represented an increasing share of the budgeted spending by the Council, with "the special position of the International Settlement call[ing] for unusually heavy expenditures on military and police protection" (Lockwood 1934: 1036). In 1907, for instance, the Council spent over 547,000 *taels* on police, fire and military protection, or a little under 29 per cent of its 1.9 million *taels* of total revenues received; by 1929 over 4.7 million *yuan* went to police, fire and military protection, or a little under 40 per cent of 12 million in revenues; by 1935 these figures had risen to over 12 million *yuan* accounting for over half of the 23 million in revenues (SMC 1907: 240-242; SMC 1929: 337, 347-351; SMC 1935: 286-291). Elected by the ratepayers of the Settlement, the Shanghai Municipal Council's decisions therefore represented the interests of the ratepayers, embodying the wealthy and landed interests; i.e., those with the most private property. As such, it is hardly surprising that significant portions of Council monies were spent on tools ensuring the protection of private property rights.

9.5.2.1. Perceived Oases of Peace

The emphasis on defence-related expenditures assisted the Council in safeguarding its autonomy and interests, as well as enforcing the prohibition of domestic Chinese police and military authorities from operating within the Settlement. By application of three devices—implicit foreign power gunboat presence, and explicit external and internal martial power—the International Settlement enjoyed relative freedom from the turmoil that was otherwise widespread in China throughout much of the late-imperial and republican period. Aside from the early attack of the Taiping rebels and several sporadic incidents typically involving strike-related riots, the International Settlement was a safe haven with law and order compared to the rest of the country, including the neighbouring domestic Shanghai municipality. Warlords, revolutionaries, and Japanese military invasions—up until 1937—all effectively stopped at the borders of the Settlement. Predatory practises such as looting and pillaging by local bandits or warlords, or forced conscription of labour or service by government forces, prevalent in much the rest of China, did not occur in the Settlement.

The perception of the foreign settlements as oases of safety within a more dangerous domestic political environment appears to have been well-recognised by contemporaneous domestic economic agents, leading to continual inward migration into the settlements by Chinese nationals, punctuated by sharp influxes of refugees during periods of acute political strife. It is noteworthy, however, that the extraterritorial settlements were initially intended by both the applying foreign Consuls and the granting Daotai to serve as sections of the city to house only foreign residents. By decree of the 土地章程 (Land Charter) in 1845 handed down by the Qing Court via the local Daotai, Chinese residents were required to reside within the confines of the walled city, referred to Nan-shi, while foreigners were segregated into their respective foreign settlements. However, the political violence and unrest surrounding the Small Swords uprising in that occurred in Shanghai from 1853 to 1855 drove thousands of refugees from the local surrounding neighbourhoods outside the walled domestic city into the foreign settlements for safety. Prior to 1853, only about five hundred Chinese nationals were estimated to have been residents of the foreign settlements, but by 1854 this number had increased dramatically to over twenty thousand, after a large number of domestic Chinese were allowed to remain residing in the British Settlement. Initially met with considerable apprehensive on the part of many European residents (de Jesus 1909: 95-104), the number of Chinese residents continued to steadily grow. By 1855, Qing officials formalised the precedent by issuing a statement that any Chinese wishing to live in the foreign settlements needed to apply to the relevant foreign consul of the foreign landlord, and undertake to "conform strictly to the land regulations and contribute his share to any general assessments" (Advocate 1927: 156). The population increase was partially accepted because it brought about considerable economic benefits to foreign landlords; Hauser (1940: 55-61) documents the resultant spike in real estate prices and rents in 1855 that accompanied the initial population increase. When Taiping rebel forces marched on Shanghai in 1862, another major wave of domestic Chinese refugees, numbering nearly 500,000, fled into the foreign settlements for protection (SMC 1863).

Over the succeeding decades, increasing numbers of Chinese residents chose to move into Shanghai's extraterritorial settlements. As shown in Figure 1.2 in Chapter One, the relative domestic and expatriate populations comprising the International Settlement over the late-imperial and early-republican period indicates a continual increase in the size the domestic population, with Chinese residents making up no less than ninety-five per cent of the Settlement's total population for the entirety of the period. Occasional episodes of outward migration, such as in 1900 after the Boxer Uprising (SMC 1900: 158) were relatively rare, and temporary in nature. The perception of Shanghai's foreign settlements as oases of peace within a turbulent domestic Chinese political environment continued long after the early period following the Short Swords and Taiping rebellions; even post-1937 after the start of

open military hostilities between the Japanese military and the Guomindang government, the perception of the settlements as areas of relative safety drew people into Shanghai, continuing to reshape the economy of the city. As Bloch (1941: 31) relays, "The International Settlement of Shanghai... has now become a center of attraction to Chinese peasants. From Japanese oppression to which they are subject at home, they escape into Shanghai factory life. The sharp decline in the Shanghai real wage level thus mirrors to a large extent the decline in the Chinese peasants' living standard under Japanese rule and the newly increased competition for jobs in Shanghai's industries."

Further, it was not only individuals who came seeking the protection perceived to be offered by the settlements' internal and external institutional mechanisms promising a monopoly on violence, hence limiting the destruction to life and property by violence potential perpetrated by nonstate actors. Entrepreneurs and major business leaders too identified the settlements as areas of safety that would better protect their private assets than what the domestic institutional environment could offer. As Feetham (1931) notes in his report, the Settlement was the not only the principal banking centre in China, with the most important Chinese banks having their head offices there, including the Central Bank of China. Johnstone (1937:947) echoes this concept when observing, "The Shanghai International Settlement... contains headquarters for most of the foreign banks and business houses operating in China. A large proportion of foreign and Chinese industries are also located in these foreign-controlled areas, where they are generally free from Chinese jurisdiction and taxation, and where their property is under the protection of foreign guns."

9.5.2.2. Diminishing Capacity of Monopoly on Force: 1932 and 1937 Incidents

The ability of the Shanghai Municipal Council to maintain the perception of the International Settlement as an oasis within the otherwise militarily dangerous larger domestically-administered municipal Shanghai environment began to falter after the events following the Shanghai Incident (一·二八事变) of 28 January 1932. Public anger in China toward the Japanese in the aftermath of the September 1931 Mukden Incident and the subsequent occupation of Northeastern China by Japanese military forces led to mass protests and boycotting of Japanese goods. Clashes and discord between Japanese soldiers and Chinese citizens became common, particularly in Shanghai given the city's large Japanese population and Japanese military presence.

By this time frame, Japanese residents now represented the largest number of foreigners in the International Settlement, with 7,169 Japanese, out of a total of a total foreign population of 18,519, with 4,822 British the second-most populous nationality (SMC 1915: 162B). In 1915, the Japanese obtained one designated seat on the Council, and by 1925, they had secured two seats. The Japanese population continued to rise to exceed 18,000 in 1930, with the vast majority of the Japanese population living in the Hongkou (虹口区) section of the Settlement (*Contemporary Japan* 1936), leading to its role as the centre of Japanese civil, political and military presence in Shanghai.

On 20 January 1932, a fight between several apparently drunk Japanese monks of an extremist nationalistic sect and Chinese workers triggered a military action from Japan on Shanghai. In response, the Shanghai Municipal Council declared a state of emergency (FRUS 793.94/3970. Annex "Statement Issued by Mr. Murai, Consul General of Japan at Shanghai, on January 29, 1932"). From the beginning of the incident, the Japanese leadership provided assurance there was "no intention of interference with the rights or interests of any foreign powers in Shanghai" (FRUS 793.94/3679. 28 January 1932). Notwithstanding such assurances, Japanese forces started using parts of the International Settlement as a base for military manoeuvres, causing much consternation to the American ambassador in Shanghai (FRUS 793.94/3758f, 31 January 1932; 793.4265, 15 February 1932). Written protests by

the American and the British consulates to the Japanese military authorities in Shanghai and the Japanese government in Tokyo were met with assurances that there was "no intention to cause damage to foreign life and property" (FRUS 793.94/4311, 19 February 1932).

Tuchman (1971) describes the bombing campaign as "the first terror bombing of a civilian population" in China. Despite urgings from the American and British consuls for all sides to forgo aggression, Japanese military forces continued fighting and brought in an additional 3,000 troops, housed within the Hongkou section of the International Settlement (FRUS 793.94/4014a. 6 February 1932). As Chinese military forces arrived on the scene, Japanese forces would further increase to 15,000 land troops and 3,000 marines in the following days (FRUS 793.94/4201. 15 February 1932). The fighting within Shanghai lasted several weeks, and Japanese military action in other parts of China continued until May when a peace agreement was finally brokered by the Western powers.

The damage to the city from the 1932 Shanghai Incident was considerable, with over 14,000 Chinese casualties, including more than 10,000 civilian deaths (Mitter 2013: 57). However, as airstrikes and fighting primarily took place outside of the foreign settlements, their impact was unevenly felt. The vast majority of the damage occurred in the domestic-administered sections of the city, with relatively little impact experienced within the foreign settlements, other than the mass influx of refugees. That said, while there was little physical damage to the International Settlement, business and trade slowed tremendously. The stock and bond markets closed for several weeks, and even after they reopened, trading was muted given uncertainty over the political turmoil.

The events surrounding the 1932 Shanghai Incident underscore two main issues. First, as with prior instances involving civil strife and military violence that occurred in the city's history, the perception amongst the population that the foreign settlements provided greater protection of life and property from civil strife than did domestically-controlled areas of the city was underscored as the settlements experienced a massive inflow of refugees seeking security once fighting broke out.

Second, the year 1932 represented a beginning of the loss of sovereignty and control over the International Settlement by the Municipal Council, and a breakdown of the "rule of law." As a direct result of the Shanghai Incident, the local Japanese took direct control of the Hongkou district, with law and protection enforced to varying degrees by the Japanese Consular Police and Japanese members of the Shanghai Municipal Police. The Shanghai Amalgamated Neighbours Union, a militant group of Japanese shop owners and small business interests in the Hongkou district actively patrolled the streets of the district, frequently intimidating and harassing outsiders (*Review of Japanese Affairs* 1936: 452).

In response to the perceived weakness on the part of the SMC internal policing apparatus, Japanese military forces began to act in ways that disregarded the sense of "rule of law" that the International Settlement had prided itself in upholding. An example occurring shortly after the Shanghai Incident came in the aftermath of a terrorist attack in Hongkou Park where a large Japanese crowd had gathered to celebrate the Emperor's birthday on 29 April 1932. A single Korean assailant threw a hand grenade that resulted in serious injuries to the leaders of the celebration, as well as the death of the president of the Japanese Residents Association. In response, the Japanese military police went through the concession areas, arresting and beating Korean residents, without due process of law. According to a report by the *China Weekly Review* (7 May 1932: 3), there were many instances of Japanese police officers beating the elderly and women trying to ascertain the location of the Koreans who were thought to be hiding in American missionaries or at the homes of American or British friends. In addition, over the protests lodged by the Municipal Council, the Japanese military marched 10,000 troops along with heavy artillery and tanks through the streets of the International Settlement the following week (*China Weekly Review* 7 May 1932: 4).

By 1936, the Shanghai Municipal Council had already lost effective control over the Hongkou section of the Settlement, as well as the ability to levy taxes to Hongkou residents, as the Japanese military presence in the district had grown in size since the 1932 Shanghai Incident. As a British observer wrote at the time: "Of the fifty different nationalities which go to make up foreign population of the international settlement the Japanese alone have so definitely made for themselves a special racial quarter, have so deliberately and thoroughly organised themselves as a separate entity apart from and almost, at times, in opposition to all the others. It is a development which goes altogether contrary to the international conception of the settlement, and threatens to break up the spirit of international co-operation which has so far distinguished its administration... Hongkew, is constantly patrolled by pockets of Japanese marines and the Japanese military are ready, I had almost written anxious, to turn out at a moment's notice to 'assist' the settlement police in the task of maintaining order. A Chinese boy on the roof of a house throws a stone at a cat and the stone accidentally rebounds off a wall and drops on the shoulder of a Japanese marine. Immediately the Japanese military are on the spot, a foreign police inspector has to be summoned, and an utterly trivial occurrence is magnified out of all proportion by this unjustifiable military interference in the management of the district. At frequent intervals, too, the Japanese parade their troops through the streets, on one occasion practically 'occupying' the area for the purpose of their manoeuvres. ... The deliberate organisation of the community along its present lines and the manner in which Hongkew is being converted into a special area where the Japanese military claim equal authority with the Municipal Council is not a healthy portent for the future" (*Spectator* 18 September 1936: 454).

An important symbol of loss of sovereignty of the Council was the Council's inability to control the actions of the Japanese military within the Settlement, except so far as to issue expressions of "displeasure." Public anger among the Chinese at the Japanese military presence in Shanghai led to various incidents of terrorist bombings by activists against the Japanese troops. On 3 December 1936, when the Japanese troops of about 6,000 marched through the International Settlement, a grenade was thrown by a Chinese, killing three Japanese soldiers and wounding more. Japanese officials immediately put on a search in the International Settlement and on the same day, demanded the Council that Japanese troops be allowed to pass through the International Settlement without prior notice. By April 1937, both the International Settlement and the French Concession had accepted agreements with the Japanese military to allow the Japanese troops access; additional liberties taken by Japanese military forces of patrolling the streets of the Settlement and preventing Municipal Police from performing their normal duties were perfunctorily met with protestations from the Council and equally perfunctory assurances by Japanese civilian authorities that steps were being taken to avoid similar future events nonetheless continued to occur throughout the year (SMC 1937: 17, Shanghai Concessions Archives 2001: 104).

The outbreak of open warfare in August 1937 signified another significant loss of sovereignty by the Municipal Council. To begin with, unlike at any other time in the Settlement's history, the physical toll of war directly caused severe and extensive loss of life and property inside the International Settlement itself. Contemporaneous reports tell of horrendous loss of life to the city, both within the International Settlement and without, from bombs and artillery fire. *The China Journal* (September 1937: 3), an English language monthly, described the situation, when carnage came to "streets and foreshore at the time were packed tight with a mass of refugees from the Chinese area of Chapei [Zhabei] and Kiangwan [Jiangwan] seeking safety in the International Settlement. But in the afternoon the same day was to bring home, as never before, to the Shanghai people, who have many times during the past two decades seen it at their very doors, what modern warfare really means...." Bombs were dropped on the Palace Hotel, "demolishing the upper stories and killing a large number of Chinese there, the other landing in Nanking Road between the

Palace Hotel and the Cathay Hotel, dealing out death and destruction amongst the crowds of Chinese refugees, largely women and children, blowing out the windows of the sumptuous shops that line the street in this area, and setting fire to numerous motor cars. Several foreigners also were killed and others injured at this spot." The journal also reported on the bomb falling near "the junction of Tibet Road with Avenue Edward VII, at all times Shanghai's most crowded corner and particularly so at this moment with the huge influx of refugees.... The result was a scene of slaughter that has probably never before been witnessed by man." Such devastation was to be repeated several days later when bombs fell on Nanjing Road and destroyed parts of some of Shanghai's most prominent department stores, including Wing On Department Store, killing an estimated two hundred people.

The economic effect of the war proved significant. The extraterritorial-run stock exchange remained effectively closed for months, with little trading taking place; the domestic-run stock exchange was permanently closed. Weekly Share Reports published by the Shanghai Stock Exchange in October 1937 indicated market activity remained at a complete standstill:

1 October: "There is about as much movement in the market as there appears to be in the local war although the latter makes considerably more noise about it. The conviction that the struggle is likely to be prolonged gathers strength as the days go by and although Shanghai would gain enormously were the theatre of war to shift even a score of miles from its gates there can be little real recovery in trade until there is peace once more... there is naturally very little investment demand."

15 October: "Another week of almost complete idleness was experienced on the Stock Exchange... The Settlement is still rocked from time to time by bombing and shell fire and every day casualties in the International Settlement are recorded... The greatest bar to trade, however still continues with the moratorium of Chinese Banks and it is indeed surprising that the powers that be allow this position to continue."

22 October: "...we have once again to report a week of practical stagnation. There does not appear to be any improvement of consequence in the general situation, the International Settlement continues to be surrounded by armed forces and ceaseless gunfire and bombing are the order of the day."

Writing of the period following the invasion, Barnett (1941:112) describes, "Shanghai's great industrial resources were either destroyed, disabled or starved for raw materials; Shanghai's commercial life was at a standstill; and the threat to life and property was so great that those with liquid capital sought to disperse it to safer regions, either in China or abroad." Overall, the Battle of Shanghai signified a stunning inability of the Council to protect the loss of property and life within its borders. The economic and property damaged suffered within the Settlement was considerable; the Council's yearend Annual Report estimated over \$7.4 million in damages to properties within the Northern and Eastern Districts of the Settlement alone (SMC 1937: 268).

Yet the severity of the military violence and economic damage was, relative to that experienced in the domestic sections of the city, considerably less, and the settlements' status as safe havens accordingly returned as hostilities within the city died down within the end of the year, especially as worsening fighting took place in the broader China theatre. Barnett (1941:112) notes how the capital exodus now reversed itself, as seeking safety, it again found concessional Shanghai to be the relative safest home within China: "when it became evident that the foreign areas in Shanghai were to remain safe from danger and free from wartime political control, the process [of capital flight] was reversed—rich refugees and liquid funds from all over China began to return to Shanghai. ...Shanghai became an area where investors began to put their money in goods or industries." As the fighting ended in Shanghai, the Japanese military occupied all areas of Shanghai except the International Settlement and French Concession.

The inability of the Council to prevent the military violence of August 1937 from impacting the property and lives of its residents underscored the increasing deterioration of the Council's sovereign power vis-a-vis the Japanese military. Although formal hostilities within Shanghai ended by October, anti-Japanese incidents continued to be carried out within the Settlement by groups of Chinese residents. Such actions were cited as rationale by Japanese military authorities to exert greater control within the Settlement. On 12 November 1937, the local Japanese military leadership presented a list of demands to the Council to suppress anti-Japanese activities, including shuttering anti-Japanese organisations in the Settlement, evicting Chinese governmental officials and representatives, and forbidding any Chinese government news or telecommunications. While the Council initially attempted to refuse the order by declaring the Settlement would remain "neutral" in the on-going Sino-Japanese conflict (Jackson 2017:88), the ability of the Council to enforce a free and open environment that respected property rights based on rule of law was severely compromised. Soon thereafter, a number of private Chinese language newspapers that had been operating in the International Settlement were closed down, with newspapers such as *ShunPao* and *Ta Kung Pao* suspended. A few Chinese newspapers and journals, such as *Meiri yibao* (每日譯報), and *Wenhui Bao* (文匯報) changed their corporate registration and paid British nationals to become nominal owners to avoid Japanese harassment. These too, however, were shut down by the following year (Hanwell 1938: 170-171).

Additional disintegration of the International Settlement's institutional structure was also reflected in damage to the integrity of the Settlement's legal system. Whewell (2015: 210-212), for instance, describes a criminal case in October 1939 where Japanese police and military personnel coerced and intimidated witnesses. The occurrence created a climate undermining the supposed independent and objective administration of justice by the consular courts: "If the Japanese were interfering with incidents and witness statements how could consular jurisdiction reliably operate?"

Friedman (1940: 36) highlights one of the ancillary impacts the 1937 war had on Shanghai's economy, drawing attention to the fact that the activities of the Whangpoo Conservancy Board—the multi-national engineering enterprise created in 1912 responsible for dredging the sand bars that had previously plagued shipping activities along the Huangpu River—had been suspended since August 1937 after the Japanese military seized the Conservancy's ships and equipment, greatly disrupting "the vital role that dredging plays in the economic life of Shanghai." In January 1940, the Japanese military authorities agreed to restart the Board, but only after Japanese military personnel were given positions on the board and all Chinese staff were replaced with Japanese engineers. Effective control of the economic lifeblood of the city, shipping, thus came to be held by the Japanese military.

From 1937 to April 1941, the Council continued to operate those areas of the Settlement still under its control, which now excluded the Hongkou district. Much of the activity of the Council centred on managing the huge influx of refugees that had poured into the Settlement to seek shelter from the war. *The Shanghai Journal* (September 1937) estimated more than one million Chinese refugees entered the extraterritorial settlements over the course of a month. The Council struggled to provide adequate services in the wake of the economic and social problems that grew in the aftermath of the refugee inflow. While solid economic growth did return by the close of the 1930s, the Council faced a multitude of related problems, including lacking the financial and bureaucratic capacity to conduct the five-yearly census in 1940 (SMC 1940: 26), noting: "Dictates of economy necessitated the Council deferring the taking this year of the usual five-yearly census of population... So large a population rendered impracticable the former manual system of tabulating census returns. Only a mechanical process would have sufficed to undertake the census of so large a population. It was estimated that the cost of taking a census would have amounted to approximately... \$134,000 for [a population of] 2,500,000." Estimates, however, placed the domestic Chinese resident population at figures above two million (SMC 1940: 124).

A degree of normalcy nevertheless returned to the International Settlement after the halt of active hostilities. The influx of new Chinese residents into the extraterritorial settlements included amongst them numerous wealthy individuals and business entrepreneurs, who brought with them physical, financial and human capital. The resulting increase in manufacturing output and employment within the Settlement was substantial. Whereas at the start of the hostilities in August 1937 there existed approximately 1100 factories operating within Settlement borders, by the end of the year after the outbreak of hostilities this number had increased by 422, and by 1 May 1938, it had increased by an additional 339 (*Chinese Economic & Statistical Review* May 1938: 24). These increases represented nearly seventy per cent in the number of factories operating in the Settlement. Dong (1940: 101) finds that by the end of 1939, the number of domestically-owned factories operating in the Settlement had further increased to 3310, suggesting a near tripling of the number of factories that had either moved into the Settlement or been subsequently founded by its new domestic residents within two years after the start of the war in August 1937. Similarly, Wei (1985) cites additional signs of economic growth in the Settlement during this period, with over five hundred new stores having opened during the 1938 to 1940 time period.

9.5.2.3. Collapse of State Capacity in Preventing Violence: Total Loss Sovereignty

In March 1941, the Shanghai Municipal Council acquiesced to pressure from the Japanese military and accepted an additional Japanese member, after prior refusals from Britain and the U.S. failed. In April 1941, the Japanese authorities suspended the Land Regulations, and a consular-appointed council was established under the Provisional Council Agreement. The Japanese takeover of the governance of the International Settlement was, according to Bickers (2004: 247), "slow, legalistic, and undertaken with due decorum." The Guomindang government refused to participate nor consent to the modifications of the Regulations.

With the all-out attack on Pearl Harbour and declaration of War on the Allies by Japan in December 1941, Japanese military forces in Shanghai mobilised to take over all of the International Settlement. At first, a facade of normalcy was attempted, with the Shanghai Municipal Council maintaining its nominal administrative control over of the city. However, several weeks thereafter, the Japanese military "requested" British and U.S. members of the Council to resign, and a Japanese council member, Katsuo Okazaki, was installed as the new chairman (SMC 1942: 1). On 10 October 1942, Britain and the United States declared their renunciation of extraterritorial rights in China, formally returning the International Settlement to China, although in actuality the entire city was under Japanese military control.

Loss of monopoly on force complete, so too lost Shanghai Municipal Council power to prevent expropriation of private property by external actors such as the Japanese military. Expropriation by confiscation or forced nationalisation had hitherto never occurred in the Settlement, but now became commonplace. Businesses had their assets confiscated or the operations overtaken by the Japanese administrators under the direction of the Asia Development Board, and nearly all Allied nation employees were fired (Bickers 2004: 246).

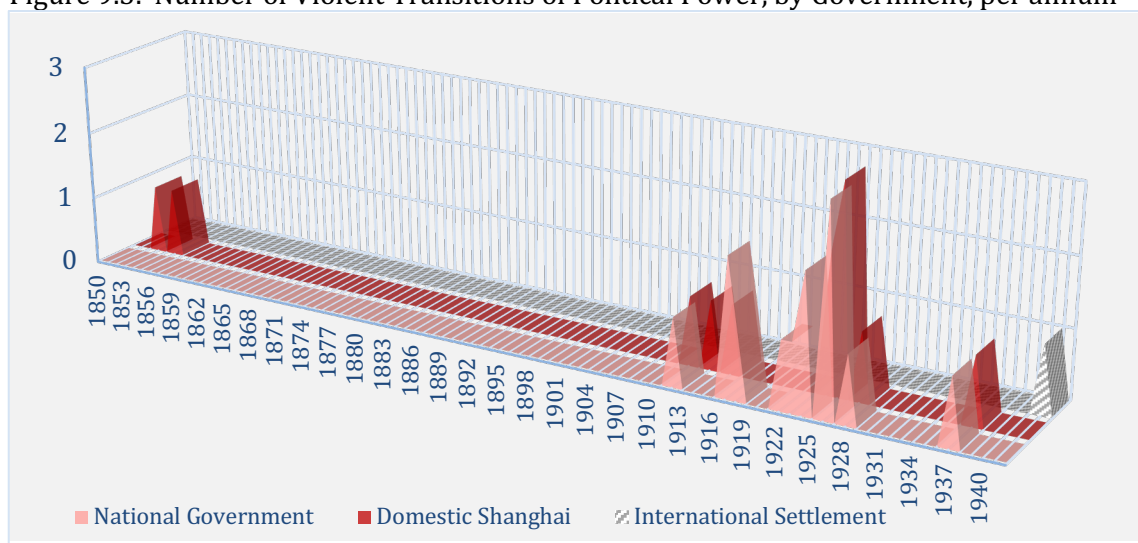
Loss of property and liberty soon also included forced taking of personal residences and the ban on free movement. Citizens of Allied Nations were at first required to wear armbands signifying their nationality when outside their homes, and later rounded up by the Japanese military and placed in internment camps. Shanghai had 12 such camps in total; most, such as Lunghwa internment camp, held more than 1,800 foreigners in dirty and over-crowded conditions, with "[h]unger and malnutrition [and] disease coming from lack of clothing, poor housing, poor sanitation, over-crowding and the stresses associated with captivity" (*SCMP* 4 February 2014). Life in the camps was difficult mainly because of the treatment by the Japanese guards. Rosebury Beck, a former inmate later recalled "[the] constant fear that you might have been shot, picked up, or tortured, anytime" (Felton 2013).

While the majority remained interned in camps, foreign nationals were not immune from suffering some of the same inhumane torture that happened to Chinese inmates in the Japanese military prisons. Wasserstein (1998) presents archival accounts of the few survivors of the Bridge House Hotel, which was run as a prison by the Kempeitai (Japanese secret police) organisation, where countless Chinese and foreign prisoners were tortured in gruesome manners, including death by beating, forcing prisoners to consume gallons of water mixed with kerosene or petrol, and the application of electric shocks or hot instruments to genitalia. American reporter John Powell was illegally taken from his home to the notorious Bridge House prison where Japanese military police subjected him to "atrocious assaults, beating him unmercifully" (Niderost 2017). Limited knowledge exists of this military prison, with just a few reports by Sir Frederick Maze (former inspector-general of Chinese Customs) and Howard Woodhead (editor of *Oriental Affairs*), who were amongst the most fortunate, as albeit tortured over a course of several weeks, they were ultimately released alive (Felton 2013). Such fear of death by torture represents perhaps the most drastic form of a total breakdown of private property rights and liberty experienced by Shanghai's residents after the collapse of the existing government structure.

9.5.2.4. Extraterritorial State Capacity in Preventing Violence: An Absence of Traps

As mentioned at the start of Section 9.5, the contrast between the level of civil strife and open warfare in domestic and extraterritorial environments was relatively stark. From the standpoint of the Violence Trap analysis employed in Chapter Six, the difference becomes even more pronounced when considering the thirteen violent regime changes occurring at the national level between 1840 and 1941, or the twelve such instances between 1840 and 1941 at the domestic Shanghai level, measures that underscore the outlier nature of the singular violent regime change experienced by the extraterritorial governments at the very end of 1941. These differences provide sharp relief between the level and nature of political violence that defined the domestic and extraterritorial institutional environments. The stark difference in the frequency of violent overthrow of the existing governance structure is demonstrated graphically in sharp relief in Figure 9.3. As the figure also makes clear, at least from the standpoint of political violence characterised by violent regime change of the existing political authority, the years following the fall of the Qing through the start of the Guomindang regime in 1927 were extremely tumultuous on the domestic side.

Figure 9.3. Number of Violent Transitions of Political Power, by Government, per annum



Sources: refer to Tables 6.1 and 8.1

As noted previously, the Cox *et al.* (2013, 2017) measure of violent forced regime change represents a circumscribed consideration of actual levels of political violence and civil strife, with instances of military events not resulting in regime change not included in the measure, no matter how large-scale or ruinous their effects on the economy and human life might be, nor included are non-military levels of violence characterised by an inability of the state to enforce a monopoly on violence to prevent the actions of organised criminal activities. As described in Chapters Six and Eight, this implied a serious undercounting of significant levels of political violence that defined the domestic national and Shanghai municipal environments. Somewhat conversely, however, as evident from the discussion throughout this section, overall levels of political and organised criminal violence within the Settlement remained relatively low, in both absolute and comparative terms, as did resultant impacts on private actors' private properties and productive assets. It was true that organised crime levels were considered problematic by the Settlement's leadership, and inflicted important costs on economic activity; however, even assuming the level of Green Gang activity to have been constant across both domestic and extraterritorial Shanghai, the vast difference in military battles occurring within the two environments itself was enough to heavily skew the perception of the levels of political and social violence between the two environments.

The implication of this stark difference in the level of political violence across Shanghai's two parallel institutional environments was accordingly large. Regarding primary effects, unlike in the domestic environments of broader China or non-extraterritorial Shanghai, little destruction of private assets, or human life, took place as a result of military actions. The exceptions were important, but limited, such as the damage stores and businesses in the wake of the May Thirtieth Movement-related riots, or to businesses along Nanking Road (now 南京东路) during the 1937 Sino-Japanese hostilities. Similarly, there was an absence of expropriation and theft of private assets by internal or foreign military actors. These two factors signify huge positive implications for entrepreneurial economic activity. Owners of private property and firms operating within the extraterritorial settlements faced considerably lower risks of their productive assets being destroyed in the process of military battles, or seized by military actors. This level of security helped make the prospect of costly outlay of investment more likely to produce positive returns for entrepreneurs and investors. Such perceptions were acted upon, for instance, by the opening of factories and businesses by domestic entrepreneurs in the Settlement cited above that occurred in the wake of the August 1937 military violence. Similarly, Shanghai's extraterritorial municipal governments were spared from the need to constantly devote resources to rebuilding roads, municipal buildings and other public facilities destroyed in the course of military actions, nor was their bureaucratic and administrative capacity destroyed or hampered by actions of military combat or violent overthrow of the existing political regime. A more favourable tax collection situation was also implied, given that widespread destruction of productive assets, residences, and lives of extraterritorial municipal residents was relatively infrequent, thereby allowing for the creation of greater taxable output for the government to tax.

Likewise, significantly lower levels of political violence in the extraterritorial setting also implies significant differences in regard to secondary effects owing to political violence across the institutional environments. In particular, we find there to have been an absence of the kind of political violence related "traps"—either the Violence Trap of Weingast and his co-authors, or our concept of a "low credibility trap"—thereby alleviating much of the pressure on state actors to operate under significant short-term biases that can induce drastic expropriative behaviours, and instead enhancing the incentives to commit resources to developing and maintaining credible commitment mechanisms that stimulate economic growth. These mechanisms included a representative form of governance that operated under adherence to a written and known constitution (the Land Regulations). These mechanisms were viewed to be credible given that the negative consequences accruing to state actors by deviating from adherence to their maintenance, could credibly be viewed by

private actors as likely higher than potential received positive consequences. Thus, for instance, if state actors acted to violate private property rights by enacting onerous taxation rates, or by ordering the expropriation of private assets without just compensation, they would likely be voted out of office by the electorate of ratepayers (i.e., property owners), and thus unable to benefit over the long term from their policy implementations; or, similarly, the extraterritorial court system could rule in ways that prevented implementation of policies that violated established norms or rules specified under the Land Regulations. As such, the expected costs for state actors of attempting to violate property rights were high, thus implying net expected benefits from such attempts were likely to be considerably lower than the expected net benefits derived from encouraging commercial activity to grow under a strong property rights environment.

Nonetheless, as discussed throughout the description of the domestic institutional environments at both the national and domestic Shanghai level, the institutional features that determine the strength of private property and contract rights are represented by a complex and multi-faceted set of vector that are not only non-unidirectional at any single given time period, but also certainly each individual vector itself highly subject to experienced variations in both strength and direction over time. This would certainly be the case in regard to the set of vectors characterising the level of political and social violence within the extraterritorial settlements over the time frame, particularly so during the period of rising Japanese militarism throughout the 1930s. The ability of the International Settlement to maintain a monopoly on internal coercive force during the 1930s noticeably waned, especially during the post-1937 time frame, when the Municipal Council faced an increasing number of realistic existential threats owing primarily to aggressive actions of the Japanese military. As a result, extraterritorial state actors operated in a changed institutional environment, facing a series of existential threats to regime survivorship that had not previously been present.

This changing reality led to a changing institutional environment, one with a degraded level of protection on private property and legal rights for the Settlement's residents. The increasing power of the Japanese military, combined with a decided retreat by American and British politicians in the willingness or ability to provide political and military support to the Settlement, led to a set of pressures and incentives on state actors that made them more open to the undertaking of violations of private property and legal rights previously considered off-limits. This was demonstrated by the actions of the Municipal Police and backed by rulings of the local courts in reference to a loosening of civil protections for suspects arrested under suspicion of communist support. Likewise, from an economic policy standpoint, the Council considered actions such as the implementation of price controls, or open to consideration to break with over a century of adherence to the "constitutional" dictates of the Land Regulations in order to implement an income tax. The economic wisdom of introducing an income tax aside, the more salient issue is that the Land Regulations—the Constitution—had been considered sacrosanct, and undertaking policies that violated its mandates were seen as politically unacceptable. We are able to observe, however, as in the case of domestic government actors who operated in a political landscape defined by arguably much greater and more continual existential threats, so too did extraterritorial state actors, in the face of increasing existential threats, begin to consider behaviours that violated previously socially and politically accepted norms and constructs. The implications of such drastic behavioural changes by state actors is highly significant. By way of such examples, we observe evidence—while admittedly qualitative and certainly open to interpretation—that is suggestive of support for the Violence Trap thesis, where political actors in an environment facing serious existential threats behaved in ways considerably different than similar political actors behaved when operating in an environment considered to be under substantially less serious existential pressures.

9.6 State Actions: Commitment to Protect Private Property Rights

In words and perception, if not in deeds, the founders of the Shanghai Municipal Council were ostensibly committed to a general adherence of the classical liberal state. From an economic standpoint, this implied conduct of a minimally-intrusive state that taxed its populace only enough to extract resources necessary to maintain the ability to create an institutional legal environment of consistent rules while maintaining a dispassionately-administered system of law and order that protected residents' private property rights from internal and external threats. Outright expropriation of private economic assets by the state, or explicit interference with the market process was conceptually inherently prohibited. However, a degree of limited regulations imposed on economic actors to ensure consumer safety or to address externalities, such as polluting activities that externalised production costs onto larger society, were consistently stated as being appropriate. In the broader area of civil society, too, a generally-limited conception of the state's role was expressly articulated, albeit again, certain economic or social private behaviours were deemed subject to regulation or prohibition based on morality or social acceptability grounds.

9.6.1 The State's Role in the Economy: Taxes, Regulation, and Expropriations

As noted in the prior discussion, the role of elections and the annual and extraordinary Ratepayers Meetings provided relatively effective checks on Council members' natural proclivity to increase the size of the state, and their personal prestige and power, through taxation. Overall, the system was successful in keeping taxation at a minimal, with Lockwood (1934: 1036, 1039) commenting, "Tax rates in the International Settlement are unusually low and the powers-that-be are reluctant to sanction any upward revision. ...Foreign business, which is largely exempt from home taxation, has had to bear only the comparatively light burdens of municipal taxes, except in so far as operations outside the Settlement brought it within reach of the Chinese authorities."

The taxation structure imposed by the Council, however, was not necessarily designed to promote entrepreneurial activity. As noted, the membership of the Council and the electorate Ratepayers Association was heavily comprised of owners of the largest and most economically powerful business ventures operating in the Settlement. Taxation policy, therefore, reflected the interests of these larger concerns. From the earliest beginnings of the ratification of the Land Regulations up through its subsequent revisions and expansion of the size of the state, the Council operated under the initial interpretations of the Land Regulations that the Council lacked authority to levy direct taxes on residents. As such, throughout its history, there was no system of personal or business income taxes levied on residents. Thus, the majority of revenue was derived from real estate taxes and fees imposed on business operations. Such licensing taxes were viewed as regressive by many of the small business owners operating in the Settlement, with one arguing in early 1941 that the Council was blithely ignoring the needs of the common businessperson: "In what other part of the world would a wee little provision shop be levied license fees while the large importers are allowed to enjoy their profits free from license or income tax? ...This plainly shows that there is plenty wrong with the present system of taxation here and that it is high time that bold steps be taken in order to make it possible for the Council to levy a tax on business profits, which would not only give the administration all the funds it needs but would even make it possible to alleviate the burden of the public by reducing housing taxes and excessive licensing fees" (*NCDN* 1 February 1941).

The relatively light tax burden on residents and businesspersons operating in the Settlement was matched by a relatively light regulatory regime, particularly in regard to those on business activity. The Settlement was for the most part "devoid of factory regulations except for a few building rules and fire regulations" (*Pacific Relations* 1934: 2), with factory conditions reflecting "unbridled exploitation" and frequently using child labour. As noted, the factory law promulgated by the Nanjing government in 1929 was only implemented in 1934, and even then only weakly put into effect. At the start of the 1930s, Tawney (1932: 149) finds the Settlement's factory conditions "recalling those of the first, and worst, phase of the Industrial Revolution in England... [Working conditions] are little better than barns, and in which the most elementary conditions of health and safety appear to be ignored."

The lighter tax and regulatory requirements imposed on business owners and residents of the International Settlement compared to the outside domestic Shanghai municipal tax and regulation regime did not go unnoticed by domestic economic actors. This is perhaps best noted by the vast number of domestically-owned factories that set up production inside the concession areas over the years. The reasons for this were many—certainly not the least of which, as discussed below, were in regard to the relative increased safety against destruction from military activity. Yet another reason can be gleaned by the statement made at the 1939 Annual Ratepayers Meeting by a ratepayer of surname Harris submitting an amendment (successfully motioned) to require the Council to increase regulations to curtail pollution and dangerous conditions coming from newly constituted factories. His remarks underscore the difference between the costs of doing business in the domestic- versus foreign-administrated sections of the city as perceived by domestic Chinese entrepreneurs: "I asked [the owner] of one factory where they were before the 1937 outbreak, and they replied 'in Chapei.' I asked: 'Why don't you go back?' and they said that if they went back they would have to pay rates and taxes, and also levies on the goods which they produce, whereas... [on the outskirts of the Settlement] they could put up very cheap straw huts for their workers, and could pay them very small wages and were able to make a profit of 200% per annum, as against 30% in Chapei" (SMC 1939: 11).

Nonetheless, the Shanghai Municipal Council did pass regulations that impacted the private sphere of economic activity and of citizens' daily lives. Regulations and civic codes were enacted quite early in the history of the Settlement, including regulations on business activity, such as codes defining the amount of space a transitory vendor must leave between their stand and the doorway of an established business, or the requirement of permits to be obtained from the Council before a new road or ditch could be constructed, large equipment be transported, or alcohol sold. Codes were quite specific, detailing for instance the style for the carrying of live chickens (to be done only in cages and not by hand). Hence, it can be argued that unlike the Qing or Beiyang governments at the same period, the "state" as represented by the Council sought to impose a larger presence on everyday life, seeking to control particulars of social and business interaction. This practice followed in many aspects the expectations and norms of the role of the state the ingrained in the predominantly western leadership of the Settlement—it was more accepted that the state would impose rules and regulate social norms, especially in the commercial sphere, and not leave resolution of commercial disputes to custom, as was the case in traditional China.

Overall, there appears to have been a constant push for additional licensing and regulation. This is perhaps not surprising, as the incentive structures that drive the push for greater government involvement in the economy—whether from specific forms of regulatory capture (Stigler 1971, Laffont & Tirole 1991), or a more generalised process of growth of government administrative powers owing to what Hayek (1944) identified as inherent in the government planning system—were certainly present in the Settlement's administrative structure. To begin with, direct financial incentives existed—as indicated by

the financial statements provided in the Council's Annual Reports, licensing fees contributed a large percentage to the municipal budget. In addition, as the Shanghai Municipal Council was comprised of primarily of the Settlement's wealthiest businessmen, and given that larger and wealthier business ventures are better able to comply with the demands of greater state oversight and regulation, it is not unexpected that the Council entertained continual suggestions to increase the regulatory power of the state. One of many examples found in the Annual Reports was in 1916, when several owners of extraterritorial businesses urged the Council begin the licensing of domestic money shops operating within the Settlement (SMC 1916: 155A). Regulations were also pushed forward on morality grounds by groups of "concerned citizens" desirous to extend their personal moral mores upon the rest of society, leading to numerous calls by citizens groups to impose prohibitions on varying economic activities. In 1923, for instance, over half the Settlement's brothels were forced closed over morality concerns (SMC 1923: 77). Further, the specificity of regulations imposed could be impressive: prohibitions on the sale of poisons over public safety concerns came with many pages of precise regulations over which drugs were considered poisonous, under what circumstances and who should be allowed to buy and sell or prepare the drugs, which such sales could be take place as either retail or wholesale distribution, and onwards (SMC 1923: 85-94).

Regulatory measures were prevalent on many types of economic activities deemed in the "public interest." Thus, the Tramway Company which operated transportation tram service within the Settlement was subject to oversight of the fares it could charge. That the company had been granted monopoly rights to operate the Settlement's only tram service was viewed as justification for such oversight. In 1923, for instance, when the company intended to raise fares as a way to deal with the issue of overcrowding of tramway cars, the Council debated in a series of back and forth communiques with the company leadership before acquiescing to permitting a fare increase, but only after acceptance by the Company of a change in their original proposal (SMC 1923: 67-78).

The degree of government involvement in the private business sphere remained primarily regulatory in nature, with relatively few instances of outright state ownership of productive resources. One exception was in regard to utility companies, perhaps not surprising given the then-prevailing view of utilities as natural monopolies necessitating either outright public ownership or heavy regulation. In 1893 the Council leadership voted to municipalise the local privately-run electricity provider, purchasing the Shanghai Electric Company, and creating a new administrative unit, the Electric Light Department, after the purchase. Already by 1899, however, higher than expected operational costs led the Council to put forward a formal plan to privatise the utility, but tenders were not forthcoming (*Shanghai Chronicle* 1906: 684). Eventually, in April of 1929 the Council successfully completed the sale of the utility to the Shanghai Power Company, officially ending the Council's nearly four-decade experiment with state ownership of utility services (SMC 1929: 22).

Private ownership of utilities, however, did not mean they were not considered public utilities; or, in the parlance of the day, as defined by the U.S. Supreme Court, "utilities affected with the public interest" (*Munn v Illinois* 1877 94 US 113). As described in regard to its control over the fare schedule of the Tramway Company, the Council maintained rather intensive regulatory control over what it determined to be public utilities. In addition, the Council was heavily involved in the formation of several of the utility companies; for instance, in 1923, the Council undertook a series of prolonged negotiations with local business leaders and investors that culminated in the creation of the privately funded and run enterprise, the China General Omnibus Company, that was designated a public utility and given exclusive rights to operate a motorised passenger bus service throughout the Settlement (SMC 1922: 285A; SMC 1923: 79-82).

Beyond regulation of public utilities, which included oversight on the setting of prices, the Council mostly avoided direct interference in the market process in other business matters. The Settlement's oft-asserted commitment to adherence to *laissez-faire* economic policies, and associated credible commitment mechanisms—such as constitutional constructs that imposed limits on the Council's ability to intervene in the market—were severely tested, however, following the outbreak of war in 1937. War led to severe shortages in basic food and other essential commodities; these events helped portend an upward spiralling of prices. Such drastic economic conditions led to consequent demands from multiple Settlement constituencies for the outright usurpation of the market process and the implementation of severely interventionist policies, such as price controls on consumer goods deemed necessities. The response of the Council is suggestive of the way in which even relatively strong institutional safeguards on private property rights can be swiftly eroded by the state when social actors become complicit.

