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'The efficiency of the Chinese silver standard, 1920-33'

The efficiency of the gold standard has been one of the most actively pursued avenues of research in economic history. However, not much research exists about countries outside the gold club. In the present paper, we focus on the case of interwar China, the only major country on a silver standard at the time. We lay out the conditions of the monetary system in China and examine how well its silver standard functioned.

Although China as a whole was on the silver standard, the traditional silver currencies used were not produced by a central authority. By contrast, the circulation of a particular kind of silver currency was usually confined to a local trading area. This characteristic of China's silver regime generated a domestic exchange market which was conceptually analogous to the foreign exchange markets between the gold standard countries, meaning we can rely on the large literature on gold point arbitrage as a framework to examine the efficiency of the silver standard. We formalize the mechanism of silver arbitrage in the presence of transaction costs as it relates to the special circumstances within China.

We estimated silver points between Shanghai and major commercial centers in north and central China. Based on the compilation of high-frequency exchange data and the flow of silver currency between Shanghai and several major financial sub-centers of China, we find that the Chinese silver standard in this period was efficient by using standard criteria. Our inferred measures of silver points favorably match the measured costs of silver shipments derived from contemporary accounts. The daily observations of silver-point violations were rare, silver-point violations did not persist for long, and silver currency shipments generally occurred in the profitable direction as a response to silver-point violations. Moreover, the exchange-market efficiency of the Chinese silver standard was not much different in magnitude to that of the classical Dollar-Sterling gold standard before World War I. This naturally leads to the conclusion that the degree of Chinese financial market integration was substantial in this period.

While in recent years literature on the market integration within pre-communist China has emerged, most market efficiency benchmark comparisons between Western Europe and China have focused on agricultural commodities. We make one of the first assessments of the degree of financial market integration. Our findings contribute to a reevaluation of market development during China's Republican period, and carry implications for the historical understanding of market integration at a time of political disintegration.