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The Development of Credit and Paper Money in the Song Dynasty

INTRODUCTION

Chinese paper money had its origins in the concept of credit. Salt licenses were created by merchants in order to facilitate the salt trade. These were slips of paper that were contracts between the two parties, based on trust. Soon, the idea was taken up by the state government which then issued various forms of paper currency over the years. This article will detail the development of credit and its eventual transformation into paper fiat currency, as well as the assorted problems that paper money faced. I will show the intimate connection between credit and paper money and explain just how paper came to be accepted as a viable form of money.

SONG CREDIT SYSTEMS

The development of paper money is intimately connected to the development of credit, as the idea behind them are similar: both involve a contract of trust between two parties. Credit refers to the ability of a customer to obtain goods or services without payment, provided that the customers pays eventually, usually with interest. This concept was not at all common in early China, as "from the very beginning in imperial China, taxation…was almost constantly in existence while public loans were difficult to find. For many centuries before the [An Lushan] Rebellion, Buddhist monasteries had played a dominant role in the loan market" (Liu 67). Ironically enough, despite the doctrinal ban against monks owning property and the prohibition

of carrying money, Buddhist monasteries were some of the wealthiest institutions in the realm. Large monasteries evidently had so much liquid revenue that they could provide public and private loans on a much greater scale than even the imperial government. However, during the heyday of the Song dynasty, Chinese society experienced drastic changes. In particular, we find a "development toward a money economy with adequate facilities for the transfer of funds and the provision of credit" (Shiba 13). Although Buddhist monasteries were the first major providers of credit, it was also done on smaller, often local scales by individual merchants or consortiums of merchants. During the development of institutionalized credit, statesmen "first learned how to use instrument of credit from merchants" (Liu 68). This was useful as they were able to see what worked and what did not, as well as resolve problems that they saw in the private system.

In 1069, Wang Anshi instituted his New Policies, which included the State Trade Bureau (STB):

> The State Trade Bureau originally was intended to eradicate what Wang perceived as monopolistic price manipulation by merchant cartels and usurious moneylenders…the STB engaged in a wide range of fiscal operations, such as trading in salt certificates… The STB also extended credit to petty retail shopkeepers such as fruit-sellers and butchers. Soon it branched out into more generalized financing, offering low-cost loans…of coin, goods, and precious metals to individuals or groups. To ensure the solvency of this loan program, borrowers were obliged to provide guarantors and to pledge collateral as security (Von Glahn (2016) 238-239).

Crucially, the STB offered loans to a wide variety of individuals and organizations, likely helping the economy grow and enticing startup businesses. Without these low-cost loan services,

many merchants would have been unable to sustain their small businesses due simply to the lack of capital (Shiba 14). Although the STB was short-lived, the idea remained strong. Without the STB there was nothing to prevent the re-formation of cartels, but regardless, the system still seems to have worked out well. In fact, according to the prefect of Hangzhou in 1092, "'as a rule cash is scarcely used in private trade in recent times. Instead retail shops rely on guarantees provided by trustworthy and wealthy individuals to make purchases on consignment from traveling merchants. Year after year they redeem the old debts and make new purchases" (Von Glahn (2016) 267). The importance of this lies in the fact that the system simply worked, and it worked well. With the development of credit as a viable purchasing method, it was only natural that paper money would develop out of the system.

ORIGINS OF PAPER MONEY

Money can take many forms. At its most basic, money is simply a physical object that can be exchanged for goods or services. Money can be cowrie shells, leather strips, or even large, carved stones. Money is convenient, as it is generally more portable and easier to handle than the direct trade of goods for goods (for example, exchanging salt for sugar). During the Song dynasty of China, the world's first paper money was developed and it soon became a popular method of barter. The invention of paper money arose directly out of simple necessity. In Song China, the main form of money was iron or bronze coins. A one-cash coin generally weighed around 3 grams each, which was not that much individually. However, since coins were usually carried and transported in strings of 1,000, a typical string would have weighed a little over 3 kilograms (~7 pounds). This is still reasonable. But, considering that merchants would travel long distances and carry with them large sums of money, the sheer weight and volume of coins often proved unwieldy to deal with in transactions. A contemporaneous example involves the

conversion rate between salt and coin in Sichuan: one pound of salt required one and one-half pounds of iron coin to purchase (Von Glahn (2016) 233). Let's consider a hypothetical merchant who wanted to purchase one thousand pounds of salt. He would have to bring one thousand and five hundred pounds of coin to the purchase destination, and then transport one thousand pounds of salt back to his starting point. Instead of being forced to transport such a large amount of weight and volume both ways, would it not be much easier and more convenient to only have to do that one way? Evidently merchants in Chengdu thought so, as they began "to issue their own paper bills of credit, known as *jiaozi*" around the year 1000 (Von Glahn (2016) 233). Since salt required such a large amount of iron coins to purchase, the merchants warmly welcomed a system where they could forego the initial transportation of cash and instead simply bring along a bill of credit. This system quickly devolved into the over issue of *jiaozi* by too many issuers, a problem that was solved when local government authorities stepped in. They created a "standardized format for the bills and restrict[ed] their issue to a consortium of sixteen Chengdu merchants" (Von Glahn (2016) 233). Although this was seemingly effective for a while, the government still had to intervene in 1014, taking over the issue of *jiaozi*. "By fixing the value of the bills in standard denominations of iron coin with a three-year term of circulation, the state transformed the *jiaozi* into the world's first genuine paper money" (Von Glahn (2016) 233). This was a great historical success, as for the first time ever, people could pay for everything they needed using nothing more than slips of paper. However, this particular system "remained confined to Sichuan" (Von Glahn (2016) 233). It would not be until some time later than an empire-wide paper money system was established.