The primary causes of the drastic increases in general price levels came from two sources. First was a general inflationary monetary phenomenon. After the currency reform implemented by the Guomindang government in 1935 banning the use of the silver *yuan* and introducing a fiat paper *yuan*, commonly referred to as the *fapi* (法幣), the ability for the central government to utilise the power of the printing press to engage in seigniorage greatly increased. Given that the war led to steep increases in the level of government debt, as well as cutting off many prior revenue sources, the attractiveness of such a policy apparently came to outweigh its long-term costs. From 1937 the domestic national money supply—during a time of unprecedented loss of physical and human capital and greatly reduced output—rose drastically. Based on Huang (1948), the money supply slightly more than doubled over the two years 1937 to 1939, and then nearly doubled again each year from 1939 to 1940, and again from 1940 to 1941. Hence, over the span of the first five years of the war, the total money supply increased sevenfold, with physical cash in circulation increasing ninefold. Given such monetary circumstances, the resultant hyperinflation can hardly be viewed as anything but expected.

A second factor driving increasing price levels in Shanghai came on the supply side of the real economy. Within several months after the outbreak of full-scale war in August 1937, the Japanese military gained control over most of north China and the maritime provinces, including Shanghai's surrounding areas. Only the two extraterritorial settlements remained outside of the control of the Japanese military; importantly, therefore, (extraterritorial) Shanghai theoretically could continue to play its role as an open entrepôt port with free access to global markets. Yet while international trade flows traditionally served as one of the city's primary economic engines, prior to the start of the war, Shanghai had been mostly utilising local domestic markets to supply its basic food and commodity needs.

As China's most populous city—and having further experienced a massive inflow of refugees in the immediacy of the aftermath of the outbreak of hostilities in mid-1937—Shanghai was an important market for North China's and Jiangnan's producers of rice, wheat, soybean, cooking oils, and other primary crops. Assumption of control over these regions by Japanese military forces brought a change to this historical pattern of interior-to-littoral trade flow.

Henriot (2000: 43) notes that starting in 1939, the Japanese Imperial Army began to limit supplies of rice and other cereal grains sold to the settlements, instead conscripting the vast majority of occupied China's agricultural output for export to Japan; by 1940, less than one-

tenth of the city's minimum food supply requirements was officially supplied by domestic producers.[§] (Nonetheless, as documented by Henriot & Yeh (2004: 5), smuggling became an active, and profitable, activity that served to partly alleviate the shortages caused by the restrictive trade prohibitions imposed by the Japanese military.)

In response to dwindling agricultural products obtainable from the interior, the settlements turned increasingly to overseas markets to meet their needs. Data provided by Chou (1968: 106) and Henriot (2000: 43), and from foreign trade reports in the *North China Herald* (e.g., 26 October 1938: 149) demonstrate a sharp increase in rice and other food imports, with annual rice imports increasing from approximately three hundred thousand to nearly six million tonnes over the course of 1937 to 1941, representing a twentyfold increase. Similar increases in imports of flour, wheat and other agricultural staples occurred. Problematically, the costs of imported foodstuffs were considerably higher than those locally-produced, especially as wartime activities increased the risks and associated costs of transportation. For instance, additional costs were incurred as non-Japanese and non-German cargo ships arriving in Shanghai's ports were subject to frequent detainment by Japanese military inspectors with their freight occasionally confiscated (*Cheng Yien Pao* 21 December 1940). As such, the real cost of food staples continued to increase drastically as the war continued, with an especially sharp spike in import prices occurring mid-1939 and again in 1940.

The Council's initial response to these price movements and supply shortages began with some relatively cautious actions that sought to avert widespread famine while avoiding becoming too involved in the market process for food provision. As early as a month after the outbreak of hostilities, in August 1937, the Council formed a Material Resources Supply Committee (colloquially referred to as the Rice Committee) to specifically work with merchant guides to control prices and attempt to ensure an adequate supply of basic foodstuffs was available to the majority of Settlement residents (*NCH* 25 August 1937). The role of the Committee quickly grew, however, to soon include organising massive buying of rice and other products deemed essentials for distribution to refugees or resale to firms and the public, regulating "profiteering" behaviour by merchants, and later, outlawing the sale of imported rice to the Wang-government municipality (*NCH* 5 February 1941: 218, Henriot 2000: 47). Prices of many of these products were published daily in several of the Settlement's primary newspapers such as the *China Press*, the *North China Daily News*, and the *Shun Pao*. While the prices of other goods could be set and adjusted by store owners and other sellers of goods to the public—and were, primarily and significantly to the upside—a select list of products were required to sell at fixed prices (*NCH* 26 October 1938: 149).

That the public was concerned about the costs of such interventionist policies is indicated by frequent "letters to the editor" published in local newspapers demanding greater transparency of the Committee's work and suggesting the undertaking of more cost-effective procedures in the Council's price-purchasing strategies. One such letter demanded that the large-scale orders of rice imports by the Rice Committee take place under an open bidding procedure accessible to multiple firms involved in the importation of foreign rice, as opposed to simply utilising the single merchant house selected by the Committee in a non-transparent, non-open bidding process (*NCDN* 22 August 1937). In any event, such direct purchasing schemes were discontinued by the end of 1937 (*NCH* 5 February 1941: 218).

[§] It was not only private merchants and public authorities in the extraterritorial settlements who experienced difficulties procuring rice shipments from the interior due to what essentially amounted to an unofficial blockade by the Japanese military and conscription of agricultural output for export to Japanese markets. The Japanese-controlled Shanghai domestic municipality also faced shortages. In 1940, Chen Kung-Po, mayor of Shanghai Special Municipality, engaged in protracted negotiations with Japanese military authorities to allow shipments of rice from the interior. While able to secure promises from military leaders to allow shipments into non-settlement Shanghai, the amounts were small, on the scale of 168,000 piculs annually (*NCDN* 22 December 1940)—roughly equivalent to ten thousand tonnes, such amounts represented less than one-fiftieth typical annual consumption levels.

The effectiveness of the Council's early measures were relatively limited. Henriot (2000: 47) claims the bureaucratic administrative and enforcement structures of both extraterritorial settlement areas lacked sufficient efficacy to enforce on a substantive level punishment against offending merchants who flouted rules designed to limit profiteering or non-sanctioned sales. Further, the settlements continued to suffer from an undersupply of essential foodstuffs sufficient to meet the minimum dietary needs of their populaces. The result was frequent bouts of internal spontaneous nonstate-sanctioned violence. Several months of particularly severe rice shortage in the Settlement, for instance, led to a riot in December of 1939, as mobs smashed windows and raided rice shops; a similar event occurred again a year later in December 1940 in response to the unwillingness of merchants to sell customers rice at the published prices (Henriot 2000: 48).

Calls from the community to impose more effective and binding price controls on vital foodstuffs and cooking oil grew. The Shanghai Municipal Council was exceedingly hesitant to attempt the introduction of more blatant interventionist policies; to begin with, there was no legal precedence for such action; Council members and numerous Ratepayers expressly pointed to the lack of authority for the Council to engage in such actions under the existing Land Regulations. Conversely, seemingly equally loud voices were found in the press of continued calls from readership for greater action on the part of the Council, even when such actions called upon the "absolute indispensability of circumventing the land regulations" (*NCDN* 1 February 1941).

Beyond the seriousness of disregarding constitutional limits on Council powers, the Council was also faced with the prospect of attempting to enforce strict price controls on agricultural products on which it lacked any command over their production and transportation costs. In addition, many correctly identified that the economic logic of price controls was in fact counterproductive to achieving the main goal of increasing the supply of rice and other foodstuffs available—if prices were mandated on what wholesale importers could receive, they had little or no incentive to import foods at prices levels that would prove unprofitable; the similar case was true if prices were mandated to final resellers, as they would chose not to order products from wholesalers or importers if it meant paying higher prices than those at which they could resell.

Under consideration of such logic, and combined with the prospect of potentially administering an associated system of rationing that would necessarily accompany such price controls, the Council continued to argue for caution in terms of further direct intervention in the market. At the 1940 Annual Ratepayer's Meeting, held in early February of 1941, a senior member of the Council, Mr Franklin, discussing the difficulties the public faced given the severe inflationary pressures on commodity prices, expressed the Council's position in regard to reasons for hesitation before implementing drastic measures that would interfere with the market process (*SMC* 1940: 9). Specifically in regard to the call for the Council to implement price controls on certain consumer goods, Mr Franklin noted: "I refer to the grave problems we are faced now as the result of the rapid rise in the price of food and other essential commodities. We are not professional economists, and in the field of economics we must walk warily. It would be dangerous for me to encourage you to hope for too much as the result of municipal control and effort in the field of economics. Control carried to excess frequently defeats its own ends. ...It follows that unless there is a free flow of foodstuffs into Shanghai from the hinterland, with no unnecessary restrictions or taxation, there can be no substantial fall in the price of essential foodstuffs." (To Mr Franklin's statement we might only wish to add, as Hayek (1988) cautions, it would likely be wise for professional economists to also walk warily in the field of economics.)

The Council had already begun to implement set the stage for increasingly aggressive interventions in the market to combat food shortages and the potential for further social unrest that additional price increases and supply declines portended. The Rice Committee continued to actively work with merchant groups to urge them to keep prices within the ranges of the prices set by the Committee, and constantly surveyed and published food prices in the local papers, as found in the three primary market locations—Hongkew Market, the Western District's Seymour Market, and an average across various smaller markets in the French Concession (*NCH* 5 February 1941: 216). Yet these attempts at moral suasion over economic actors proved difficult, given the rather feckless enforcement mechanisms the Committee possessed, as well as the economic logic behind the futility of price controls in terms of inducing rational agents to consistently sell for less than their costs.

Prior calls for restraint on the part of the Council, however wisely stated by Mr Franklin in early 1941, were to be ultimately upended when by mid-1941 inflationary pressures further intensified. Beginning in the timeframe after the start of the war, combined wholesale price levels over the latter half of the year nearly doubled, rising from 891.2 in June to 1597.8 by December. Tensions in the community rose as rice shortages again became severely acute, and it became clear that the strategies employed by the Council and the Rice Committee were proving ineffective to solve the crisis. In response, an extraordinary meeting of the Ratepayers was called at the start of November at which the by-laws of the Settlement were amended, granting the Council sweeping new powers to set price controls on any commodity or good deemed as "necessary" to the overall welfare of the Settlement, and further to impose criminally punishable penalties on merchants or other resellers caught violating mandated prices (*NCDN* 3 November 1941).

From a liberal governance argument, while the willingness of the community to agree to modify the constitution and grant the state greater powers over free economic activity and the natural market process might have been concerning to some residents, the majority ultimately gave way to what were seen as more immediate expediencies. In some sense, albeit by way of a different mechanism, we can find a parallel to that situation which was described on the domestic Chinese institutional environment landscape where the existence of plausible existential threats led state actors to prioritise short-term goals over long-term costs; similarly, the social and economic emergency resulting from the Japanese military invasion of China created the conditions for sentiments amongst Settlement ratepayers to similarly discount the potential long-term danger of increased state power over economic activity in order to all the state to provide expected economic and social benefits in the short term.

Broader public sentiment on the issue can perhaps be ascertained from the headline of front-page article in the *North China Daily News*, published the following month on 7 December 1941, reading, "Shanghai Public Cheered by Continued Price Control". The article describes the appreciation of the community for the perceived assistance that local authorities were providing in the form of continuing price control measures: "The first day of the week brought the glad tidings that the price of Hongay coal had been fixed by the authorities of the F.M.C. at \$600 per ton, as compared with \$900 which had been quoted not so long ago. ...Major coal companies in the International Settlement had supplied the Shanghai Municipal Council with statistics of monthly consumption figures, and it was expected in distributors' circles that the Settlement authorities would adopt similar regulations."

More recent views likewise appear to express equally positive expectations of the benefits the Settlement's formalised system of price control that it had newly instituted, with Henriot (2000: 52) for one, lamenting not that the Council instituted price controls, but rather that it had waited too long in doing so: "The SMC issued on 9 November 1941 a

proclamation laying down a system of control over the price and movements of rice in the International Settlement. ...The regulation prohibited the sale of rice above the fixed price and threatened violators with fines, confiscation of stocks, and expulsion from the settlements. The freezing of rice prices, although it could not be enforced perfectly, caused severe damage to rice profiteers. Some 1,000,000 bags of rice bought locally or elsewhere at prices ranging from 160 to 200 *yuan* could only be sold at the fixed price of 130 *yuan*. The local rice merchants took an aggregate loss of between 50 and 70 million *yuan*. Yet these measures came too late, as the SMC was about to lose all its powers under Japanese occupation."

Economically, the benefits anticipated by consumers or modern commentators were unlikely to have materialised. Indeed, Henriot (2000:62-65) later notes the failure of a subsequent price control and rationing system the Wang regime implemented in Shanghai after the fall of the extraterritorial settlements; while he assigns blame for the policy's failure on poor implementation in light of weak bureaucratic capacity, we would argue the underlying lack of economic rationality of price control and rationing systems to have been equally culpable. To begin with, the "profiteering" referred to by either contemporaneous or modern observers—that is, making "excessive" or "unfair" profits—is a concept based on an inherently subjective criterion that seems oddly misplaced in a market society, for who is to say what is a "just" price and what profits are "excessive"? The very concept of the market mechanism is that it enables market prices to work as an allocation tool that allocates a given commodity to those who most value it. In other words, prices ration scarce resources; viz., food and other essential commodities under a wartime situation. Trying to circumvent the market price mechanism in a market economy not only creates grave distortions to the economy as a whole, but more fundamentally, it disrupts the very allocation method that market prices perform as they continually adjust to attempt to achieve market clearing levels. When there is an attempt to keep prices artificially low in relation to the available supply—as in the case of foodstuffs and other "essential" commodities in the Settlements—then inherently prices will be too low to induce sufficient numbers of sellers to procure the goods so as to sell it or part with it if they already hold the good, thus further reducing the available supply; and further, the number of consumers who would be willing to purchase the good at the artificially low price are much greater than the amount of goods available, and those who would have been willing to purchase the good at higher prices are unable to receive any, as the good quickly becomes sold out, while those who valued the good more dearly end up consuming more than they would have had the price been allowed to fluctuate to approach its market-clearing level. That is, everyone is pleased with lower prices—to wit, the cited front-page headline of the *North China Daily News*—except for those who are unable to acquire the good at any price once supply has been exhausted.

However, our discussion has ignored the issue that many observers, whether they be the Shanghai Municipal Council members, or contemporary academics and politicians, deem the most important—that of fairness. Understandably, it appears inherently unjust that in a situation of dire shortages of materially essential goods such as food that wealthy individuals should be able to obtain such goods while those less economically fortunate might not be able to pay the demanded price and hence suffer and even perhaps starve. This is a noble albeit logically incoherent position. For, why is it that in "normal" times, the market price mechanism is viewed as the most appropriate to perform the allocation function of goods to consumers—where again, those consumers with access to greater economic resources can afford to obtain more and better goods can those with less, and even where the most destitute amongst the populace might well not possess enough resources so as to purchase essential resources and therefore suffer and even starve—but not during times of economic distress and imposed scarcity of goods? Whether the answer is simply the scale of the number who are made to suffer, or the potential for sellers to obtain profits higher than they normally would have under "normal" circumstances, neither

argument undermines the fact that the market price mechanism is that most superior in not only allocating goods across consumers to those valuing the good most, but also to identify goods most valuable in society and signal to entrepreneurs the potential for future extraordinary profits so as to induce actions that will bring about an increase in the supply of the desired good and thereby increase its supply. Thus, as noted, Henriot & Yeh (2004) find a variety of active smuggling operations taking place throughout the period; likewise, we observe a surge in agricultural commodity imports into Shanghai replacing those previously supplied by central and north China. The reasons for this was the high prices that could be obtained by selling foods, and the opportunity for extraordinary profits that entrepreneurs expected from these activities.

Thus, rather than focus so much (ineffective) effort on precluding "profiteering", the Council could have allowed the market price mechanism to function unfettered and drive processes and solutions—many perhaps some unforeseeable and unknowable—that could have been devised by creative entrepreneurs to bring more foodstuffs and other essentials into the settlements to sell to willing Settlement consumers, thereby increasing the supply of these goods. Simultaneously, to address the issue of potential famine, direct transfers of foodstuffs through private charitable organisations could have alleviated much of the potential for suffering. Given the ineffectiveness of the policies the Council instituted, near-famine conditions existed for many of the refugee population who had fled to the Settlement in the wake of the outbreak of open military fighting in 1937 that consequently swelled the population of the Settlement by nearly one million. In response, many wealthy Chinese merchants donated food supplies to help feed the refugee population; for instance, twelve hundred bags of "Saigon" rice, valued at one hundred thousand *yuan*, were donated by a merchant of surname Yu in the Settlement's western district (*Shun Pao* 24 December 1940). Whether such private efforts would have been sufficient to fully address the needs of the Settlement's refugee and other suffering populations is unknowable, but what we do know is that the state-sponsored efforts that were undertaken proved to be insufficient.

9.6.2 State's Role in Civil Society

The liberal concept of free expression and free association is central to the successful maintenance of what Weingast (1997) refers to as "open access" societies, later defined by North *et al.* (2013:16) as those societies that are "sustained by institutions that support open access and competition: political competition to maintain open access in the economy, and economic competition to maintain open access in the polity." Such competition mechanisms help allow the coordinated actions of economic actors to place limits on state actions. In order for these mechanisms to successfully operate, open societies must create the type of institutions that facilitate "political competition to maintain open access in the economy and economic competition to maintain open access in the polity that allows citizens to form social coalitions that can overcome social coordination issues enough to successfully react in concert to violations of previously promised limits to state actions" (Weingast 1997: 261).

Central to such institutions is the liberal concept of freedom of expression and freedom of assembly. According to the expressed sentiments of Council members and the Settlement's other self-interested supporters and apologists—and oft assumed within the current economic history literature—the International Settlement well exemplified the ideals of the Weingastian open society, operating under a rule of law, protecting the rights of residents based on a commitment to well-established principles, which included commitments to freedom of expression and civil association, thus allowing the formation of social coalitions that could organise to defend their interests in regard to potential desired changes in government policy, or to engage in other forms of social action. However, the actual often deviated—substantially, sometimes—from the ideal.

Contrary to the concepts of freedom of expression and assembly underlying the British common law system that formed the underlying legal framework of the Settlement, the Shanghai Municipal Council imposed restrictive limits on the ability of local media concerns to publish the type of information their managers believed their readership was interested in consuming. There were prohibitions against the publication of "indecent" or "blasphemous" writing. (Such prohibitions did not limit blatantly racist caricatures, both verbal and sketched, of Chinese individuals in the western press, which frequently depicted supposed conversation with domestic Chinese individuals by "humourously" using "Pidgin English"; e.g., *NCH* 23 July 1921, *NCH* 23 October 1940).

Much of the enforcement of such provisions was directed towards the Chinese-language press. By the turn of the century, nearly half of all Chinese-language newspapers in the country were published in Shanghai, most out of the International Settlement, with many openly advocating for political reforms such as a parliamentary system of government, institutional reform, and even the overthrow of Manchu monarchical rule. *Ming Li Bao* (民立報), printed in the French Concession, became an unofficial voice-piece of what became the 1911 Revolution. It was one of the widest circulated newspapers during the time, printing over 20,000 copies per day, and including a young Mao Zedong amongst its readership (SHTS 1999 v3: 358, 355; Gu 1998: 70). The choice of domestic newspaper to locate their offices within the settlements in part reflected relatively stronger provisions on freedom of expression in the press than elsewhere in China. However, such protections were fairly circumscribed, reflecting more an adherence to process and standardised penalties than to full protection of speech. Given the authoritarian nature of the various domestic Chinese governments, the Chinese-language press occasionally contained messages critiquing the lack of rights Chinese citizens possessed under the given current regime, or discussing the lack of government accountability, transparency, adherence to rule of law, or other failings attributed to the domestic state. Such materials were considered both in violation of both Settlement bye-laws and domestic Chinese government proclamations forbidding the printing of seditious materials. The Municipal Police would actively suppress the publication of journals containing such critiques, as well as arrest the editors or authors of the journals. Kotenev (1927: 74-76) details a specific example of the limits to free expression in the press that defined the Settlement's civil society, illustrated by events leading to the censorship of the *Su Pao* newspaper in 1903, and the prosecution of its publishers for acts of sedition against the Chinese state. Having published an article calling for the overthrow of the Qing monarchy and the installation of a republic, two of the six defendants charged were ultimately found guilty of sedition, and were expelled from the Settlement and sentenced to three years of hard labour in prison.

At times, the Municipal Council also actively sought to undertake legislative action to strengthen the Settlement's own internal legal provisions against seditious material. In March 1916, at a called Special Meeting of the ratepayers, the Council leadership proposed a new Bye-law, mandating that all newspapers or periodicals published or sold in the Settlement must be licensed by the Council, and that the Council possessed the sole authority "in its absolute discretion to refuse or waive the issue of any such license or permit without assigning the reason for such refusal or waiver", with a further provision attached that allowed the Council to expand the terms of the Bye-law "in such manner as it may in its discretion think fit" (*Municipal Gazette* 22 March 1916). Such blatant attempted overreach of state power by the state leadership in this instance was met with relatively strong resistance by the majority of ratepayers, and the proposal to license the local press was sounded rejected at the meeting, and instead subjected to revision by a committee created to redraft the Bye-law, leading to multiple redraftings and resubmissions of proposals over the following decade, yet with no final ratification to the Bye-laws regarding press licensing ultimately consummated (Kotenev 1927: 89).

Efforts by the Council to control the local press continued to be primarily directed toward the Chinese-language press. This was particularly true after the rise in anti-Japanese sentiments subsequent to the start of the May Fourth Movement in 1919. A renewed proposal requiring licensing of the press, which included such overly-broad language as that prohibiting "matter of a seditious or scurrilous character or that is calculated to incite a breach of the peace or the disturbance of good order be printed, lithographed or otherwise published" again failed to be adopted (SMC 1919: 239A). Other subsequent attempts at registering the press were met with strong opposition from members of the Chinese press, with much of the contention centring over language that would require all published materials to include the names and addresses of editors and publishers (Kotenev 1927: 88). The desire for anonymity on the part of some in the domestic press likely owed to their apprehension of arrest and punishment under objectively draconian press laws enacted under both Beiyang and Guomindang iterations of the central government, given that as Chinese citizens they were subject to be charged under such laws, as the results of the well-publicised *Su Pao* case demonstrated.

In later years, many of the restrictive measures on the press were specifically intended to limit the publication and distribution of newspapers and journals sympathetic to the communist movement (Wakeman 1995a). Council policy enabled the use of the legal system to suppress "subversive" ideas such as those published in pro-communist literature. For instance, the Municipal Police worked closely with the domestic central government authorities when it came to the suppression of communist activities, and actively arrested and enforced bans on the printing and distribution of materials that supported socialism or communism. Starting in the 1910s, the annual summary by the chief of the Municipal Police in his report to the Council on criminal activity in the Settlement typically included updates on communist activity, including for instance in 1930, when the report stated: "The open activities in the Settlement [by communist supporters] included 53 demonstrations, of which 6 were attended by violence in the form of stone throwing and window smashing of tramcars and other vehicles. The subversive agitation included a series of secret meetings and the dissemination of propaganda matter of which no less than 895 kinds came into the possession of the Municipal Police. Measures taken by the Municipal Police in their efforts to suppress Communism included the raiding of 69 communistic bases and the arrest of 570 persons for participating in demonstrations, disseminating literature and kindred offences. Of these 185 persons were handed over to the Chinese Authorities, the remainder being dealt with by the Special District Court" (SMC 1930: 95). Of note is that arrests were made on the basis of individuals participating in demonstrations and disseminating literature expressing opinions not in accordance with those in power. Such actions indicate police tactics that fail to accord with Weingast's concept of an open society that allows for free association and exchange of ideas, even ideas with which those holding positions of political authority might find strong disagreement.

The importance of such actions is underscored by the fact that not only communists came to be targeted by such measures. As the 1930 report by the Municipal Police chief continues, it is clear that the activities of individuals other than solely communist sympathisers are additionally curtailed: "Local reactionary elements, other than communists, manifested considerable activity in the Settlement in their agitation against the Nationalist Government and the Kuomintang. The agitation was furthered by the printing and surreptitious dissemination of mosquito newspapers and other propaganda matter. In connection with these offences the Municipal Police apprehended 104 persons and raided 4 places of which 3 were printing establishments. Of the prisoners 35 were handed over to the Chinese Authorities and 69 were dealt with by the Special District Court" (SMC 1930: 95). Indeed, the Municipal Police actions could well be seen as providing support for the Guomindang's larger "partyfication" efforts, where any criticism of the government was interpreted as

"reactionary" and liable to arrest for sedition (*Yi Shih Pao* 4 February 1931). Overall, the clear lesson one finds from a reading of case details and the reaction of the Council to political pressure by the authoritarian Guomindang state was that significant limits on free expression was a defining feature of the nature of Settlement civil society, notwithstanding the constant claims by the Settlement's advocates of its support of liberal ideals.

As a final note, it is important to provide a sense of balance to the discussion regarding the nature of the protections on free expression and association existing in the Settlement, and the mechanisms designed to enforce such protections. As described, a serious lack of credible commitment mechanisms existed in support and defence of a free press. Applications of poorly-defined labels of "indecent" or "seditious" were used to shut down publication of materials deemed offensive on the part of state leadership, and the authors and editors of offending pieces could and did face punishments that included prison sentences.

Employing a comparative analysis of this aspect of the extraterritorial institutional environment to that of the broader domestic Chinese environment proves instructive. In this regard, for all the problematic issues one might find in the Council's failure to uphold liberal ideals of free exchange of information via an open and free press, the Settlement nonetheless was viewed as offering a more discriminate, less arbitrary set of procedural protections. Indeed, within greater Shanghai, there existed many Chinese-language newspapers and periodicals, yet the overwhelming majority of them chose to publish out of the extraterritorial settlements, and not the domestically-controlled municipality (Kotenev 1927: 73). This further instance of observed revealed preference is indicative that at least in terms of perception by domestic actors engaged in activities related to expression in the press, the extraterritorial settlements' institutional environment offered superior protection.

It was formality of legal procedure regarding free expression that the institutional framework of the Settlement offered, if not actual freedom of expression in execution. A situation involving a Chinese-language newspaper published out of the International Settlement, the *Hua Yueh Pao* (春江花月報), is exemplative in this regard. In 1902 Daotai Yan accused the paper of indecency for printing an article describing visiting houses of prostitution, and ordered the paper to be shut down; in fact, the following day domestic constables boarded up the paper's premises in the Settlement, attached with the Daotai's seal. However, "without desiring or attempting to defend the publication of indecent literature", the Council refused to turn the editors over to the local domestic authorities or allow the paper to be closed without first there occurring a formal trial in the Mixed Court, ordering the Municipal Police to break open the sealed premises and remove the order of suppression. As the Council Chairman Bayne stated in a communique contained in the Council's Annual Report, "the Council's object has been to maintain the proper and recognised procedure of justice in this Settlement. Whatever the facts in this instance, however serious the offence committed, the general principle that trial should precede punishment is one which cannot be abandoned without the gravest danger to the public interest" (SMC 1902: 68).

Similarly, the Council reaffirmed its commitment to procedural protections in regard to the aforementioned *Su Pao* case. After the Daotai ordered that case's defendants arrested to face trial "wherever and whenever it might please the Government of China", with the penalty of death decreed as the punishment for the publication of seditious materials, and the offending paper's offices to be shuttered, the order of extradition was refused by the Council on grounds that as Settlement residents, and as the alleged crime took place within the Settlement, the Mixed Court was the sole responsible adjudicating body. The Municipal Police were likewise ordered to reopen the seal on the paper's premises. The case against the defendants, as tried in the Mixed Court, took several months before its final resolution, finding two of the six defendants guilty of sedition. Summarising the outcome of the case, Council Chairman Mr Bayne declared: "The Council... adheres to the general and necessary

principle, frequently enunciated in the past, that the due protection of the rights of residents in this Settlement necessitates recognition of the rule that trial should precede punishment, and that this principle cannot be abandoned, even in deference to the wishes of the Chinese authorities, without the gravest danger to public interests of the community. The Council desires at all times to act in harmony with the Chinese authorities but is unable to depart from the policy of its predecessors, sanctioned by the unanimous support of the Ratepayers, in regard to the protection of the status and liberties of native residents" (SMC 1903: 62). Continuing his statement reviewing the case, Mr Bayne refers to the necessity to maintain an adherence to a procedural interpretation of rule of law in order to avoid placing the desirability of outcome above the need for formalised procedural protections, contrasting this interpretation with that of the domestic legal system, if albeit in a characteristically derogatory manner that often defined extraterritorial-domestic relations: "It would seem unnecessary to lay stress in the readiness with which the native officials resort to such irregular proceedings, and to point out how such a precedent as this would inevitably be construed to justify other and more serious irregularities" (SMC 1903: 68).

Kotenev (1927: 73-74) later underscores Chairmen Bayne's contrast between the domestic and extraterritorial legal concepts, opining that "only in the foreign settlements and concessions did the native press enjoy the freedom essential to its growth. In all other parts of China it was at the mercy of the administrative and judicial discretion of various officials who did not fail to use their privileges to strangle any semblance of free thought and opposition... Protecting the native press in the Settlement against the administrative pressure of the Chinese government and its agents, the foreign authorities were compelled to extend this [their] protection... to the Chinese press. Practically speaking there was [under the Qing] no legislation whatever in China regarding the press, for any free thought regarding the monarchical form of the government in China, any slightest criticism of its function, could be interpreted as *lese-majest* and the unfortunate editor or author, and even their relatives, were liable to the penalty of death."

While such critiques are supportive of our earlier contentions regarding comparisons of the domestic and extraterritorial institutional settings, it is imperative to read them with an appropriate degree of scepticism as they are originating from a solely western perspective, self-interested in advocating the superiority of the extraterritorial system, a system whose stated fundamental basis for existence owed to the supposition that the domestic institutional environment lacked sufficient judicial and legal safeguards. Hence, we should not be surprised to find parties whose interests were represented by the extraterritorial system willing to identify and colour instances that would appear to find the domestic legal system thusly so lacking. As such, the reliance on more direct observed behaviours by economic actors, such as the choice of domestic Chinese publishers to locate their activities within the extraterritorial settlements as opposed to domestically-controlled sections of Shanghai, can serve as more objective and thereby persuasive evidences than simply the written assertions of self-interested parties, however compelling they might appear.

Finally, we might also note that the numerous examples included above of strident complaints and critiques by the residents and observers of various aspects of the International Settlement that are to be found in the contemporaneous local press certainly underscore many of the weaknesses and failings of the overall institutional environment and effectiveness of those credible commitment mechanisms designed to support that environment. Yet too, the publication and discussion of such criticisms simultaneously are partly indicative of the healthy functioning of structures that allowed energetic and somewhat open criticisms of the functioning of the sovereign, and the society created within the political environment defined by that sovereign. Such ability by observers and participants reinforced the operation of credible commitment mechanisms, and provided of greater accountability, accessibility and oversight to those governed.

9.7. Conclusions

In regard to the unique dualistic institutional environment that defined Shanghai throughout the late-imperial through the early-republican era, a comparative analysis demonstrates that the extraterritorial institutional environment and associated private property rights framework appears to have been consistently perceived by contemporaneous economic actors as relatively stronger than that which operated within the domestically-controlled municipality. Multiple factors seemed to have helped drive such a perception amongst economic actors, including the existence and development of relatively impartial formal institutional legal structures designed to protect private property and contract rights. While cited interventionist actions or overreaching economic and social regulations represented troubling deviations from a strictly liberal governance practise, overall such manifestations were more exceptional than endemic in quantity, and failed to reach the level represented by onerous taxation or outright expropriation of private property in kind.

Furthermore, the representative structure of the extraterritorial state contributed to a greater degree of accountability and limits on state actor behaviours than allowed for by the authoritarian structure of the domestic state. Likewise, the extraterritorial legal system more explicitly provided codified protections on contracts, operating in a manner ostensibly more committed to adherence to a rule of law as opposed to rule of subjective decision-maker, although in practise the degree to which this was observed is certainly open to debate. Nonetheless, those legal protections that were afforded were for the most part similarly proved to all residents, whether domestic or foreign. Further, there were notably lower levels of corruption amongst Settlement government officials, especially during the Guomindang period.

While relatively professionalised, the extraterritorial bureaucracy continually expanded in size and was plagued with inefficiency; nonetheless, the state did exhibit a limited amount of bureaucratic capacity. This was particularly observable in regards to budgeting, with the Settlement running relatively small deficits financed by bond issuances that were consistently repaid, compared to the domestic national government which was plagued by an inability to raise sufficient funding, with large deficits in the republican period financed by debentures upon which the government frequently defaulted.

Likewise, whereas it is possible to cite numerous examples of domestic Chinese government actions which imperilled private property rights, including repeated instances of onerous taxation and outright expropriation of private business and investor assets, with such behaviour easily creating distrust of government motives amongst entrepreneurs and investors as to the strength and credibility of stated commitments to the protection of private property rights, there were relatively few comparable episodes of such actions undertaken by the extraterritorial settlement governments. Third, the severe level of political turmoil and civil violence that defined much of the domestic institutional environment of greater China and specifically domestically-administered Shanghai—symptomatic of the domestic state's lack of state capacity in maintaining a monopoly on coercive force within its territorial borders—was relatively absent in the extraterritorial settlements. Consequently, the extraterritorial settlements were largely spared from the destruction and expropriation of private property assets from the exercise of violence wrought by non-state actors that the domestic state was repeatedly unable to prevent.

Ostensibly, therefore, it appears that the traditional depictions in the literature—whether evidenced by frequently self-congratulatory language of contemporaneous English-language writings, or the implicit assumptions in more recent work—of the extraterritorial settlements being defined by a strong foreign-imposed institutional framework are largely correct. Likewise, the differences between the extraterritorial and domestic institutional environments appear in many regards to have been exceedingly significant. Caveats to such conclusions are necessary. To begin with, these findings admittedly are the result of a relatively subjective reading of the historical record, and are undoubtedly partly coloured by my own personal biases and assumptions. Nonetheless, attempts at identifying objective measures of differences in institutional quality, such as those reflected in the measure of violent political change, seem to support our qualitative judgements.

Second, as we have attempted to emphasise throughout the analysis, considerable complexity and variability characterises concepts such as institutional strength and state capacity. In fact, the extraterritorial institutional environment, and associated protections on private property rights, were defined by variation—across time, as the nature of the protection and credibility of the attendant commitment mechanisms experienced variation over time, and at any given moment in time across the various vectors that help to define the subjective perception of institutional strength held by economic actors.

Thus, for instance, the tension between the sovereignty of the Chinese state and the sovereignty of the extraterritorial settlement municipal governments waxed and waned over the course of the late-imperial and republican period. In general, one finds the extraterritorial municipal governments more able to exert their authority during the Qing and Beiyang periods, with a distinct lessening and more conciliatory approach after the Guomindang took control of the central government, coinciding, not coincidentally, with the waning of British and American government support for the continuance of the extraterritorial system. This further coincided with increasing militarism and aggression on the part of Japanese military authorities operating in China, with the ability of the Shanghai Municipal Council to resist acquiescence to demanded concessions by Japanese military authorities in areas such as policy changes or its authority over Japanese residents decreasing over time.

Similarly, while the extraterritorial institutional environment was characterised by a relatively strong framework of procedural legal protection, the protections afforded to domestic Chinese residents deviated substantially from its claimed impartiality, given the overarching degree of racial prejudice and bias that mitigated the relative power of non-western agents operating in a western-controlled institutional setting. Likewise, while multiple sets of credible commitment mechanisms worked to provide economic agents with relative assurance of the protection of private property and contract rights, much weaker sets of commitment mechanisms appeared to exist for limits on state actors' ability and willingness to control aspects of civil society, especially in regard to issues related to free expression and publication of differing ideas.

Overall, our strategy has been to consistently look to the observed behaviours of contemporaneous economic actors to understand how these actors perceived the relative institutional quality and strength of protections on private property and contracts that could expect across the dual institutional environments that defined Shanghai of this time period. The observed behaviour of these actors—instances of revealed preferences, so to speak—seem to indicate that many domestic Chinese agents, when provided the opportunity to choose, consistently chose to locate their assets within the extraterritorial institutional environment, rather than the domestic.

Thus, we can turn to using the simplest of indicators for such analysis, the seeming constant desire for evermore numbers of domestic Chinese citizens to choose to relocate their personages, businesses and financial capital out of the domestic institutional environment and into those of the foreign settlements. By way of illustration, we turn to a statement provided by Chamberlain (1931: 151), who notes: "The settlement is the most important banking center of China. The most important Chinese banks have their head office there, including the Central Bank of China, an exclusively government organisation. The total amount of note issue of these banks is estimated at 242,000,000 dollars, Chinese currency, in which the foreign banks share only to a negligible amount. Against these note issues are held huge stores of silver in vaults in the Settlement. The protection and the order which the present independent regime of the Settlement, supported by foreign governments, assures to the Chinese banks against the actions, even of their own government."

Chamberlain's observation underscores two important factors. First, as we have attempted to emphasise throughout our discussion, the so-called "foreign" settlements were far from solely foreign enclaves—they became successful economic centres precisely because they were able to attract such substantial amounts of both Chinese physical and human capital. Second, relatedly, in spite of the imperfect nature of the institutional environment the settlements offered, particularly to domestic Chinese actors, the collective decision of domestic actors was to choose to relocate large sums of financial and physical capital, as well as their own personages, into the extraterritorial environments. It is this fact that is perhaps the strongest qualitative evidence we can provide in arguing that the extraterritorial settlements appeared, from the perspective of contemporaneous economic actors, to offer a more robust institutional environment, with a set of seemingly more credible commitment mechanisms attributed with the environment's protections on private property and contract rights, than that available to those same actors in the domestic institutional environment. For domestic entrepreneurs and other economic actors attracted to Shanghai to take advantage of its business opportunities, it was the extraterritorial institutional environment they consistently chose for its relatively stronger property rights framework it offered over the domestic environment to protect their assets.

Part IV. Financial Markets and Private Property Rights

Chapter Ten. Both Roving and Stationary Bandits? Relationship between Equity Shareholders and Government Actors: Two Cases

Various differing and sometimes contradictory developments contributed to shaping domestic institutional quality over the late-imperial and republican time period. In this chapter, we utilise two specific examples of joint-stock companies—the corporate history of the Bank of China, and the evolution of the China Merchants Steamship Navigation Company shareholder experience—to highlight the nature of the state's relationship with private domestic equity investors. These two examples illustrate many of the multi-dimensional and time variant dynamics that helped shape contemporaneous economic actors' perceptions of private property, contract and investor rights over the period.

10.1. The Bank of China's Capital Composition

A study of the corporate history of the Bank of China provides a representative illustration helping to highlight the role of the state in regard to its relationship with private shareholders, and the ability of private firms to exercise control over decision-making vis-a-vis state actors. The origins of the Bank of China are traced back to 1897, when the Qing government issued an imperial decree to found the Board of Revenue Bank (戶部銀行), in order to create a centralised issuer of paper currency. It took until 1905, however, before the bank was officially established in Beijing. Its authorised capital was set at four million *taels*, to be jointly equally owned by the Ministry of Finance and private owners; shares were not allowed to be owned by or transferred to foreigners. Due to difficulty recruiting private shareholders, however, the Ministry became the initial sole funding shareholder of the Bank, and it was not until the following year that the Bank formally opened, with only two million in capital. Yet with business proving lucrative, the government was soon able to attract additional capital from private subscriptions, such that by 1908 subscribed capital had increased to ten million *taels*, divided into 100,000 shares, with equal portions held between private investors and the Ministry of Finance (Tang 1935: 171). In that year as well the name of the banks was formally changed to Da Qing Bank (大清銀行).

10.1.1. Late-Qing Period: Government Backing, Government Interference

As the first bank formed by the Qing government, the Da Qing Bank was granted central bank functions such as issuing currency and managing the treasury funds. Although the Imperial Bank of China (中國通商銀行) was first Chinese-owned modern bank and formed by a high ranking court official, Sheng Xuanhuai, in May of 1897, it was directly controlled by Sheng, and despite its moniker, it did not serve as an official or central bank under the direct control of the Qing central government. (Given its transliteration in the English language, there remains some amount of confusion on this issue in some of the relevant literature; Purtle (2014: 109) for instance claims the Imperial Bank of China to have been the precursor to the Bank of China, citing, surprisingly, Chinese language sources (Zhao 1977), but this is not correct.) As a government bank receiving preferential treatment, the Da Qing Bank was able to become quite profitable. In 1909, regulations were promulgated to forbid direct foreign loan borrowing by provincial governments, requiring all such borrowing to go through the central government and be coordinated by the Ministry of Finance via the Da Qing Bank (Ichiko 1980: 403-407).

The Ministry of Finance, as the largest shareholder, also became the Bank's largest client. The Ministry kept millions of silver *taels* deposited with the bank, and most of the Ministry's tax remittances were also transferred through the bank. This service was highly profitable for the Bank, and via its close relationship with the government, succeeded in securing nearly all official government remittance business, effectively pushing the majority of the Shanxi 票號 (*piaohao*), an earlier form of indigenous banks, which had previously dominated the official remittance business, into insolvency (Wu 2016). Provided special government protection, the Bank expanded rapidly, and by 1911, thirty-five branches had been set up across the country. The Bank of China soon became the largest domestic bank in China, possessing a robust business of taking deposits, issuing banknotes, and extending loans to local provincial governments and businesses (Yuan 2005: 89-90; Pen 2007: 43-47).

While the close relationship with the Ministry brought the Bank benefits, it compromised the independence of its business decisions. To begin with, private investor rights were marginalised, with shareholders meetings sometimes scheduled, but never convened (Peng 2007: 84). Further, despite the intention to create a modern banking corporation managed by merchants, selection of senior management was directly controlled by the Ministry of Finance, which reserved the power to nominate Bank superintendents and top management. As a result, business decisions could not be exercised without government influence. For example, faced with requests to make loans to local provincial governments, the bank was seldom in a position to say no, and as such, loans to local governments began to take up an increasingly large portion of the bank's balance sheet.

In 1908, for instance, the Liang-Jiang viceroy borrowed 4.5 million *taels* to dredge the Hungpu River, and then another 400,000 *taels* to finance military exercises. In 1910, Hunan province borrowed 200,000 *taels* to finance external debts, Anhui borrowed 200,000 *taels* to pay a local mine lawsuit, and Fujian borrowed 800,000 *taels* to fund its administrative expenses. The Jiangxi provincial government also borrowed over 800,000 *taels* at the start of the Xinhai revolution to finance government operating expenses, which were never repaid after the Qing government fell. Indeed, the Xinhai Revolution brought about the collapse of the Bank, as the Qing central and local governments began defaulting on their loans, with overdue debts from local and central governments on the Da Qing account book totalling over 23 million *taels* (18 million *taels* from local governments, and 5 million *taels* from central government), with an additional 15 million from private businesses (Peng 2007: 84).

10.1.2. Beiyang Period: Weakening State Protection, Weakening State Control

With the establishment of the Republic of China in 1912, the assets of the Da Qing Bank were transitioned to a new, related bank, commissioned the Bank of China (中國銀行), renamed thus not only to signify the new political reality, but also to attempt to limit the transference of prior government-related liabilities to the new bank (Kong 1986). Incoming government officials had initially sought to transition the Bank into a fully government-owned state bank by converting outstanding private shares into deposits and retiring private shares in instalments. As Lan (2013: 68) notes, this was met with strong resistance, and eventually an agreement was reached to continue the equal ownership structure of the bank. The Shanghai branch, one of the few of the Da Qing Bank branches that had avoided suffering a collapse of its balance sheet, initiated in 1912 a reorganisation plan that gained support of private shareholders, with part of the plan including for shareholders to receive deposit receipts at five per cent interest, redeemable within five years (Tang 1935: 171). In April 1913, legislation

regarding "Regulations of the Bank of China" (中國銀行則例) were authorised, mandating the bank remain a joint-stock limited liability company, with a capital of 60 million *taels* in 600,000 shares, maintaining an equal balance between government and private investors ownership of outstanding shares. The new agreement further stipulated that if total private subscription exceeded 300,000 shares, the government would sell its prepaid shares to private investors on instalment. In 1915, the Bank increased its authorised capital to 100 million *taels*.

The continued heavy presence of government officials running the bank, however, led to continued difficulty recruiting additional private shares. Further, despite the Beiyang government officially having subscribed to half of the shares, it failed to make full payment of its portion of the capital, and the bank's total paid-in capital was less than half the authorised capital (Yuan 2005: 102). Thus, the government was unable to provide sufficient capital to allow for the bank's expansion. The government-owned shares of the Bank of China were subsequently pledged to other private banks, including the Kincheng Banking Corporation, the Continental Bank, and the Shanghai Commercial and Savings Bank as collateral for loans, and when the Beiyang Government was unable to redeem them by the loan maturity date, these bank creditors became private shareholders in the Bank of China.

The Beiyang Government, faced with mounting fiscal difficulty, frequently looked to reach its hands into the banking sector to subsidise its fiscal shortcomings. Tang (1935: 172) somewhat poetically describes the situation as "many trials had to be faced, not the least of which were the constant and insatiable demands of the Peking Government for money." Banks such as the Bank of China and the Bank of Communications were often utilised to provide financial support for the government. As Lan (2013b: 6) describes, "During the period of the Beiyang government, raising debts from banks was almost the most important means to tackle the government's finances." Overdrafts and government bonds were relied on as funding for the Beiyang government; while theoretically the large quantities of bonds bought by the bank could be resold to the public, as these bonds came with weak collaterals and low credibility, the public was reticent to purchase, and hence banks ended up holding most of the public bonds, and used as reserves for the issuance of banknotes.

The suspension of the banknote exchange that took place in 1916 was illustrative of the contested relationship between the banking sector and government officials. By 1915, the Beiyang government had borrowed 12 million *yuan* from the Bank of China, and 47.5 million from the Bank of Communications. These borrowings severely exhausted both banks' reserves; in fact, the 12 million borrowed by the government from the Bank of China was nearly equal to the bank's total amount of its paid-in capital (BOC 1995: 74). The two banks resorted to issuing banknotes to solve their own shortage of funds; backed by depleted silver reserves, the situation was untenable. Once news of the situation became public, the Bank's notes depreciated immensely and a financial crisis ensued; in response, on 12 May 1916, the Beiyang government ordered the two banks to halt their banknote exchange (Peng 2007: 75). The announcement, perhaps unsurprisingly, led to a general run on banks and market chaos. The Bank's Shanghai branch managers, seeking to calm the markets and end the run on the Bank, defied the order from the government. Enlisting support from the local financial sector as well as several of Shanghai's foreign banks, the Shanghai branch declared it would continue to honour its issued banknotes and redeem them for silver at face value. Faced with mounting pressure, the Beiyang government eventually reinstated the banknote exchange. As Yuan (2005: 103-104) notes, the damage to the banks' balance sheets was severe and the fallout of the suspension was still being dealt with as late as 1921. Nonetheless, the defiance of the government's order and subsequent refusal to take on additional government debt over the near term seemingly saved the Bank from bankruptcy or nationalisation (Hong 2004: 139).

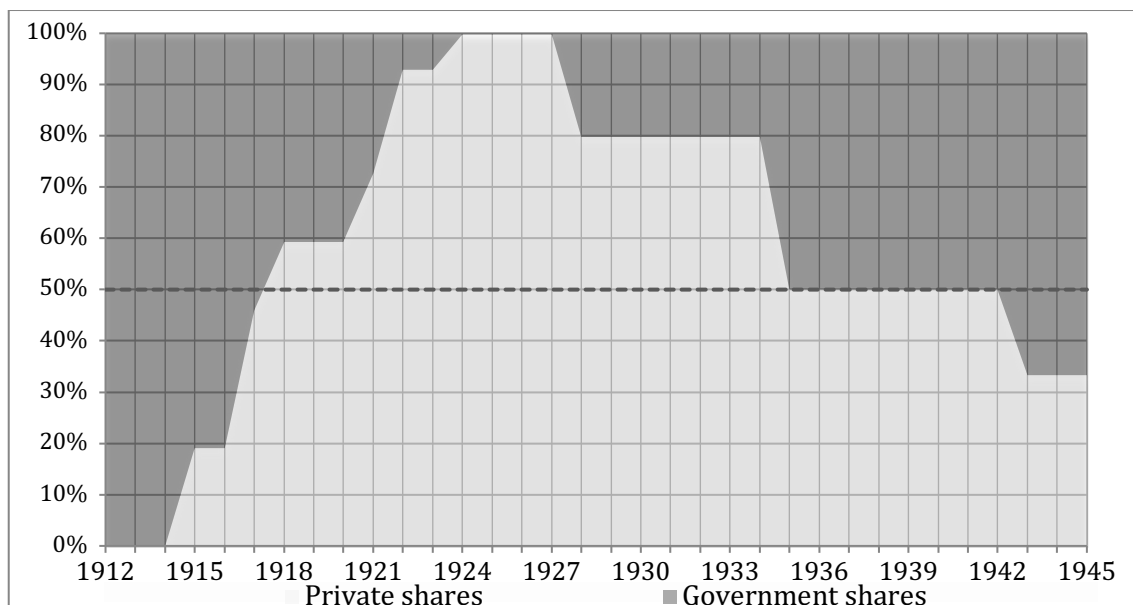
Government control also resulted in frequent change in the senior management of the Bank. Between 1912 and 1922, the president of the Bank changed eleven times, with average term of office only one year (Lan 2013b: 11). However, the banknote crisis and ability of the Shanghai branch to successfully push back on government demands helped swing the power slightly towards private shareholders over the government. In 1917, as the Bank remained desperate for cash, a new agreement was reached between private shareholders and Ministry, which Tang (1935: 172) notes provided an important signal: "the danger of government interference was lessened by a clause insisting that the Governor and Vice-Governor must be chosen from directors appointed by the shareholders... This regulation, dictated by the disturbed political state of the country, is probably one reason why the bank sustained so little damage during the ensuing years of internecine strife." The agreement also led to the recruitment of private shareholders to be completed immediately thereafter by the end of 1917. It also saw the Bank leadership become more stable, with the new manager appointed by private shareholders in 1921 serving for a full five years.

Also from 1917 onwards, the Bank's management undertook active measures to increase privatisation; with greater private ownership, government interference in the operation of the Bank could be reduced. This effort became especially pronounced after 1921, and by 1923, the Bank became mostly privately owned. Government shares only constituted 50,000 shares out of a total capital of nearly twenty million *yuan* (Lan 2013a: 66-67; 2013b: 6-9). The privatisation effort also allowed the Bank to attract significantly larger amounts of private capital, thereby increasing its capital base (Yuan 2005: 124). An independent shareholders' association was formed in which every member had power to vote for the president and the general manager through the board of trustees (Ji 2003: 176). These efforts achieved a significant level of independence from government interference.

However, the inability of the Beiyang government to maintain a monopoly over internal coercive violence led it unable to provide protection to the Bank of China from expropriation of its assets by powerful quasi-state actors, such as warlords. As the largest bank in China with branches in various provinces, the Bank of China made for an easy target to warlord armies, or susceptible to arbitrary and onerous taxes imposed by local governments. For example, in 1914, Warlord Zhang Zuolin took 500,000 *yuan* by force from the Bank of China's Fengtian branch. The Heilongjiang government similarly took one million *yuan* from the Bank of China in 1915, and forcibly borrowed another one million. The Guizhou provincial governor received one point three million *yuan* as a "loan" from the Bank in 1916 that was never repaid. The Kulun government forced a loan of 300,000 *yuan* to pay military salaries in 1921. Meanwhile, from 1925 to 1927, the Bank was required by the rival southern Guomindang government to lend it money to support funding of its Northern Expedition Army, including 500,000 *yuan* to Guangdong, 800,000 *yuan* to Changsha, 1.47 million *yuan* to Wuhan, and 700,000 *yuan* to Fuzhou (Peng 2007: 84).

Weak state capacity in regard to an ability to maintain a monopoly over violence on the part of the Beiyang government was accompanied by weak bureaucratic administrative capacity. In this regard, government regulatory oversight and interference partly subsided, and private interests were to gain more control of the Bank and its direction. This process of increased privatisation and control power residing in the hands of private shareholders was seen across the banking industry. Notably, at the start of the 1920s, the banking industry was comprised of twenty-eight modern banks, the majority government-run or operating under joint private-government ownership. By the end of 1925, the industry had expanded to include one hundred thirty banks, the vast majority operating under private ownership; of those still jointly-owned, private shareholders were the controlling segment. Received capital also increased, rising from 76,053,000 to 93,087,000 *yuan* (Xu 2010: 82). The rising power of the private shareholders is demonstrated graphically in Figure 10.1, which presents the history of the relative government-to-private capital composition of the Bank of China from its formation through the end of 1945.

Figure 10.1. Bank of China capital composition, percentage ownership, 1912–1945



sources: BOC 1991: 2060, 2095, 2130, BOC 1995: 908-909; Lan 2013: 9-10

An overall trend towards a greater degree of private control and ownership played out across much of the banking industry throughout this period. For instance, as late as 1917, Kincheng Bank's shareholder composition was dominated by warlords and local government officials, at 54 and 36 per cent, respectively (金城銀行史料 1983: 23). By 1927, however, these levels had fallen from a combined total of ninety per cent to less than half, allowing much greater control to private shareholder interests. The Bank of Chekiang (浙江銀行), founded in 1909 under a joint government and private corporate structure, as was typical of most banking concerns founded under the Qing, was later dissolved in 1923 and split into two separate entities, one of which, the Industrial Bank of Chekiang (浙江實業銀行), was completely private and therefore funded solely by private investor money, while the Chekiang Bank (浙江地方銀行) became fully state-owned (BOC 1995: 1137).

10.1.3. Guomindang Period: State-Led Control and Expropriation

As Figure 8.1 also makes clear, the trend towards greater private shareholder control began to reverse itself once the Guomindang Party assumed control over the central state apparatus in 1927. Guomindang leaders initially planned to consolidate the Bank of China and the Bank of Communications into a Central Bank of China wholly owned by the government. The plan was met with strong resistance, and was eventually discarded, with a separate government-owned Central Bank of China formed in October 1927. With the formation of the Central Bank, however, previous central banking functions that the Bank of China and the Bank of Communications had performed were significantly diminished, affecting the two banks' profitability, although the Bank of China still served as a foreign exchange bank, designated to issue domestic and external public debts, and buy and sell foreign currencies, gold and silver.

Of greater concern to the viability of the Bank of China were the conflicts between the Bank management and the government that soon emerged. Besides monies that had been lent in April 1927 by the Bank to support the Northern Expedition military mission, General Jiang Jieshi requested the Shanghai Branch of Bank of China to provide the new Nanjing government with one million *yuan* in connection with the issuance of the Two-Five Surtax Treasury Bonds (二五附稅庫券). The manager of Shanghai Branch, Song Hanzhang (宋漢章), resisted the request,

demanding the government provide a security deposit as way of collateral for the bonds. Song's refusal was ill-received by Jiang—the Bank's profit-orientated goals, and indeed such goals of all of private commerce, were to be treated as subordinate to the goals of the Party (Zanasi 2006). Jiang retaliated by increasing his demand, mandating the Bank of China to prepay ten million *yuan* for the Bank's portion of the Two-Five Bonds. Jiang personally threatened Song with being charged with 'obstruction of revolution' and 'helping the enemy force' if Song continued to resist. Song petitioned the Ministry of Finance, stating that the repeated government requests for loans had exhausted the Bank's funds, and that complying with Jiang's request would require the Bank to use its emergency reserve fund, causing serious concerns to the Bank's credit. After mediation, the Bank of China eventually agreed to purchase four million *yuan*, while underwriting another six million *yuan* worth of the government bonds. Song subsequently resigned his position in July (SMA 2012).

The Guomindang government continued to take active measures to increase its ownership and control over the banking industry. In 1928, the Ministry of Finance adjusted the regulations covering the Bank of China, and used compulsory means to increase its ownership percentage of outstanding shares to twenty per cent; however, instead of providing actual capital, the Ministry paid in increased capital by contributing government bonds valued at par, even though the bonds traded often more than forty per cent below par. Increased government regulatory control brought on greater government-forced lending to local governments. The Bank was often caught in an uncomfortable position of making knowingly commercially unviable loans. In 1932, the Bank of China Head Office notified its branches: "Unless no alternative exists, try to avoid all official borrowing" (*trans.*, BOC 1995: 250). By the end of 1933, overdue debts from local governments reached 17.08 million *yuan*, comprising fifteen per cent of the Bank's total overdue government debts (BOC 1995: 251).

The Bank nonetheless still sought to exhibit a considerable degree of independence from direct bureaucratic government control. After relocating its headquarters from Beijing to Shanghai in 1928, the Bank started a new research institute that was designed to produce objective economic analysis based on its collection of economic and financial data; the Bank further sponsored research of economists leading to publication in leading academic journals. Moreover, the Bank produced its own economic reports, which by the early 1930s were increasingly critical of Guomindang government policy; the Bank's 1932 and 1933 Annual Reports similarly reflected criticisms of Ministry of Finance regulation of the banking industry, which the reports suggested proved detrimental to the industry's growth prospects.

Again in 1935, the Ministry of Finance issued revised banking regulations, these mandating the government to contribute additional capital to bring it to at least sixty per cent controlling ownership of outstanding capital. Once again, the increase in capital was to come via par-valued government debt, with twenty million *yuan* worth of bonds to be placed in the Bank of China, and ten million in the Bank of Communications. This mandated attempt was met with strong resistance by private shareholders. A contested negotiation left a compromise to create an equal Bank of China ownership split between the government and private shareholders, while Bank of Communications shareholders were unable to obtain the same result, with the government controlling sixty per cent (Yuan 2005: 124). In essence, however, actual decision power was controlled by the Ministry of Finance—Song Ziwen, the Minister of Finance, and Jiang Jieshi's brother-in-law, was nominated chairman of the board of directors, and government-nominated directors increased from three to nine, with all key managerial positions becoming staffed by Party appointees (Yuan 2005: 126). As Peng (2007: 82-83) pointedly notes, "under Nationalist rule, especially after Joint Head Office was established, the Bank of China was subject to the strict intervention of the government in loan practice. Funds were directed toward inefficient and politically connected SOEs." Many of these government-mandated loans were not economically rational—made at low interest for long duration, the prevailing high inflation environment made such loans immediately not commercially viable.

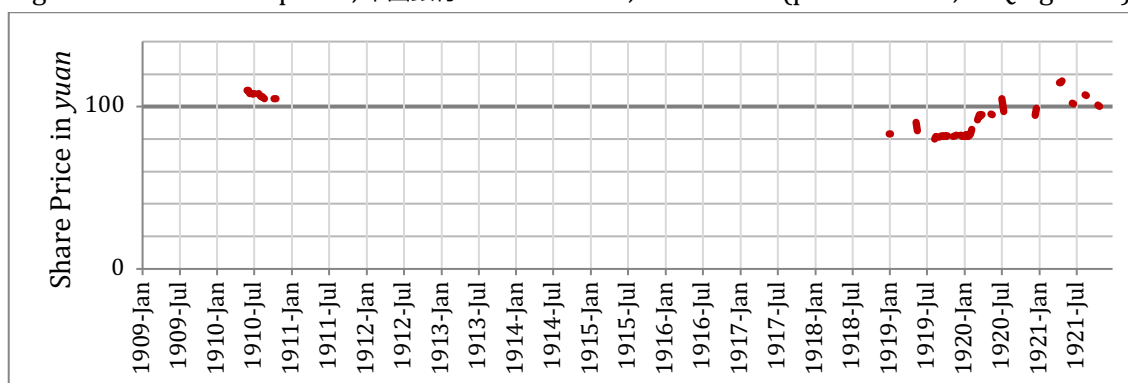
10.1.4. Equity Share Price Analysis

In order to supplement and advance the discussion regarding the relationship between investors and the government, we utilise another one of our constructed datasets, this one of domestic and extraterritorial equity share prices. By considering the trading history of shares of the Bank of China, we observe how contemporaneous market participants perceived the value of the joint vector of expected future cash flows and the risks to such cash flows, which could include company-specific, industry-specific and business environment economic risks, as well as non-economic risks, such as those attributed to the potential for destruction from military activity, or theft or expropriation by either nonstate actors, or via government decree. To provide a broader view of the Shanghai banking industry, we also consider the share price histories of other domestic-registered and extraterritorial-registered banks.

10.1.4.1. Bank of China Historical Share Price and Trading History

Figure 10.2 presents the trading history of common equity shares of the Bank of China, as listed in Shanghai's local newspapers and financial journals. Note the sparsity of listed prices does not reflect issues with our data collection methodology; daily financial media were searched for the entirety of the time period, with the displayed pricing data representing the extant quantity contemporaneously available. Thus, these data reflect a relatively low level of trading activity. Note that share prices of the stock remain relatively constant across the near-entirety of the recorded period of data available. This remarkable consistency is further highlight by the fact that the only additional available pricing data found in the financial literature after 1921 was in the *Chinese Economic Review* published in 1941 which reported Bank of China shares trading over the course of 1939 in a range between 115 and 140 (adjusted for currency changes); however, adjusted for inflation into constant 1921 values, the equivalent prices represent as range between 48 and 58.5, well below the share's par value of 100.

Figure 10.2 Recorded prices, 中國銀行 Bank of China, 1909-1921 (prior to 1911, DaQing Bank)

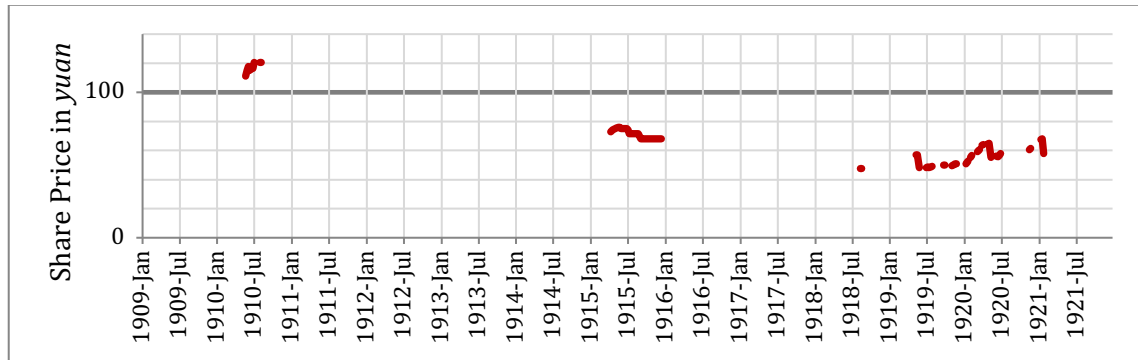


Sources: *Shunpao*, various issues, 1909-1921; *Bankers Weekly*, various issues, 1919-1921

10.1.4.2. Comparative Share Price Trading History

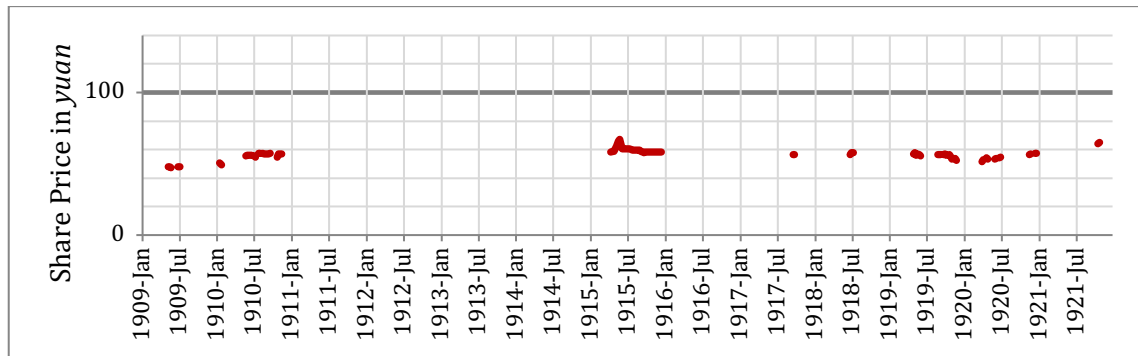
We can also learn from observing the share pricing behaviour of similar companies that traded on Shanghai's domestic and extraterritorial markets. Consider, for instance, the trading histories of two of the largest domestic modern banks, the Bank of Communications, and the Commercial Bank of China, as provided in Figures 10.3a and 10.3b. As seen in these figures, shares of these companies consistently traded at prices well below par. Available data on trading in 1939 from the *Chinese Economic Review* indicate that shares of the Bank of Communications traded in a range similar to that of the Bank of China, from 101 to 138, adjusted for differences in currency; accounting for the substantial rate of inflation, these share prices are equivalent to a trading range between 42 and 58 *yuan* in 1921 prices.

Figure 10.3a Recorded prices, 交通银行 Bank of Communications, 1909-1921



Sources: *Shunpao*, various issues, 1909-1921; *Bankers Weekly*, various issues, 1919-1921

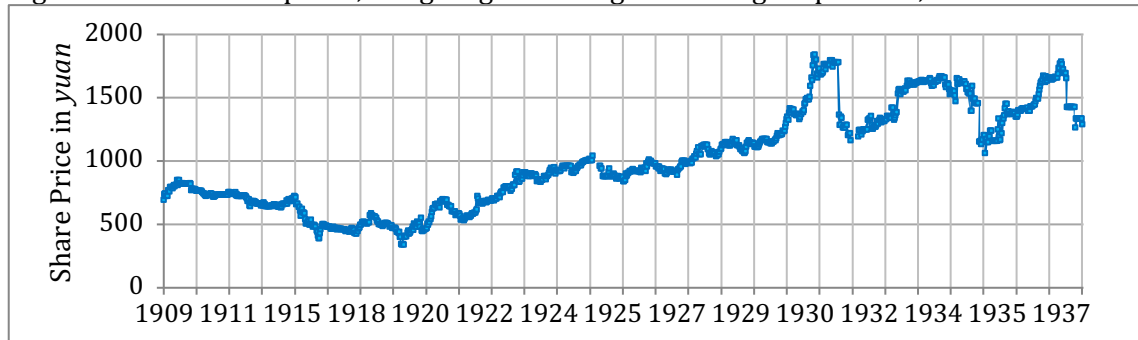
Figure 10.3b Recorded prices, 通商银行 Commercial Bank of China, 1909-1921



Sources: *Shunpao*, various issues, 1909-1921; *Bankers Weekly*, various issues, 1919-1921

Finally, also by way of comparison, we present the trading history of another modern commercial bank, the Hongkong and Shanghai Banking Corporation (HSBC), which served as one of the more important of Shanghai's foreign banks. Registered under foreign legal regulations (Hongkong Company Ordinances), the bank operated under Shanghai's extraterritorial institutional environment, and thus its investors were protected by extraterritorial-defined private property and contract rights, as opposed to those banks and their investors operating under the domestic institutional environment. As indicated in the trading history of the Figure 10.4, the differences in terms of both trading activity and share pricing behaviour are striking. For sake of comparison, share prices have been converted into *yuan* over the course of the entirety of the listed pricing history, and standardised such that 100 *yuan* is equivalent to the equity's original par value. To provide further comparison with the Bank of China and Bank of Communication share prices, we note HSBC share prices in 1939 fluctuated between 2153 and 5327 *yuan*; adjusting for inflation to 1921 prices generates values of 901 and 2229, respectively, obviously well above the stock's par value.

Figure 10.4. Recorded prices, Hongkong and Shanghai Banking Corporation, 1909-1937



Sources: *North China Herald*, various issues, 1909-1937

Based on both the differences in share prices relative to par, as well as differences in the propensity to hold these financial instruments as reflected by the relative frequency of price listings of completed trades, it is clear that investors valued the shares of an extraterritorial-registered company more favourably than they did shares in similar domestic-registered companies. Such findings accord with previous observations about the predilection of domestic actors to choose, when given the option, to hold the banknotes of extraterritorial banks over those of domestic banks, as described in Section 5.2.3.3. While intriguing, these findings should be considered as more suggestive than definitive, given we are only considering a limited number of companies and industries. Forthcoming work by Adam Harris & Li (2018) utilises domestic and extraterritorial equity data from Shanghai's early markets to produce more sophisticated comparative analyses in considerably greater detail.

10.1.5. Summary

The corporate history of the Bank of China is indicative of many of the trends and forces shaping the domestic private property rights environment discussed throughout Part II. Under the Qing, when ownership was equally divided between private and government shares, the Bank's private investors were happy to take advantage of privileged market access and limits to market competition afforded by the close relationship with the Ministry of Finance. However, despite the equal ownership share split, state officials effectively controlled Bank management. Thus, extraordinary profits obtained via privileged market access were counterbalanced by government-appointed Bank managers controlling important lending decisions, leading to loans for questionable projects extended to provincial governments and other politically-favoured clients based on political rather than economic rationales.

The Beiyang period brought about a decided change in the relationship between the government and private shareholders. Officials seemed no less interested in controlling the banking industry—seeking to nationalise the Bank of China at the start of the Republic—but weak bureaucratic capacity and the poor fiscal position of the government limited the ability of state actors to exert control, especially after government shares divestiture. The rebalancing of equity ownership effectively rebalanced the power relationship between government and private shareholder, epitomised by the decision by the Bank's managers—beholden at the time primarily to private shareholders—to refuse to comply with a government directive to suspend banknote convertibility in 1916, helping preserve the Bank's reputation, and avoid potential insolvency or forced nationalisation. However, increased private control and shareholder power did not reflect stronger commitments to the protection of investor, contract or property rights by relevant government actors, but rather a result of ineffectual state bureaucratic capacity, which itself was symptomatic of overall weak state capacity. Yet given that weak state capacity was also reflected in the state's inability to affect a monopoly over internal violence, state internal military and policing apparatuses proved insufficient to prevent nonstate actors from utilising force to expropriate the Bank's private assets, such as when powerful military leaders known as warlords forced loans from the Bank that were rarely repaid. Thus, the Bank's private owners were subject to property rights violations, with assets seized by "roving bandits".

The start of the Guomindang period brought new challenges for private shareholders. While still facing the danger of expropriations of Bank assets by non state-sanctioned actors, such as warlords, or local officials operating outside of legal boundaries, an increasingly competent central state bureaucratic apparatus proved capable of enforcing regulatory measures to force the bank to hold government-issued bonds that exposed the Bank to significant sovereign default risk. Later, executive state power was employed to forcibly dilute private shareholders' ownership rights, leading eventually to forced nationalisation, allowing state officials to assume more direct control over the management of the Bank by 1935. Under this scenario, private shareholders as a group effectively lost control rights over the managerial decision-making of the company, including dividend payout decisions.

10.2. China Merchants Steamship Navigation Company

The history of China Merchants Steamship Navigation Company has been considered frequently in the literature (Liu 1954, 1962; Feuerwerker 1958; Haviland 1962; Lai 1988, 1990, 1991, 2010; Li 2001; Cao 2002; Zhu 2006b, Halsey 2014; Wang & Ng 2014, Chu & Liu 2016). This is not surprising given that the company was the first successful joint stock venture incorporated under domestic Chinese law, remaining in business for over seventy-five years, and played an important role in the economic history of China. The account of the company's corporate history also reflects many of the changes that took place in the state-commerce relationship and the country's private property rights environment. Founded as a collaborative effort between the state and private business interests, it reflected the ideal of state-supported commercialism and industrialisation. After initial excessive government oversight gave way to more private sector control, the enterprise was eventually undermined by increasing government interference, and ultimately forced expropriation of all assets.

10.2.1. Qing Period: Government Patronage and Interference

The China Merchants Steamship Navigation Company (中国轮船招商局) was born out of the post-Opium Wars environment. The opening of Shanghai as a treaty port granted opportunities to foreign companies to operate steamship transportation business along China's coastal lines, as well as on the Yangtze River. The Treaty of Nanjing allowed British merchants the privilege of re-export, with a fixed tariff rate and one-time transit tax, providing cost predictability and safeguarding them from arbitrary extraction by local officials. With the advantages conferred through use of the more advanced steamship, and protections from excessive taxation, Western-owned steamship companies began to dominate the transportation business in China.

For instance, the Shanghai Steam Navigation Company, founded by the American trading firm Russel & Co. on 27 March 1862 with capital of one million *taels*, became one of the largest shipping concerns in the Yangzi region (Liu 1954:168). Various other British and American companies, including Augustine Heard & Co., Jardine, Matheson & Co., and Dent & Co., also became actively involved in the coastal and Yangzi transportation business. From 1855 to 1863, the total number of voyages made by foreign commercial vessels into Shanghai ports increased from 589 to 6,947, and total cargo increased tenfold, from 157,121 to 1,961,199 tons (ZSJS 1988: 6). From 1867 to 1872, Shanghai Steam Navigation exercised a near-monopoly on steam traffic along the Yangzi River, as well as a dominant position along China's coastal lines, operating sixteen steamships between Shanghai and Hongkong alone (Cao 2002). This business proved profitable; in the eight years from 1867 to 1874, the company's shareholders received an average annual dividend of about 18.75 per cent on capital (Liu 1954: 155, 179).

The traditional Chinese shipping method used to traverse coastal and inland waterways was by sailed, wooden ships, *fanchuan* (帆船), or by larger vessels, *shachuan* (沙船). With the arrival of foreign steamships, . Prior to the Opium War, commodities such as soybeans grown in northern China were transported via *shachuan* to Shanghai and then distributed via *fanchuan* to other provinces in the Southeast. With Shanghai serving as a regional trading centre, its wharfs along the Huangpu were filled with upwards of 5000 *fanchuan* and *shachuan* daily, and the shipping industry employed over 100,000 workers. As early as 1860, however, Chinese operators of these traditional vessels saw their commercial shipping business replaced with the arrival of foreign steamship companies. Chinese archives document that by the end of the decade, tens of thousands of traditional wooden ships lay idle and rotting in docks along the Yangzi (Halsey 2014: 87). In 1862, Shanghai *fanchuan* and *shachuan* owners petitioned the Qing authorities for protection from competition by excluding foreign merchants from engaging in domestic soybean transportation. Despite the support by Li Hongzhang, the Court denied the request after vehement opposition applied by the British Envoy Wade Giles. In 1864, Chinese merchants once again petitioned to exclude foreign merchants from operating the soybean transportation at the Shanghai port, but again this second petition met with similar foreign opposition and ultimately went unanswered by the Court (ZSJS 1988: 8-10).

10.2.1.1. Jiangnan and Fuzhou Shipyards as Precursor

The unsuccessful implementation of his desired protectionist policies helped motivate Li Hongzhang to become an advocate for the modernisation of China's economy, and in particular led to his support for the formation of the China Merchants Steamship Navigation Company. The company's origins draw back to prior military industrialisation efforts that brought about the founding of two government-funded shipyards—the Jiangnan Arsenal in Shanghai in 1865 by Li, and the Fuzhou Naval Yard in 1866 by General Zuo Zhongtang, who, like Li, was a strong proponent of the Self-Strengthening Movement. Zuo had secured a seven-year budget for the Fuzhou shipyard, with the purposes to construct a "modern naval dockyard and academy, to build sixteen gunboats, and train the Chinese in all aspects of naval construction, marine engineering, navigation and command of the small squadron" (Pong 1987:121). These defence industry projects represented exactly the type of "self-strengthening" activity the reform movement envisioned—the government leading and funding an effort to modernise the country's military arsenal using leading foreign expertise (construction at Fuzhou was directed by two French naval officers, and at Jiangnan by an American chief engineer, T. F. Falls) to build a modern naval fleet, and foster knowledge transfer of foreign military technology into the domestic knowledge base.

However, both projects soon ran into serious cost overrun. Further, as one of the most expensive outlays in the Qing budget, the Fuzhou Naval Yards represented an easy target for conservative forces within the Court. The project's administration certainly provided critics with ample ammunition—Fuzhou Navy Yard was originally budgeted to cost approximately three million *taels*, yet five years into the project, only six out of sixteen projected ships had been constructed, at a cost of three and a half million *taels*. The reasons for the cost overruns were complex, but the most significant was the failure to anticipate large maintenance costs. Of far greater importance, however, revolved around the nature of the central-provincial power relationship, with a weak central government unable to force provincial governments to take ownership (and hence responsibility for maintenance costs) of the built naval ships, as had initially been expected. As a result, the majority of the ships remained stationed at the naval yard even after having been officially completed (Pong 1987: 135).

Additional criticism came from within the military, most notably by cabinet member Song Jin (宋晉), who complained that the quality of the equipment and ships built by both ventures fared poorly compared to foreign-made vessels. Indeed, part of the reticence on the part of provincial governments in taking ownership of Fuzhou-built steamships was their perceived poor quality. Hence, Song argued, the very rationale for building the ships—to provide the nation with a modern naval arsenal that could be used to ward off subsequent foreign aggression—was fundamentally flawed. In response to this rather pointed criticism levelled at the projects, which by 1872 saw their funds running out, many of the leaders of the Self-Strengthening movement came forward to defend the ventures. Chief among them were Generals Zeng Guofan and Li Hongzhang, who justified the initial production cost overruns as an inherent trait early in the industrialisation process. Using the experience of Western nations as a model, Li claimed they too had undergone a similar learning curve early on, and argued that as production increased, costs would naturally start to fall. Hence, he argued, the only way forward was to increase the government's commitment. His support also included, however, a recommendation that the Naval Yard build not only military vessels, but also commercial merchant ships (ZSJS 1988: 24-26; Pong 1987: 138).

Eventually, the financial crisis was resolved later that year, with Qing government officials reallocating additional funds so the shipbuilding activities at the Naval Yard could go forward. Nonetheless, as the Fuzhou Navy Yard continued to represent such a large line item in the budget, it continued to generate considerable criticism. The situation also highlights that the Qing central government possessed limited fiscal resources, or political will, to provide continual financial backing to quasi-commercial ventures, during their initial start-up, even those with inherent state military purposes.

10.2.1.2. Founding of China Merchants: an application of 官督商办

In response to these pressures, Li and other Self-Strengthening Movement leaders began to advocate a new formulation of the state-run mercantilism model, referred to as 官督商办 (government-supervised, merchant-managed). A corporate governance concept, it envisioned businesses to be run as a partnership between merchants, who would contribute the majority of the capital, as well as supplying business acumen by way of daily management of the enterprise, and the state, which was to provide the authority of state backing, which included advantages such as favourable financing, tax relief, and privileged market access; it also included however as final oversight on shaping the guiding direction of the company's decision-making. Writing in 1872, Li expressed his vision of the merchant-government official relationship as, "The enterprise will be under official supervision and merchant management. While the government will lay down the general principles and keep its eye on the company's merits and demerit, the merchant directors will be permitted to propose their own regulations so that the shareholders will be satisfied (Feuerwerker 1958: 277).

Li contended that the rationale behind the Self-Strengthening Movement was not simply to create a stronger China that could compete with foreign powers on a military basis, but also on a commercial basis. Hence, it followed that sponsoring of commercial endeavours was of equal importance to the promotion of national interests as building military arsenals. To further this goal, and in light of the inability to get provincial governments to accept the delivery of military steamships from the Fuzhou Naval Yard, Li proposed previously military-intentioned steamships to be refitted for commercial purposes to begin a company that would be supplied with commercial steamships built at the Fuzhou Naval Yard.

Li's efforts led to the formation of the China Merchants in 1873, authorised to raise capital of one million *taels*. In his 1872 petition to the emperor requesting the authority to create the company, Li argued the goal was not only to create a company to compete with foreign navigation firms, but given that the venture was organised as China's first formal joint-stock enterprise, one that could also attract domestic capital from Chinese investors. The plan was for the government to provide a loan to fund part of the initial capital, but for private investors to contribute most of the capital. Domestic private merchants and compradors had been actively investing their capital in foreign-owned shipping companies, and Li's plan was to solicit "investment from Chinese merchants so as to enable those who have their ties with foreign capital gradually to transfer their funds to the official bureau" (Feuerwerker 1958: 99).

Operating as it was under the patronage of Governor-General Li, and as the only Chinese-owned shipping company with imperial government backing, the company could be expected to enjoy important privileges in terms of market access, beneficial tax treatment, and funding. By government mandate, the company received monopoly rights to operate as the only domestically-owned steamship enterprise; it was also granted a monopoly franchise for the carriage of tribute rice, designed to ensure the company's profitable operation (Liu 1959: 443). The Qing Court also mandated regulations requiring local government officials to use the company for shipping certain supplies (Halsey 2014: 90).

Although authorised capital was set at one million *taels*, to be divided into one thousand shares valued at one thousand *taels* per share, the initial plan was to raise half the authorised amount by issuing five hundred shares. While Li expected offered shares to have been quickly subscribed, the company faced reluctance from private investors. Two wealthy silk merchants, Hu Xueyan and Li Zhenyu, were initially expected to supply the majority of private capital, but both ended up backing out. The difficulty attracting private investors was protracted, with Zheng Guanying, who was later nominated to be the director of the company in 1882, mentioning in his shareholders meeting speech that "well over a year into the subscription, there was almost complete lack of interest" on the part of investors (Zheng 1883). This lack of interest is reflected in the fact that by the end of the first year, while the company had subscriptions for 952 shares, received paid-up capital reached only 475,000 *taels*, with the majority of paid-in funds coming from Li and other board members.

Reticence for private investors to put capital into the new venture is difficult to identify. Li's first appointee to run the company was Zhu Qi'ong, whose prior position had been in charge of *shachuan* transportation in Zhejiang. Unfamiliar with the steamship industry, Zhu's leadership was characterised by mis-management, and the company quickly ran into financial difficulties, having overpaid for outdated vessels, and purchased vessels not suitable for the designed routes, bringing on significant losses (ZSJS 1988: 42). Hence, the early financial troubles facing the company likely played a role in depressing investor interest. Of perhaps greater salience was the operating philosophy of the company, that placed government interests over merchants'. Although having purchased an official title, Zhu was a merchant; his lack of knowledge of the steamship industry an initially disqualifying factor to his appointment as head of the new company, Zhu fully recognised he owed his appointment to the support of Li, and in return, pushed through corporate regulations that mandated a system of tight oversight by government officials, with explicit language stating that the company's managers needed to be appointed by Li.

While the exact reasons for the reticence of domestic investors to invest capital in early domestic joint-stock companies remains unclear, most scholars suggest it was due to lack of familiarity with the Westernised business form. Faure (2006: 51) surmises that "Early reluctance by Chinese merchants to invest in [China Merchants] reflects probably more a sense of caution towards the unknown than an assessment of the company's business potentials." We find this line of argumentation unconvincing. To begin with, Faure and similar analyses cite no direct evidence of a "sense of caution" amongst entrepreneurs and investors, who otherwise displayed by their actions a relatively high degree of risk-taking in their willingness to start and invest in new businesses during this time period. Second, by this time there already existed a large class of relatively sophisticated investors, many of whom had experience investing in joint-stock companies. Lui (1962) provides considerable archival-based evidence from the period of the relatively high levels capital invested in early extraterritorial joint-stock companies by domestic investors. This included, for instance, the 200,000 taels invested by Chinese investors in China Merchants' competitor, Shanghai Steamship Navigation, operated by Russel and Company. Similarly, research on the holdings of former and acting compradors such as Xu Run, Zheng Guanying, Chen Shutang, and others indicates that large percentages of their financial assets were comprised of shares in extraterritorial-owned joint-stock companies (Wu 1974, Lee 1991:25).

Thus, the argument that Chinese investors were prevented from investing in domestic firms due to "caution towards the unknown" regarding the corporate form of joint stock companies fails to hold up to empirical analysis. Nonetheless, this argument regarding unfamiliarity or "foreignness" of the joint-stock form remains persistent in the literature; even Hao (1970: 456) argues compradors were willing to invest in these western forms of corporate form only after undergoing the "infusion of western values". Yet, such culture-based arguments fail to be supported by the historical record, especially given describing proto-joint-stock corporate forms with dispersed ownership structures run by managers who were not direct owners of the firm, as explicated in research on merchant groups in Furong, Hunan (Zelin 1988) and Zizong, Sichuan (Zelin 2005a), and Shanxi bankers who paid managers partly with non-voting ownership shares as an early form of stock option compensation structure to help overcome the principal-agent problem and increase interest alignment between bank management and ownership (Morck & Yang 2011, Wu 2016). These indigenously-developed proto-joint-stock corporate forms were found within the Chinese economy prior to the introduction of the joint-stock form from outside. Obviously, then, domestic Chinese investors and entrepreneurs were willing to engage in these types of corporate structures, when the incentive system was favourable. As both Zelin and Wu argue, however, the lack of further deepening and development of these proto-joint-stock corporate forms in the domestic economy can be related to a distinct lack of sufficient property rights mechanisms that could have facilitated a greater utilisation of these financial instruments that allowed for the separation between ownership and control.

Therefore, a more plausible rationale for the willingness, or lack thereof, of domestic investors to put capital into either extraterritorial or domestic joint-stock ventures would be related to their perceptions of the relative strength of private property protection offered by the corporate governance systems that differed between that of extraterritorial and domestic companies. This was particularly true in the case of companies that operated under the government supervision-merchant management corporate governance form such as China Merchants. Numerous private businesspersons expressed discomfort with the state-economic agent relationship under the government supervision-merchant management concept, one in which the government was the more powerful side, represented particularly in its power to appoint directors and managers and intervene in business operations. Ultimately, private shareholders had no effective resources to protect their interests. Peng Rucong, for instance, was an entrepreneur who sought to establish the first domestic Chinese-owned cotton manufacturing mill utilising mechanised production means. After initially receiving support from local business leaders, his application made in 1878 to establish his company was denied by the government officials, including Li Hongzhang, because he sought to set up the firm as a purely private venture, outside the government supervision-merchant management system, to be run solely by merchants, not subject to interference by government officials' oversight (Wang 1994: 66).

These concerns were well-founded, as indicated by the corporate history of China Merchants Steamship. The lack of independent supervision by private shareholders resulted in a lack of an effective mechanism to prevent government officials from using its access to the corporate coffer, becoming the implicit residual recipient of corporate profits. Such behaviour on the part of the government regarding its takings of profits amounted to expropriation of private assets, and can help explain a rational reluctance on the part of investors to become shareholders in companies that lacked protections against such actions on the part of government officials. This proved to be particularly the case when it was possible to invest in similar firms that operated under a stronger set of property, contract and investor rights protections, in the form of extraterritorial joint-stock companies. Hence, the reason for the lack of domestic investor support for domestic joint-stock firms, vis-a-vis extraterritorial joint-stock firms, can be better ascribed to rational economic decision-making on the part of Chinese investors.

10.2.1.3. Ascendency of Merchant Control: Xu Run, Tang Tingshu, and Zheng Guanying

However loyal he proved in advancing the interests of government officials backing the company, Zhu's poor performance record prompted Li at the end of 1873 to remove Zhu and appoint two Guangdong merchants as the company's new general managers. Both Xu Run (徐潤), a former comprador for Dent and Company and one of Shanghai's richest businessmen, and Tang Tingshu (唐廷樞), a comprador for Jardine Matheson, possessed experience in foreign-run steam navigation companies, thus providing important business knowledge. They also came in with a sharply different view as to the appropriate corporate governance structure for the firm, with Tang insisting that company posts be appointed by the business side, instead of by government officials (局務由商任, 不便由官任). As a result, a moderate reform took place within the company's management structure, solidifying merchant management over corporate affairs. The hiring of Tang and Xu as business managers, together with their strong connections to the business community—particularly amongst other Guangdong-based merchants—allowed the company to gain credibility among Chinese investors (Goodman 1995: 141).

While initial returns during the first few years of operation under Xu and Tang were favourable, owing in part to the generous payments the company received from the government on its monopoly agreements for shipping "tribute rice", already by 1875 returns had dipped lower. Although China Merchants enjoyed monopoly rights preventing competition from other domestic firms entering the market, foreign-operated steamship companies provided serious competition for business, implying tight operating margins. The firm's business model however operated on the assumption of healthy returns, for its equity shares carried with them the promise of high fixed-interest dividends. As a result of these obligatory dividend payments, as well as other financial demands, capital accumulation proved difficult to achieve, hampering growth opportunities.

Nonetheless, after several years of moderate growth, the company expanded greatly when it acquired Russel and Company's Shanghai Steam Navigation Company. After China Merchants Steamship applied for and received permission from the Court to undertake the purchase, Li personally wrote to the emperor to grant his permission for the company to be granted a ten-year loan of one million *taels* from the treasury at favourable rates, with the first five years of interest payments deferred, in order to complete the purchase, which was eventually approved (Li 1876 (2005: 2889-289)).

The merger added another sixteen steamships to the China Merchants fleet of fourteen; with thirty steamships now under management, China Merchants became the largest steamship operator in the country (Hao 1985: 205). Improved business also alleviated some of the company's financing issues, and the greater degree of merchant control over business operations saw paid-in capital begin to rise, reaching 830,000 *taels* by 1880, and finally the full subscribed amount of one million by the end of the following year. Yet hesitancy on the part of private investors still existed, as the expectation that Chinese shareholders in Shanghai Steam Navigation would transfer their 200,000 *taels* of capital in that firm to the merged China Merchants company went unrealised, with records indicating that none of the fifteen recorded domestic Chinese shareholders of Shanghai Steam Navigation joined the new company as shareholders (Liu 1962).