The beginnings of a Song state-developed paper money system arose out of necessity due to extreme military and defense expenditures. Facing great threats from the north, "by the middle

of the eleventh century, for example, the regular army numbered 1.25 million men… As of 1065 defense expenditures alone consumed 83 percent of the government's cash and 43 percent of its total yearly income, surpassing by 35 percent the entire Ming budget of 1502" (Smith 81). This is extreme. By spending such an incredible percentage of their GDP, the Song soon found themselves completely strapped for cash. The example cited is from the 11th century, but as early as the 9th century the Song government was already spending more than they probably should have on their military. To cut costs, "in the late ninth century, the Song government introduced the *ruzhong* approach to encourage merchants to supply military provisions to the frontier in return for high profits" (Liu 68). Naturally this system depended on credit and actually helped stimulate the development of commercial loans. The way the system worked was thus: a merchant would deliver goods to the destination; he would receive a state-issued receipt for the amount of goods delivered; the state would become a debtor until the goods were claimed (Liu 68). The receipts that the merchants received were then basically as good as cash, spurring a voucher market where receipts could be bought, sold, and circulated as "instruments of short-term credit" (Liu 68). This system was later transformed when defense costs increased during the Tangut war in the 1040s. Since so much money was being spent on defense, the government needed a way to increase the inflow of revenue. To do this, they "decoupl[ed] the salt licenses from the frontier delivery system in 1049. Merchants could simply purchase salt licenses outright, without undertaking the delivery of military supplies…Moreover, the salt licenses could be redeemed for money rather than salt, and thus served as a negotiable bill of exchange" (Von Glahn (2016) 231). This innovation was an extremely important development in the evolution of paper money as the vouchers were now able to be redeemed for cash. This allowed holders of these licenses to buy other goods with the money they received for redemption. This incredible

development was so appealing that it "spurr[ed] the formation of a secondary market for trading salt licenses in Kaifeng. By the beginning of the twelfth century virtually the entire salt trade was in the hands of private merchants operating under state license" (Von Glahn (2016) 232). This license market helped paper achieve popular success and contributed to the later development of state-issued paper notes.

PROBLEMS WITH PAPER MONEY

Perhaps unsurprisingly, a major issue with paper money was lack of faith in the fiat currency, and the associated hyperinflation. By definition, paper money is worth only what one *believes* it to be worth. A note can be stamped with a value of one string but unless both parties – the payer and the payee – accept that the paper is worth one string, then it may as well be worthless. However even if the note was accepted as a viable money payment, it ran the risk of only being accepted at a discount. "Even when the paper currency system was under good control, a one-string note circulating in Liangzhe circuit was commuted to 750 coins, rather than its nominal face value of one thousand. After the disastrous military adventurism of the Kaixi period…one string's worth of the eighteenth-run paper notes, supposedly worth 400 to 650 coins, came to be worth only 192 to 250 coins toward the end of the dynasty" (Lee 140). This shows that in spite of what was likely attempted strict enforcement on the part of the government to solidify values, the public's perception was everything. When faith in the government declined, such as due to poor military campaigns or defeats, so did the value of paper decline as well. A seriously detrimental phenomenon that could have occurred is the selective acceptance of notes across businesses. For example, one business may not accept a particular issue of note at all. But, the store across the street might accept it, but only at a severe discount. This would put

the buyer at a quandary, as they would be forced to either spend their money for much less than it was worth, or not spend it at all.

Inflation can occur due to a variety of situations, but a major one in the Song was due to excess military expenditures. In order to keep funding military campaigns, the government would simply print more money to create the illusion that the state had money. This can only work for a short time before it falls apart. For example, in the early 13th century, "the Song financial administration issued a larger amount of *huizi* [a type of state-sponsored paper money] than the market could absorb to pay for rising military expenditure. In 1252, just two decades before the Mongol conquest of the Song dynasty, the amount if *huizi* reached 640 million, about seven times greater than the tax revenues" (Liu 72). This extreme oversaturation of the market with paper led to severe hyperinflation as each note was worth less and less with the printing of each new note forcibly inserted into the market. An example of this occurring is after disastrous offensives and a failed attempt by a Sichuan warlord to secede from the empire, an enormous amount of *huizi* notes were released into circulation. This led to the notes losing 40% of their value in short order, hitting an all-time low of each note being worth just 25% of its face value (Von Glahn (2016) 264). Despite all the problems that paper money faced, it still proved to be the most convenient way to trade. So even in spite of the extreme devaluation of *huizi* mentioned above, the notes still managed to "largely displace bronze coin, at least in larger transactions, in both public and private finance" (Von Glahn (2016) 264).

CONCLUSION

Paper money owes its entire existence to the credit system set up by early Song salt merchants. Within this system, vouchers were issued to facilitate the salt trade, which proved useful as it reduced the time and cost of transporting large volumes of iron or bronze coins. This

credit system was further developed by the state government, which culminated in the issuance of state-sponsored paper money. Along the way, paper money faced a variety of issues. From hyperinflation to lack of acceptance, paper experienced a turbulent infancy. In the end, paper money became the medium of choice for money transactions big and small, and the legacy of Song paper money is still felt to this day.

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