The benefits China Merchants gained from the government supervision-merchant management system were clear in terms of limiting market access to potential domestic competitors, as well as access to favourable government-assisted financing, such as in the case of financing that facilitating the purchase of the Shanghai Steamship Company. However, on a larger scale, the domestic industry suffered from a lack of competition and innovation. Government intervention in the economy via granting monopoly rights, or providing favourable tax treatment to certain companies, directly inhibited the growth of private enterprises that were not fortunate enough to benefit from such preferential treatment. To maximize profit, China Merchants frequently used its access government support to suppress market competition and prevent other private entrepreneurs from engaging in shipping and transportation. In 1882, a private application to form a steamship navigation company made by Ye Chengzhong (叶澄衷), leader of the Zhejiang merchants in Shanghai, was rejected by Governor-General Li to prevent competition to China Merchants (*NCH* 10 September 1887). Multiple other requests from other merchants in Shanghai (including one from Zheng Guanying before he joined China Merchants) to operate steamship in inland and coastal waterways were all repeatedly blocked by China Merchants (*ZSJS* 1988: 133). As the *North China Herald* noted at the time, China Merchants had become the biggest impediment to private merchants from engaging in coastal trading and navigation (*NCH* 15 April 1879: 349-350). In the decades following the founding of China Merchants, the overall Chinese steamship transportation industry failed to experience any private-led growth.

While having expanded greatly and now controlling over a third of the country's steamship traffic (Hao 1985: 206), operational inefficiencies and financial pressures continued to weigh on the company, especially given the demands imposed by the company's high debt levels and the fixed dividend system (ZSJS 1988: 62). In 1881, Zheng Guanying (郑观应), another important Guangdong merchant, was brought in by Li to serve as the new General Manager, along with Xu and Tian. Zheng was the author of an outspoken book, *盛世危言* (*Words of Caution in a Prosperous Age*), which first appeared in 1860's and was republished multiple times, and in which Zheng offered his suggestions for economic reforms. Zheng, a proponent for the separation of government and business management, pushed for to modify the company's charter to give shareholders the sole right to nominate the company's management without interference from the government. Zheng was frustrated by the reality that under the government supervision-merchant management system, power was consolidated with top government officials, with the term "merchants-managed" existing in name alone (Zheng 1860, v.10). In his writing, Zheng raises concerns of inefficiency resulting from government control over business, such as how officials frequently placed their friends and relatives on the company payroll, or that managers were often forced to make non-economic decisions in order to cater to official interests.

Under Zheng's direction, the company became more profitable. The following year, the company reported annual profits exceeding one million *taels*. Zheng also led the company to increase its capital base to two million *taels*, converting its division of equity to twenty thousand shares of 100 *taels* par value each, with the lower par value designed to increase the subscription base (Xu 1927: 31, ZSJS 1988: 79). The success enjoyed over the following two years increased the confidence of Zheng, Xu and Tang that their merchant-centric model was the most appropriate; in 1884, the three leaders of the company submitted a request to Governor-General Li, suggesting the company undertake to "reimburse to the government its invested funds in instalments, and all due accumulated interests, upon the completion of which China Merchants Steamship Navigation will be run by businessmen, who shall assume full responsibility for profits and losses. China Merchants shall no longer have government involvement, and the government shall no longer appoint business managers" (cited in Yang 2000). These attempts to privatise China Merchants did not go well with Li (Leung 1986). In 1884 and 1885, both Xu and Tang were evicted from China Merchants after accusations by Li that the two had misappropriated funds, stripping them as well of their ownership shares; Zheng managed to retain his position but was to be undermined by the new General Manager brought in by Li in 1885 (Lai 1988).

10.2.1.4. Ascendency of Government Control: Sheng Xuanhuai

Dissatisfied with the attempt by Xu, Tang and Zheng to remove government oversight and control over the company, Li appointed his attendant, Sheng Xuanhuai (盛宣怀), a career government official, as China Merchants' new general manager. Sheng, having observed the fate of Xu and Tang, worked to push out many of the private investors, and operated the company more along the lines of a directly-controlled government bureaucratic entity. All major managers were nominated by the government. Zheng, disagreeing with the direction of the management style and rollbacks to earlier reforms implemented by Xu, Tang and himself, eventually resigned from his role in the company.

The subordination of private managerial power, accompanied by tighter government control of company decision-making, failed to bring higher revenues, and the company's growth subsequently declined. Corruption, embezzlement and poor management became particularly serious problems in the late 1880s. On several occasions Li was forced to step in and protect the company's senior management, including even one time writing directly to the emperor to

defend Sheng from prosecution for accepting a bribe (Li 1882 (2005: 61-62)). By 1894, China Merchants still operated the same number of steamships as it had ten years prior, and by this time had lost its previous-dominant position in Yangzi transportation to foreign steamship companies, such as Swire and Jardine, Madison. The deleterious impact owing to the change in managerial authority from private merchants to government officials at China Merchants did not escape the attention of contemporaneous observers. Douglas (1895: 264), for instance, notes of the effect of government officials running the company: "At first, by the careful employment of official influence to promote its welfare, the scheme answered tolerably well, and in 1877 the Company was in a position to buy the steamers of the Shanghai Steamship Navigation Company with all the dockyard plant, for the sum of 2,000,000 taels. It is amusing to see the efforts which were made by Li to bolster up a concern, which without such aid must have been inevitably ruined by the official element in the management. Unhappily in China the presence of Mandarins [government officials] on a Board means that bribery and corruption form a part of the policy of the undertaking, and this Company, which left to the hands of mercantile men might have succeeded well, was constantly imperilled by the very support which was intended to give it strength."

Interference in corporate management by government officials included pressure to direct company funds to various government offices. In February 1890, a government auditor charged China Merchants and the Imperial Chinese Telegraph Administration with making excessive profits, demanding these firms pay increased distributions to the government. Sheng temporarily succeeded in fending off the request by citing the dependence of Hanyang Ironworks and Ping Xiang Coal Mines on the support of China Merchants, pleading that further demands for contributions would jeopardise all four enterprises. To mollify continuing requests for additional contributions, the following year China Merchants contributed 100,000 *taels* to famine relief, in exchange for the government foregoing the previous year's interest collection on an earlier loan (*NCH*, 14 April 1892: 503). In 1894, China Merchants contributed 50,000 *taels* out of company profits to an "Imperial Celebration Fund" for official celebrations of the sixtieth birthday of Empress Dowager Cixi, and the company's managerial staff personally contributed an additional 50,000 *taels* (Feuerwerker 1958: 173). In 1896, Sheng agreed the company would make fixed annual contributions of 80,000 *taels* to go to various government education projects. In 1898, the government issued two edicts ordering Sheng to draw up the accounts of the financial status of China Merchants and the Telegraph Administration, together with a plan for regular payment of surplus profits to the government. Despite Sheng's protest that "the surpluses... were continuously used to expand their capital; thus there is no ready cash that can be transferred to the government," the company was pressured to agree to set aside twenty per cent of annual net surplus as donations to the government, with the minimum amount to be donated mandated at 60,000 *taels* annually (Feuerwerker 1958: 175).

Overall, these contributions, undertaken to win the favour of influential state actors, exerted a significant burden on the company's financial viability. Table 10.1, constructed from data based on China Merchants' financial statements, illustrates how such numerous financial demands on the company, including fixed dividend obligations and compelled donations to the government, combined with declining revenues, eventually brought the company's reserves into deficit. The constant demands from the government for large contributions, acquiesced to by the company's government official-led management team, inhibited the ability of the company from achieving significant capital accumulation, thereby adversely affecting the company's ability to undertake capital improvements such as upgrading its fleet, expanding business operations, or investing in new technologies. Over time, this contributed to the company losing its competitive advantage, evidenced by the fact that while the value of China's total foreign trade increased six-fold from 153 million to 974 million *taels* over the period 1885 to 1913, China Merchants' gross earnings from shipping remained essentially unchanged (Remer 1926: 76, 125).

Table 10.1. Allocation of profits, China Merchants Steamship Navigation Co., 1895-1911

Year	Profits	Fixed Dividend	Bonus dividend	Employee Bonus	Donation to Gov't	Accumulated Capital
1895	651,062	120,000	280,000	25,107		225,950
1896	530,756	120,000	280,000	13,076		117,680
1897	524,044			52,404		471,640
1898	690,380	240,000	240,000	21,038		189,342
1899	709,420	400,000	154,710	51,570	145,760	(42,620)
1900	637,007	400,000	118,503	39,501	140,000	(60,997)
1901	503,900	400,000	51,950	17,317	140,000	(105,367)
1902	386,994	400,000			140,000	(153,006)
1903	538,759	400,000	69,379	23,126	80,000	(33,746)
1904	715,428	400,000	157,714	52,571	105,144	0
1905	677,857	400,000	138,929	46,309	80,000	12,619
1906	559,715	400,000	79,857	26,619	80,000	(26,761)
1907	427,802	400,000	13,901	4,633	80,000	(70,738)
1908	412,207	400,000	6,103	2,035	80,000	(75,931)
1909	325,884	400,000				(74,116)
1910	51,443	600,000				(548,557)
1911	(282,953)					(282,953)

Source: China Merchants Steam Navigation financial records, compiled in ZSJS 1988: 242

Faced with a risk of losing control of the company, the shareholders decided to register as a corporation under the 1904 Qing Company Laws, hoping that the legal system would provide shareholders a greater degree of protection. Shortly thereafter, a shareholders' meeting was held pursuant to the requirements of the Company Laws, and new articles of association were drafted, and a nine-member board of directors elected, with Sheng appointed chairman. Nevertheless, the Ministry of Posts and Communications chose to disregard these changes allowable under the new Company Law, claiming that as China Merchants Steamship was designated a "government-supervised, merchant-managed" company, the government retained the right to appoint the company's managing director and chief managers, and required reporting of major events to the Ministry (ZSJS 1988: 271-72).

Over the ensuing years, the company continued to post declining profitability, and after years of losses, in April 1909, many within the government, including General Yuan Shikai, argued for full nationalisation of the company. With the support of former general manager Zheng Guanying, Sheng was able to mobilise enough support from the primarily Guangdong-based shareholders to vote against the nationalisation plan, and to petition the government once again for the right to incorporate under the Company Law. With the backing of strong shareholder support, the company finally obtained permission to remain a private concern, and was formally incorporated as a limited liability company in 1909 (Lee 1991: 13).

10.2.2. Lacklustre performance under the Beiyang

Sheng Xuanhuai's management of China Merchants Steamship in a manner that mostly accorded with government interests earned him an official appointment to head the Ministry of Posts and Communications in early 1911, thus ending his directorship of the company. In an interesting side note, it was Shang's subsequent efforts in his new governmental role to consolidate state control over railroad projects, including the nationalisation of several private local railroads, that ultimately sparked major protests and led to the Railway Rights Protection Movement (保路运动), which served as a direct precursor to related political protest movements culminating in the Xinhai Revolution, and the eventual overthrow of the Qing empire (Fairbank 1983: 211).

In the immediate aftermath of the revolution, China Merchants faced challenges dealing with the resultant political uncertainty. As the largest of the government supervision-merchant management companies under the Qing, the company occupied an awkward position after the 1911 Revolution. The October 1911 Wuchang Uprising caused considerable damages to the company's facilities in nearby Hankou port, as wharves and warehouses were burned and destroyed, resulting in estimated property losses of 1.6 million *taels*. In December 1911, the revolutionary military force that occupied Shanghai made repeated requests to assign a supervisor to the company. The company's board of directors, unsure of the permanency of the new revolutionary provisional government, and simultaneously not wishing to alienate either the new regime, nor the embattled but still officially reigning Qing imperial government, attempted to deflect the requests until a resolution of the situation crystallised. Amid the uncertainty, by the end of the year, many directors had resigned from their posts, while most of those that remained refused to attend board meetings (Xia 1981: 238).

It is noteworthy that this situation aligns quite well with that which is described by Weingast and his co-authors in regard to the conditions that spring from Violence Trap—in a conditions marked by high levels of political violence where the overthrow of the regime is perceived to be realistic, private actors who have aligned themselves with the existing regime are often at risk when the regime changes, and can find their property, including their lives, threatened when a new regime takes control. This explains part of the reason existing board members were loathe to continue to serve on the board once the fall of the Qing seemed possible, and also underscores why environments defined by high levels of political violence are likely to achieve lower levels of realised investment compared to potential investment.

The initial resistance shown towards the new revolutionary government, however, soon gave way to forced collaboration. In January 1912, faced with a revenue crunch, the newly formed provisional Guomindang government in Nanjing under Sun Zhongshan's leadership turned to the China Merchants Steamship Navigation Company, and requested the pledge of the assets of the company to Japanese banks in an effort to raise bank loans. General Sun's request was coercive in nature—shareholder equity (including that of Sheng, who remained the company's largest shareholder) was subject to confiscation by the new provisional government; further, refusal by private shareholders to fulfil the demand would result in the government taking "all necessary measures" to secure compliance (*Shun Pao* 25 January 1912). On 11 February, after attempts by the company directors to stave off the request failed, China Merchants made a public announcement in the *Shun Pao* that it was providing collateral to back the provisional government's loan request. In addition, the new government commandeered China Merchants Steamship vessels for military purposes, paying little compensation in return. The company was able to recover less than fifty per cent of the payables accrued from the provisional government's use of its properties, which totalled 200,000 *taels* in a period of less than two months in 1912 (ZSJS 1988: 289). Somewhat ironically, the Provisional Constitution (临时约法) enacted by the provisional government shortly thereafter explicitly stated that "The people shall enjoy the right to protect their private properties and the freedom to engage in businesses" (Article VI).

Efforts to exert greater control over China Merchants Steamship continued after the fall of the Nanjing provisional government and move of the Republic to Beijing under Yuan Shikai. In October 1912, the Department of Communications nominated a supervisor and the executive manager of the company, announcing to restore the government supervision system. In response, twenty-nine shareholders of China Merchants issued a joint statement, calling on all shareholders to protest the government's action (*Shun Pao* 27 October 1912). The fight over the control of the company continued through November. The political chaos associated with the establishment of the new Republic under Yuan, particularly that related to the dismissal of the National Assembly, and start of the failed Second Revolution by secessionist southern provinces, temporarily distracted much of the bureaucratic efforts surrounding corporate organisational issues of China Merchants, providing the company's management with a temporary reprieve.

In 1914, in an effort to preserve assets, and "avoid unwarranted expectations by outsiders," China Merchants Steamship spun off its real estate businesses and other related assets, valued at over five million *taels*, into a separate and independent company, Jiyu Property Company (積余產業公司). Registered as an independent company, the new company issued separate ownership shares (ZSJS 1988: 293-294). By then, the real estate assets represented the most profitable parts of the China Merchants Steamship business. The move represented an attempt by private shareholders to separate some of the more profitable assets from the steamship navigation business, as it had often faced onerous government regulation and intervention.

10.2.3. Nationalisation of China Merchants under the Guomindang

Western scholarship on the China Merchants Steamship Company primarily focuses upon application of the government supervision-merchant management system (Feuerwerker 1958, Haviland 1962, Goodman 1995, Halsey 2014), with historiography related to the end of private ownership of the company mostly neglected. Nonetheless, this period of the company's corporate history is particularly instructive in highlighting the extreme actions undertaken by state actors, represented by outright government expropriation of private assets without just restitution, reflective of an institutional environment that in many respects failed to provide even the minimal of effective protections on private property rights.

Shortly after the official founding of the Guomindang government in Nanjing in 1927, measures were undertaken by state authorities to take control of the China Merchants company. In April 1927, a committee was appointed by the Ministry of Finance to provide an audit and financial supervision of the company, with government-nominated personnel to oversee a mandated company reform. Deeming this move to be a direct infringement of private shareholders rights, the board of directors, led by its chairman Li Guojie (李國傑), refused to cooperate with the Ministry's mandated reform. Li voiced outspoken dissatisfaction, stating at the time that "the government's interference in the company's business rights not only causes great panic among our shareholders and employees, but also causes alarm among other private businesses in Shanghai." Li's protest, however, produced little effect, and instead, the Ministry increased pressure on the company leadership via intimidation tactics. Government actors employed the strategy referenced in Section 7.2.1.4 of utilising charges of traitorousness and sedition against private property owners to ensure compliance with government takings demands. Accordingly, later the same month, an arrest warrant for Fu Zongyao (傅宗耀), the company's Managing Director and Manager of Properties, was issued on charges that included conspiracy and collusion with enemy forces. Facing imprisonment, Fu resigned, with his two hundred shares confiscated by the government (ZSJS 1988: 377).

The battle over corporate control between the board and the government ended several months later in January 1928 after the government supervisory office issued an order to suspend all board members, and place them under investigation. Subsequently, new rules and regulations promulgated on 6 March 1928 designating the formation of a General Management Office (總管理處) to be responsible for all affairs of the China Merchants Steamship Navigation Company. Shortly thereafter, on 18 August 1928, the Guomindang government announced its plans "to nationalise China Merchants as a matter of principle, and in the meantime to operate it as a joint government-private business enterprise as a matter of transition" (*Bankers' Weekly* 1930, 14/10: 11-20).

Under the government's nationalisation plans, the assets of Jiyu, the real estate holding company spun off in 1914, were to be included in the government-mandated expropriation. Although Li Guojie had been removed as the general manager of the company, he continued to advocate for the interests of Jiyu's private shareholders, asserting that "Jiyu was a property company, licensed and registered with the Department of Trade & Commerce, independent from China Merchants. Its assets are unrelated to China Merchants" (ZSJS 1988: 386). The advocacy by Li and other private shareholders soon ended, however, once the government charged Li with illegal obstruction of public service, and revoked Jiyu's corporate registration.

In October 1928, the Guomindang government officially completed the forced nationalisation of the two companies, paying 50 *taels* per set of shares, with each set consisting of two China Merchants Steamship Navigation shares, and one Jiyu share. According to the government notice, the price was based on the average market price over the last three years, with the purchase constituting "a financial boon to the shareholders." The government paid shareholders a little over two million (2,126,340) *taels* for the stock purchase. However, the paid-in capital of China Merchants Steamship alone was 8.4 billion *taels*. Estimates from the time indicated the total combined assets of China Merchants Steamship and Jiyu to have been possibly greater than fifty billion *taels*; deducting total liabilities of approximately seventeen billion, net assets were therefore likely over thirty-three billion *taels* (ZSJS 1988: 405, 408). Hence, the government's restitution of just over two million *taels* represented just 0.006 per cent of the actual value of the company; or, in practical terms, essentially nothing.

The nationalisation of China Merchants Steamship represents one of the most blatant examples of government takings of private business property without restitution as one might identify in corporate history. The interests and rights of the private owners of the company were marginalised, and their assets taken from them unwillingly, with essentially no compensation provided in return. The forced nationalisation of the company represents an extreme but not uncommon example of government expropriation during the Guomindang period, illustrating a state-commerce relationship defined by a rather complete subjugation of private capital to the coercive power of the state.

Chapter Eleven.

Shanghai's Early National and Municipal Bond Markets

This chapter analyses in detail the issuance histories, market prices, and trading activity of the bonds of the three issuers under consideration: Chinese national governments, Shanghai's domestic municipal governments, and an extraterritorial municipal government. In regard to the latter, we focus primarily on the municipal bond issuances of the Shanghai Municipal Council, leaving aside for the most part the more limited issuance and trading history of French Municipal Council bonds. We partake in this strategy for several reasons. First, we wish to avoid duplication and replication of results and analysis, as the overall averaged price series of Shanghai Municipal Council and French Municipal Council bonds performed remarkably similarly over the 1870–1941 time period, especially when contrasted with that of the bond issuances by domestic government entities we consider. Second, bond issuances by the French Municipal Council were considerably smaller in number, scale and variety than those of the Shanghai Municipal Council. In contrast to the fifty-four issuances completed by the Shanghai Municipal Council, the French Municipal Council issued just fifteen, with a total 30 million *taels* face value amount representing only twenty per cent of the Shanghai Municipal Council's 136 million *taels*. Finally, the financing methodology of the French Municipal Council was slightly different, owing especially to a considerably different governance structure as referenced earlier in Chapter Nine. Fiscal budgeting decisions, including the raising of revenue, was the purview of French government-appointed officials, and funding for the operation of the French Concession partly came from the French government. This situation differed considerably from that of the International Settlement, where locally-elected officials depended exclusively on the ability to raise funds from internal revenue sources. To maintain the focus of the discussion between the domestic and extraterritorial institutional setting as distinct and clean as possible, using solely an analysis of International Settlement debenture issuances therefore appears justified.

11.1. Central Government Internal Domestic Bonds

Historically neither the Qing nor previous Chinese central governments borrowed money for its finances, with traditional Confucian aversion of debt often ascribed for the lack of such practise (van de Ven 2014: 136). However, for the most part, land tax receipts had historically proved sufficient for the relatively low levels of Ming and Qing central government spending, as much of the expenditures related to government activities were both undertaken and financed at the local levels (Feuerwerker 1976: 90-92). Expenditures, including of extraordinary nature due to war or rebellion, were determined based on available tax resources. This situation changed after China suffered defeat in the Opium War, incurring significant financial burdens due to indemnity payments, followed immediately by the mid-century outbreak of concurrent rebellions including the Taiping, Nian, Du Wenxiu and Miao. The government began to take on ever-increasing military expenses, placing a sufficiently heavy strain on Qing finances.

Given the difficulties the domestic state faced in raising tax revenues, alternative funding sources became increasingly important to the state. One issue affecting the fiscal capacity of the domestic state was the lack of developed capital markets that could have been used to raise funds. As a result, when the sudden and large fiscal needs state actors perceived as required in light of the multiple internal and external military threats of the mid-nineteenth century could not be sufficiently met with an increasingly ineffective system of tax extraction, the supposed Confucian-based "cultural disinclination" for state borrowing was conveniently put aside. As the indigenous banking system comprised of transmittance banks (*piaohao*), *qianzhao* and pawnshops that lacked sufficiently large amounts of capital

available for lending to the government, the government was forced to turn to debt financing for the first time in its history. At both the national and provincial level, Qing officials first turned to overseas markets to raise capital, and began to issue an ever-increasing amount of bonds in overseas (especially British) financial markets. Referred to as external, or foreign-sourced, bonds, these issuances were typically well received by foreign investors because they came attached with quite strong collateral guarantees, such as (foreign-administered) customs revenues or salt or other monopoly tax revenues.

Such a strategy, however, did not prove to be a panacea for the state's fiscal pressures. To begin with, to access foreign capital markets, foreign bankers demanded stringent collateral agreements to bind state actors into honouring these loan commitments. Most of these included not only the pledge of specific revenue-generating sources, such as the Chinese Maritime Customs receipts, or revenues from the salt monopoly tax, but also partial or complete foreign control over the administration of these organisations so as to ensure a layer of control over the distribution of funds accrued from these revenue sources whose incentives were more aligned with those of the foreign power creditors than with domestic state actors. While such arrangements successfully created credible commitment mechanisms that increased foreign investor confidence enough to lend to the Chinese government at relatively attractive rates, it also was accompanied with the baggage of imperialist overtones, given it involved significant foreign administrative control over institutions such as the Chinese Maritime Customs Service or the Central Salt Administration.

Conversely, accessing domestic capital sources posed its own challenges given the lack of developed internal capital markets. The lack of capital markets in China at this time cannot be ascribed to a lack of capital, as with a relatively robust economy in spite of the bevy of problematic interventions by the state, the merchant and landed classes had collectively accumulated great wealth (Ou 1947, Ma 2008). Instead, the issue was partly institutional in nature. Debt formation behaviour requires the creation of trust mechanisms, for nature of lending involves an intrinsic lack of simultaneous exchange between lender and borrower. Thus, inducing creditors to lend requires borrowers to create a perception of trust that they will fulfil their future obligations. As previously discussed, the authoritarian structure of the Qing and subsequent domestic Chinese states meant many typical institutional forms that could create credible commitment mechanisms were inherently missing. Unlike under representative state structures, the authoritarian rulers of China's domestic governments could not easily be replaced by an electorate comprised of propertied lenders were they to renege on their promises to repay. Similarly, there was neither the existence of a legislative body possessing authority over spending and taxation, nor an independent judicial system to compel state actors to adhere to terms proscribed in financial contracts such as government bonds representing *ex ante* promises to repay. As such, the state faced inherent difficulty inducing creditors to lend money. In such an environment, it is hardly surprising that capital markets had not indigenously developed.

The Qing government's first domestic borrowing from civilians took place in 1894 when the Court, upon recommendation from the Ministry of Revenue, tried to raise money from wealthy merchants to fund the First Sino-Japanese War in a process known as "*Xijie Shangkuan*" (息借商款). The loan had a term of two and a half years at annual interest of about 8.4 per cent. To entice investors, the Court promised to award official titles to anyone subscribing over 10,000 *taels*. Nonetheless, the debt issuance was met with lacklustre interest, with total amount raised about 11 million *taels*, and the government eventually ceased the effort in May 1895. Given the fact that this issuance was only directed at a limited number of wealthy merchants, it is debatable whether this would be classified as a true public loan, or even that the government viewed *Xijie Shangkuan* as a mandatory sovereign debt obligation—officials faced pressure not only to subscribe to the loan, but the lauding

and encouragement of loan subscribers who declared their loan subscription to be treated as a “tribute” to the court and declined to claim the debt certificates suggested the donations were more forced than voluntary (Qian 1955: 5-6).

The first recognised internal debt issuance more conceptually in line with a true bond obligation was the 1898 Zhaoxin Shares (昭信股票), an effort to raise money for indemnity payments due under the Treaty of Shimonoseki. The bond was issued with an authorised amount of 100 million *taels* for a twenty year term at an annual interest of five per cent. The bond was guaranteed by land tax and salt monopoly tax receipts. The government urged generals, court and local officials to set an example to the public in subscribing to the loan; however, less than twenty million *taels* was actually raised (Qian 1955: 6). Although pledging and transfer of the loan instrument was allowed upon registration with the relevant bureau under the Ministry of Revenue, no formalised nor market trading took place in this issuance. The poor finances of the Qing, under strain from multiple indemnity payment burdens, soon resulted in a default in payment of this bond issuance after only five years in 1903 (Jia 1930).

It would be twelve years before the Qing central government conducted another domestic internal bond issuance. In 1910 the government authorised a thirty million *tael* bond issuance known as the “Patriotism Bond” (愛國公債) at six per cent annual interest of a tenor of nine years. However, before the issuance process was completed, the Qing government was overthrown; less than half the authorised amount (11.6 million) had been issued, mostly to court officials and royal family members, with only a minimal amount—less than ten per cent—in public circulation. Overall, there appears to be no evidence in the historical record of any trading activity of any of the three Qing-era internal government bond-style instruments. As such, they are not included in our quantitative price analysis.

The provisional Republican authority in Nanjing began issuing debt in the immediate aftermath of the 1911 Revolution. The \$100 million 1912 Military Bond, with a six year tenor at eight per cent interest, was guaranteed by treasury cash and grains receipts. However, many of these bonds were expropriated by military generals in Guomindang-controlled regions and resold at discount, or used as payment to soldiers for army salary. Qian (1955: 9) notes that the Nanjing government received only about five million *yuan* in revenue from the issue.

Once the Beiyang government under Yuan Shikai gained power, it negotiated a *quid pro quo* agreement assuming all prior external debt obligations in return for the granting of additional funds by Western lenders. While the agreement applied to China's external loans, the obligations of the two outstanding internal loans—the Qing-era Patriotism Bond, and the 1912 Military Bond—were also assumed in full by the new Beiyang regime (Straight 1913; Qian 1955: 6, 366).

The Beiyang government faced increasing pressure by foreign lenders in regard to additional foreign external bond issuances, who suspected much of the lent funds were going into the pockets of President Yuan's associates and local military leader supporters (Winston 1916: 775). Furthermore, the government was running out of income-generating revenue streams that could be used as collateral pledges deemed acceptable to foreign lenders. As such, the government began to increasingly turn to the internal domestic market. Public debt issuance reached a new phase after 1914 when a formal borrowing institutional framework was created with the establishment of the Bureau of Public Debt (内国公债局). Seemingly better controls were put in place to secure repayment of the debt; for instance, repayment funds were required to be held in trust with designated banks. Domestic internal bonds' perceived security level increased, and the bonds were often purchased and held by domestic banks as investment (Qian 1955: 8-15).

Given the lack of credible commitment mechanisms deriving from its authoritarian form, the state required alternative structures to induce creditors to lend it capital. To access the foreign capital markets, the state had not only pledged revenue streams to service the debt, but had also acquiesced to outside control over the administration of these revenue streams. The Maritime Customs and salt gabelle tax receipts represented some of the largest and most consistent of the central state's income streams, yet their initial use as pledged collateral for foreign loans meant these tax revenue streams could only be assigned subordinated status if also used as collateral on domestic loans.

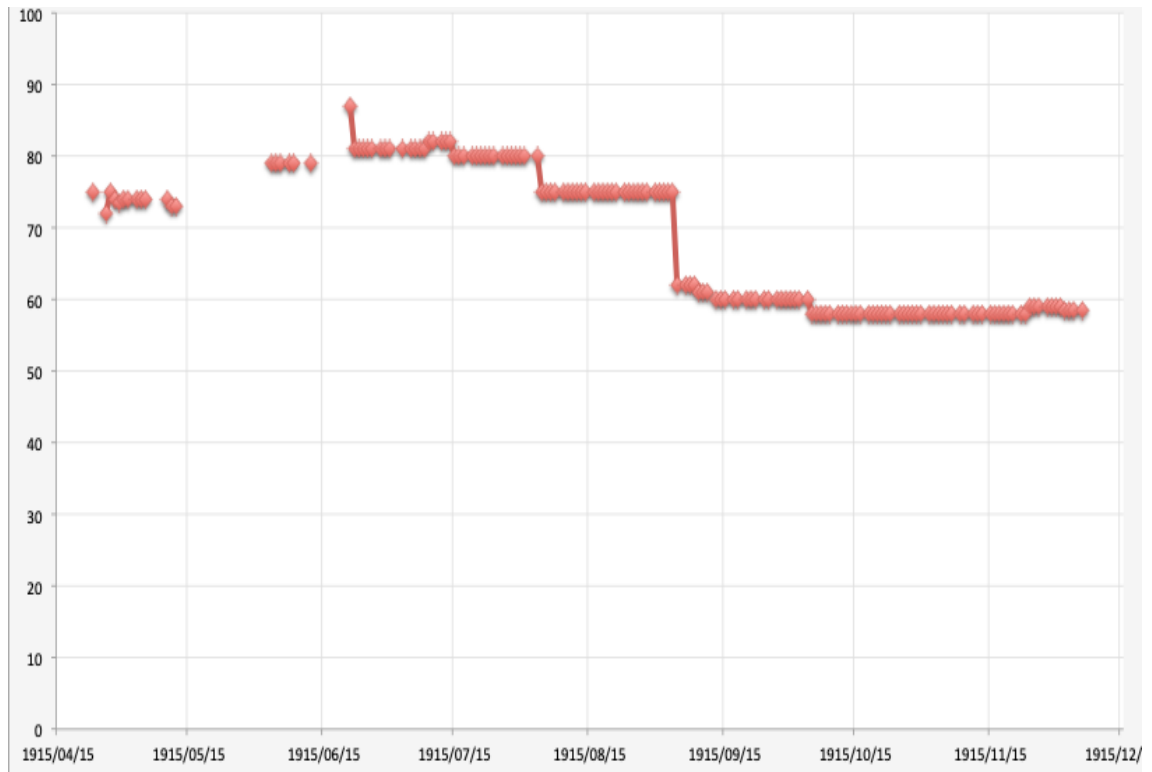
The difficulties the central state faced in extracting general tax receipts further implied difficulties in its attempted use as collateral for loans. Potential creditors viewed the central state's inability to effectively extract tax revenues as therefore indicative of lower probability of ability to affect repayment. Thus, domestic state actors found themselves faced with another structural fiscal trap, as the state's need for debt financing owed in large part to its inability to effectively extract tax revenues, yet obtaining debt financing at attractive terms required creditors to anticipate repayment, dependant on the state's ability to secure adequate tax revenues.

Nonetheless, continually high expenditures and limited tax receipts led central government leadership to continually look to finance the budget via domestic and foreign borrowings. The ability for the state to easily access credit markets was constrained by a combination of several factors. The very need for high levels of bond financing—a poor state capacity in securing consistent tax receipts—had investors reticent to lend money to the government as they foresaw problems obtaining tax income as limiting the state's ability to repay its debts.

Important for the generation of investor interest in a domestic internal bond issuance was the inclusion of a dedicated funding source for repayment. Thus, for instance, the First-Year Six Per Cent Bond issued in 1913 was to be funded with residuals from the Stamp Tax receipts. However, although most of the bonds issued at the time were ostensibly backed by a collateral device, in practise these collateral mechanisms proved less than reliable, given that as residuals, they depended on the existence of large enough surpluses remaining after payments were made on previously-pledged obligations. In general, most of the reliable revenue streams had already been pledged as primary funding sources for external loan issuances. Internal bond issuances were in this sense subordinated debt, given that their funding streams were prioritised only after being used to pay off external debt obligations.

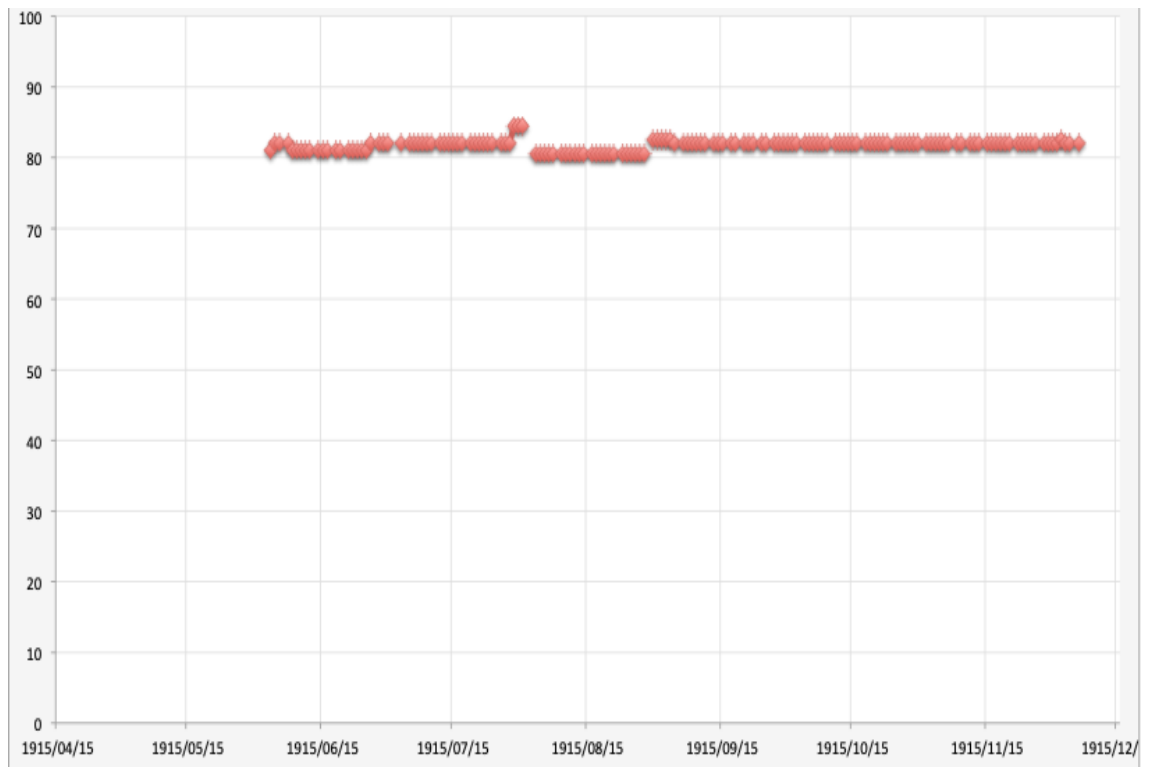
Still, the attachment of specified funding sources was a welcomed feature, as was the establishment of a dedicated government agency, the Internal Debts Bureau, in charge of bond issuances (Wang *et al.* 2014: 30). In response to these reforms, a market for domestic internal bonds began to develop, and what had been quite sporadic trading in the early period turned slightly more active. Bonds were traded amongst investors on the nascent stock trading outlets of the time. As such, we begin to find information on market prices of government bonds in the local financial press. From a review of the early records, the earliest period for which we find consistent data on bond prices was 1915. This coincided with the start of *Shunpao* listing securities traded by the Shanghai Stock Business Association, established in 1914. Both the 1912 Republic of China Military Bond, and the Six Per Cent Third-Year Bond originally issued in 1914 by the Beiyang government were listed in *Shunpao* during this time frame, along with prices of several provincial-level and railroad bonds. The combined price history of these two government internal bonds over the course of 1915 are presented in Figures 11.1a and 11.1b.

Figure 11.1a. Traded prices of 1912 Military Bond, April to December 1915 (in *yuan*)



Source: *Shunpao*, various issues, 1915

Figure 11.1b. Traded prices of 1914 Third Year Bond, April to December 1915 (in *yuan*)



Source: *Shunpao*, various issues, 1915

From the Figures, it is clear that both bonds traded at fairly steep discounts to their face values, with the more severe of the two being the 1912 Military Bond. The Military Bond also had a relatively sharp drop in its traded price late in August 1915. While neither *Shunpao* or other contemporaneous reports provide any trading notes or news articles indicating the specific reason for such price differential, investors might have perceived the risks associated with the Military Bond issuance higher than the Third-Year Bond given their dedicated funding mechanisms. The Third-Year Bond funding was specified as accruing from tax revenue on the Peking-Hankow Railroad. The Military Bond, conversely, had no specific funding sources, only the general revenues of the central government (the original granary taxes had been removed when the Beiyang government subsumed the obligation); the lack of a dedicated funding stream could rationally be interpreted as more unstable and susceptible to default risk. Such potential investor reticence appears to have been well deserved, for while the Third-Year Bond was repaid on time in 1925, the Military Bond—scheduled to have been fully repaid by 1918—went through consolidation in 1921 and was only fully reimbursed by 1925.

While the internal bond market showed signs of growth, the Beiyang government faced continuing rising obligations on their debt obligations, at the same time that their revenue streams were continually shrinking. The collateral pledged to secure the issuance of external government bonds had tied up customs and salt tax revenues. Meanwhile, disintegration of central government control over an increasing number of provinces and regions allowed territories controlled by military warlords to keep nearly all tax revenues collected locally that could have gone to the central government. Writing at the time, U.S. diplomat Paul Reinsch (1914: 893) estimated that the Beiyang government was receiving "no more than five percent of the tax revenue due from the provinces... [The central government] was barely surviving from hand to mouth." Given its deteriorating fiscal situation, the Beiyang government continued to turn to the internal bond market for funding.

Various measures were taken early on to increase investor appetite. In 1915, in order to increase investor confidence, officials in the Finance Ministry turned to the private foreign bank the Hongkong and Shanghai Banking Corporation to assist the domestic banks Bank of China and Bank of Communications in issuing a new twenty-four million *yuan* Fourth-Year Bond, at six per cent coupon. As described by Winston (1916: 769), officials went to great length to assure investors the government was serious about honouring its repayment commitments: "The ministry of finance was to raise the full amount of \$1,440,000 (one year's interest) and hand it to the Inspector General of Customs to be deposited in the two state banks as a guarantee for interest. As a further security the ministry of finance was to transfer every month to the Inspector General of Customs \$120,000 which the Inspector General would then deposit in those banks for payment of interest as it fell due. The participation of the foreign bank and the foreign Inspector General and the elaborate provision for interest payment showed a consciousness on the part of the Chinese government that the public confidence was still not to be counted on with entire assurance." As further inducement, the bond was offered at 90 *yuan*, at ten per cent discount.

These efforts proved successful, and the bond was slightly oversubscribed at issuance. Successful issuances such as the Fourth-Year Bond were followed by issuances of ever-increasing nominal amounts. In 1918, the government brought to market a combined one billion *yuan* on its two Seventh Year Bond issuances, divided equally between separate issuances of five- and twenty-year tenors. However, as a result of continuing financing difficulties, by 1920, the Beiyang government began missing many of the payments on its debt obligations. In September of 1920, an attempt was made to reorganise some of the outstanding short-term debt that had fallen into arrears by issuing the seven-year tenor sixty million *yuan* Consolidation of Short-Term Debt Bond at six per cent. Although this bond was fully subscribed, financial issues continued to plague the government.

By the start of 1921, an impending financial crisis loomed, with the Beiyang central government facing default on nearly all its loan obligations, both external and internal. In turn, Minister of Finance Zhou Ziqi proposed a debt restructuring plan to President Yuan, one that avoided a complete stoppage of payments on all debts. Instead, Zhou's plan called for the reduction in coupon rates, partial reduction of outstanding principal to be repaid, elongation of repayment tenor, and "temporary" suspension of any repayment for some bond classes—in all, there were nine strategies based on different bond classifications (Qian 1955: 68-71). Yuan agreed, persuaded by Zhou's concern that a complete stop on all principal and interest payments would not only damage the government's reputation and limit future borrowing prospects, but given that so many banks held so much government debt on their balance sheets, a complete default would likely cause a financial crash and cripple the entire banking industry.

While a complete default was avoided, the situation did not substantially improve after implementation of the restructuring plan. The government subsequently issued a series of consolidated bonds meant to replace and reorganise non-performing internal note and bond debt. Two of the largest of these included the fifty-five million *yuan* Consolidated First-Year Bond at six per cent, in May 1921, which was undertaken to replace the previous First-Year Bond; and in January 1922 the ninety-six million *yuan* Consolidated Short-term Debt Bond at eight per cent, which came to be referred to as the "96 Consols".

In spite of the financial difficulties faced by the Beiyang government, the bond market continued to remain active. Indeed, some of the most intense activity took place during the crisis, as banks and investors looked to either liquidate positions or buy at steep discounts, hoping the repayment situation would improve. The intensity of the level of trading helped to stimulate the country's growing domestic financial markets. In Shanghai in particular, a financial boom ensued, with many new exchanges appearing as investors poured money into the government bond market.

Investor concerns appear to have been well warranted. The financial crisis that culminated in the Beiyang government's initial and then additional defaulting on debt payments led to a general financial contagion that greatly affected Shanghai's financial industry. Following the failure of several finance and trust companies, investors began to exit the market *en masse*, immediately reversing the prior year's run-up of domestic company share prices and government bond issues. Securities exchanges in Shanghai, which had numbered 136 at their peak in mid-1921 (*Bankers Weekly* 24 January 1922), fell to only two by the end of 1922 (*Shunpao* 3 March 1923). Trading activity and investor interest dried up, and financial journals such as *Bankers Weekly* or the financial section of *Shunpao* had no domestic bond trade activity to report for several months. While eventually domestic government bonds began to trade again, it appears to have been at significantly lower volumes. While specific volume traded data on domestic internal bonds were not to be reported again in the financial press until the 1930s, the decrease in the number of exchanges can be taken as indicative of the fact that the market became much less active in the aftermath of the bubble.

Even several years after the crisis, Beiyang government finances were in little better shape. Outstanding short-term debt issuances, such as Treasury Notes, were not being paid. A review of China's domestic debt outlook as described in the 1924 *China Year Book* paints a bleak picture of the repayment situation. For instance, in the section listing outstanding Treasury Notes and other short-term debt, every issuance is flagged with a note of some kind, all of which indicate some form of default event having occurred. Over ten pages of default incidence notes on the outstanding short term obligations of the government are listed, and the approximately twenty-five to thirty per page correspond to nearly one each for every then-currently outstanding loan. For illustration, we present the first five notes from the top of page 754:

- (25) The repayment was due in June 1922, no payments have yet been made.
- (26) The repayment was due in February 1921, and no fund could be found to meet it.
- (27) The repayment was originally to be \$100,000 in December 1920, and \$150,000 in June 1921. The amount paid was \$130,000. There is no fund to pay off the balance.
- (28) The repayment was due in April 1921, and there is no fund to meet the obligation.
- (29) The repayment was due in May 1922 and there is no fund available for it.

Given that these default incidence notes were published based on available information as of September 1924, a full two or three years after these bonds were due to be repaid in full, the Beiyang government's ability and commitment to honour its loan obligations would have been regarded as at best uncertain over this period.

Considering prior and continuing repayment performance on its internal debt, besides its large consolidation bond issuances, it proved difficult for the government to continue accessing the internal debt market. To induce investor participation, the government was forced to issue debt at relatively high coupon rates, and further sell the bond offerings at large discount rates. The eight internal domestic bond issuances by the Beiyang government made prior to 1920 represented a total face value of three hundred thirty-three million *yuan*, and all except one were issued at a coupon of six per cent. After the financial crisis of 1921, the government only managed to bring sixty-one million *yuan* in new long-term debt to the market, all carrying a coupon of eight per cent. To place short-term issuances, which were secured with lower-quality subordinated collateral, the government, faced an inverted yield curve, and was forced to issue debt at interest rates as high as twenty-four per cent in the midst of the financial crisis. Even several years afterwards, the government's cost of financing with short-term notes remained high, with coupon rates around eighteen per cent.

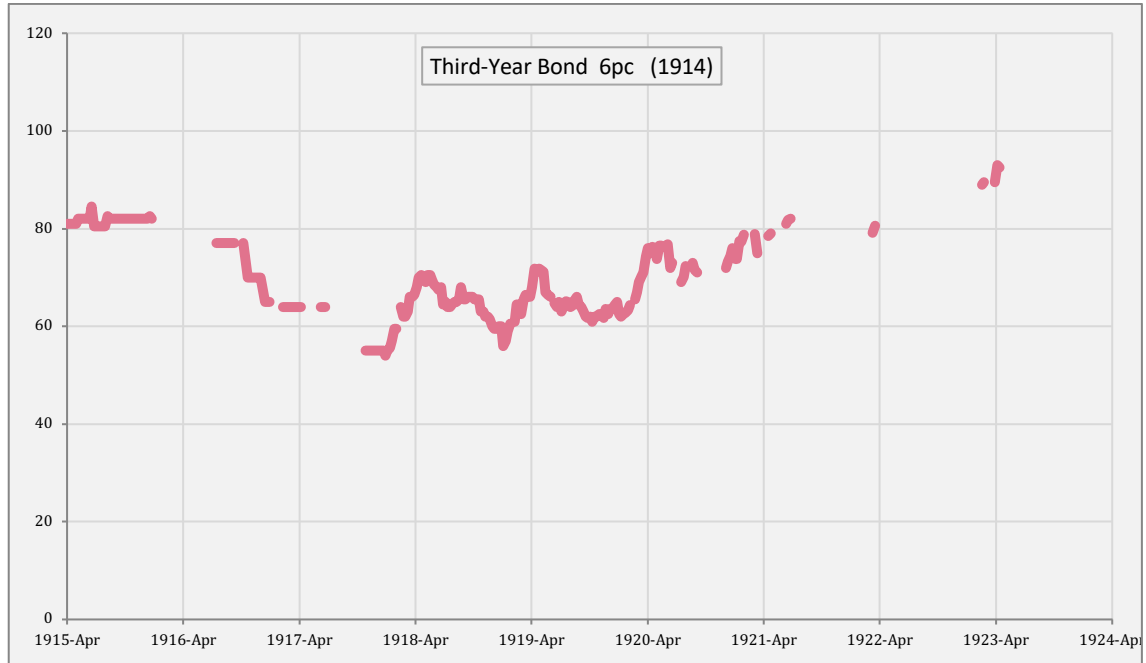
As the Beiyang state proved unable to limit local military warlords from capturing a majority of the revenues intended for the central government, while simultaneously incurring greater outlays to combat increasing Guomindang military offensives on the faltering regime, by late 1926, the Ministry of Finance faced another financial crisis. In response, the bond markets once again began heavily trading off government internal debt issuances. Trying to contain the crisis, the Shanghai banking industry, as primary holders of government debt, persuaded the Chinese Merchants Stock Exchange to suspend trading on several of the most widely-held bonds. As reported on page 381 of the 18 December 1926 issue of the *Chinese Economic Bulletin*, trading in "96 Consols" was suspended 18 through 20 November inclusive. "The suspension was agreed upon by all the bankers at a meeting held on November 18 and was intended (1) to keep the bonds from further decline, (2) to allow sufficient time to collect margins due, and (3) to prevent the weak tendency from spreading to other government bonds." The fall by nearly a quarter in value of the bonds, from \$62 to \$47, was cited as the impetus for the move. This move, however, did not prevent continued significant downward pressure to remain on this bond, and trading in the issue was suspended indefinitely.

Ultimately, we find investors continually hesitant to hold the majority of Beiyang central government internal debentures, with prices reflecting steep discounts from par. We can observe the overall trend in investor perceptions on the government internal bonds by consideration of the price performance of several of the Beiyang debt issuances. Many bonds indicated a general downward trend in prices, as investors grew increasingly concerned about the sustainability of the Beiyang regime.

Figure 11.2 for instance, provides an extended look at the price history of the Third-Year Bond, explored in detail for 1915 in Figure 11.1b. As defections by military warlords and financial crises mounted, prices fell further from the already discounted levels observed in 1915. Nonetheless, this bond was exceptional in that it experienced relatively few repayment disruptions, and was successfully repaid in 1924 (Jia 1930). Note from the figure that as time to maturity approached, we observe two phenomena. First, prices rose—as

previously discussed, as the maturity date approaches, default risk, all things equal, will fall, given there exists less time for default events to occur. Second, trading activity lessened, which was due to the unique nature of drawings bonds; the closer to final maturity date, the fewer bonds remain on the market.

Figure 11.2. Bond prices, Third-Year internal government bond, 1915–1924

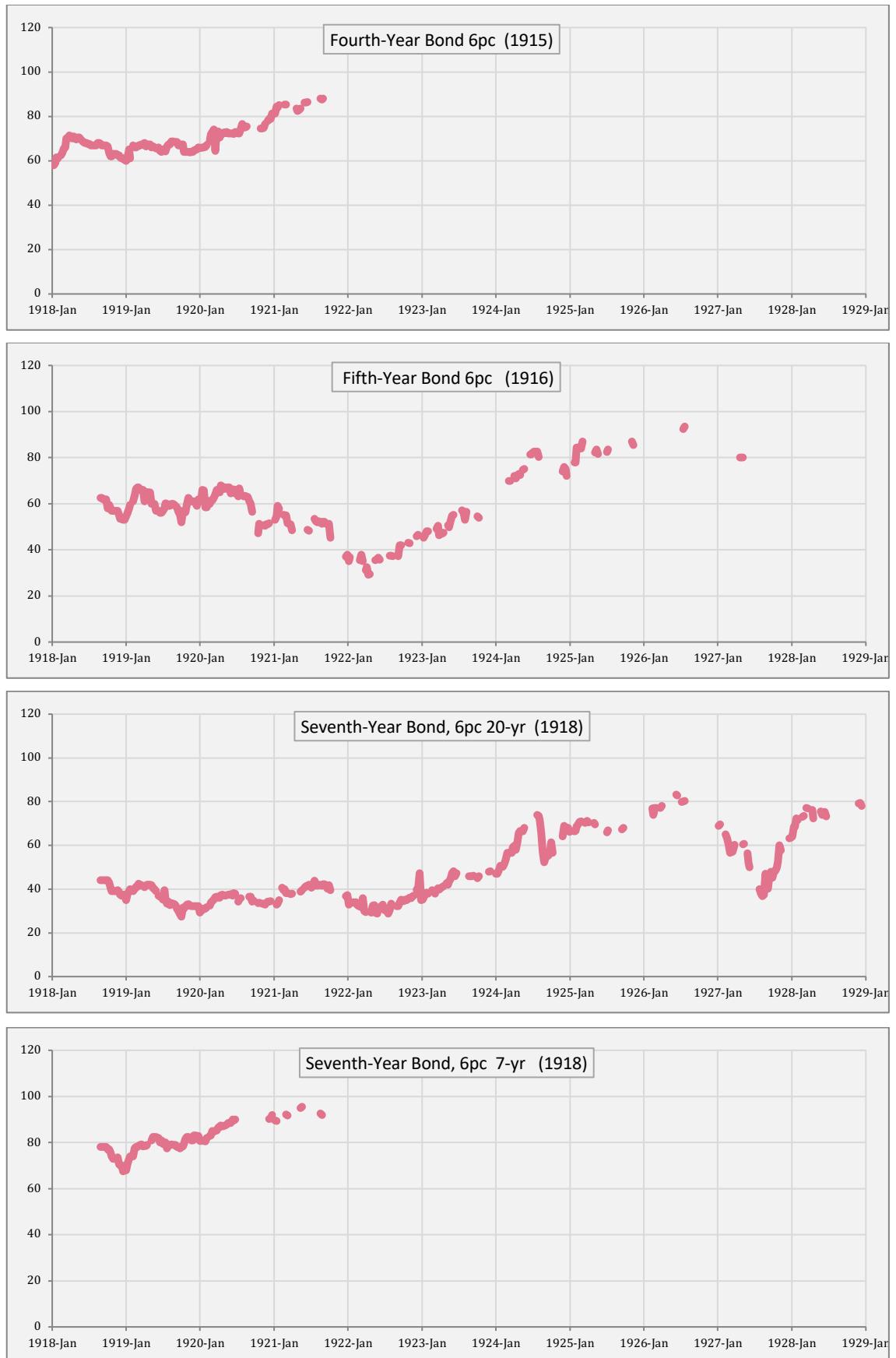


Sources: *Shunpao*, various issues, 1915-1920; *Bankers Weekly*, various issues, 1919-1924

Figure 11.3 presents the full price series for several other bonds issued by the Beiyang authorities. These price series highlight several aspects of investor perception in regard to the ability or will on the part of the government to honour its contract commitments. To begin with, we find that all of the bonds traded at discounts to their face value, in some cases, quite steep discounts of forty to even sixty per cent. Second, we observe the impact of time; for most of the series there is a definite upward trend as the repayment date approached; as discussed above, the unique drawing feature contained in the bonds' repayment structures helped to draw the price upwards at a relatively steep slope. That investors were not confident in the long-term commitment ability of the government is further underscored by comparing the pricing on the two Seventh-Year issuances, with the twenty-year bond requiring a much steeper risk premium than the seven-year. Note that as the Seventh-Year Bond of seven-year tenor bond was paid off early in a consolidation effort in late 1922 (Chia 1930), it shows a relatively short prices series.

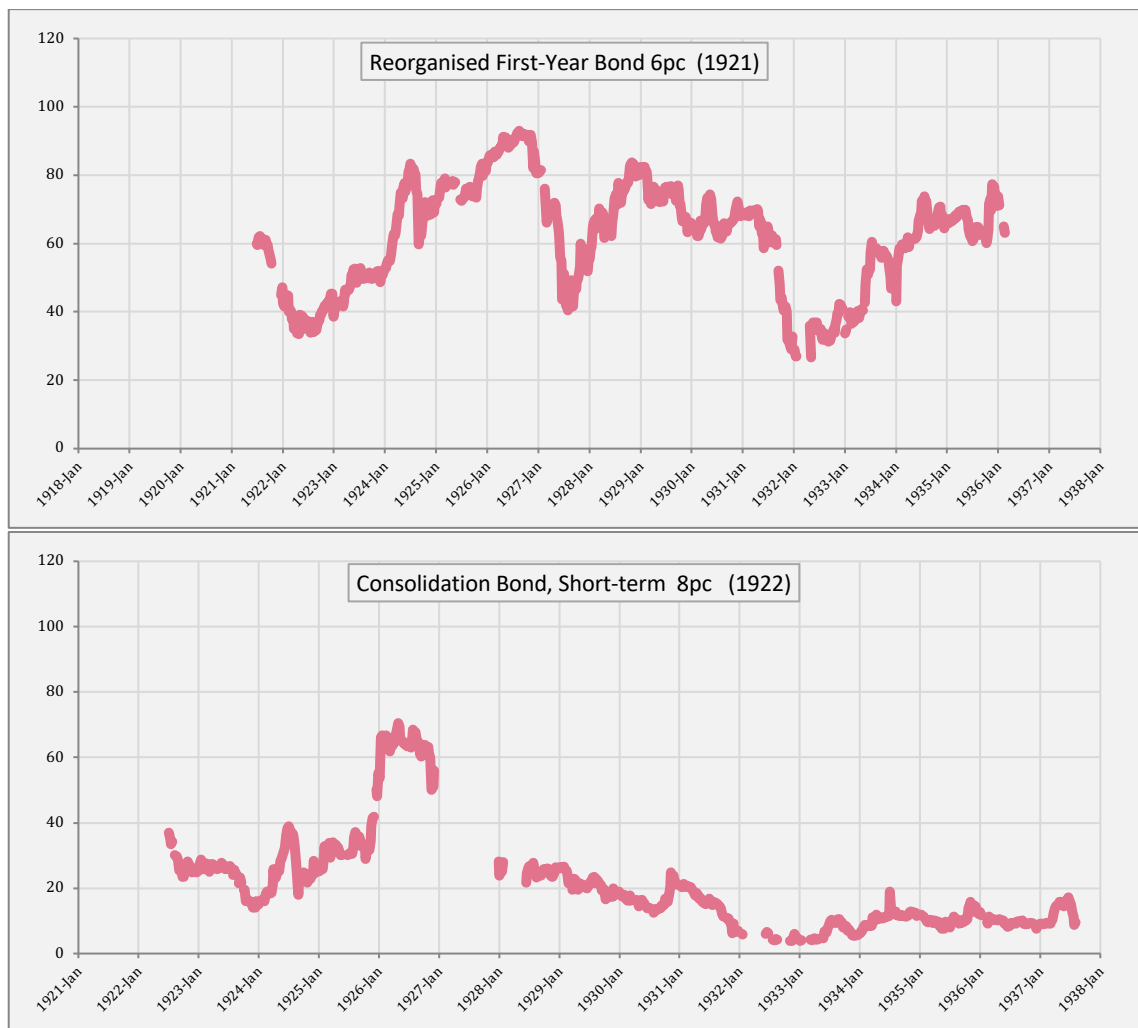
The price series of the two largest consolidated issuances, the 55 million *yuan* Reorganised First-Year and the 96 million *yuan* Consolidated Short-term Debt, and displayed in Figure 11.4 stretch out considerably further, given their extended tenor structure. That said, considerably different price behaviour is observed. Both reflect recovery after the crisis, and then a sharp fall with the overthrow of the Beiyang regime. However, while the incoming Guomindang government continued repayment on the Reorganised First year Bond, the Consolidated Short-term Debt Bond received less commitment from the new regime and as such no further payments were made up through 1937, reflected in the bond trading at more than ninety per cent discount. That it continued to trade as heavily as it did was a reflection both of a small but persistent hope that interest and principal repayments would be restarted, as well as its large issue amount and number of investors.

Figure 11.3. Bond prices, selected Beiyang government internal issuances, 1918–1928



Source: *Bankers Weekly*, various issues, 1918-1928

Figure 11.4. Bond prices, selected Beiyang government internal issuances, 1918–1937



Source: *Bankers Weekly*, various issues, 1918-1937

As the Beiyang government faced continuing deterioration of centralised power, the competing Guomindang government in Guangdong issued a series of three domestic internal bonds in 1926 in an effort to fund the Northern Expedition. Meanwhile, in 1927, the Wuhan-based branch of the Guomindang government conducted their own series of debt issuances. Qian (1955: 16-17), using archival data from each of these two separate government sources, estimates the total bond amounts issued by Wuhan and Guangdong governments to be not insignificant, approximating 42.5 million *yuan*.

Once the Nanjing branch of the Guomindang party assumed nominal control over most of China with the conclusion of the Northern Expedition in 1928, officials within the new government were faced with the decision whether to honour the outstanding bonds that had been issued by the Beiyang government. Backed by collateral controlled by foreign administration, China's foreign bond issuances had fared better in terms of repayment commitments; nonetheless, by the end of the Beiyang period, a considerable amount of foreign debt obligations were in arrears; in particular, the state had essentially defaulted on all borrowings not secured by the foreign-administered Salt Gabelle Tax Administration or the Chinese Maritime Service. The new government faced considerable pressure to continue paying on the external bonds issued to foreign markets; had the Guomindang forsaken such debts, it would have been difficult to gain access to overseas bond markets moving forward. Nonetheless, fiscal constraints meant repayment delays continued; by 1931, total

outstanding default amounts on Beiyang-era foreign-issued bonds totalled 240 million *yuan* (Maguire 1931: 70-71). Given the lack of foreign external pressure, internal bonds were theoretically more open to consideration of repudiation, but in the end, the Guomintang leadership chose to honour most outstanding Beiyang internal issuances. Looking to bring order to the rather uncoordinated outstanding internal bond issuances, new consolidated bonds were issued that replaced all previous internal debt issuances.

However, given that the Guomintang leadership proved unwilling to commit financial resources to honouring such overseas-issued bonds secured by domestic general or specified tax revenues—such as the Title-Deeds Tax, Alcohol Tax, or domestically-administered customs revenues—as opposed to foreign-administered revenue streams, foreign borrowers were reticent to offer new financing to the Guomintang central state unless secured by either Salt Gabelle Tax Administration or the Chinese Customs Maritime Service revenues. As these revenue streams had already been designated as collateral by a limited number of bonds the Chinese government had already previously issued on foreign markets, additional funding by foreign capital markets for the Guomintang government effectively dried up. As such, the central government was forced to depend heavily upon the domestic capital markets to supply additional debt financing.

From 1927 to 1931, the Guomintang Government, using tax receipts as guarantees, issued about 1.5 billion *yuan* of public debt, with interest rates varying from 8 to 16 per cent per annum. The debt service on such debt levels was fairly high—by 1931, the budget required to service the public debts amounted to approximately 300 million *yuan* annually. Thus from early on, the new Guomintang regime leadership was faced with serious budgetary issues. As shown in Table 11.1, the government ran substantial deficits during the period. In the last column, we calculate expenditures as a per cent of revenues; on average, revenues exceeded expenditures by more than a quarter over the period, at 126 per cent. With continual increases in military outlays, the need for deficit financing via greater bond issuance remained high throughout the prewar era.

Table 11.1. Guomintang Government Expenditures and Revenues, 1928-1937 (*yuan*)

Year	Expenditures	Revenues	Deficit	Per cent
1928-1929	433,000,000	334,000,000	(99,000,000)	130%
1929-1930	585,000,000	483,000,000	(102,000,000)	121%
1930-1931	774,000,000	587,000,000	(217,000,000)	132%
1931-1932	749,000,000	619,000,000	(130,000,000)	121%
1932-1933	705,000,000	614,000,000	(91,000,000)	115%
1933-1934	853,000,000	706,000,000	(147,000,000)	121%
1934-1935	976,000,000	780,000,000	(196,000,000)	125%
1935-1936	1,077,000,000	808,000,000	(269,000,000)	133%
1936-1937	1,180,000,000	889,000,000	(291,000,000)	133%

Sources: Statistical Abstract (1935), China Quarterly (1939)

Nonetheless, as the turmoil brought about by the fall of the Beiyang government receded, the domestic bond market began to recover, with the bond market during this period relatively active. Yet the volatility that characterised the internal bond market during the Beiyang period continued for much of the Guomintang era. The market responded sharply to the 1930 warlord rebellion, and next to Japan's annexation of Manchuria the following year. The relatively poor perceived quality of the internal national bond issuances was indicated by Secretary Cai of the Shanghai Department of Finance in October 1932, who noted that in the preceding year, internal bonds issued by the government could only be placed on the market for seventy per cent face value (*Shunpao* 27 October 1932).

A cause of greater turmoil to the markets was the Japanese military offensive that began with the Shanghai Incident in January 1932, and that forced the domestic government bond markets to close for three months from February through April. Liquidity dried up and prices of government bonds fell sharply (*NCH, Shunpao*, various issues, March and April 1932). This event underscores the significant difference in the way in which markets reacted to Chinese national government internal and external debt issuances.

Internal bonds were primarily backed by general funding or junior collaterals; external bonds, conversely, were primarily backed by senior claims to British-controlled and collected Maritimes Customs receipts or foreign-controlled railway fees. Contemporaneous reporting of the impact of the military incursion underscores the differential perceptions of China's external and internal debt. While the weekly Share Market Report in the 15 March 1932 issue of the *North China Herald* noted the Chinese Domestic Bonds Exchange remained closed, external Chinese foreign bonds continued to trade on the London market, with prices remaining firm. Thus, even as the market for internal debt closed down, foreign investors appeared relatively nonplussed by this incidence of Japanese military assault, and did not appreciably discount China's external bonds in response.

The Guomindang government's difficulty to turn over its debt and place new bonds led to an impending government default. In response, the Ministry of Finance announced a public debt restructuring. In February 1932, with the exception of the 17-Year Long-Term National Loan, interest rates on all outstanding public loans were lowered to six per cent, and the tenor of most outstanding loans were extended. Yu (1934) posits that since Finance Ministry officials understood the importance of maintaining access to credit markets given the government's dependence on bond financing, this created sufficient pressure to avoid a complete default. The Ministry worked hard to present the restructuring as the result of a "voluntary" agreement with the Bondholders' Association (which mostly consisted of Shanghai banks), to forego part of their interest in light of the "national crisis" (國難).

As Qian (1955: 214) reports, the Declaration of Domestic Bondholders (持票人會對於內債之宣言) reads: "Although the provisions of public debts were approved by Legislative Yuan, and the face of the bonds endorsed by the Minister of Finance, and despite the fact that government financial difficulty should in no circumstance be used as a reason to modify the terms of issued debt, the current national crisis has caused a stagnation in business and a sharp drop in government tax revenue. Even if the government were to wish to temporarily honour its debt obligations, the reality may not allow it. Therefore, upon mutual consultation, a restructuring is agreed" (author's translation).

The statement also requested the government to put in stricter controls on repayment funds, and demanded greater fiscal transparency and better budget planning. Another clause emphasised that in exchange for the "sacrifice" made by the bondholders, the government should not make any further changes to the terms of issued bonds, and to abstain from attempting to place more government debt on the merchant communities to support its civil and external wars and political expenditures. Quan (1955: 215) further cites a verbal agreement between the Bondholders' Association and the government of a moratorium on public debt issuance for a period of four years.

Liu (2015) argues that such efforts by business groups to push back against acts of government expropriation helped pressure officials to better respect the property rights of bondholders, and to improve management of the funding for government bonds. While Liu

is likely correct that these efforts on the part of the Bondholder's Association and other business groups such as the Shanghai Bankers Association might have influenced government decision makers to limit actions such as employing intimidation tactics to place bonds, or allowing bond payment defaults, private economic actors at this moment in time nonetheless found themselves in an increasingly weakened position in regard to the coercive power of the Guomindang state apparatus. For instance, the 1927 attempted arrest and imprisonment of the country's wealthiest businessman, Shanghai capitalist Rong Zongjing—for initially refusing to purchase, on behalf of the Chinese Cotton Mill Owners, the full amount of 500,000 *yuan* worth of government bonds General Jiang Jieshi had "requested" the Association purchase—served as a clear signal to the business community that state authority would be exercised at the expense of private interests (Cochran 2000: 138-140). Thus, calls on the government to "promise" not to make further changes to bond terms, and not to force merchant groups to buy government securities, were likely to have been perceived as ultimately hollow. As the statement itself noted, the issued bonds already represented a promise by the government, one that was being broken; the value of additional government promises was to be viewed with considerable scepticism by investors.

Of further note is that the language of the Declaration by the Bondholders' Association underscores the argument advanced in previous chapters in regard to the ability of the state to successfully credibly commit to provide strong private property rights protections when the state is facing existential threats. Candidly admitting that "Even if the government were to wish to temporarily honour its debt obligations, the reality may not allow it" suggests a clear recognition that forward-looking investors and economic agents can foresee that even when the intentions of government officials to honour promises to protect private property and contract rights are viewed as sincere, it remains understood that under distressed circumstances (such as when the state faces an existential threat), the state will logically undertake necessary actions to ensure its survival, including those that expropriate private property in express violation of previous commitments. Hence, as emphasised throughout Part II, given the continual series of existential threats experienced by successive Chinese national governments, it is unsurprising were rational economic doubtful of the state's attempts to credibly commit to protect private property and contract rights.

After Shanghai's domestic bond market reopened in May 1932, trading in domestic national internal bonds recommenced at relatively robust levels, spurred on perhaps by the fact that throughout the end of the year, the Guomindang government kept its verbal commitment to the Bondholders' Association on a moratorium of new debt issuances. By the middle of 1933, however, public debt issuance resumed. From 1933 to 1935, an additional 578 million *yuan* in domestic internal bonds were issued. Nonetheless, the markets continued to absorb the debt issuances, and responded favourably to the government's currency reform enacted in 1935.

Bond prices began to rise and trading volumes were robust. Even at the time, however, there was concern that rising prices were less to do about confidence in the ability of the government to meet its debt obligations, and more about a lack of viable and profitable investment opportunities. As the industrial sector stagnated and economic growth in interior China lagged, funds from the interior of the country also flowed into Shanghai seeking attractive investment opportunities. Writing at the time, Yu (1934: 80-82) makes note of a substantial rise in idle capital, with the amount of cash held in Shanghai banks increasing from \$312 million to \$594 million from the end of 1931 to 1934. By 1934, daily trading volume often exceeded thirty million *yuan* on active days, and new volume records were continually achieved.

Yet by 1936, the bond repayment situation was once again in crisis. In response, the Guomintang government instituted another debt substitution program. As Paauw (1952: 6) notes, "Intensive domestic borrowing during the Nanking period caused a complete collapse of the domestic bond market in 1932 and again in 1936. Service charges on domestic debt had become so costly that the government was unable to cover total interest and amortization payments... At the times of both crises in the government bond market, the situation was "saved" by reorganization of the government's interest and amortization charges. These reductions in the cost of loan service amounted to partial repudiations of the government's financial obligations." Approximately 1.4 billion *yuan* of new bonds were issued to retire old bonds, along with an additional 622 million *yuan* of new public debt. This massive debt reorganisation resulted in the consolidation of many bonds into five main new issuances of consolidated bonds, named Twenty-Fifth Year Consolidation Bonds, labelled *A* through *E* (甲 through 戊).

Market price movements over this period reflects market perceptions regarding the Guomintang government's commitment mechanisms. Paauw (1952: 6) notes how investor perceptions of the existential threat posed by the Japanese Imperial Army shaped market responses, noting, "The Japanese attack on Chapei... undermined confidence in the financial stability of the government." As previously observed in Figure 11.4, bond prices fell sharply with the Japanese military incursion into Shanghai at the start of 1932.

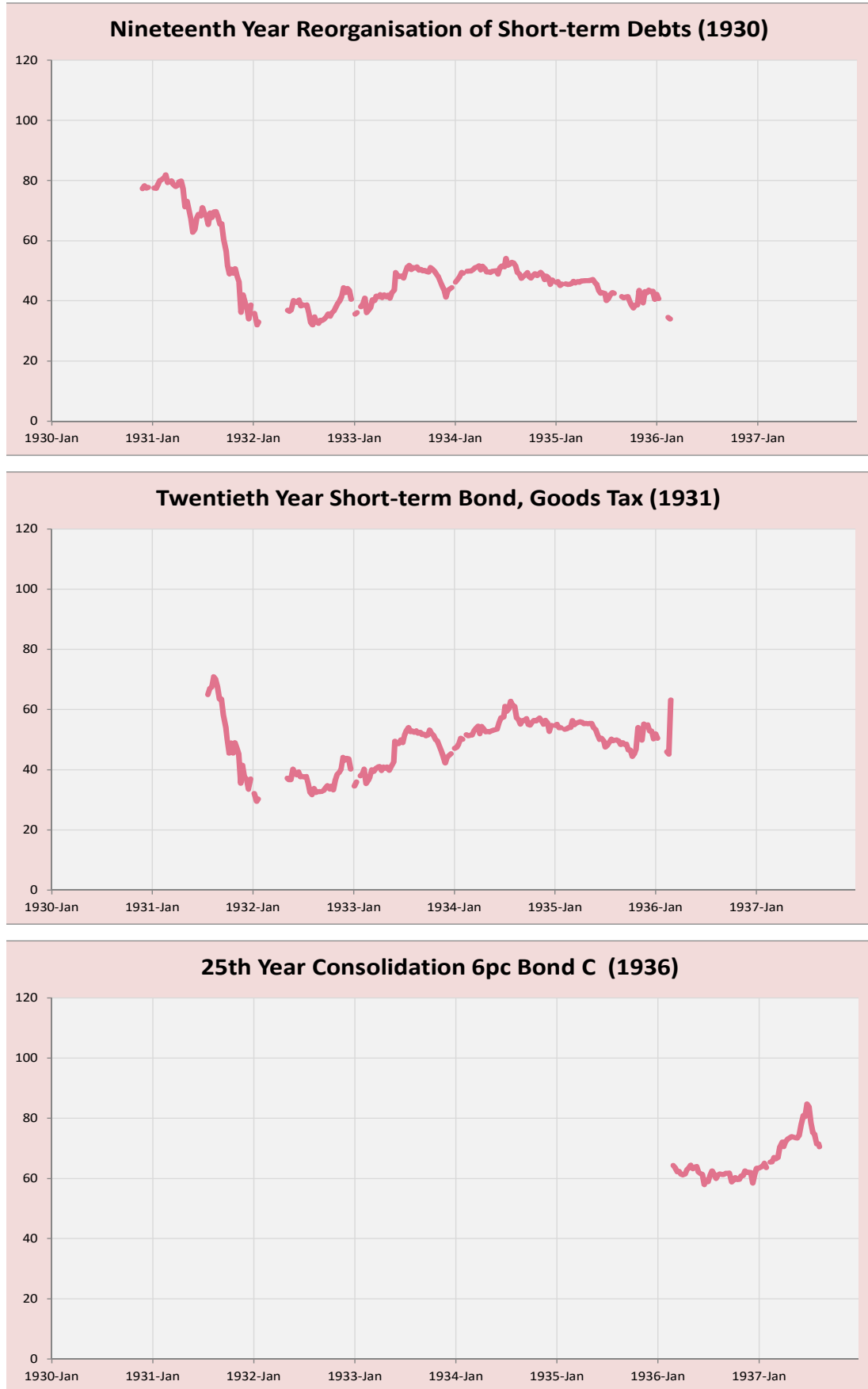
The price histories of two of the bonds presented in Figure 11.5, the Nineteenth Year Reorganisation and Twentieth Year bonds, both of which represented consolidations of short-term outstanding bonds and notes, indicate the initial impact and recovery that occurred in the market in the aftermath of the 1932 Japanese military actions. After the fall in prices in early 1932, there was slight but tepid recovery, with neither bond priced above 60 *yuan*, except very briefly on the Twentieth Year.

Such poor price performance likely occurred due to the fact that no drawings were held for principal payments over the post-1932 period (the terms of the original bond repayments had been adjusted after the 1932 reorganisations of these two bonds, each of which represented previous reorganisation efforts), and only semi-annual coupon payments were being made, with those occasionally delayed. Both of these bonds were swapped out for the new Twenty-Fifth Year Consolidation Bond *C* issuance in 1936. As observed, the market responded rather favourably to the government's comprehensive 1936 Consolidation effort. (Given prices of each of the Twenty-Fifth Year Consolidation Bonds *A* through *E* all followed nearly identical price trajectories, only *C* is displayed).

Interestingly, this positive response to the government's bond consolidation efforts came at a time of increasing budget deficits, as previously displayed in Table 11.1. Apparently, the bond market had gained enough confidence in the restructuring efforts to increase demand for the five consolidated issuances to nearly ninety per cent par, before dipping right prior to the outbreak of the Second Sino-Japanese War in August 1937.

That the government was able to continue to place significant bond issues in the face of rather tumultuous political turmoil in general might be viewed as instructive that the public had some faith in the government's ability and willingness to uphold its commitments. Some of the demand for these instruments could be seen as a response to a lack of other viable private domestic investments. In an economic environment where private assets could be expropriated by the government or destroyed due to military conflicts, diversifying investments to include those of the government engaging in much of the expropriation might well have been viewed as a prudent investment strategy. The steep discounts most of the bonds were priced at, however, display the limits of investor faith.

Figure 11.5. Prices of selected Guomintang-era bond issuances, 1930 – 1937



Sources: *Bankers Weekly*, various issues, 1930-1937

A history of prior defaults, combined with a lack of efficiency in tax administration, led investors to perceive domestic bonds issuances as representing high repayment risk. Such risks were repeatedly realised well into the Guomindang period, as orderly repayment of domestic bonds continued to face issues, disrupting the bond markets. Further, the continued absence of credible commitment mechanisms such as representative governance structures, or the foreign administration of much of the collateral on its domestic bond offerings, also contributed to investor perceptions that there existed few devices binding state actors to honour the government debt obligations. As discussed in Chapter Two, unstable political environments can create a self-replicating perception trap that limits the state's ability to credibly commit to honour previous promises to repay. The presence of existential threats, whether from internal rival warlords or external armies, created a perception amongst investors of low probability that state actors could honour prior commitments to repay, no matter how costly were commitment devices devised; as such, foreseeing this circumstance, state actors had little incentive to undertake attempts at credible commitment.

In general, the combination of this myriad of factors had two main impacts on the nature of central government borrowing from internal domestic investors and the workings of the internal bond markets—a high cost of capital on government borrowing, and a perverse incentive structure that contributed to state actors finding it to expedient engage in borrowing practises that continually led to violations of investors' private property rights.

Domestic Bond Issuing— High Cost of Capital

The first main impact was that the government faced a high cost of capital. In those instances when the government was forced to turn to direct loans from the banking sector for its financing needs, Ting (1935: 596) finds annual effective interest rates on such loans averaged more than twenty-five per cent during the early Guomindang period, and frequently reached as high as forty per cent, although Jiang (2011) finds rates fell closer to ten per cent from 1934 to the outbreak of war in 1937. More generally, the government sought to finance its deficit through bond issuances, especially bonds designed for the domestic market. However, in order to induce investors to purchase its bond offerings, the central state was forced to issue domestic debentures with relatively high coupon rates. In addition, effective interest rates were even higher than nominal rates, given that those bonds the government could place were mostly done at steep haircuts. When bonds are sold to an investor at a discount—that is, for less than the par value of the security—the expected yield the investor receives increases. For instance, assuming a non-default scenario, a one-year note priced at 100 with a single coupon of ten per cent will return the investor 110, a ten per cent return; if the investor buys the same note at a discount of 90, at maturity she will still receive 110, and hence an effective return of twenty per cent.

As Paauw (1952: 6) observes, "In the periods after these reorganizations [of 1932 and 1936], the government found great difficulty in disposing of its bonds. It typically resorted to offering its bonds to banks at considerably depreciated prices. This policy made it necessary for the government to pay charges on such borrowing at the face value of the bonds, while it received only a fraction of this value as proceeds." This necessitated practise of discounting the placement price of its bonds below par therefore contributed to further increasing the realised cost of capital the state faced when undertaking borrowing in the domestic bond markets. The impact of such discounts was not immaterial. As Paauw suggests, the discounts could be considerable. Remarks made in October 1932 by Shanghai Finance Secretary Cai indicated that internal bonds issued by the central government in 1931 could only be placed at seventy per cent their face value (*Shun Pao* 27 October 1932).

Adapting data provided in Young (1971: 433-435) allows us to calculate the scale of discounts the government needed to provide investors to induce voluntarily purchases. Young has data on annual income actually received by the government treasury from borrowing over the eight-year period 1929 through 1936. Combining these data with that compiled from archival fiscal records by Qian (1955) and Yang (1985) of annual amounts of bond issuances, we can compare differentials between total annual amounts of issued bonds at face value, with total annual amounts actually received from borrowing. While data from Young on income from borrowing includes not solely that of domestic bonds but also bank loans and overdrafts[†], these additional categories comprised relatively small amounts of total borrowings; although as Paauw (1952: 10) notes, direct bank financing rose considerably after 1932. This implies our calculations represent a lower bound on the degree of discounts at which the central government offered initial placements of its bonds.

Our results show from 1929 through 1936, total income received by the central government from borrowing was approximately 1,137 million *yuan*, while the nominal value of the domestic bonds issued totalled 2,101 million *yuan*. Had the government received full face value for its bond issuances, its borrowing income would have been at least 2,101 million (ignoring any additional amounts received from bank loans or overdrafts). The 1,137 million actually received represents only fifty-four per cent of issued nominal amounts. On average, therefore, the total difference between potential and received income on national domestic bond sales was in the range of 964 million *yuan*, suggesting that in order for the government to place its bonds it was forced to provide abnormally large price haircuts averaging forty-five per cent of face values. While it is not unusual that received income be lower than the issuance's nominal amount due to fees paid to underwriters who help place the bond offerings, such fees rarely exceed ten per cent. In this instance, the majority of the observed differences between the total received and nominal values was due to price discounts provided to buyers of the bonds necessary to encourage investor interest in these bond offerings. The size of these discounts from the nominal bond values is all the more striking given these calculations represent the lower bound of discounts.

Evidence later provided in regard to the prices of government debt as sold on Shanghai's secondary capital markets is indicative of the complex and nuanced relationship that existed between the banking sector and the government, especially during the Nanjing government period. We find, in general, that secondary market prices of government debt frequently were in the 60 to 80 *yuan* range; as nearly all bonds were issued at par value one hundred, such prices indicate about a ten to fifteen per cent margin between prices banks paid the government for their bonds and that which the instruments could be sold on the market. Therefore, while it is certainly true that the government was forced to heavily discount the offering prices of its bond offerings (or, alternatively, to have significantly increased bond coupon rates), as reflective of the high repayment risk investment in its bonds brought, the initial offering prices it placed its bonds at with the banks were significantly lower than the market price at which such instruments traded. Thus, as early evidence from Xu (1936) denotes, even with the high rates of default events that characterised internal government bond issuances, the banking sector in general was able to earn enormous profits from their role as underwriters of domestic government bonds.

[†] The raw data supplied by Young also include the approximately 190 million *yuan* (50 million U.S. dollars) China received by way of the 1933 Cotton and Wheat Loan from the United States, but we subtract this amount from the total borrowing amount received.

Evidence later provided in regard to the prices of government debt as sold on Shanghai's secondary capital markets is indicative of the complex and nuanced relationship that existed between the banking sector and the government, especially during the Nanjing government period. We find, in general, that secondary market prices of government debt frequently were in the 60 to 80 *yuan* range; as nearly all bonds were issued at par value one hundred, such prices indicate about a ten to fifteen per cent margin between prices banks paid the government for their bonds and that which the instruments could be sold on the market. Therefore, while it is certainly true that the government was forced to heavily discount the offering prices of its bond offerings (or, alternatively, to have significantly increased bond coupon rates), as reflective of the high repayment risk investment in its bonds brought, the initial offering prices it placed its bonds at with the banks were significantly lower than the market price at which such instruments traded. Thus, as early evidence from Xu (1936) denotes, even with the high rates of default events that characterised internal government bond issuances, the banking sector in general was able to earn enormous profits from their role as underwriters of domestic government bonds.

Given the control the government exerted over the banking system by way of regulatory decrees and government officials within bank management, and given the systemic expropriative behaviour observed in government actions throughout many other avenues of state-commerce relations, on the surface it appears puzzling why government actors agreed to terms so favourable to the banking industry. To begin with, while banks could earn good returns on the bonds they sold, banks were required to hold large quantities of government bonds as reserves. Thus, when such bonds fell into default, banks were forced to hold non-performing assets on their balance sheets, affecting their viability. Second, while true that the state had access to regulatory, legal and even police power over the banking industry, particularly during the Guomindang period, by exercising their collective power, the banking industry could occasionally successfully bargain with state actors to attempt to prevent the implementation of onerous violations of private property rights. For instance, in 1932 after the Ministry of Finance initially signalled it intended to default *en masse* on the majority of central government internal bonds, intense lobbying on the part of the Shanghai Bankers Association brought about changes in final policy implementation; instead, interest rates on all outstanding public debt were lowered to six per cent, while bonds' tenors were extended Yu (1934). Yet this partial repudiation, while still negatively affecting the banking industry, was a considerably more favourable outcome than had would have been the proposed complete default on all existing internal debt obligations.

Third, a public choice viewpoint of the state-banking industry relationship highlights attention to the fact that state actors personally benefitted from assisting the banking sector. The high levels of profitability that banks enjoyed from the issuance of government debt helped keep the banking industry invested in the continuance of the system, which was therefore beneficial to government actors insofar as it decreased conflict with the sector while facilitating the continual flow of funds necessary to implement state-sponsored military and development plans. Further, state actors also frequently also financially benefitted from policies favourable to bank profitability, given the web of direct linkages existing between bank ownership and management that included government and senior Guomindang Party officials. This is perhaps most strikingly underscored by the interests Song Ziwen and Kong Xiangxi, both brothers-in-law of Jiang Jieshi, had in Shanghai's banking sector at various times throughout the 1930s; Song and his brother, for instance, were both appointed directors of the Bank of China and Bank of Communications in 1935 (Peng 2007). Paauw (1952: 10) provides a similar critique of the effect that ties between the state and the banks played on policy decisions by observing that "members of the Ministry of Finance who held large banking interests were willing to pay high interest rates [on loans to finance purchase of government bonds] for their private profit."

Domestic Bond Issuing— Degradation of Investor Property Rights

The second main impact is that these factors helped induce state actors to further degrade respect for private property rights in order to raise funds. As indicated in Figure 11.6a, the Beiyang government was limited in the quantity of bonds the market accepted, as even with high interest rates and price discounts, the level of expected (and realised) default risk limited the attractiveness of such bonds. Adjusted for inflation, Beiyang government annual domestic issuances averaged 61 million *yuan*. With the assumption of power by the Guomindang military, however, state actors began resorting to coercive strategies to ensure targeted revenue goals were met by way of income from sales of internal national bond issuances, thereby heavily impacting the demand for domestic internal government debt.

First, the ability for the Guomindang government to continue to place its bond issuances was a partly function of coercive regulations put in place by the Ministry of Finance, compelling banks' reserve requirement balances to be composed of primarily of government bonds. In 1934, the Savings Banking Regulations (儲蓄法) were issued, requiring that one quarter of banks' reserve requirements be held in the form of central government bonds; other regulations required that additional reserves of government bond holdings were necessary for banks to be authorised to issue banknotes (Yu 1934: 82). Thus, the Ministry implemented regulations creating inherent demand for its own bond issuances.

Second, to help enforce the implementation of such regulations, the state gained authority over banking and other major industries by using state power to obtain controlling interest in joint stock companies—effectively nationalising many of them via either outright expropriation or by forcing firms to dilute existing share bases and issue shares to the government—and by placing state officials in controlling positions within private enterprises. For instance, the Ministry of Finance issued regulations revising the charters of the Bank of China and the Bank of Communications to allow the state to increase its ownership stakes—and hence control—of the two banks, which by 1935 reached a controlling fifty and sixty per cent, respectively (Yuan 2005: 124). With government officials effectively dictating bank purchasing policies, it is not surprising that banks continued to serve as the primary customer for new government debt issuances.

Another more direct coercive strategy employed by the state to increase bond sales was by mandating private actors such as leading companies and business associations to purchase large amounts of government bonds. For instance, as reported in May 1927 in the *North China Herald*, government officials had designated mandatory bond purchases totalling five million *yuan* to be divided amongst dozens of domestic firms, including Nanyang Tobacco, Sincere Company, Commercial Press, the Wing On and Sun Sun department stores, as well as the Shanghai Bankers Association, which received the largest allocation of over one million and a half *yuan* (NCH 21 May 1927: 320). Business associations were often used to ensure compliance. In 1927 a government-appointed committee comprised of Guomindang Party members took control of the Shanghai Chinese Chamber of Commerce in order to facilitate their commitment to these policies (Coble 1979: 9).

To ensure compliance with these mandatory bond purchasing requests, state police power was used to threaten private individuals with high personal costs for defiance. Those business leaders who resisted demands to purchase specified large quantities of government bonds were ordered arrested. Fu Zongyao (傅宗耀), for instance, a prominent businessman who in April 1927 was serving as Chairman of the Shanghai Chinese Chamber of Commerce and director of the Commercial Bank of China, was ordered arrested after resisting a command to buy ten million *yuan* worth of government bonds (Coble 1979: 8). Song Hanzhang (宋漢章), manager of the Bank of China Shanghai branch, initially resisted the Party's request of one million *yuan* in bond purchases; in response, on the orders of Jiang Jieshi, Song was charged with "obstruction of revolution" and "helping the enemy force," after which he ultimately complied (Ji 2003: 175). Other similar arrests also ended with the

release of the arrested individuals after sizeable donations were made to "support the Nationalist cause", such as when the son of wealthy businessman Si Baoshen was freed once a donation of 200,000 *yuan* had been offered (*NCDN* 28 May 1927). Even Rong Zongjing, the cotton tycoon recognised as perhaps China's wealthiest businessman, was ordered arrested after he initially rejected the state's request for his companies to purchase half a million worth of government bonds, to which he eventually acquiesced (Cochran 2000:138-140). The authoritarian Guomintang military regime's targeting of some of Shanghai's most well-known capitalists served two purposes. Not only did the strategy effectively extort those with the largest stores of capital so as to funnel it into state coffers, but secondly it was clear government leadership sought to demonstrate that the power of the state over private interests was absolute. Economic actors and investors acted accordingly—when given the option to conduct business or hold contracts, including financial contracts, in a domestic institutional environment that so little regarded private property rights and contracts, versus doing the same in a stronger property and contract rights environment, they consistently chose the latter over the former.

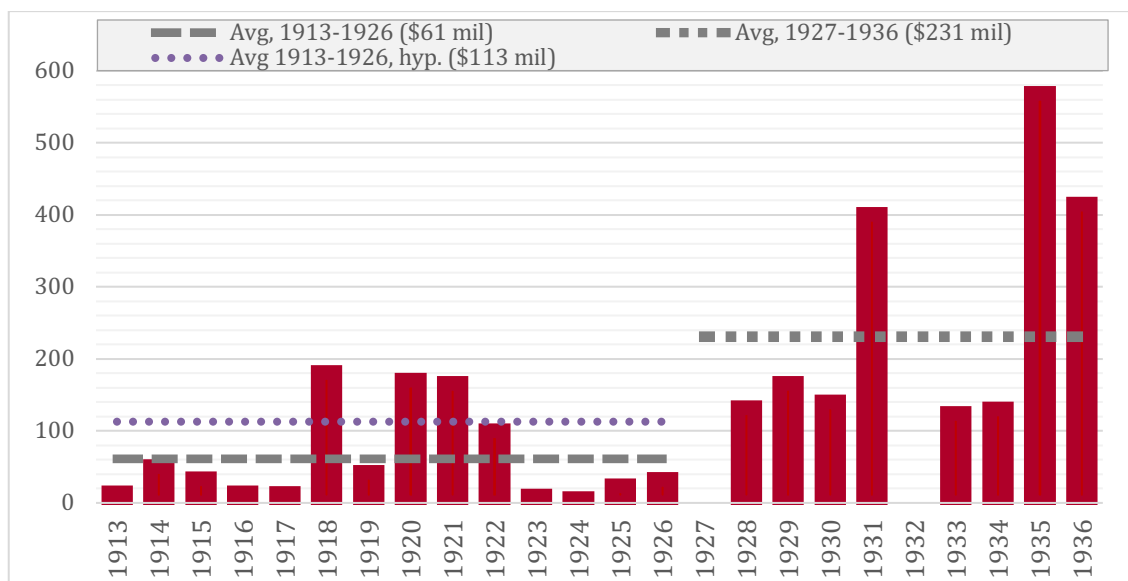
As negative as such policies were in terms of violating private property rights, these coercive strategies proved effective, at least so far as to increasing central government domestic bond placements. As indicated in Figure 11.6a, average bond issuances by the Guomintang Nanjing government during the pre-war period averaged an inflation-adjusted 231 million *yuan*, nearly four times as large as under the Beiyang era.

Technically, comparing the 61 million in domestic national bonds issued during the Beiyang period with the 231 million issued during the pre-war Guomintang could be considered misleading, given that the size of annual average deficits also rose. To attempt to account for this, using the same data sources used to calculate Figure 11.6a, we calculate the average budget deficit in the Beiyang years to have been 139 million *yuan*, while inflation-adjusted deficits during the pre-war Guomintang years averaged 282 million, or about 1.8 times as large. Under an overly-simplistic counter-factual that assumes deficits equally as large under the Beiyang as under the Guomintang pre-war era, we might hypothesise that bond issuances would have averaged 113 million *yuan*, or 1.8 times 61 million. Even under such assumptions, this hypothesised 113 million *yuan* in annual bond issuances still would have been less than half the actual annual average of 257 million issued by the pre-war Guomintang through 1937.

More fundamentally, this hypothetical 113 million incorrectly presupposes the size of the deficits run by the Beiyang governments to have been independent of the amount of debt financing the government was able to obtain; instead, it is more accurate to assume that part of the reason the Beiyang governments ran lower budget deficits is because they were limited by the amount of debt financing they could obtain. By employing coercive tactics, the Guomintang regime endogenously increased the amount of its bond issuances, and therefore its ability to run larger budget deficits.

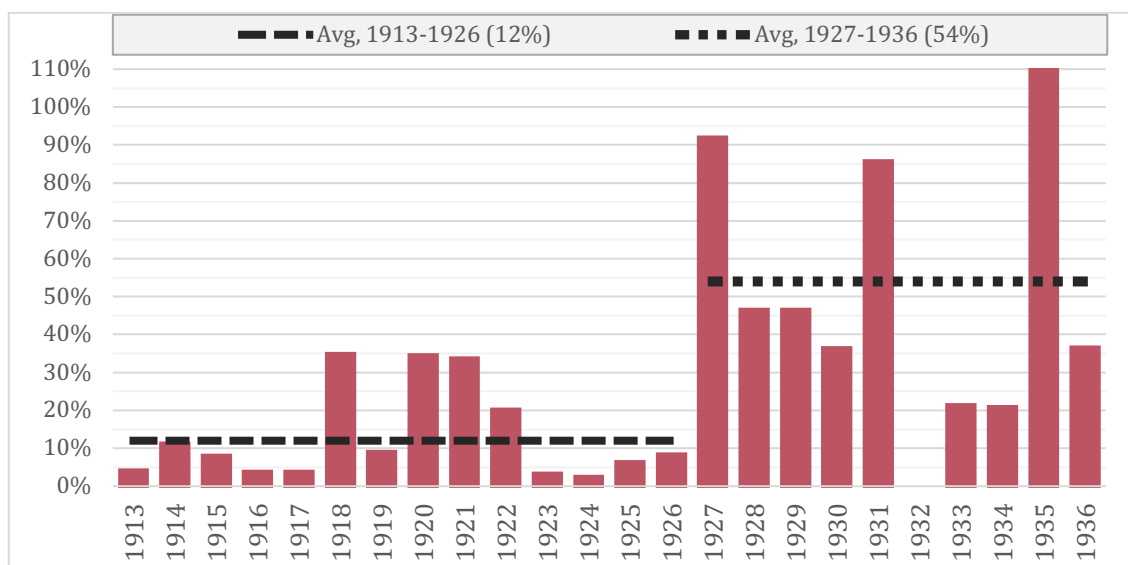
Coercive Guomintang policies designed to increase bond issuances led to a complex set of interacting impacts on the bond markets and investor responses, in particular regulations requiring banks to hold government bonds. To begin with, as shown in Figure 11.6b, the government was able to increase the size of bond issuances as measured as a percentage of overall incoming revenues. As indicated, the value of bond issuances averaged about twelve per cent of government revenues during the Beiyang period, but increased substantially to average over fifty percent during the pre-war Guomintang period. While this likely indicated a slight improvement in perceptions on the part of investors of the state's likelihood to repay, the reduction in the degree of civil strife experienced under parts of the Guomintang period itself was slight. As such, we argue the difference in the ability of the two governments in placing their bonds is more directly related to each government's respective ability to coerce private actors into holding such bonds.

Figure 11.6a. Value of Issued Domestic National Bonds, millions of *yuan*, 1913–1937



Sources: Bond values calculated from Qian (1955) and Yang (1985); inflation adjustments based on price index constructed from He (1927) and Shanghai Economic Research Institute (1958).

Figure 11.6b. Issued Domestic National Bonds as Per Cent of Total Revenue, 1913–1937



Sources: Bond values calculated from Qian (1955) and Yang (1985)

Second, whether organically derived or forced, the impact of the Guomindang policies increased the demand for their bonds. As the demand for bonds rose, so too did pressure on bond prices to rise, and hence yields to fall. Theoretically, this works to reduce the government's cost of capital. At the same time, however, the lower yields result in investors receiving lower returns on the purchase of such bonds. Given perceived default risks, lower yields could trigger a reduction in the natural level of bonds demanded, putting downward pressure on prices. Depending on the size of the willing investor class vis-a-vis the coerced holders of domestic bonds, the effects on prices, and hence yields, *a priori* can be indeterminate. The observed fall in yields, and increase in the amount of bonds issued, suggests the impact of the government's coercive placement policies that drove much of the increase in demand phenomenon.

Data from Qian (1955: 24) indicates support for our contention that the observed increase national domestic government bond issuances was significantly driven not by market forces, but rather by coercive government mandates and policies. Qian finds approximately half of all outstanding public debt was held by just twenty-seven domestic banks in Shanghai. Since such bonds were held as reserves for regulatory purposes, a substantial supply of outstanding government bonds did not trade on the open market. Thus, while individual investor behaviour continued to shape the movement of market prices, much of the absolute price levels were impacted by regulatory changes enforced by Guomintang monetary authorities. Our subsequent analysis focuses on these market prices as the more salient of factors in terms of evaluating public perceptions of the default risk and the level of contract rights protections afforded under the Guomintang government.

The impact regulatory changes had on the demand and resulting prices of domestic national bonds is not atypical; Cutsinger & Ingber (2018), for instance, report similar effects on the demand and prices of bonds issued by the North government during the United States' Civil War. In 1863, the government instituted sweeping regulatory changes under the National Banking Act that required banks wishing to issue currency to back such notes with upwards of eighty per cent of the North's government treasury bonds. Hence, not unlike the Guomintang government, when faced with an extraordinary existential military threat that was likely to depress the natural market demand for its bonds, and thereby increase its cost of capital and limit its ability to borrow, the North government turned to coercive tactics to induce greater levels of holding of its debt obligations.

Further indirect support for our contention comes from the fact that budgetary outlays represented relatively low levels of national income. Based on estimates derived by Liu (1946), total central government expenditures as a percentage of national income from 1931 through 1936 averaged just three and one-half per cent. Given the apparent desire by government actors to increase expenditures, difficulties in placing debt implies, had there existed sufficient market demand for additional government debt issuances, it is likely the government would have issued more so as to finance desired increased spending.

In summary, we can identify two main features that consistently defined the public investor response to domestic central government internal debt offerings over the span of the late nineteenth through the early twentieth centuries. First, there was uneven interest by the public for holding such debt issuances. Investor interest in regard to early Qing government issuances was largely absent. While both the Beiyang and Guomintang governments were able to institute some reforms in the bond issuance process that increased investor confidence and participation enough so as to create a market for government bonds, the liquidity of that market was relatively volatile, increasing at certain times but falling sharply during other periods. As noted, much of the increased demand observed in the later period came from the banking sector owing to regulatory mandates and government-appointed bank officials. Second, various inducements were necessitated to increase investor interest. Bonds were frequently floated at steep discounts in order to induce investor interest. Issued as drawings bonds, their effective maturity dates implied investors faced lower repayment risk than had they been issued as bullet or standard amortised bonds. Third, analysis of market pricing behaviour indicates that investors accepted these central government debentures with a sizable degree of scepticism, albeit one that varied over time. As evidenced by the price series displayed in Figures 11.2 through 11.5, all of the internal bonds issued by China's central governments that traded on the open markets did so below their par values, in some periods at significant discounts. Overall, given a climate of heightened civil and social strife, and combined with numerous examples of government expropriation of investor monies by way of numerous default events, it appears investors viewed the level of investor and contract rights protection provided by the central government institutional environment to be considerably tenuous.

11.2. Shanghai's Domestic Municipal Bonds

Utilising archival and original information obtained from the Shanghai Municipal Archive's "Shanghai Archives Information Network" (上海档案信息网), and publications including the *Shunpao* newspaper, and the *Bankers' Weekly* and *Native Bankers' Monthly* financial journals, we describe the local bond issuances undertaken by Shanghai's municipal authorities under Qing, Beiyang and Guomindang governments. While we supplement this history with pricing and volume traded data from our dataset, much of our analysis centres on the issuance process itself, and the degree of acceptance by the market of these domestic-authority municipal bonds. This strategy is necessitated in part because, except for the later Guomindang period, there is a dearth of market price data available on these bonds. However, this lack of trading information owes not to missing historical financial records but rather is indicative of a relative disinterest by investors to hold these debt issuances, leading to difficulty by domestic municipal authorities to place their debt issuances.

By the time the first bond issuance by a Shanghai domestic municipal entity took place in the late Qing, representing the first such to take place in China, the city's extraterritorial municipal entities had already been issuing public debt for over four decades. This lack of utilisation of bond financing by domestic Chinese municipalities owed partly to a lack of fiscal need on the local level. The role of a municipal governance organisation structure requiring revenue and spending functions necessitating the raising of funds via municipal bond issuance was a relatively recent phenomenon in the Chinese context. For the vast majority of dynastic China, government authority was highly centralised—while localities were administered locally by local officials, such officials were appointed by, and received their authority from, the central government. Indeed, even the concept of a "national" or "central" government was somewhat redundant, in that all governmental structures were centrally controlled. All fiscal matters were centrally-controlled. Taxes collected at the local level were transferred to the national government. Local spending directives and resources were provided to localities by the central government.

Further, government structures at the local levels provided relatively little in terms of civic services. Beyond tasks such as the collection of taxes and the administration of justice by local magistrates, few social services were undertaken by local government structures. Prior to the Republican era, only court-appointed magistrates and his staff of government officials comprised city leadership. A limited municipal government role persisted through the end of the early modern period, and even until near the end of the Qing rule. Thus, in essence, prior to the start of the twentieth century, in domestically-controlled Shanghai as in other Chinese cities, the relative lack of municipal service provision necessitated little in the way of significant local government outlays. As such, formal functions such as planning or budgeting associated with municipal administration were absent (Elvin 1969), as was therefore the need for local revenue raising such as bond issuance.

Two factors helped drive an expanded conception of municipal government responsibilities, and therefore associated fiscal requirements, in the Shanghai context. One important factor originated from the centre. As reformers both inside and outside the government increased their calls for a more representative government structure, with some calling for an end to imperial rule, the Qing court sought to mollify these efforts by advocating more responsive government structures. Some of the constitutional reforms undertaken by Qing officials included a strategy to create greater autonomy in local governance structures. Specifically, the 地方自治運動 (local self-governance) movement, developing around the turn of the century, culminated in 1909 with a formal edict designed as part of an overall seven-year national plan to bring about the conditions appropriate for a transition to constitutional rule. The 城鎮鄉地方自治章程 (Regulations for Local Self-Government in Cities, Towns and Villages) decreed that greater authority would be given to the organs of local government, including the responsibility for planning, collecting and spending local municipal finances.

A second factor motivating the creation of more formal municipal governance structures in domestic Shanghai predated this larger national movement. Even prior to the turn of the century, a bottom-up process starting pushing the older domestic governance structure to better respond to domestic residents' needs. The proximity of the extraterritorial settlements played an important role in this process. Residents living and conducting business in domestically-controlled Shanghai observed the benefits received from the provision of municipal projects and services by the formal municipal structures operating within the extraterritorial settlements, and over time began demanding similar services from local domestic civic authorities. They too wished for the building of more and better-paved roads, sewage systems, garbage collection, and education services for their children. Thus, much of the origins for the foundations of formal municipal governance developed organically.

It is important to avoid, however, ascribing all of the changes that occurred in the nature of the administration of municipal governance as indicative of direct imitation from that which had developed in the extraterritoriality-administered settlements. Such couching of any (positive) changes developing in the domestic Chinese municipality as implicitly owing to imitation of the (supposed superior) western model exemplified in the city's extraterritorial settlements can be found throughout the contemporaneous English-language literature. For instance, de Jesus (1909:254) notes how judicial reforms within the domestic government are due to the integrity judicial reforms are a result of the model provided by western jurisprudence: "just as its fiscal reform was due to the integrity of foreign administration first tested at Shanghai, so too may the still more momentous judicial reorganisation find its initial stage through the ready acquiescence to the principles governing the foreign tribunals there." More troubling are the similar sentiments that continue to be echoed in more current literatures, such as Fairbank (1969)'s conceptualisation of treaty ports as interaction flashpoints for institutional dissemination in his "foreign impact, Chinese reaction" thesis of domestic Chinese institutional development. Ma (2006: 19) similarly suggests a process of imitation to have taken place in the late Qing, citing Elvin (1996) for support: "Chinese gentry and merchants set up their Shanghai City Council in 1904, and practiced what Mark Elvin called "gentry democracy" in the Chinese area, a direct imitation of the Municipal Council in Western Shanghai [i.e., the extraterritorial settlements]."

Rather, the changes that occurred administratively in the domestic sections of the city were reflective of a broader organic process occurring throughout China as the merchant class sought to utilise their increasing economic and political power vis-a-vis the state to better construct the institutional landscape in ways more favourable to their business interests. As previously referenced, institutional change typically results only due to a change in the relative power of groups benefiting from an existing institutional framework (Acemoglu *et al.* 2005). Changing state-commerce dynamics provided property owners more opportunity to reshape the institutional framework in ways more beneficial for the development of commercial activities. This included increasing the access to and accountability of local government structures to allow for greater empowerment of business groups. As Ma (2006: 19) notes, it was private actors in the merchant and local landed class who initiated efforts to construct domestic Shanghai's first formal locally-responsive governance structure. While local domestic elites utilised their experiences with the government forms found in the foreign settlements, to attribute all of these changes to simple imitation of the settlements is overly-reductive. Williams (1904: 108)'s observation as to why domestic Shanghai lacked some of the same level of municipal services is noteworthy: "The Chinese [living in the extraterritorial settlements] are ready enough to enjoy and support the higher style of living, but they are not yet prepared to adopt and maintain similar improvements among themselves. The difficulty of being sure of the co-operation of the rulers in municipal improvements deters intelligent natives from initiating even then tinniest sanitary enterprise of their foreign neighbors." While expressed in a manner noxiously typifying a sentiment of inherent superiority oft found in the period's western writings on non-

European places, Williams nonetheless perhaps inadvertently underscores how the lack of responsive local governance and other institutional mechanisms, particularly those associated with the provision of protections on private property rights, disincentivised private domestic actors from making costly investments that could have resulted in infrastructural and other improvements to the domestic municipal commercial environment.

The nascent and organic domestic City Council referenced by Ma (2006:19) reflected a drive to create more responsive municipal governance structures. As he describes, "[The Council] experimented with the separation of power between the legislative and executive branches, having open debates and majority votes, standardizing tax collection (in place of tax farming), maintaining and improving public facilities, developing its own merchant militia, courts of justice with elected judges, and promulgating various regulative laws and moral codes." Moreover, the Council was a driving force behind further commerce-state efforts, such as the semi-private entities created soon thereafter that undertook public works efforts and looked to finance such projects through the issuance of debt instruments. Nonetheless, the early experiments described by Ma in terms of more responsive and accountable local governance structures were swept away once the authoritarian military-led national Beiyang and Guomindang governments came to power, with the domestic municipality leadership structure to be dominated by appointed military personnel.

The physical structure of the domestic city helped shape the nature of the municipal state-building process. Prior to the Treaty of Nanjing and subsequent arrival of foreign merchants and creation of extraterritorial settlements, Shanghai had primarily consisted of a walled city, the location of which was south of what would become the French Concession and International Settlement. In the decades following the designation of Shanghai as a treaty port, the growth of Shanghai's economy led to significant migration from the countryside. The non-extraterritorial neighbourhoods outside the city wall grew considerably, ultimately encircling the extraterritorial settlements. By the turn of the century, there existed three main sections of the domestic municipality—the original walled city, which came to be referred to as 南市 (Nanshi); the residential centre to the north called 閘北 (Chapei), although also referred to as 滬北 (Hupei); and the northeast section along the Huangpu known as 吳淞 (Woosung). These sections, however, were separated not only geographically but also in terms of administration. While all of domestic Shanghai was nominally under the purview of the local magistrate and local Daodai, these separate sections did not function in ways equivalent to the "district" division (區) of modern Chinese municipal governance. There existed little in the way of overall city planning or coordination between the sections of the city. As such, the processes driving the creation of more formal municipal government structures developed somewhat independently across the various sections of the city.

The creation of a local public goods initiative occurred in 1895 when a group of merchants and local officials located in Nanshi approached the Daotai to advocate the creation of a quasi-government enterprise known as a bureau (局) to construct a road along the bank of the Huangpu River running south of the Bund, so as to link this undeveloped section of the waterfront with the 十六鋪 (16 Pu) section of the city.[†] The bureau structure referred to the *shangban guandu* (merchant-financed, government managed) concept of quasi-government initiatives that were designed to promote national or state-related development goals by mobilising private investment. The local Daotai received approval from the Qing Court to set up the 上海市馬路工程局 (Road Building Bureau), and a southward extension of the Bund was successfully completed by the end of the ensuing year. After completion of the road, the bureau was reconstituted as 南市馬路工程善後局 (Road Maintenance Bureau).

[†]十六鋪 had served, since the Northern Song, as the city's primary port and marketplace, where local fishermen and shipping merchants of the Yangzi commercial route gathered to trade goods. By the Qing period, the area became an administrative unit of the domestic municipality, designated by local officials to be divided into sixteen sections, and hence its modern name (上海市档案馆 2006).

In accordance with the bureau enterprise concept, the Road Building Bureau raised investment funds for the construction of the road from the local business community. Using as a guide the usage fee strategies employed within the neighbouring extraterritorial settlements, the Road Maintenance Bureau was empowered to coordinate the collection of a vehicle tax as a continuing financing mechanism in order to obtain return on investment and provide for the maintenance of the road.

Soon thereafter, other areas of domestic Shanghai also began to create entities to undertake capital improvement projects. In 1898, in Woosung (Wusong), a similar bureau responsible for public works received approval to operate from the central Qing authorities and started operations. In 1900 in Chapei (zhabei) another public works bureau was created. As the region of the domestic part of the city closest to the International Settlement, Chapei faced competition for customers base and investment monies, spurring a local business association to initiate a new public works enterprise, the goal of which was, in effect, municipal development projects, including the building and maintenance of roads and improvement of the area's business district. Unlike the public works bureaus operating in other sections of the city, this enterprise was originally run as a private concern; by 1904, however, given its a lack of authority to impose taxes, management of the venture was taken over by government officials and the concern was restructured as a formal bureau.

These early beginnings of relatively small-scale, project-directed bureaus helped to both serve as a blueprint and impetus for some of the larger national-level reforms the Qing government was beginning to inch towards in promoting local governance structures, as well as themselves receiving support from the national movement as well. Thus, for instance, in 1905 the Nanshi Road Maintenance Bureau was incorporated into part of the Qing government's early initiatives to create more formalised and self-financed municipal self-governance structures. Restructured as the 上海城廂內外總工程局 (Shanghai General Engineering Bureau), its role was expanded from road maintenance to also providing police, new public works, and social housing services, with each of these functions having separate budgets (Huang 2003).

Such moves can well be regarded as the beginning of a sea change for domestic local government finance. The complexity of the local municipal government structure increased, no longer consisting solely of a local magistrate, but now also included multiple divisions with specific designated functions associated with the provision of civic services. More significant, for the first time, local authorities were responsible for creating and maintaining a budgeting process, with an embryonic local municipal government structure possessing the responsibility of both local expenditure determination and local fund raising to finance desired expenditures. The fundamental change derived from the fact that no longer was local government to operate solely on the basis of the central government allocating money, but rather the local government became responsible for raising and spending money itself.

Not coincidentally, it is during this period that, in 1906, in order to meet the increased responsibilities for social service provision, we find the Nanshi Shanghai General Engineering Bureau turn to seeking additional means for of raising capital to finance such activities. First, the Bureau—which began to assume the functioning of a formal municipal government entity—increased the number of taxes it imposed within its jurisdiction. Besides the vehicle tax, new taxes on boats and real estate property were introduced. Second, it is also at this time that the Shanghai General Engineering Bureau undertook the first domestic municipal-level bond issuance in Chinese history. This bond, intended to raise 30,000 *taels*, was to pay eight per cent interest, with a term of only three years. The bond's funding source was designated as operating proceeds from the Dada Company (大達公司), a local shipping and docks concern that had been founded with the support of the local government.

While little information regarding the subscription or repayment the 1906 issuance exists in the historical records, apparently it was enough of a success to warrant a second issuance, taking place in September 1908 with identical terms, also issued by the Shanghai General Engineering Bureau and funded by proceeds from Dada. Although a *Shunpao* newspaper article, dated 1 October 1908, noted the reason for the bond was to "help build municipal facilities", no other particulars were given.

Two years later in 1910, a third domestic municipal level bond was issued. In this instance, the issuing body was the 上海城廂自治公所 (Shanghai Municipal Authority), a nascent formal municipal government structure created in response to the local self-governance movement developed in the waning years of the Qing (Tung 1964: 13). This bond issuance was more optimistic, with an authorised amount for 100,000 *taels*, carrying an eight per cent coupon over five years. The funding source for this bond was again designated as revenues of the Dada Company. However, the bond fell well short of its 100,000 *tael* issuance goal, managing only to raise 38,187 *taels* (Liu 2005).

Unfortunately, for all three of these Qing-era municipal bond issuances, there appears not to exist pricing information anywhere within the historical record. We found no listings for any of these three bonds in the local newspapers that typically reported prices on domestic central or provincial government bonds, railway bonds, or the municipal bonds of Shanghai's extraterritorial settlements. Given the lack of price reporting, it appears that little if any market trading of these bonds took place. Instead, it is likely these bonds were more similar in many aspects to syndicated loans, initially financed and held to term by banks and wealthy private investors

While many of these early tax and bond revenue-raising strategies consciously followed, in many respects, similar municipal fiscal techniques utilised by the councils governing the extraterritorial settlements, there existed important differences. To begin with, unlike in the extraterritorial settlements, the issuing body was a quasi-government entity. While Bureaus possessed some authority to collect taxes, they lacked the weight of sovereign authority possessed by an actual sovereign municipal government. Relatedly, despite its moniker, the Shanghai General Engineering Bureau was not a full municipal level entity, operating only within Nanshi. At this time, there existed no coordinated formal municipal management structure with authority over all Shanghai, and different areas of domestic Shanghai each had their own project-specific local bureaus responsible for responding to specific needs within their area of the city, a positive development model that allowed experimentation and the creation of unique local solutions to local issues. However, potential investors could well have felt concern that these specific bureaus lacked scale and were constrained from a capital standpoint by a limited tax base. Third, the domestic municipal governance structure itself remained limited in its ability to credibly commit to protect either domestic resident or investor property rights. While some financing authority was transferred to local government, the city was still administered by central government-appointed officials, as were the public works bureaus. Decisions were made by fiat, and the fiscal health of the bureaus were neither vetted by a transparent budgeting process, nor open to public debate. While the impact of these factors in creating a viable market for these bond issuances is unknown, it is noteworthy that the municipal bonds issued by Shanghai's extraterritorial municipal councils were, over the same time period, listed and traded on the city's financial markets.

The founding of the Republic brought with it the installation of a formal municipal authority in Shanghai, under the authorisation of the Beiyang government. One of the first tasks undertaken by this new municipal administration was to seek to raise funds via a bond issuance, and in September 1912 the Shanghai municipal government authorised a newly constituted organisation that was similar to the old Qing-era Shanghai Authority Bureau to

issue a 40,000 *tael* bond at eight per cent over ten years. As under the Qing, operating proceeds from the Dada Company were designated as its funding source. However, trust in the reliability of this issuance was low, given the missed interest payments that took place on the previous bond issuance by the old Shanghai Authority Bureau (SFTR 1995: 1127). After one year, just 22,000 *taels* of the bonds had been subscribed, representing only about half the funds the city administrators sought to raise. As with the previous Qing-era issuances, there appeared to be little trading of these bonds; at the very least, there were no reports of such trade in any of the city's newspapers or financial journals, although its basic issuance information was listed in the 1914 *China Stock & Share Handbook*.

The situation began to change, however, with the growth of the financial markets and an associated increase in trading activity that occurred at the start of 1920. Starting in April of 1920, prices for the "Shanghai First Bond Issue" were reported in the *Bankers Weekly* and occasional issues of *Shunpao*. From these we generated a price series on this bond issuance through December 1921, when the speculative bubble burst and trading of most securities came to a standstill. The market prices on these bonds—only averaging approximately 40 *taels* over the period—provide a good indication that they were perceived to be highly risky.

The inability of the municipal government to honour previous bond obligations undoubtedly diminished the appetite for additional offerings, as suggested by the fact that it was a full ten years before another bond issuance took place. In June 1922 a 100,000 *tael* issuance took place carrying a 10 per cent coupon with a term of 10 years. Similar to national bonds, interest was to be paid semi-annually, with early repayment made on ten per cent of the bonds based on annual randomised drawings. The funding source of this issuance was more general, indicated as general tax revenues. The issuing body was again not the official municipality but a new local quasi-government institution, the Zhabei District Industrial Bureau. News reports in *Shunpao* at the time state the purpose of the bond was to rebuild city roads in the Zhabei district.

The public response to the issuance appears to have been tepid. The 100,000 *tael* issuance actually represented phase one of a planned 200,000 *tael* total issuance, with the second 100,000 supposed to be issued in December 1922. However, given difficulties placing the first phase, the planned second phase was shelved. Nonetheless, a separate issuance by Zhabei District Industrial Bureau took place a year later, wherein which they tried to raise an additional 200,000 *taels* to construct bridges in the district. This bond was also to pay 10 per cent coupon with a 10 year term. The funding source was once again local tax revenues, with the bond agreement more specifically requiring approximately 1500 *taels* per month to be allocated into a sinking fund for repayment purposes. Once again, however, public appetite was limited, and only 83,600 *taels* out of the desired 200,000 was collected.

Overall, investors appear to have been relatively sagacious in their reluctance to subscribe to these issuances; the first bond issuance of 100,000 *taels* ran into trouble early on, unable to fully repay principal to bondholders selected in the first lottery drawing, who were returned only 90 per cent owed principal. As with previous issuances besides the brief period during the bond market bubble of 1920 and 1921, price and volume data seem non-existent for either of these two municipal bonds.

Nonetheless, based on reports surrounding the potential fate of these bond obligations that took place within the local press near the end of the Beiyang-sponsored domestic Shanghai municipal administration in 1927, we know these bonds were making at least sporadic repayments. The fate of these bonds was settled in line with the Guomindang central government's stance on honouring national and provincial level bond issuances by the Beiyang government. Officials in the city's new Department of Finance decided in 1929 to consolidate and replace these previous debt obligations under the framework a new bond

issuance. As reported in a series of short articles in several issues of *Shunpao* (16, 24, 26, 30 April 1930), municipal bonds issued under the previous Beiyang city government were declared defunct. However, it was reported that the new municipal government was willing to honour the payments implied by the old bonds, but that holders of those issuances would need to exchange them for a new municipal bond issuance (the 1929 issuance described below); upon exchange, the bonds would be honoured at 80 per cent their face value. Whether this represented a fair exchange for the values of the bonds is unclear, given we have no market price data given their apparent lack of trading on the local bond market.

With the formation of the Nanjing-based government, the Guomindang leadership set about consolidating and legitimising its power by installing new local governments loyal to the Guomindang Party. In Shanghai, the City Government of Greater Shanghai municipal administration, installed in late 1927, was tasked with promoting economic growth and modernisation within the domestically-controlled areas of the city. However, funding issues proved to be a major obstacle for the domestic municipal government to achieve these goals.

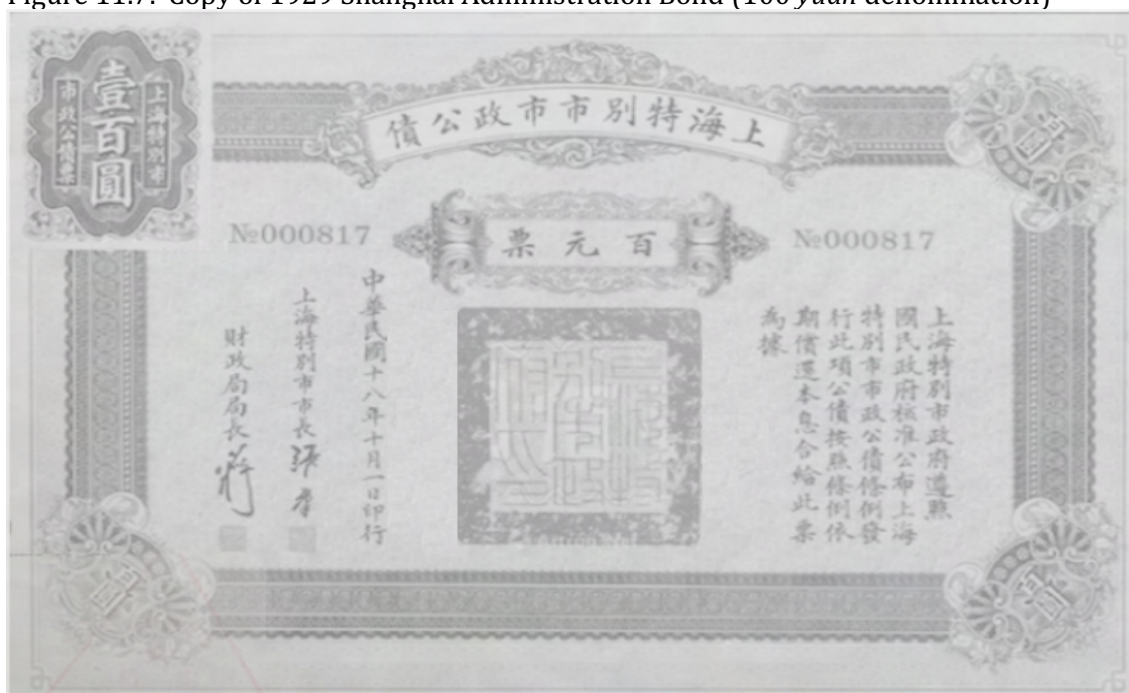
The Guomindang government's emphasis on developing a more bureaucratised and professionalised infrastructure led to the creation of several new municipal departments, including the Shanghai Department of Finance, tasked with restructuring the city's finances. Given the city's funding needs, Department officials looked to bond issuance. However, the aforementioned decision by the Ministry of Finance to honour previous debt obligations of the Beiyang regime also contained several new directives designed to bring order to what had been a highly disorganised set of outstanding bond issuances. New regulations prohibited all provincial and local governments from conducting their own bond issuances; moving forward, the Ministry of Finance was the only government entity allowed to issue bonds.

In accordance with the new regulations, the Shanghai Department of Finance applied to the national Ministry of Finance for the right to implement a local debt issuance. Although the Ministry of Finance served as the official government entity through which the bonds were issued, the responsibility for repayment was to rest solely with the local Shanghai Municipality administration. As such, analysing the public's response to the bond issuances by the Shanghai municipality represents a useful way to gauge public perception as to the credit worthiness and financial viability of the domestic Shanghai municipal authority.

After permission was granted by the Ministry of Finance, the Shanghai Municipal Government authority conducted a bond issuance in October 1929, for three million *yuan* worth of bonds at 100 *yuan* face value, coupon rate of eight per cent with an eight year term, semi-annual coupon payments, and following the standard methodology of the time of selecting via random drawing a percentage of outstanding bonds for full repayment each year. The bond was to use the local residential housing tax as the designated funding source. Figure 11.7 displays a copy of one of these issued bonds.

Gathering price data regarding this first issuance by the Nanjing-backed Shanghai Municipality administration proved to be unsuccessful. Unlike for the internal domestic national-level bonds (or, for that matter, some provincial-level or railroad bonds) that were contemporaneously issued, and for which price data was readily available during this period, neither *Bankers Weekly* nor *Shunpao* published market prices on this issuance. Hence, we lack a clear bond price data series for this particular domestic municipal issuance. While preventing construction of a price series enabling a comparative analysis, the lack of any published pricing information on this issuance does provide us with some information, insofar as the lack of a market indicates that investors were apparently not interested in holding it, instead preferring to hold alternative investments that were actively traded during the same period.

Figure 11.7. Copy of 1929 Shanghai Administration Bond (100 *yuan* denomination)



Source: Shanghai Municipal Archives (319-6-2568).

Analysing published information in the *Shun Pao* newspaper over this two-year period regarding the 1929 municipal bond issuance suggests that the overall public perception of the faith and credit of the municipal government authority was relatively poor. There was still nearly one million *yuan* in unredeemed municipal bond obligations issued by previous administrations to be honoured, and potential investors were perhaps uncertain the new municipal administration could raise sufficient tax revenues to take on an additional three million *yuan* of new debt obligations (Woodhead 1933: 664). It is clear from the reported articles that while significant effort was put forward by officials in terms of advertising and promoting this bond issuance, which even included pressuring government employees and business leaders to subscribe to the bond, there appeared to be little appetite on the part of most potential investors to subscribe to these bonds. The fact that municipal employees also showed such hesitancy to subscribe is perhaps most damning, as they represented members of the public with the best information regarding the effectiveness and trustworthiness of the government. In general, it is clear that the risk profile of the bond was not attractive to the majority of investors at the time.

The initial lack of fundraising success of the 1929 floatation led the domestic city government the following year to undertake creative strategies to attempt to reach the three million *yuan* in intended subscriptions. Thus the newly-created City Bank of Shanghai was assigned over one million of the bond offering as its initial capital reserves, bringing total subscriptions up to \$2,940,000 (Woodhead 1933: 664). However, given that the Bank was funded with taxpayer monies, such purchases of municipal bond issuances by the City Bank simply represented an accounting procedure as opposed to reflecting an actual influx of new funds.

Given the relatively advanced state of Shanghai's financial press at the time, the lack of published pricing data for the 1929 issuance is a fair indication that this bond did not trade in any substantial quantity, underscoring the fact that the public's perception of this investment option was indeed quite poor. Further evidence regarding these bonds' perceived value can be gleaned from comments made by Secretary Cai of the Shanghai Finance Department an official with the Shanghai municipal authority, who, speaking in 1932, admitted the city had only been able to raise part of the 1929 issuance's intended three million *yuan*, while noting that the bonds were only currently worth approximately half their face value (*Shun Pao* 27 October 1932).

We turn now to a discussion of the final two bond issuances undertaken by Shanghai's municipal authorities up through 1937. As to be described, the juxtaposition between the 1929 bond issuance and the two subsequent bond issuances is telling in regard to improvements in both the professionalisation of the city's fund-raising strategies, and the perceived efficacy of local governmental authority.

In the aftermath of the 1932 military battle with Japanese forces that had devastated much of Shanghai, Jiang instituted new leadership structures in many of the important urban centres. In Shanghai, the Provisional Municipal Council was installed, organised along corporatist lines (Lee 1995:11). This Council was given more authority and power to institute policies, impose taxes, and raise capital to undertake work relating to recovering from the war and enhancing economic development. One of the first tasks of the Shanghai Department of Finance after the war was to raise capital for municipal reconstruction projects. As such, it was decided soon after the war that a new bond issuance dedicated to reconstruction projects should be undertaken. It was clear that the relative failure of the previous bond issuance revolved around a low level of trust by investors in the Shanghai municipal authority's ability to coordinate and structure an effective bond issuance, as well as its inability to institute structures to assure the public that repayment of the loan was likely. The 1929 bonds had been issued directly by the municipal government itself; i.e., there had been no financial underwriters for the bond issuance. Only the Bond Recruiting Committee was tasked with the responsibility of selling and placing the bond. As a way to both increase the trust in repayment and improve the amount of money taken in from the bond issuing process, the Department of Finance this time turned to outside financial professionals to serve as underwriters for the new bonds to be issued.

As reported in the 27 October 1932 issue of *Shunpao*, the Secretary of the Shanghai Department of Finance indicated in a speech that given the sizable reconstruction costs, the city was planning on issuing bonds to raise sufficient capital. The difficulties encountered in the past regarding the previous bond issuance encouraged the Department to utilise professional underwriters in order to ensure that sufficient capital would be acquired. While the city would need to sell the bonds to the underwriters at a twenty per cent discount (hence only receiving 80 per cent of the full issuance amount), it could receive the revenue immediately and in full.

The paper carried a draft of the proposed details of the bond offering: "Six million yuan of 復興公債 (Revitalisation) bearer bonds will issued in November 1932, with an annual coupon of seven per cent, to be paid semi-annually. The underwriter banks will only need to pay 80 per cent of the face value, with commission fees to be calculated separately. The government will also pay 0.25 per cent commission fee to the bond agent bank chosen to manage the principal and interest payment process. The government will designate one of its income streams as a designated funding source, and will set up a fund for paying back interests and principals." As with nearly all domestic government bond issuances, the bond was designated to be in the form of a drawings bond, with regularly scheduled drawings to be held semi-annually.

An updated article in *Shunpao* appeared three days later on 30 October reporting that additional details of the bond had been decided upon during negotiations between banking groups and Department of Finance representatives. "The Rehabilitation bond will use full tax income derived from dockyards as a funding source, and the term structure of the bonds would be set at 20 years." As was standard for domestic bonds, repayment was to be conducted under the drawings methodology, with full repayment of outstanding principal to take place by August 1952. Less than three weeks later, *Shunpao* carried an article announcing, "British firm Benjamin & Potts underwrites the Rehabilitation bonds," and described the contract signed between the foreign underwriting firms and the city's Department of Finance. The paper printed the following details provided by Finance Secretary Cai regarding the agreement:

- (1) The underwriter is Benjamin & Potts, and the agent bank managing payments of principals and interest is the Hongkong & Shanghai Banking Corporation (HSBC);
- (2) Once Benjamin & Potts pays the underwriting money, the municipal government will not be involved in selling the bonds;
- (3) Benjamin & Potts will purchase the bonds at 80% face value; no additional commission fees will be paid.
- (4) Benjamin & Potts will sell the bonds to the public at 85% of face value;
- (5) Benjamin & Potts will be responsible for paying all promotional and advertising fees, and will cooperate with HSBC in promoting the bonds.

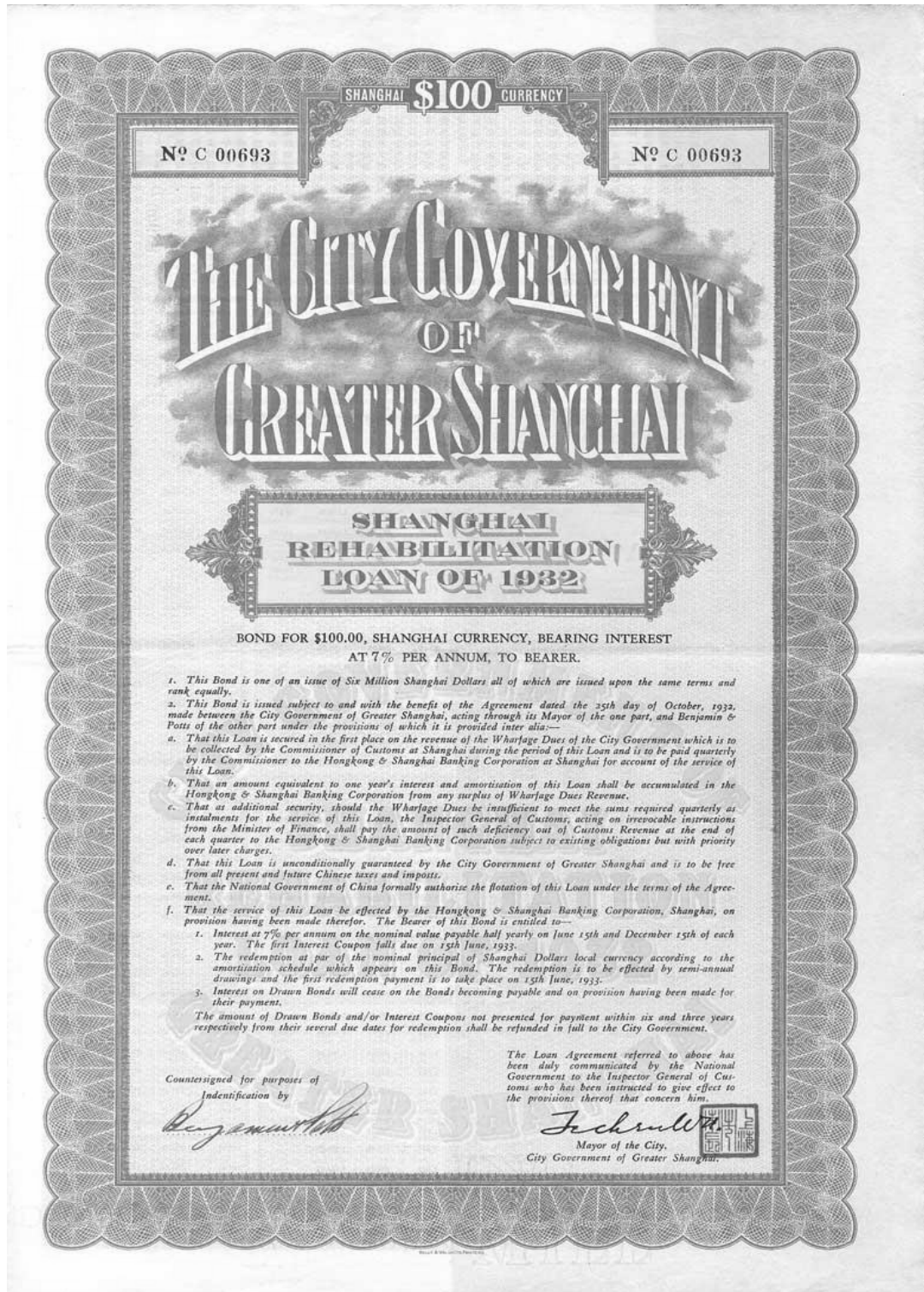
Later reports in local newspapers and financial journals provided additional information, including that the dedicated funding source would be the city's Wharfage Dues, an important signal to investors given the significance of shipping to the domestic city's economy. In addition, it was further announced that an agreement had been reached with the foreign-operated Shanghai Stock Exchange to list the bonds on the exchange. It is interesting that city officials saw it important to have the bonds listed on the foreign-run stock market; at this time, both of the domestic-run stock exchanges (Shanghai China Merchants Stock Exchange, and Shanghai Chartered Stock and Produce Exchange) sold bonds, and had sufficient institutional capacity and expertise operating in the bond market. In fact, both of these exchanges handled at the time large volumes of trades in national government bonds, as described in the previous section. Thus, the city looked to the foreign-run exchange not for its institutional apparatus, but more likely rather as a signalling device as to the (improved) trustworthiness and quality of the bond issuing and repayment mechanisms that had been put in place.

For the city, the agreement proved to be an important success, as they immediately received 4.8 million *yuan* in bond sales revenue from Benjamin & Potts (80 per cent of the six million total issued debt). Thus, unlike with the 1929 issuance, the Department of Finance immediately received the money upfront, removing uncertainty in regard to the timing and the amount they would ultimately take in from the bond sale.

In addition, the public response to the 1932 issuance proved vastly different than the response to the 1929 bond offering. Benjamin & Potts had little trouble placing the bonds. Indeed, many of the local domestic banks quickly agreed to subscribe to large lots of the bonds at 82.5 *yuan* (Liu 2015: 98 suggests some banks paid as high as 85 *yuan*), enabling the underwriter to easily earn a healthy return. The largest subscribers included the Bank of China and Bank of Communications—together they subscribed to more than 2 million worth of the bond issuance. The domestic banks were easily able to resell the bonds to domestic individual investors—when the bonds were offered for sale to the public on 21

December 1932, in just over two hours branches of the two banks received approximately 3.78 million *yuan* in subscription orders, after which sales had to be shut off; investors were subsequently assigned actual bond amounts proportional to their requested subscriptions (*Shunpao* 24 December 1932). Figure 11.8 displays a copy of one of the issued 1932 bonds.

Figure 11.8. Copy of 1932 Domestic Shanghai Municipal 7 Per Cent City Loan Bond (100 *yuan* denomination)



Source: Shanghai Municipal Archives (319-6-2568).

The positive response by the market to the 1932 city bonds encouraged the Department of Finance to again turn to using a bond issuance to raise capital two years later. In 1934, the City Government of Greater Shanghai received permission from the central government authorising it to conduct another bond issuance. This time, the Department of Finance contracted with the foreign-incorporated brokerage house Swan, Culbertson & Fritz to serve as the bond's underwriters, who would then be solely responsible for selling the bonds to banks or directly to institutional or individual investors. As indicated in an article in *Shunpao* on 1 July 1934, the purpose of this new bond was to collect funds for the improvement of public works, including road improvements, bridge construction, and building public structures such as libraries, museums and stadiums. The bond's funding source would be from its vehicle tax (a tax fee applied to all cars, whether human-pulled or motorised). The city would sell the bonds at a 7 per cent discount to the underwriter, and reports in *Shunpao* at the time indicated the city cleared the full 3.255 million *yuan* just seven days after the contract was finalised. The contract agreement represented a big win for the city—in a span of just two years, they were able to negotiate from having to pay a 20 per cent underwriting fee, down to only 7 per cent.

On 14 July 1934, the city issued 3.5 million *yuan* of bearer bonds, of face value 100 *yuan*, with an annual coupon rate of seven per cent, paid semi-annually, with a term of 12 years; the principal would be paid back via drawings method starting in June 1935. Swan Culbertson & Fritz negotiated with the three designated agent banks (Bank of China, Central Bank of China, and Bank of Communications) for all bonds to be sold to the public at 98 *yuan*, a two per cent discount of its face value. The appetite by the public for the city's bond offerings had changed rather drastically from just five years prior—indeed, on the first day of public subscription, order for over 20 million *yuan* came in only two hours, more than five times oversubscribed. It was reported that both Chinese and foreigners applied. Given the extreme over-subscription, the banks allocated the bonds proportionally, with those who applied for 5000 *yuan* and below to receive the full amount for which they applied, and those who submitted more than 5000 *yuan*, would be allocated 5000 *yuan* worth plus nine per cent of the amount applied for above 5000 *yuan* (*Shunpao* 18 and 19 July 1934).

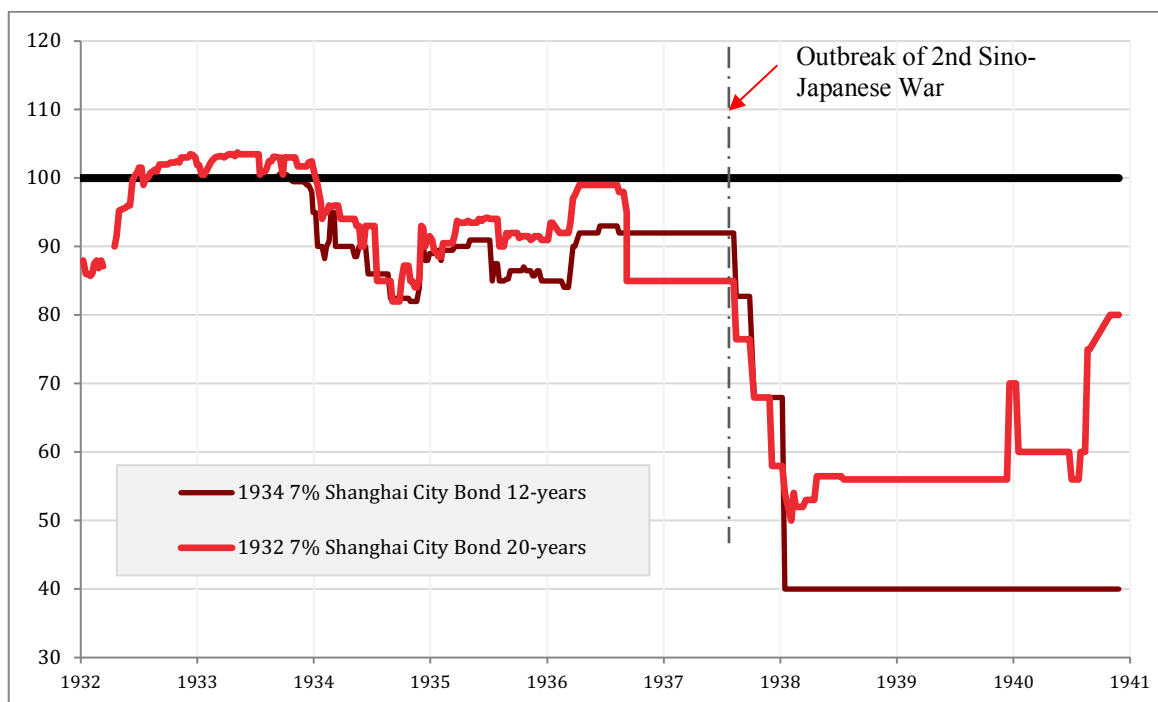
In particular contrast to the earlier 1929 bond issuance, the 1932 and 1934 issuances were deemed, certainly initially, as important successes for the City Government of Greater Shanghai. The local financial journal *Native Bankers' Monthly* Shanghai in early 1935 wrote favourably about the great popularity of the bonds amongst investors, noting that both Chinese and foreign investors were active in the market for these bonds, and attributed some of the popularity to their listing on the Shanghai Stock Exchange (1935 vol. 15: 119).

There are several factors that can be ascribed to the initial success of the 1932 and 1934 bond issuances. First, the outsourcing by the city to professional underwriters and bond agents greatly increased the confidence of investors, taking away some of the uncertainty over whether the procedural aspects of the repayment process would go smoothly. Relatedly, the use of reputable, professional underwriters such as Benjamin & Potts and Swan, Culbertson & Fritz also increased the confidence of investors. Having a bond underwritten by a company well-regarded in the financial community is in some ways analogous to receiving a "seal of approval"—the very fact that a well-respected underwriter would trust it could place a bond issuance can itself serve as a signal to the market about the quality of the investment opportunity (Easterbrook 1984: 655). Finally, and perhaps most important, was the impact from the bonds being listed on the foreign-operated Shanghai Stock Exchange. Similar to using well-known bond underwriters, it is likely that some amount of positive signalling effect was gained. Also significant was the impact on investor's expected liquidity risk. As described, nearly all of the previous municipal bond offerings issued by domestic municipal authorities saw very little activity on the secondary market. This implies that an initial investor in the bond would likely be making a long-term

commitment to holding the bond until its redemption, increasing liquidity risk for the investor. Conversely, there had been a healthy secondary market for the foreign settlement governments' municipal bonds on the Shanghai Stock Exchange since early on, implying investors could purchase one of these municipal bonds knowing that they could easily get out of their position if they desired the return immediately or if they believed it was no longer an investment in which they wished to partake. Hence, the recognition by investors that the 1932 and 1934 bonds contained the ability to more easily exit the investment meant they would be more willing to enter the investment. Finally, it is also noteworthy that the Shanghai Stock Exchange itself was an extraterritorial company, and hence operated under the jurisdiction of extraterritorial legal system, with all the associated investors rights that this implied, whereas the domestically-operated exchange was a firm registered under the Guomindang legal system. The extent to which investors viewed legal protections on their investment activities to be better protected by the extraterritorial compared to domestic legal system was also likely a possible driver of the observed increased investor demand for the domestic municipal government's bond issuances.

Figure 11.9 presents the weekly price histories of these two domestic municipal issuances for the period through 1941 (after which the foreign-run stock market was shut down permanently with the fall of the foreign settlements). As is evident from the figure, after briefly trading over par in 1934, demand for the bonds fell slightly, pushing prices down below par back into the 90s by mid-1935. Prices remained stable until the outbreak of war in 1937 with the Battle of Shanghai, indicated by the vertical dotted line. The fall of the Guomindang-backed municipal government and installation of a Japanese-backed administration led to questions over whether repayment of the bonds would continue. Once the market reopened, prices declined sharply, especially for the longer-term 20-year bond, with the looming chance for default before redemption during this highly uncertain period driving prices downward. Demand for the shorter-term 12-year bond also mostly evaporated, with little trading taking place. There were a few submitted sell offers at all centring around 40, but no buyers; the observed apparent price stability a symptom of a low-liquidity environment for these domestic municipal bonds in the post-1937 period.

Figure 11.9. Bond prices: 1932, 1934 City Bonds, 1932–1941 (Face value 100 元)



Source: *North China Herald*, various issues, 1932–1941

None of the stock exchanges operating after 1941 report any market prices on either of these bonds. Using *Shunpao* as our primary source, we searched the historical record to find whether the collaborationist municipal government honoured the prior debt obligations of the Guomindang municipal government. Keyword searches † in *Shunpao* revealed that the last mention of the 1934 bond was at the end of 1938 (31 December), noting coupon payments made on the bond by the Bank of China, Bank of Communications, and Central Bank of China. Unlike for several other bonds mentioned in the notice, there was no mention of principal repayment, although whether that was an unintentional omission or an indication that none was being made is unclear. In any event, no subsequent report regarding the bond was found afterward. Conversely, coupon and lottery drawings for principal repayments still continued up through 1941 for the 1932 city bond as per multiple announcements regarding the results of lottery drawings and when interest and principal payments would be conducted by HSBC. Two articles (7 December 1940; 31 May 1941) describe how investors respected that even under the current situation, there had been no missed scheduled payments on the 1932 bond issuance. The situation changed drastically after the Japanese military stormed the foreign settlements and imprisoned many of its Western residents, shut down all Western banks including HSBC, and imposed martial law throughout the rest of the city. From this time all bond payments were subsequently stopped.

Interestingly, the article on 7 December 1940 implies that the majority of the bond holders by that time were foreigners; this would be in contrast to the situation that characterised the initial offerings of the bonds on the market in 1932, when most of the bonds ended up being subscribed by domestic investors. A dim view of the collaborationist regime by domestic investors might have led to an exit out of their positions in these bonds. Given the events occurring at the end of 1941 this might have been a prescient stance. After the war and with the return of a Guomindang-backed municipal government in 1946, there was pressure by investors who still held the 1932 bonds for the new government to resume payments. An article in *Shunpao* from 8 January 1946 reported that in response to such pressure, Department of Finance Secretary Shen Hua indicated his office was still looking at ways to deal with the outstanding city bond payments. Municipal finances were reported to be very tight, as 17 types of taxes that used to be collected by the local government were now under control of the central government, while simultaneously there were a lot of funding needs given the amount of reconstruction work required. As a result, current local tax revenue was insufficient to cover spending, necessitating the cutting of city officials' salaries and the like. That said, Secretary Shen was "hopeful" that there would soon be specific plans to address the issue. In any event, the pressure on the city government was sufficient such that bond repayments were restarted the following year. In a brief announcement in the financial journal 征信所報 ("*Credit Reporter*", vol 258: 3), it was noted that the 1932 City Bond would resume lottery drawings to pay back principal on 17 June at HSBC branches in Shanghai. Within a few short months, however, the persistent hyperinflation rendered subsequent bond repayments essentially worthless, and therefore future repayments were discontinued.

† Difficulties arise when performing word searches for financial instruments and terms, as the media frequently used different naming conventions over the time period. For instance, articles referred to the 1932 City Bond as "災區復興公債", "上海特別市災區復興公債", "災區復興公債", and "復興公債". However, caution needed to be applied, as there existed several articles referencing a different bond, one issued by the domestic central government, also as "復興公債". As best possible, care was taken to avoid missing references by ignoring appropriate references while attempting to avoid over-counting via incorrectly ascribing a non-municipal bond reference.

11.3. Shanghai's Extraterritorial Municipal Bonds

In his report on the future of extraterritoriality and the International Settlement, Judge Richard Feetham noted that the independence the Shanghai Municipal Council enjoyed in governing its own affairs was both "blessing and curse", for while the lack of funding by foreign governments alleviated local leadership from being beholden to outside control, it also forced the Settlement to find its own financing sources to conduct the business of its self-governance (Feetham 1931). The need for the residents of the early foreign settlements to organise their own governance and fiscal matters originated with the initial days of the British Settlement. As early as the mid-1850s,

British government officials in the Foreign Office were stressing that the provision of municipal services and upkeep of the such would be viewed as internal matters of "voluntary associations" of the Settlement's inhabitants, and not part of official British government matters. The Foreign Office's Lord Clarendon, in an official dispatch to the British consul in Shanghai, Sir John Bowering, wrote "The comfort and safety of the European residents may also require an internal police and sanitary Regulations, which cannot be supplied by the Chinese Government, and the residents may have voluntary Associations for the purpose of supplying these wants; but I have to instruct you carefully to avoid pledging Her Majesty to the maintenance of the Regulations which may be laid down by the Associations, by becoming parties to them in name of Her Majesty's Government" (*Foreign Office Papers* No. 158: 1855).

In the early beginnings of the operation of the Settlement, revenue collected for public projects were almost exclusively from tax receipts on real estate. By the start of 1861, the Council members began to explore the idea of setting up a licensing arrangement to raise additional monies; additional justification for requiring merchants to obtain licenses to sell goods was given as " for the preservation of regularity and good order in the settlement" (*NCH* 9 February 1861: 23).

Achieving this took some time, however, and the licensing issue remained an important but open topic of discussion for several cycles of ratepayers meetings and Council reports (*NCH* 5 April 1862: 55-56). Beginning in 1862, the Council started collecting licensing fees from sampans (small boats carrying passengers and cargo along or across the Huangpu) by issuing each vehicle a unique identifying number and charging approximately 3.75 *yuan* per vehicle, raising 5,292 *yuan* on 1,323 registered boats (*NCH* 11 April 1863: 58). Also in that year, the Council began requiring public entertainment halls operating in the Settlement to be licensed, registering 30 halls and collecting 200 *yuan* per hall, or 6,000 *yuan* in total for the year.

As the population and demand for civic service provision grew within the Settlement, so too did the need for greater revenue collection strategies to meet its fiscal needs. However, under the power of the Land Regulations and its founding by-laws, the Shanghai Municipal Council possessed limited authority to tax residents and economic activities. Given the fairly light tax structure that the Council could effectively impose on the business community and residents, it would have been difficult to fund large-scale infrastructure improvements without debt financing. As such, the Council turned to debenture issuance relatively early on. Table 11.3 presents the extant total of annual bond issuances by the Shanghai Municipal Council, beginning in 1872.

Table 11.3. Municipal bond issuances of the Shanghai Municipal Council

Count	Issued	Coupon	Term Years	Call Option	Exercised	Redeemed	Currency	Issue Amount
1	1872	8.0 %	20	5	Yes	5	Taels	28,700
2	1873	8.0 %	20	5	Yes	8	Taels	21,000
3	1875	8.0 %	20	5	Yes	11	Taels	42,800
4	1878	8.0 %	20	5	Yes	10	Taels	24,000
5	1882	7.0 %	20	5	Yes	7	Taels	60,000
6	1883	7.0 %	20	5	Yes	11	Taels	45,000
7	1884	7.0 %	20	5	Yes	10	Taels	15,000
8	1885	7.0 %	20	5	Yes	11	Taels	30,000
9	1888	6.0 %	20	5	Yes	10	Taels	70,000
10	1890	6.0 %	20	5	Yes	11	Taels	20,000
11	1891	5.5 %	20	5	Yes	10	Taels	20,000
12	1892	5.0 %	20	5	-	20	Taels	50,000
13	1893	5.5 %	20	5	-	20	Taels	125,000
14	1894	6.0 %	20	5	Yes	17	Taels	105,000
15	1895	5.0 %	20	5	-	20	Taels	115,000
16	1896	5.0 %	20	5	-	20	Taels	140,000
17	1897	5.0 %	20	5	-	20	Taels	268,000
18	1898	6.0 %	20	5	Yes	13	Taels	300,000
19	1900	5.5 %	20	5	-	20	Taels	33,900
20	1901	6.0 %	20	5	-	20	Taels	250,000
21	1902	6.0 %	20	5	-	20	Taels	150,000
22	1903	6.0 %	20	5	-	20	Taels	490,500
23	1904	6.0 %	20	5	-	20	Taels	214,500
24	1905	6.0 %	20	5	-	20	Taels	320,000
25	1907	6.0 %	20	5	-	20	Taels	500,000
26	1908	6.0 %	20	5	-	20	Taels	650,000
27	1909	6.0 %	20	5	-	20	Taels	300,000
28	1910	6.0 %	20	5	-	20	Taels	500,000
29	1911	6.0 %	30	10	Yes	19	Taels	900,000
30	1912	6.0 %	30	10	Yes	18	Taels	600,000
31	1913	6.0 %	30	10	Yes	17	Taels	850,000
32	1913	5.5 %	50	10	Yes	17	Taels	500,000
33	1914	5.5 %	30	10	Yes	16	Taels	1,203,000
34	1915	5.5 %	30	10	Yes	15	Taels	1,065,000
35	1916	6.0 %	30	10	Yes	14	Taels	1,900,000
36	1917	7.0 %	5	-	-	5	Taels	1,600,000
37	1918	7.0 %	10	-	-	10	Taels	1,800,000
38	1919	7.0 %	10	-	-	10	Taels	3,400,000
39	1920	7.0 %	10	-	-	10	Taels	2,240,000
40	1920	6.0 %	30	10	Yes	10	£ *	750,000
41	1921	8.0 %	30	10	Yes	10	Yuan	1,000,000
42	1921	8.0 %	30	10	Yes	10	Taels	5,096,400
43	1922	7.0 %	30	10	Yes	10	Taels	8,000,000
44	1923	6.0 %	30	10	Yes	10	Taels	4,920,000
45	1924	6.0 %	30	10	Yes	10	Taels	5,000,000
46	1925	6.0 %	30	10	Yes	12	Taels	5,600,000
47	1926	6.0 %	30	10	-	(d)	Taels	4,800,000
48	1927	7.0 %	30	10	Yes	10	Taels	2,187,500
49	1928	7.0 %	10	5	Yes	6	Taels	1,600,000
50	1934	5.0 %	30	10	-	(d)	Yuan	10,404,700
51	1936	5.5 %	10	-	-	(d)	Yuan	5,000,000
52	1937	5.0 %	30	10	-	(d)	Yuan	9,000,000
53	1940	6.0 %	10	1	-	(d)	Yuan	16,000,000
54	1941	6.0 %	10	1	-	(d)	Yuan	9,000,000
Averages		6.3 %	18.9	7.0	64 %	12.8		Total: \$ 136,062,645

Source: *North China Herald*, various issues 1872–1941

Notes: (d) Denotes bond defaulted after the fall of the foreign settlement areas in 1941

* Denotes converted at exchange rate of £1 = \$7.77 in 1921

11.3.1 *Extraterritorial Municipal Bond Issuances: Repayment Structures*

Two important repayment features of International Settlement bonds stand in contrast to those of the domestic government national and municipal bond issuances. First, while prior to the 1910s the Shanghai Municipal Council's bonds were also drawing bonds, subsequent repayment schedules of bonds issued by Council were in the form of bullet bonds, with bondholders to receive principal repayments in full at the end of the term of the bond. We look to emphasise the importance of this difference.

The effect of the drawing repayment scheme helps to "speed up" the time effect of expected repayment risk. Therefore, if two bonds have the exact same features differing only in repayment schemes—where one exhibits full repayment at the end of the term, and the other has an expected shorter term because of the drawings feature—the bond with the shorter effective term will exhibit lower repayment risk. Thus, all things equal, we would expect domestic bonds with the drawings repayment feature to be demanded and priced at levels representing lower repayment risk compared to Shanghai Municipal Council bonds of similar tenor.

Second, most of these bonds contained a call option that gave the Council the option to bring the bond to maturity at any date after the call date. For instance, as shown on the table, the 1872 issuance's tenor was twenty years, with a call option at year five that the Council exercised at the earliest possible date. The 1873 issuance, also of a twenty-year tenor and callable after five years, was exercised in 1881 at year eight. Conversely, the option on the 1892 bond was not exercised. As clear from the chart, the Council was relatively active in utilising the call option, doing so for more than half the callable bonds.

Thomas (2001: 62) notes investors were not fond of the call option, as it exposed them to substantial reinvestment risk. This is clear from the table—issuances in 1892, 1893, 1895, 1896 and 1897 carried low coupon rates of five per cent and were not exercised, whereas those issued earlier carrying higher coupons were called early. As noted, the addition of an early redemption option has important implications for bond pricing. As the issuer is able to exercise the option at its discretion and hence will tend do so when refinancing conditions are favourable, the existence of the option on the bond increases reinvestment risk, implying investors will demand higher coupon rates to hold such bonds, all things equal. Hence, the call options imply that—all things equal—International Settlement bonds would have been demanded and priced as representing higher reinvestment risk than similarly constructed domestic national or municipal government bonds issued *sans* call options.

Thus, both of these material differences between the repayment structures of the domestic government and extraterritorial municipal government bonds work in the same direction to increase the costs of capital on the Shanghai Municipal Council, all things equal. However, as described below, investors appeared persuaded that all things were not equal, for what we find is the opposite—coupons on Shanghai Municipal Council bonds were in fact lower than those on similarly constructed domestic municipal or national bonds, and investors seemed considerably more willing to subscribe to the extraterritorial bonds than to domestic bonds. Further, when domestic issuances could be placed and were traded on the bond markets, they did so at discounts greater than those at which the International Settlement's municipal bonds traded. These pricing phenomena are explored below in the following section; first we present the history of the extraterritorial municipal issuances.

11.3.2. *Shanghai Municipal Council Bond Issuances: Historical Overview*

As indicated by Table 11.3, bond issuances proved to be a significant source of funding, with the Shanghai Municipal Council typically issuing one bond per annum over the course of its existence, the main exception being 1929 to 1933, when proceeds from the sale of the Municipal Electrical Department to the Shanghai Power Company proved sufficient to meet budgeting needs (SMC 1929: 329-331).

The Settlement's first general funded bond series was issued in 1872, a 30,000 *tael* five-year bond offering an eight per cent coupon paying interest semi-annually with a face value of 100 *taels*.[†] The Council raised 28,700 of the authorised 30,000. Through 1892, the nominal amounts of the bond issuances averaged 35,500 *taels*. As its population grew, so did the demand for better services and infrastructure, as did funding needs. From 1894 to 1900, average bond issuances were on the scale of 150,000 *taels*, increasing to 375,000 the following decade, and ballooning to 1.5 million *taels* for the decade 1911 to 1920. Bond nominal amounts remained high going forward, with the average for the period 1921 to 1928 increasing to 2.6 millions *taels*, and 3.5 million *taels* for the period 1934 through 1941.[§]

Over the course of its history, the International Settlement's cost of funding generally trended lower, as coupon rates fell from 8 per cent in the 1870s to 7 per cent in the 1880s, down to 6 per cent in the 1890s; although it subsequently fluctuated between a low of 5 per cent to as high as 8 per cent, the median rate was 6.3 per cent. The generally low rates the Shanghai Municipal Council were able to obtain on its bond issuances reflected the overall perception amongst investors as to the creditworthiness of the Municipal Council's ability to meet its debt obligations.

There were several factors driving investors' general positive perception. First, the budgeting process was relatively transparent and professionalised. The fiscal affairs of the International Settlement were handled by a designated Financing Committee and Department of Finance, created by the Council in 1897. These institutions were tasked with managing the Settlement's finances and producing both a summary of each prior year's expenses and forecasting a budget for the next year. Financial matters grew increasingly complex over time; while the 1879 accounting Financial Statement published in that year's Shanghai Municipal Council Report comprised sixteen pages defined by nearly 240 line items, the Financial Statement in the 1937 Report comprised thirty-seven pages, consisting of approximately twenty-five major categories with over nine hundred line items (SMC 1879: 122-139; 1937: 283-319).

[†] Technically, the Council had authorised several small quasi-bond issuances starting in the late 1850s as a way to raise funds for specific infrastructure projects. For instance, an existing 4000-*tael* loan collateralised by the Municipal Police Building is referenced in the notes to the Council's 1860 annual Ratepayer's Meeting (*NCH* 5 April 1861). However, given that by the end of 1860 the obligation was held by only three entities (Dent & Co 1000 *taels*, Russell & Co 1000 *taels*, and the Shanghai Library 2000 *taels*), it appears likely this obligation was not traded, or at the very least not actively, as no trading in these loans are reported in the newspapers during the ensuing years. The 1872 issuance is the first general obligation bond issued reported sold to the public and had its prices listed in the Share Market reports of the *North China Herald* newspaper.

[§] The lattermost figure requires additional explanation. With the currency reform and abolishment of the *tael* in 1933, subsequent debentures issued by the Council were done so in *yuan*, with nominal amounts averaging about 9 million *yuan*, equivalent to about 6.5 million *taels*. For direct comparison purposes, however, we choose to discount this amount by the high inflation rate of the latter years of the period (1937 to 1941), which brings the figure down to what would have been approximately 3.5 million *taels* in real terms.

Second, the budget was reviewed annually in public at the Annual Ratepayers meeting, at which time items could be scrutinised and contested, which occasionally happened. Issues relating to transparency and potential corruption in regard to the Settlement's financing were important issues the Council was pushed to address early in its existence, as evidenced by the example cited in Chapter Nine that occurred in 1861 over the Defence Committee's use of the authority of the Daotai to pressure the Settlement's Chinese residents to pay an intended voluntary contribution to domestic collection agents who had the opportunity and incentive to skim off a majority of received payments (*NCH* 5 April 1862: 56). Such issues existed throughout the life of the Council, as for instance at the 1933 Ratepayers Meeting, with a particularly contentious disagreement occurring over the use of funds for proposed construction of a new park that several Ratepayers felt would be wasteful (SMC Report 1933: 18-22). Third, the elected nature of the Municipal Council theoretically provided a check on the spending activity of the Council; were spending to become too far out of line with Ratepayer's expectations, Council members could be replaced with those more committed to tighter budgeting. Fourth, the Council used professional outside accountants to audit the Finance Department's annual budgets before they were submitted to the Ratepayers. Fifth, the track record of bond repayments remained unblemished, fostering investors' confidence as to the Council's commitment to avoid missing scheduled coupon or principal payments.

Finally, another likely source of investor confidence was derived from the relative safety and independence enjoyed by the Settlement, especially in comparison to the levels of civil strife and political machinations that plagued the domestic municipality, as described in Chapters Six and Eight. This comparative degree of safety was in large part afforded to the Settlement by the existences of an ever-present implicit threat of western military force that could be brought to bear on attempts to interfere with the political sovereignty and financial solvency of the International Settlement. Thus, while not receiving direct funding from foreign governments, the Shanghai Municipal Council operated with—and investors undoubtedly perceived—there to be an implied protective shield around the Settlement within which the Shanghai Municipal Council could conduct its mundane business of providing an appropriate business and social environment concomitant with the Ratepayers' expectations.

Accordingly, bonds issued by the Shanghai Municipal Council proved to be readily accepted by the investor community, being held by both domestic Chinese and foreigner individual investors, as well as by local domestic and foreign banks and other financial institutions. The bonds were consistently listed in the market Share Reports compiled by the Bissett brokerage and published in the local newspapers, and traded on the foreign-operated Shanghai Stock Exchange. Available trading volumes in the Shanghai Municipal Council bonds were relatively robust, indicating that one of their advantages for investors was a relatively low liquidity risk. As Table 11.3 indicates, these bonds were issued for the local investor market. All of the bonds were done so in local currency, denominated in either *taels* or *yuan*, with a single exception in 1920 when the Council floated a £750,000 bond for sale on the London market.

11.3.3. Investor Demand and Price Histories of Shanghai Municipal Council Bonds

Before beginning a more rigorous comparative analysis across bond categories, we briefly consider the observed price histories of the bond issuances by the Shanghai Municipal Council. In general, all Shanghai Municipal Council bonds were issued with nominal face values of 100 (usually in *taels* or *yuan*). Utilising the financial tables and supplementary fiscal data within archived copies of the Shanghai Municipal Council's Annual Reports, we calculated exact placement prices and subscription amounts for many of the Council's bond

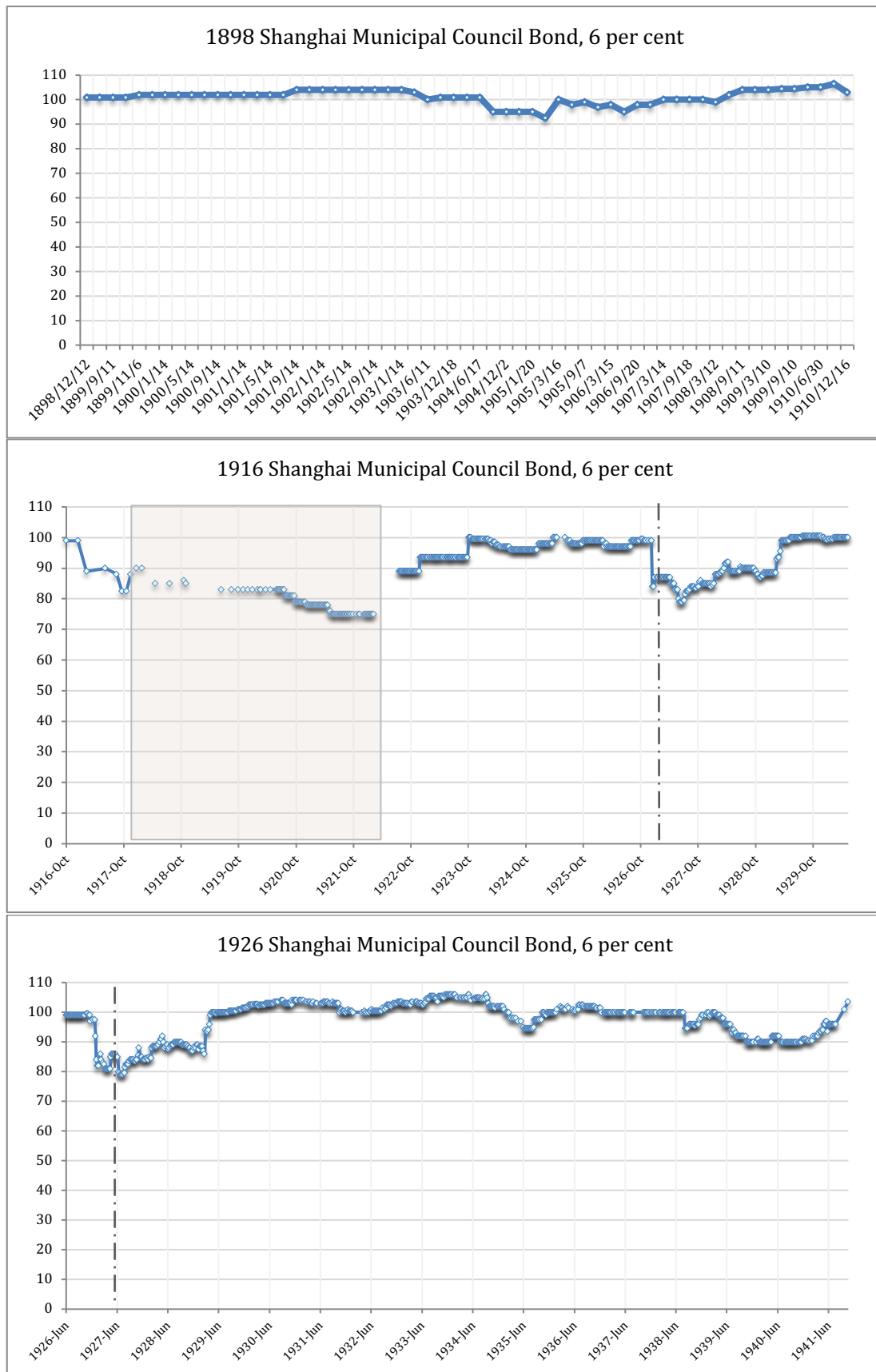
issuances. Analysis of these data indicate that in general, the market was continually receptive for the Council's planned bond issuances over the course of the period. The overwhelming majority of the issuances were fully subscribed, with many issuances oversubscribed. More important, the Council was able to receive excellent prices on its initial offerings. In sharp contrast to the experiences of most domestic National and Shanghai municipal bond issuances, the Council placed its bonds with at most a slight discount, never more than five per cent (*Shunpao* 12 July 1919; *China Stock & Share Handbook* 1933: 28). In fact, in contrast initial offerings could frequently be placed at a slight premium, enabling the Council to fully raise intended amounts relatively easily. For instance, both the 1895 and 1896 bonds were heavily oversubscribed, and both issuances were placed at prices that averaged above par (100.05 and 100.10, respectively). Average initial placement prices fell slightly below par as in ensuing years, the Council offered current holders of issues due for repayment during the year in question the option of conversion to the current year's issuance at a slight discount. For instance, in 1916, holders of the 1896 debenture were given the option to either receive full payout on the 1896 issue, or to convert their holdings into an equivalent number of 1916 bonds at a discounted price of 99.5 (SMC 1916: 29C). Overall, given that most of the Councils bonds entered the market near par, the 100 *tael* or *yuan* price point provides a useful general barometer as to whether valuations rose or fell subsequent to issuance.

Figure 11.10 presents the price series of three representative bond issuances, for 1898, 1916 and 1926, that traded over the time frame before 1941. Overall, we observe that these Shanghai Municipal Council bonds traded at prices that generally did not stray too far from par. Exceptions are notable, and typically reflect the impact of on-going civil strife occurring in the larger China theatre. Such events likely led to investors weighing the risk that these outside events might endanger the Settlement in ways economic or existential, and hence undermine its ability to uphold its repayment obligations. Relatedly, tumultuous socio-political events also tend to push up interest rates, leading to a concomitant fall in bond prices on the secondary market.

For instance, prices dipped into the mid-80s once the unrest of the warlord period began (represented by the shaded region on the graph of the 1916 issuance). Bond prices fell further as the financial crisis that hit Shanghai at the start of the 1920s unfolded, with the failure of several native banks leading to a drying of credit and therefore a sharp rise in interest rates, and resultant fall in bond prices.

The year 1925 was particularly active for local debentures, dominated in large part by those issued by the two local extraterritorial municipalities. As reported in the March 1926 issue of the local trade journal *North-China Trade Review*, demand for such debentures was particularly strong: "The [Shanghai Municipal] Council found itself extraordinarily well situated in regard to the matter of flotation. On one occasion an issue of a million *taels* of municipal debentures was taken up within just an hour, while a second of the same dimensions within less than two hours." The appetite for what the report referred to as "gilt-edged securities" was driven by a perception amongst investors of a lack of viable alternative options given weakening local business conditions in the wake of 1925's May Thirtieth Movement. The impact of the boycotts on foreign imported goods in the wake of the Movement meant that monies typically employed in the financing of trade needed alternative investment options. As this local trade journal noted, "Investment companies were crying aloud for a medium in which they could place their surplus earnings, and... [n]o better medium presented itself to the public than did these debenture issues" (*NCTR* 1926:11). Hence, extraterritorial municipal bond issuances were viewed as instruments providing reliable returns during periods of uncertain economic conditions.

Figure 11.10. Three Selected Shanghai Municipal Council bonds prices, various years



Source: *North China Herald*, various issues, 1898–1941

The aftermath of the May Thirtieth Movement was followed by intense civil strife in the lead-up of the Northern Expedition (denoted on the 1916 and 1926 graphs by a dotted vertical line). Bond prices again trading in the low 80s throughout 1927 and 1928, with market reaction likely reflecting some degree of both issuer-specific increased investor uncertainty regarding the potential for civil unrest to ultimately impact the ability of the Council to honour its debt issuances, combined with the effect of increases in general interest rates occurring in the wake of the conflict.

11.4. Investor Demand and Price Histories of Bonds offered on Shanghai's Early Capital Markets: Direct Comparisons

In the prior sections, we provided a detailed overview of the issuance histories for Chinese domestic internal bonds and Shanghai's domestic and extraterritorial municipal bonds up through the end of the existence of the foreign settlement areas and the extraterritoriality system in 1941. Here, we turn to conducting a more explicitly comparative analysis, allowing us to draw more general conclusions in regard to contemporaneous investor perceptions as to the relative quality of private property and contract rights protections afforded by each of the issuers, as represented by the relative levels of acceptance and pricing across these issuance classes.

Averaged Bond Prices

This section presents a more direct comparison of the way in which the markets priced the different types issuer-defined bonds. To conduct this analysis, we construct combined averaged price series for each of the different types issuer-defined bonds. Specifically, we calculate a weighted average price of all of the bonds for which we have data across each of the issuers, over the course of the time series. Bond prices are weighted by the size of the issuances. Ideally, a more preferable weighting methodology would be the value of volumes traded on each issuance, as it would better represent the liquidity and market importance that we would like to capture, and for which the size of issuance is only a proxy. Unfortunately, available data on the value of volume traded cover only a small sub-set of the time period for which we have price data.

Care was taken in regard to construction of the foreign settlement municipal bonds price series, as some bonds traded in *taels*, and some in *yuan*, and one in sterling pounds, and at times they did so concurrently, which present issues in trying to combine them. As it would not be appropriate to price them in a single currency (causing the converted series to either appear to trade greatly over or under par in the new currency), we averaged all *tael*-traded and *yuan*-traded prices separately, calculated their prices as a per cent of par, and then combined these values into a single category, enabling averaging to take place that did not cause a misleading result. Another small caveat is that one of the domestic central government internal issuances had a face value of five hundred as opposed to one hundred *yuan*, and so prices were scaled accordingly to allow for direct comparison with other prices.

Figure 11.11 provides a comparison of these calculated averaged bond price series over the time frame. To begin with, the averaged series follow a behavioural pattern suggested by previous consideration of individual bonds' price series. Note that the averaged bond price series of the extraterritorial International Settlement-administered municipality remains

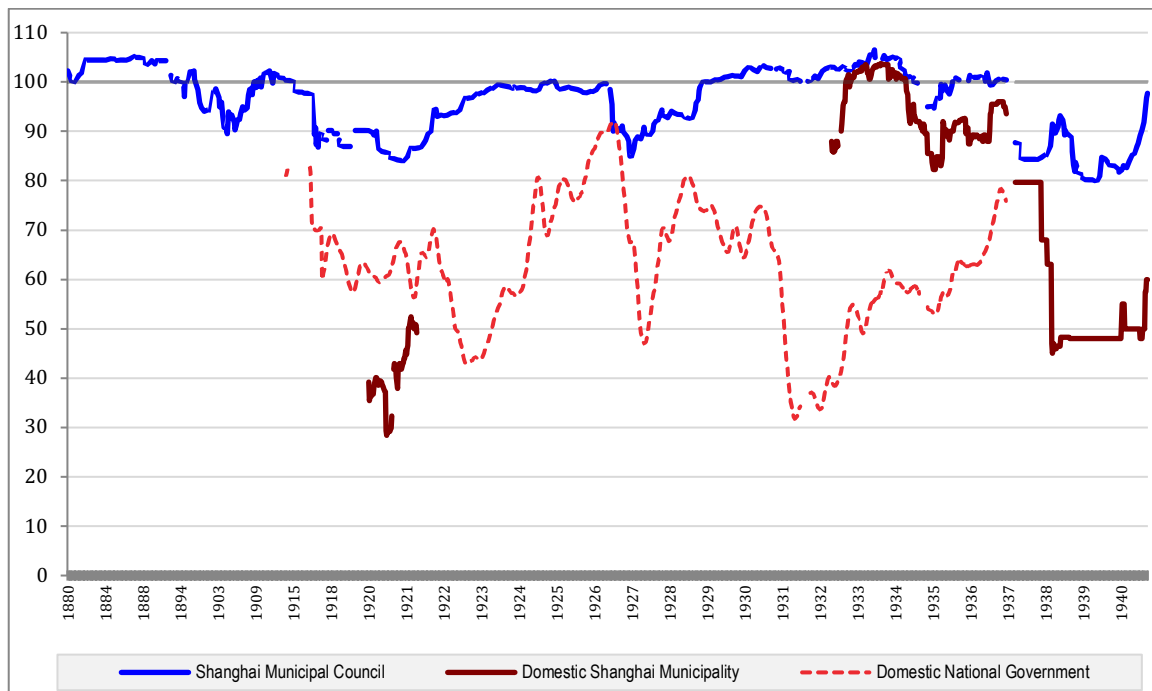
closely aligned with par value, compared to averaged prices of the other series. Note further that for periods when these extraterritorial-issued bonds did fall in value, such as during the early and late 1920s, these price falls were mimicked on a greater scale by domestic government issuances.

Second, somewhat surprisingly, at least for most of their period of overlap, the averaged bond prices of the domestic Shanghai municipality are higher than those of the domestic central government. In theory, the hierarchy of authority that national governments hold over sub-national governments would suggest that investors would, given a better theoretical risk profile, price national issuances higher than subnational.

These results are slightly misleading given that for much of the period, bond offerings of the domestic municipality authorities could not even be placed to investors such that they might be traded so as to indicate a market price. Such "failures" do not appear in the chart, with the telling exception of the 1920 period, when a small amount of trading in the Beiyang-era municipal offering was being priced at levels far below that of most of the domestic central governments' traded bonds.

Third, it is important to note that the domestic central government price series, although presented as a single series, represents the market prices of debt obligations issued and then assumed by multiple central governments. Accordingly, we observe sharp price declines at each of the transitional events representing the fall of the governments in question—in 1911 with the fall of the Qing, and in 1927 with the fall of the Beiyang government.

Figure 11.11. Bond prices, averaged across issuer, 1880-1941 (Standardised face value=100)



Sources: Foreign settlement municipal bond prices: *North China Herald*, various issues 1880-1941;

Domestic municipal bond prices: *Bankers Weekly*, various issues 1920-1922, and *North China Herald*, various issues 1932-1941; Domestic national government bond prices: *Shunpao*, various issues 1912-1922; *Bankers Weekly*, various issues 1920-1937

11.5 Summary and Conclusions

Shanghai was home to multiple stock exchanges that traded differing sets of financial instruments, with bond trading activity undergoing several upswings and downturns throughout the pre-war time period. The domestic stock exchanges dealt primarily in government bonds, with the majority of volume traded comprised of national government internal debt issuances; offerings by Shanghai's domestic municipal governments were rarely actively traded. The extraterritorial-operated stock exchange included a bond market comprised of more consistently-traded extraterritorial municipal bonds.

Overall, this chapter has provided a detailed history of the issuance processes, investor interest, and price series of the bonds of the three sets of government issuers. Employing a comparative approach, we have been able to explore the relative and changing set of contemporaneous investor perceptions of the relative quality of the underlying institutional environments as represented by the differing issuers.

The price histories of the extraterritorial municipal bonds contrast fairly sharply with those of the domestic governments' issuances, whose bonds rarely traded near par and usually were issued at sharp discounts. Nonetheless, as indicated, prices of extraterritorial municipal bonds did move in response to significant political and economic events affecting both Shanghai and the greater China political landscape. This underscores our theme that the private property rights regimes facing economic agents including investors and firms were not absolutist, either "strong" or "weak", but rather relative and variable over time.

To help resolve the important debate in the Chinese economic history literature centring around competing viewpoints of domestic institutional quality, we have leveraged Shanghai's unique dualistic institutional frameworks, one of which mimicked the broader Chinese domestic institutional environment, and the other which operated under extraterritorial legal, political and social constructs. Simultaneously, we also leveraged the fact that governments and firms that operated within each of these distinct institutional environments issued financial securities, differing in terms of the implicit private property and contract rights afforded by the institutional environments under which they were issued. Thus, investors pricing these securities were implicitly pricing the associated repayment risks of these differing sets of financial instruments. The creation of an original new weekly bond pricing data series and related material has allowed us the opportunity to analyse contemporaneous investor behaviour in Shanghai's capital markets.

Shanghai's economic actors consistently chose to invest in extraterritorial governments and firms, over those of similar domestic governments and firms, with the primary difference who contract rights and legal and economic rights were defined by the institutional environment in which they were issued. Given these results, we are able to draw fairly definitive conclusions of the perceived strength and efficacy of the respective institutional environments. By measuring relative levels of investor demand for financial assets issued by sovereign governments in both environments, we find a consistent pattern indicating contemporaneous actors perceived extraterritorial protections on private property and contract rights to be superior to those offered under the domestic Chinese institutional environment. The robustness of these findings is suggested by their considerable consistency over time and across multiple domestic central and municipal governments.

The results robustness also derive from the fact that both domestic and extraterritorial investors had the ability to purchase both extraterritorial- and domestic-issued sovereign bonds. This implies that both security types were in the portfolio possibility sets of all investors; therefore, observed market prices represent the outcome of the investment decisions of both extraterritorial and domestic investors. This is important, as it indicates that differentials in demand reflected the simultaneous decisions of Shanghai's investor class regarding these securities' repayment risks.

Chapter Twelve.

Conclusions

12.1. Objectives of this Research Dissertation

The primary focus of this dissertation has been to advance and clarify the existing debate in the literature regarding opinions on the capability, efficacy and strength of China's late imperial and republican domestic institutional environment. To help advance the debate, we looked to move beyond the standard approach of analysing China's past institutional environment by relying on current-period interpretations of historical events. The creation of an original new weekly bond pricing data series provided the opportunity to analyse contemporaneous investor behaviour in Shanghai's early capital markets. In doing so, we could capture investors' contemporaneous perceptions of the strength and efficacy of Shanghai's respective institutional environments. Given the similarities between the institutional environment of domestic Shanghai and the broader institutional environment of domestic China, our comparative analysis between Shanghai's parallel the institutional environments, allow us to make inferences about contemporaneous actors' perceptions of China's domestic institutional environment. Thus, rather than relying on backwards-looking methodologies to form opinions on China's historical institutional environment, our approach is based on uncovering and utilising the perceptions of contemporaneous economic actors. Sections 12.2 and 12.3 provide a detailed summary and analytic strategy of the study's first main research goal.

The second main research goal, discussed in greater detail in Section 12.4, involves an analysis of the dynamics of Shanghai's early capital markets, with an in-depth analysis of the operation of the city's multiple bond markets. To conduct the analysis in this dissertation, we have constructed a novel dataset that provides, for the first time in the Chinese financial history literature, weekly Shanghai municipal government bond pricing data. The scale and scope of the time series collected allow for a deeper and more robust analysis of the performance and activity of these markets than heretofore presented in the literature. Finally, a discussion of the limitations of the study is presented in Section 12.5.

12.2. Analysing China's Domestic Institutional Environment

In light of considerable debate in the literature regarding the overall strength and capacity of China's domestic institutional environment that characterised the late-imperial through pre-war republican era, we qualitatively examined the nature of China's institutional protections on private property and contract rights, with an emphasis on addressing the difficulty in capturing the inherent mutable complexities characterising these concepts. In doing so, we have underscored the inherent multidimensionality of concepts such as state capacity, institutional quality, and private property rights, which help drive the literature's competing findings that characterise the domestic Chinese institutional environment as either strong or weak.

This inherent difficulty in measuring the strength and efficacy of China's institutional environment is reflected in the scale and scope of the debate found in the economic and political history literature regarding China's institutions over the late imperial and republican era, with different sets of scholars producing convincing evidences in support of differing positions on China's institutional strength.

12.2.1. China's Domestic Institutional Environment — Contested Viewpoints

The discussion provided in Chapter Three regarding China's domestic institutional environment underscores the difficulty in succinctly answering what some regard as relatively straight-forward questions, such as whether China's domestic institutional environment for private property rights environment was either effective, or if it improved or deteriorated over time. While by all objective measures it is clear the scale of the state apparatus grew itself grew over time, with new government bureaucratic organisations and offices created and enlarged, whether positive outcomes in regard to a stronger institutional framework protecting private property or contract rights in ways that could encourage economic and financial activity is well contested within the literature. Paauw (1952, 1957), Eastman (1974, 1984a, 1984b, 1991), Coble (1980), and Myers (2000) are among those who present convincing arguments indicating a weak domestic state institutional environment, lacking in state capacity with poor tax-raising ability and a fiscal situation spiralling out of control.

Conversely, however, another set of researches pushes back against the narrative of a domestic institutional environment to be depicted as uniformly weak. Zelin (1998) and Huang (2001) provide examples of solid legal underpinnings supportive of effective private property and contract rights. Strauss (1998, 2008), van de Ven (2014), Boecking (2015), and Thai (2017) highlight examples of positive state capacity and effective institutions capable of implementing policy goals. Bian (2005a, 2005b) provides arguments supportive of both viewpoints. Sheridan (1975) and Wakeman (1996), meanwhile, describe a level of internal and external violence that could only prove disruptive to effective economic development or state-building. Given such differing views of the domestic state presented in the literature, it is logical to ask, which analyses more accurately reflect the domestic institutional environment? Are optimistic analyses by scholars more correct, or are the more negative evaluations more accurate? Somewhat confusingly, there appears to exist strong evidences supportive of both positions. Strauss (1998) herself recognises the contradictions within the Guomindang period as reflected by the title of her work, *Strong Institutions in Weak Politics*. The question, and difficulty, facing scholars is determining the respective weights and caveats to place upon the differing and competing sets of evidences.

Yet this seeming inconsistency underscores the fact that concepts such as "institutional environment", and "private property rights institutions", are inherently complex, multidimensional, and indeterminate. Thus, different scholars have been able to identify different evidences that support their particular viewpoints as to the nature of China's domestic institutional health as one of strength or weakness.

The multi-faceted nature of the domestic institutional environment has further led to significantly differing portrayals within the literature—at the same time that we observe the expanding role of the domestic state across society and within the economic sphere, and a growing scope and capacity of some state bureaucratic systems and formal legal institutions, all of which help to strengthen some important features of the private property rights environment, we can also concomitantly observe the state use its power to extract economic assets from private economic actors. Further, throughout the entirety of the late-imperial through republican period, domestic state capacity in regard to the ability of the central government to exercise a monopoly of force appears to have been persistently low, with continual occurrences of internal and external non-state actors employing military force resulting in the expropriation or destruction of private economic agent property.

At any given time, certain aspects or measures of property rights protections might be considered strong (for instance, an effective customs tax collection administration), while other aspects might be viewed as weak (for instance, the existence of numerous armed paramilitary groups able to expropriate or destroy private business assets). Relatedly, given the multi-dimensional nature of institutional quality, various defining aspects experienced differing trends over time, with some possibly improving, while others simultaneously weakening.

Understanding this complexity, therefore, allows us to rationalise the seeming inconsistency of competing viewpoints of domestic private property rights institutions, both over time and within a given time period, as multiple indicators of property rights protections—e.g., application of rule of law, expanded funding for formal court system, effective administration of customs duties, private company assets expropriated by the state, private banks compelled by regulatory decree to purchase government bonds, destruction of economic assets by internal and external military clashes—simultaneously suggest very different conclusions as to the overall health of the domestic institutional environment.

12.3. Addressing the Debate in the Literature on China's Domestic Institutional Environment

As outlined, there is an important and yet unsettled debate in the literature regarding the nature of China's late-imperial and early republican institutional environment, with some traditional mainstream approaches characterising the environment as decidedly weak, and more recent revisionist views suggesting a more effective and capable bureaucratic domestic institutional environment. We employed multiple strategies to look to address this debate.

12.3.1. The Role of Violence

To begin with, we conducted a broad yet detailed qualitative analysis, supported by empirical data where available, to consider the quality of private property and contract rights protections afforded under the domestic national institutional environment. The analysis focussed on the ways the domestic institutional environment varied along differing vectors of institutional quality, as well as changes along such vectors over the course of the time frame considered.

One of the most important methodical strategies employed in our analysis was to consider the importance that the role of political violence played in shaping the quality of the domestic institutional environment. As Weingast and his co-authors argue in their research on what they refer to as the Violence Trap, the field of development economics has consistently underappreciated the import of political violence in the economic growth process (North *et al.* 2009, Weingast 2017: 52). Their work presents evidence indicating that the level of political violence within society fundamentally affects the development process, primarily by way of powerful effects on the incentives of state actors to address the problem of violence, often in ways that inherently lead to poor protections of property rights and thereby constrain the opportunity for sustained economic development.

Our findings both employ the theoretical approach advanced by Weingast and his Violence Trap co-authors, and provide support for their arguments in the particular historical framework of late-imperial and early-republican China. Specifically, utilising the same measure employed by Cox *et al.* (2013, 2017), and supplemented by a detailed accounting of the historical record related to the period's episodes of large-scale organised political and social violence, we find the overall levels of violence within the domestic environment to have been extremely high—during certain sub-periods of the time frame to have been on par with the level of political violence suffered by some of the weakest states, experiencing average violent political regime change of once per annum. As explicated by the arguments contained within the Violence Trap and our "low-credibility" trap theoretical constructs, such levels of persistent and constant political violence generate conditions wherein which state actors are incentivised to act in ways that undermine their ability to create credible commitment mechanisms to protect private property rights while inducing behaviours on the part of state actors that prioritise the short-term benefits accruing from violations of private property rights while discounting the long-term expected benefits that can be achieved from protecting such rights.

12.3.2. Shanghai's Unique Institutional Setting

The second major strategy we employ to address the debate in the literature is to take advantage of the unique historical setting of Shanghai over the late imperial and republican period. To do so, we start with a series of observations. The first is centred on the dualistic institutional environment that characterised Shanghai during the timeframe, a city defined by concurrent, parallel institutional environments, one domestic, and one extraterritorial. Second, given the unitary nature of the domestic central government and its legal system, we argue that Shanghai's domestic institutional environment can serve as a suitable proxy for the national domestic institutional environment that is the concern of the debate in the literature. Third, we note that it is useful, therefore, to compare Shanghai's two parallel institutional environments, in order to observe ways in which contemporaneous actors behaved within and across the two parallel environments, so as to develop and understanding of how these economic actors viewed the respective institutional quality of the two environments. Finally, when undertaking this type of comparative analysis, we focus on financial market activity within the two environments. We do so because financial instruments are particularly sensitive to the strength of contract and property rights. Our primary empirical analysis utilises investor behaviours and trading activity on the city's parallel bond markets, one a domestic-operated capital market, dealing primarily in domestic national and subnational bonds, and the other an extraterritorial-operated capital market, dealing primarily in extraterritorial municipal bonds. Yet while Shanghai's bond markets were bifurcated, the city's investor class was not; that is, the market participants on both markets comprised both domestic and extraterritorial economic actors. This condition is important, for it means market prices reflect the joint revealed relative preferences for domestic and extraterritorial issuances. We are thereby able to observe the relative levels of market demand for the bonds of domestic governments, compared those of the extraterritorial International Settlement government, as reflected in the price and volume demanded differentials

12.3.2.1. Shanghai's Parallel Domestic and Extraterritorial Institutional Environments

The debate in the literature surrounding the level of domestic institutional quality in China over the late-imperial through republican time period is accompanied by a similar if less active consideration in the literature regarding the differences between the co-existing institutional environments found in Shanghai over the same period. Under the imposition of the system of extraterritoriality, Shanghai was home to a section of the city that operated under a separate, unique set of legal, political and social constructions than those defining the broader domestic environment and by extension the other parts of Shanghai. Much of the limited literature that does consider the economic impacts of Shanghai's differing institutional environments often makes rather broad sweeping generalisations and assumptions that the city's extraterritorial environment provided superior institutional safeguards on economic actors' private property rights. Thus, a related research goal was to consider provide more detailed and definitive measures of the relative quality of Shanghai's parallel institutional environments.

We sought to describe and summarise in qualitative detail the nature and foundations of the institutional environments that existed within domestic and extraterritorial Shanghai, by analysing the degree of variation both within and between them over the time frame under consideration. In particular, Part III focussed on the institutional framework that characterised Shanghai's domestically-administered areas contrasted with that of its extraterritorial settlements. Overall, we find there were two primary ways in which the extraterritorial institutional environment differed from that of the domestic.

First, the role of the state did not fundamentally change over the course of the time frame. From the start, the International Settlement was involved in an array of public works, such as paving roads and laying sewer lines, and in the provision of policing, military defence, and firefighting. While the scale of the foreign municipal governments increased in line with the growth in populace and economic activity, in general these governments continued to play a relatively

limited role. Many services, such as the delivery of tap water, gas for heating and lighting, or electricity, were supplied via private, albeit regulated, concerns. Overall, it is fair to describe the municipal government of the International Settlement as maintaining a traditional *laissez-faire* role. The Settlement's fiscal dependence on tax receipts and bond issuances played an important role in this, as the Shanghai Municipal Council faced definable, credible limits in regard to its tax policies—unlike the domestic state, it was not a military-backed authoritarian regime, instead receiving its fundraising authority from the Settlement's taxpayers, which created an inherent effective check on its power to arbitrarily raise tax rates. Settlement bonds were issued, effectively, in foreign currency (*taels* or *yuan*); thus, unlike domestic governments, the Council could not engage in debasing the currency to reduce its effective debt obligations. Nor did the Council possess the regulatory or compulsory authority to force private banks or other economic actors to hold its bonds. The Council was dependent upon its bonds being viewed as attractive investments in order to induce investor interest, which it accomplished by a commitment to a strong private property and contract rights environment, imposing relatively little regulation on business activities, and maintaining a small footprint in the economic sphere. There existed no parallel, for instance, to the Guomindang bureaucratic agencies devoted to economic planning, let alone state-owned enterprises; indeed, the Council took the opposite strategy, privatising its ownership of the Shanghai Electric Company in 1929.

Second, the extraterritorial settlements' state apparatuses exhibited capacity to protect residents' property rights from non-state actors; i.e., to sustain a monopoly on force within their sovereign areas. In many respects, the International Settlement and French Concession served as effective oases of safety within the relatively embattled domestic areas of the city. Dating back to the Taiping Rebellion and Small Swords period up through to the 1937 Battle of Shanghai, the foreign settlements experienced relatively little impact from outside military clashes that conversely devastated the domestic areas in terms of loss of property and life. This relative safety was well-recognised by the contemporaneous populace, and hence it is not surprising that the populations of the "foreign" settlements in fact comprised over 90 per cent domestic Chinese. Further, Chinese residents sought out the extraterritorial settlements not only in order to live, but also to establish domestically-owned businesses and factories; such movement of economic activities were accentuated during periods of severe civil strife, such as the outbreak of fighting during the Northern Expedition in 1928, or by the Japanese military in 1932 and 1937. Given its perception as a centre of relative safety, it is not surprising that important domestic business concerns, such as domestic modern banks and the domestic stock exchanges, chose to locate their head offices of within the boundaries of extraterritorial Shanghai.

Thus, the themes discussed above in regard to the domestic experience—the state's role in developing institutions to promote private property rights, or conversely in either itself or allowing non-state actors to violate private property rights—appear to have been considerably more positive in comparison. However, it is important not to over-inflate the degree to which the private property rights environment of the extraterritorial settlements could be considered as unequivocally "strong". While the literature has often assumed that Western-established governments are able to provide incontrovertibly strong private property rights protections, this was not necessarily the case on the ground in Shanghai's extraterritorial settlements. To begin with, while not of the scale or scope to that observed in the domestic setting, outside—and internally instigated—episodes of violence did impact the institutional and economic environments of the settlements. Violence committed by organised crime occurred within the extraterritorial settlements. The famous gangster and purported head of the "Green Gang", Du Yuesheng, not only made his home inside the French Concession, but moreover arranged kidnappings and assassinations that took place within the extraterritorial settlements themselves. The aftermath of 1925's May Thirtieth Movement led to the imposition of martial law declared within the International Settlement. Furthermore, as time went on, both the extraterritorial settlement councils, similar in trend to that of the domestic Shanghai municipal government if not in scale, suffered loss of sovereign control to Japanese military authority.

Other forms of institutional weakness and a lack of strict adherence to rule of law existed. Whilst often (self-)described as an example of "clean" government, both extraterritorial municipalities were fraught with unscrupulous examples of abuse of government power for personal gain, or simple incompetence (Bickers 1999, Whewell 2015). Outright corruption was not uncommon, especially in the terms of collusion between the French Municipal Council and the Green Gang leadership (Wakeman 1978: 207, Martin 1992). Further, particularly for domestic Chinese residents, bias and racism created conditions that deviated sharply from stated classical liberal doctrines of the equality of all in nature and in opportunity. It remains noteworthy that even in the face of such bias, so many domestic actors viewed the opportunities and environment within the settlements as preferable to that found within the domestic setting's increased exposure to both violence and expropriation of property by state or non-state elements.

Overall, it is evident that as in the domestic setting, the nature of the extraterritorial institutional environments, and the ability of their state apparatuses to protect and enforce private property and contract rights, was neither unchanging nor absolute, either when viewed individually over time, or in direct comparison to the adjoining domestic institutional environment.

12.3.2.2. Utilising Shanghai's Institutional Framework to Address Debates in the Literature

To begin to resolve the important debate in the Chinese economic history literature centring around competing viewpoints of domestic institutional quality, we sought to leverage the existence of Shanghai's unique dualistic institutional frameworks, one of which mimicked the broader Chinese domestic institutional environment, and the other which operated under extraterritorial legal, political and social constructs. Simultaneously, we also leveraged the fact that governments and firms that operated within each of these distinct institutional environments issued financial securities. The differing attendant implicit private property and contract rights of these securities were distinctly defined by the differing legal, political, credible commitment mechanisms and other characteristics shaped by the institutional environment under which they were issued. Thus, investors pricing these securities were implicitly pricing the associated repayment risks of these differing sets of financial instruments.

Moreover, while Shanghai's dual institutional environments differed considerably, both nonetheless existed within a single place, within the same time frame, affected by the same geographic, locational, and economic dynamics, and populated by the same singular set of economic actors who comprised Shanghai. These economic actors were free to engage in economic behaviours within and across the city's differing institutional environments. Such behaviours included the ability to choose between investing in financial securities issued by firms and governments that operated under the domestic institutional environment, or those that operated under the extraterritorial environment. The creation of an original new weekly bond pricing data series and related material allowed us the opportunity to analyse contemporaneous investor behaviour in Shanghai's capital markets. As we repeatedly observed, the revealed preferences of these economic actors consistently chose to invest in extraterritorial governments and firms, over those of similar domestic governments and firms, with the primary difference who contract rights and legal and economic rights were defined by the institutional environment in which they were issued.

Given these results, we are able to draw fairly definitive conclusions of the perceived strength and efficacy of the respective institutional environments. Rather than relying on backwards-looking methodologies to form opinions on China's historical institutional environment, our approach is based on uncovering the perceptions of contemporaneous economic actors. Employing a methodology measuring relative levels of investor demand for financial assets issued by governments and firms in both environments allowed an evaluation of the relative perceived strengths of extraterritorial and domestic Shanghai's institutional environments. As observed, we find a consistent pattern of reluctance by economic agents to hold domestic financial instruments, absent a steep discount, when presented with the option to hold similar extraterritorial financial instruments. Such findings imply contemporaneous actors perceived extraterritorial protections on private property and contract rights to be superior to those offered under the domestic Chinese institutional environment. The robustness of these findings is suggested by their considerable consistency over time and across multiple domestic central and municipal governments. Such findings also suggest that revisionist analyses seeking to depict high levels of domestic state capacity and institutional strength are potentially overweighting or misinterpreting evidence discounting the viewpoints of contemporaneous actors of their perceived relative degree of domestic state capacity and institutional strength.

12.3.2.3 Methodological Issues

The approach of this dissertation has been to argue the standard strategy employed suffers from the fact that because there exists so much competing evidence suggesting differing conclusions, attempting to parse and weigh their relative importance is inherently fragile. Moreover, it too heavily relies on current-period scholars sifting through secondary or primary source data, employing either qualitative or quantitative analysis techniques, to present arguments in support of one or another viewpoint, whether traditional, modified, or revisionist. Further, concepts such as institutional strength are inherently ambiguous, and the complexity and variation of data imply it is possible to construct credible, evidence-supported conclusions on either side of the argument, an outcome reflected in the published literature. It is for these reasons that we argue for the appropriateness of our methodological strategy of employing contemporaneous investor perceptions to evaluate Shanghai's parallel private property rights institutions.

First, utilising contemporaneous investor behaviour alleviates the necessity of relying on secondary analyses and current-period interpretations of historical events and institutional settings. Researchers looking back at the timeframe, each with access to perhaps different source materials, employing varying theoretical frameworks and analytic tools, can logically arrive at differing, sometimes seemingly inconsistent conclusions about the nature of the different institutional environments, such as in domestic and extraterritorial Shanghai. While such qualitative researches can add important aspects to our understanding of the processes shaping the institutional health and complexity defining late-imperial and republican China, they are necessarily subjectively-coloured by the researchers undertaking the analysis.

Second, a comparative analysis allows us to eschew absolutist measurements. It is accurate that from our analysis of the qualitative financial data, we are able to utilise contemporaneous investor behaviour to make the general observation that for investors, private property rights protections were continually and consistently perceived more robust in Shanghai's extraterritorial institutional environment than in Shanghai's and China's domestic institutional environment. Importantly, however, beyond this general finding, we observe that economic agents' behaviour indicated perceptions in regard to property rights protections were not invariant across these institutional settings, and viewed more robust in some time periods than others, suggesting the relative difference in quality of such rights between the dual institutional environments proved to be mutable over time.

Further, comparing market outcomes generated via the investment decisions of contemporaneous economic actors is methodologically consistent with the observation that private property rights and associated institutional constructs are complex and multidimensional nature, implying that seeking to capture their quality or strength via construction of a singular "objective" numerical measure is a specious exercise. Attempting to assign "the" "correct" numerical value on aspects of private property rights, such as rule of law or the level of contract rights protections, in order to create variables to be used in statistical analyses can introduce both tautological and bias issues, as well as inherent arbitrariness into the research process. More importantly, economic theory indicates that what is most important in determining economic actors' behaviours is not the "true" level of private property rights, or likelihood of expropriation, or expected return of any given investment opportunity; rather, it is the *perceived* levels of such factors that drive economic decision-making. Economic agents might be mistaken in regard to their *a priori* perceptions and expectations, and only disabused of their misconceptions once outcomes are realised *ex post*; however, what drives their actions are their *a priori* perceptions. Thus, we argue, our reliance on those signals that reflect investors' *a priori* expectations of private property rights institutions represents a more theoretically consistent approach.

12.4 Shanghai's Early Financial Markets: Contributions to Chinese Financial History

An additional contribution of this research to the literature comes from its construction of an extensive financial data series from primary historical sources comprising trading information recorded on Shanghai's early financial markets. This constructed data set includes transactions prices of traded securities. For the analysis undertaken in this dissertation, we primarily considered the market prices of bonds that traded on Shanghai's financial markets, both domestic and extraterritorial, with weekly pricing data gathered on domestic national bonds, Shanghai municipal domestic and extraterritorial government bonds. This data set is valuable because it allows us to recreate both the pricing processes as well as an understanding of relative demand by investors of the financial instruments generating these data series, and to describe many aspects of Shanghai's early capital markets in a level of detail heretofore not available in the literature. For instance, the frequency and availability of pricing data helps provide an indication of investor demand for the various instruments, beyond the actual pricing data itself. Further supplementing the price data are contemporaneous financial market reports that describe the relative ease or difficulty that issuing entities experienced in placing their issuances, again helping provide a deeper understanding of the demand dynamics for domestic and extraterritorial government securities by Shanghai's contemporaneous investor class.

12.5 Discussion of the Dissertation's Limitations

While ambitious in its approach and scope, this dissertation nonetheless suffers from several important limitations, both theoretic and methodological in nature, which must be considered in regard to their implications on the conclusions obtained. Furthermore, these limitations are suggestive of several potential extensions that might expand and further the scope of the research findings.

One major limitation comes from the methodology we employ. Although above we underscored the advantages of utilising investor perceptions to measure the relative strength of Shanghai's institutional environments, we must also recognise that this approach also serves as an important limitation of the study. First, while we argue ardently that the correct approach to analysing multi-dimensional concepts such as institutional capacity and private property rights is best approached from a comparative measurement approach utilising

investor perceptions, as opposed to absolutist approach, given that investor perceptions are inherently subjective, we lose the ability to create a reference instrument based on objective criterion. Relatedly, while rational investors do indeed seek to continually gauge expected risks facing their investments' income streams, investors can misjudge such risks, sometimes badly. For instance, as Ferguson (2006) notes, on the eve of the First World War, bond investors appeared quite sanguine about the possibility of a major war breaking out in Europe, with their subsequent surprise generating significant abrupt price downturns once the first cannons were fired.

A second limitation also relates to our methodology strategy. We chose to consider market demand measures, particularly by way of the pricing of sovereign bond issuances across differing property rights environments, to measure differentials in the strength of perceptions of private property rights protections. This strategy therefore uses investors' views of default risks impacting the demand and pricing of bonds as a proxy for measurement of such rights. But while an important indicator, sovereign default repayment risk is not the only factor that determines the nature of a given property rights environment. While bond prices do indeed provide a measure of the price of risk investors assign to the probability of default, they are also impacted by other factors, such as investors' desire for liquidity. If investors demand for holding fixed income assets changes significantly for reasons outside of perceptions relating to repayment risk, prices can change irrespective of issues pertaining to repayment risk. We do note, however, that this issue is alleviated by the fact that we are comparing the relative demand for similar forms of extraterritorial-issued and domestic-issued long-term sovereign bonds. If demand for fixed income assets rose or fell across the board, then relative prices would be expected to remain stable.

A third limitation is the lack of detailed analysis on the composition of the investor class. More complete and detailed evidences of the nature of investor participation in the extraterritorial-run and domestic markets would add to overall understanding of whose perceptions in particular were driving price differentials. Additionally, greater information of whether such investors were primarily individuals or institutional, as well as their relative participation levels, would allow us to better understand issues such as investor power and whether market prices were driven by the actions of a few large institutional players such as extraterritorial or domestic banks, or by the behaviour of atomised investors. Further attempts to locate historical records providing such data could help fill in these missing details regarding the particular make-up of investors.

Another limitation relates to the potential role that larger socio-political factors played in driving investor decisions, beyond our primary focus on private property and contract rights differentials. The argument presented in this dissertation is that observed contemporaneous investor behaviour consistently indicates that when presented a choice to invest in financial instruments issued by extraterritorial municipal governments, versus investing in similar financial instruments issued by domestic municipal or national governments, all things equal, investors chose those instruments backed by stronger property and contract rights protections. This conclusion was arrived at by focussing our analysis rather narrowly utilising the contract rights approach to financial instruments as originally advanced by Mises and later developed more formally by Hart (1995). In other settings, scholars contend that understanding financial market behaviour also requires consideration of securities issuers' and market participants' political power (Attard & Dilley 2013: 3). Accordingly, it might be that the observed investment decisions we ascribe being driven by differentials in property and contract rights were instead due to investors responding to colonial power wielded by western-backed local governments. Such an argument is somewhat tempered by the fact that Shanghai cannot appropriately be classified as a colonial state, with the government of the International Settlement not formally colonial, neither financed by nor politically linked to any particular foreign government. As its "international" designation reflected, relevant western states each had differing financial and strategic interests and were frequently at policy odds.

Nonetheless, the extraterritorial settlements of Shanghai certainly mirrored some of the trappings of more formal colonies elsewhere in the world. Specifically, the municipal councils were backed by the implicit, and occasional explicit, shows of force by foreign powers' gunboats harboured along the bank of the Huangpu. Whether in actuality or simply by perception, it might be implied that extraterritorial governments benefitted from the use of broader imperial power at the expense of domestic concerns. Given this interpretation, investors might have been more directly responding to the perception that municipal bonds issued by extraterritorial governments represented lower risk because these governments had an implicit backing by foreign colonial powers. Thus, rather than investment decisions explicitly influenced by perceptions of property and contract rights differentials, investors might have been responding to an inherent "empire effect," as first suggested by Davis & Huttenback (1986) and further advanced by Accominotti *et al.* (2011), which claims colonial governments received lower borrowing costs than comparable free nations as a result of investor perception of such regimes as an extension of the colonial power; hence, market prices of colonial bonds reflected the underlying risk associated with the credit of the colonial power. Further research might look to take account of these broader issues regarding the perceived role of colonial power so a more complete accounting of investor decision-making during this time period can be formed.

Additional limitations reflect those of time and interest. The limitations cited here, important as they are, are likely only a subset that the perceptive reader might have already noted. Nonetheless, our hope is that this current study has created the basis and impetus for additional researches to be undertaken and some of these limitations, and the research questions they imply, be explored in greater detail, all assisting in furthering our understanding of the operation and dynamics that defined Shanghai's early financial markets. While the dataset we compiled on Shanghai's extraterritorial and domestic bond markets proved valuable in conducting our analysis of comparative investor perceptions, its potential for further financial historical and theoretical research remains unrealised. Likewise, the financial data utilised in this research project represents just a fraction of a much larger and more detailed dataset we have collected on Shanghai's early financial markets, reflecting an opportunity to utilise these data to explore a host of additional questions, including both those period-specific relating to Shanghai's financial history, as well as broader issues pertaining to financial theory, that we hope will serve to further advance the literature.

Bibliography

- Accominotti, O., M. Flandreau, and R. Rezzik. 2011. "The spread of empire: Clio and the measurement of colonial borrowing costs," *Economic History Review*, 64, 2: 385–407
- Acemoglu, Daron. 2005. Politics and Economics in Weak and Strong States. *Journal of Monetary Economics*, Volume 52: 1199–1226.
- Acemoglu, Daron and F. Zilibotti. 1997. "Was Prometheus unbound by chance? Risk, diversification, and growth". *Journal of Political Economy*, Volume 105: 709–775.
- Acemoglu, Daron, Camilo Garcia-Jimeno, and James A. Robinson. 2015. State Capacity and Economic Development: A Network Approach. *American Economic Review*, Volume 105, Number 8 (August): 2364-2409.
- Acemoglu, Daron, Isaías Chaves, Philip Osafo-Kwaako and James Robinson. 2016. Indirect Rule and State Weakness in Africa: Sierra Leone in Comparative Perspective. in *African Successes, Volume IV: Sustainable Growth*, eds. Sebastian Edwards, Simon Johnson, David Weil. Chicago: University of Chicago Press: 343-370.
- Acemoglu, Daron, Simon Johnson and James Robinson. 2005. Institutions as a fundamental cause of long-run growth. *Handbook of Economic Growth*, Volume 1A: 386-472.
- Adongo, Jonathan. 2016. Creditor Protection Law Effects on Venture Capital Investment in Africa: Country-Level Evidence. *The Journal of Private Equity*, Volume 19, Number 3 (Summer): 37-50
- Aguilera, R. and C. Williams. 2010. "Law and Finance": Inaccurate, Incomplete, and Important", *Brigham Young University Law Review*. Vol 2010
- Akanbi, Olusegun. 2018. State Institutions and Tax Capacity: An Empirical Investigation of Causality. Working Paper, Economic Research Southern Africa.
- Alchian, Armen and Harold Demsetz. 1973. The Property Rights Paradigm. *Journal of Economic History*, Volume 33: 16-27.
- Alesina, Alberto and Paola Giuliano. 2015. Culture and Institutions. *Journal of Economic Literature*, Volume 53, Number 4 (December): 898-944.
- Alimov, Azizjon. 2015. Labor Protection Laws and Bank Loan Contracting. *The Journal of Law & Economics*, Volume 58, Number 1 (February): 37-74
- All about Shanghai and Environs: A Standard Guide Book*, 1934-35 Edition. 1935. Shanghai: The University Press.
- Allen, F. and J. Qian. 2009. "Comparing Legal and Alternative Institutions in Finance and Commerce." Chapter 6 in *Global Perspectives on the Rule of Law*, ed. J. Heckman, R. Nelson, L. Cabatingan, London: Routledge-Cavendish: 250-277.
- Allen, F., J. Qian and C. Zhang. 2011. "An Alternative View on Law, Institutions, Finance and Growth." Finance Department Working Paper, Carroll School of Management, Boston College.
- Almaskati, N., Bird, R., & Lu, Y. 2018. Corporate governance, institutions, markets and social factors. Paper presented at the European Financial Management Association's Financial Markets and Corporate Governance Conference, 2018 Annual Meeting, June 27-30.
- Andrews, R., G. Boyne, K. Meier, L. O'Toole, Jr., and R. Walker. 2005. "Representative Bureaucracy, Organizational Strategy, and Public Service Performance: An Empirical Analysis of English Local Government". *Journal of Public Administration Research and Theory*, 15(4): 489-504.
- anonymous. 1927. "Settlement in Shanghai"
- Antony, Robert. 1989. Peasants, Heroes, and Brigands: The Problems of Social Banditry in Early Nineteenth-Century South China. *Modern China*, Volume 15, Number 2 (April): 123-148.
- Arbor, Ann. 1995. The Green Gang and the Guomindang State: Du Yuesheng and the politics of Shanghai 1927-37. *Journal of Asian Studies*, Volume 54, Number 1, February.
- Arena, Philip and Nicholas Nicoletti. 2014. Selectorate theory, the democratic peace, and public goods provision. *International Theory*, Volume 6, Issue 3 (November): 391-416
- Armour, John, Simon Deakin, Prabirjit Sarkar, Mathias Siems, Ajit Singh. 2008. Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origins Hypothesis. *ECCI Working Paper Series in Law*, Working Paper Number 108/2008, May.
- Armour, John, Simon Deakin, Viviana Mollica, Mathias Siems. 2009. Law and Financial Development: What We Are Learning from Time-Series Evidence. *Brigham Young University Law Review*, Volume 2009, Number 6: 1435-1500.

- Aron, J. 2000. Growth and institutions: A review of the evidence. *World Bank Research Observer*, Volume 15: 99-135.
- Arum, R. 1996. Do Private Schools Force Public Schools to Compete? *American Sociological Review*, 61: 29-46.
- Ash, Robert. 1976. Land Tenure in Pre-Revolutionary China: Kiangsu Province in the 1920s and 1930s [Research Notes and Studies Number 1]. London: University of London, School of Oriental and African Studies, Contemporary China Institute.
- Attard, Bernard and Andrew Dille. 2013. Finance, Empire and the British World. *Journal of Imperial and Commonwealth History*, Volume 41, Number 1: 1-10
- Attard, Bernard. 2000. "Making a market. The jobbers of the London stock exchange, 1800-1986." *Financial History Review*, Volume 7: 5-24.
- Averill, Stephen. 1981. "The New Life in Action: The Nationalist Government in South Jiangxi, 1934-37". *The China Quarterly*, Number 88 (Dec., 1981): 594-628
- Bai Lijian. 2000. "近代中国债券市场价格变动的原因分析" (An Analysis of the Causes of Modern China Securities Market Price Fluctuations). *Nankai Economics Research* Volume 2000-2: 73-77.
- Bank of China. 1995. 中国银行行史 1912-1949 年 (History of Bank of China 1912-1949). Beijing: Zhongguo jinrong chubanshe.
- Barnett, R.W. 1941. "Shanghai's Exchange Market." *Far Eastern Survey*: 11-116.
- Basu, Kaishik, Eric Jones and Ekkehart Schlicht. 1987. "The Growth and Decay of Custom: The Role of the New Institutional Economics in Economic History." *Explorations in Economic History*, Volume 24: 1-21.
- Baten, Joerg, Debin Ma, Stephen Morgan and Qing Wang 2010. "Evolution of living standards and human capital in China in the 18-20th centuries: Evidence from real wages, age-heaping, and anthropometrics." *Explorations in Economic History*, Volume 47: 347-359.
- Beck, T., A. Demircuc-Kunt, and R. Levine. 2005. "Law and Firms' Access to Finance." *American Law and Economics Review*, 7(1): 211-52.
- Bedeski, Robert. 1981. *State-Building in Modern China: The Kuomintang in the Prewar Period*. Berkeley: Institute of East Asian Studies.
- Behr, Edward. 1996. *Prohibition: Thirteen Years That Changed America*. New York: Arcade Publishing
- Bell, M. and H Woodhead. 1912. *The China Year Book 1912*. London: Routledge & Sons.
- Bencivenga, V. and B. Smith. 1991. "Financial Intermediation and Endogenous Growth," *Review of Economic Studies*, 58, p. 195-209.
- Bencivenga, V. and B. Smith. 1993. "Some consequences of credit rationing in an endogenous growth model". *Journal of Economic Dynamics and Control* 17, 97-122.
- Bencivenga, V., B. Smith and R. Starr 1995. "Transactions Costs, Technological Choice, and Endogenous Growth." *Journal of Economic Theory*, Volume 67: 155-177.
- Bergere, Marie-Claire. 1998. Sun Yat-sen. [Translated by Janet Lloyd]. Stanford: Stanford University Press
- Bergere, Marie-Claire. 2002. *Histoire de Shanghai* [Shanghai: China's Gateway to Modernity, 2009, Translated by Janet Lloyd, Stanford, CA, Stanford University Press].
- Bernhardt, Kathryn. 1992. *Rents, Taxes and Peasant Resistance: The Lower Yangzi Region, 1840-1950*. Stanford: Stanford University Press
- Besley, Timothy and Torsten Persson. 2008. War and State Capacity. *Journal of the European Economic Association* Volume 6, Nos. 2-3 (February): 522-530.
- Besley, Timothy, and Torsten Persson. 2009. The Origins of State Capacity: Property Rights, Taxation, and Politics. *American Economic Review*, Volume 99, Number 4: 1218-1244.
- Besley, Timothy, and Torsten Persson. 2014. Why Do Developing Countries Tax So Little? *Journal of Economic Perspectives*, Volume 28, Number 4 (Fall): 99-120.
- BOC [中国银行总行, 中国第二历史档案馆 (eds.)]. 1991. 中国银行行史资料汇编 上编 (1912-1949). Nanjing: 档案出版社.
- BOC [中国银行行史编辑委员会 (ed.)]. 1995. 中国银行行史 (1912-1949). Beijing: 中国金融出版社.
- Bueno de Mesquita, Bruce, Alastair Smith, Randolph Siverson, and James Morrow. 1999. An institutional explanation of the democratic peace. *American Political Science Review*, Volume 93, Number 4: 791-807.
- Bueno de Mesquita, Bruce, Alastair Smith, Randolph Siverson, and James Morrow. 2003. *The Logic of Political Survival*. Cambridge, MA: The MIT Press.

- Bueno de Mesquita, Bruce, James Morrow, Randolph Siverson, and Alastair Smith. 2013. Testing the Selectorate Explanation of the Democratic Peace. New York University Department of Political Science Working Paper.
- Bian, Morris. 2002. The Sino-Japanese War and the Formation of the State Enterprise System in China: A Case Study of the Dadukou Iron and Steel Works, 1938—1945. *Enterprise & Society*, Volume 3, Number 1 (March): 80-123.
- Bian, Morris. 2005a. Building State Structure: Guomindang Institutional Rationalization during the Sino-Japanese War, 1937-1945. *Modern China*, Volume 31 Number 1 (January): 35-71.
- Bian, Morris. 2005b. *The Making of the State Enterprise System in Modern China: The Dynamics of Institutional Change*. Cambridge, MA: Harvard Univ. Press.
- Bianco, Lucien. 1995. Peasant Uprisings Against Poppy Tax Collection in Suxian and Lingbi (Anhui) in 1932. *Republican China*, Volume 21, Number 1 (November).
- Bickers, Robert and Isabella Jackson (eds). 2016. *Treaty Ports in Modern China: Law, Land and Power*. Abingdon: Routledge
- Bickers, Robert. 1996. Death of a Young Shanghaier: The Thorburn Case and the Defence of the British Treaty Ports in China. *Modern Asian Studies* 30, 2: 271- 300.
- Bickers, Robert. 1998. Shanghaier: the Formation and Identity of the British Settler Community in Shanghai 1843-1937. *Past & Present*, Number 159 (May): 161-121.
- Bickers, Robert. 1999. *Britain in China: Community, Culture and Colonialism, 1900–1949*. Manchester and New York: Manchester University Press.
- Bickers, Robert. 2003. *Empire Made Me: an Englishman Adrift in Shanghai*. London: Allen Lane.
- Bickers, Robert. 2004. Settlers and Diplomats: the end of British hegemony in the International Settlement, 1937-1945. in C Henriot & W Yeh (eds.), *In the shadow of the rising sun: Shanghai under Japanese occupation, 1937-45*. Cambridge University Press: 229 - 256.
- Bickers, Robert. 2012. The Challenger: Hugh Hamilton Lindsay And The Rise Of British Asia, 1832–1865 *Transactions of the Royal Historical Society*, Volume 22: 141–169
- Bickers, Robert. 2013. British Concessions and Chinese Cities, 1910s–1930s. in Billy So, Madeleine Zelin (eds.), *New Narratives of Urban Space in Republican Chinese Cities: Emerging Social, Legal and Governance Orders*. Leiden: Brill: 157–170.
- Billingsley, Phil. 1988. *Bandits in Republican China*. Stanford: Stanford University Press.
- Billmeier, Andreas and Isabella Massa. 2009. What drives stock market development in emerging markets-institutions, remittances, or natural resources? *Emerging Market Review*, Volume 10: 23-35.
- Bird, Isabella. 1899. *The Yangtze Valley and Beyond*. London: Cambridge University Press.
- Bishop, John. 1920. Extraterritoriality in China and its Abolition. *Chinese Social and Political Science Review*, Volume 3.
- Blattman, Christopher, Edward Miguel. 2010. Civil War. *Journal of Economic Literature*, Volume 48, Number 1: 3-57.
- Bloch, Kurt. 1939. War Accentuates China's Fiscal Disorder. *Far Eastern Survey*, Volume 8, Number 11 (May): 133-134.
- Bloch, Kurt. 1941. Social and Economic Shifts in China. *Far Eastern Survey*, Volume 10, Number 3 (February): 27-32.
- Boardman, A. and A. Vining. 1989. "Ownership and Performance in Competitive Environments". *Journal of Law and Economics*, 32 (April): 1-34
- Boecking, Felix. 2011a. Unmaking the Chinese Nationalist State: Administrative Reform among Fiscal Collapse, 1937–1945. *Modern Asian Studies*, Volume 45, Number 2, (March): 277-301
- Boecking, Felix. 2011b. The Bitterness of Fiscal Realism: Guomindang Tariff Policy, China's Trade in Imported Sugar and Smuggling, 1928-1937. *Harvard Asia Quarterly*, Volume 3, Number 2: 3-10.
- Boecking, Felix. 2017. *No Great Wall: Trade, Tariffs, and Nationalism in Republican China, 1927–1945*. Cambridge, MA: Harvard University Asia Center.
- Boettke, Peter. 2009. Institutional Transition and the Problem of Credible Commitment. *The Annual Proceedings of The Wealth and Well-Being of Nations* (1): 41-51.
- Bolton, Patrick. 2014. Corporate Finance, Incomplete Contracts, and Corporate Control. *Journal of Law, Economics, and Organization*, Volume 30, Issue suppl_1, May: i64–i81.