

HISTORY AS PROLOGUE: FISCAL CRISES IN CHINA PAST, PRESENT, AND FUTURE

BY

DR. STEPHEN R. HALSEY

Executive Summary

In the fall of 2021, China's largest real estate developer, Evergrande (中国恒大集团), threatened to default on its debts. Panicked investors wondered whether the firm might become "China's Lehman Brothers," worrying that the company's collapse might trigger a broader economic downturn. Would government regulators step in to save Evergrande or allow this "debt bomb" to detonate regardless of the consequences?

This raises the larger question of how the Chinese government might behave in a future fiscal crisis. What forms might state intervention in the economy take? Would officials work to collaborate with important market actors or attempt to control them? Would Beijing adopt a "go it alone" approach or embrace a coordinated international response? What risks might an unresolved fiscal crisis pose not only to the ruling Chinese Communist Party but to countries such as the United States?

This study will develop answers to these questions by examining China's behavior during past fiscal crises. For all of its predictive power, macroeconomic theory ignores the ways that normative values and past experiences influence the decisions of human actors. In contrast, this analysis will emphasize the qualitative factors that shape crisis conduct: historical memory, traditions of political economy, ideology, and psychological forces such as fear, anger, and pride. It argues that a distinct "culture" of political economy evolved over the *longue durée* of Chinese history that is both more statist and self-reflective than its Western counterpart. From early times, rulers, philosophers, and statesmen endorsed state intervention in the economy, but different interpretations of this principle led to the emergence of four distinct fiscal constitutions in Chinese history. This analysis further argues that historical case studies reveal a clear pattern of Chinese behavior that recurred time and again during past fiscal crises. These policy responses

assumed a statist, mercantilist, and, in the modern era, an increasingly nationalist form. This particular matrix of concepts, values, and ideologies will determine China's conduct during future fiscal emergencies as well.

Additional key findings

- The most severe fiscal crises in China tend to have a political rather than a purely economic origin.
- *Protracted and unresolved* fiscal crises destabilize the political order and tend to result in eventual regime collapse.
- Beijing would respond to a future fiscal crisis by deepening its commitment to authoritarian, nationalist, state-directed, and state-centered forms of development.
- This expansion of state power would likely "spill over" into areas of society unrelated to the economy, taking the form of increased social surveillance and control.
- China would prove reluctant to adopt regional or global solutions to a fiscal crisis that infringed on its own sovereignty.
- Beijing would instead adopt a "go it alone" strategy or rely on its own institutions such as the China Development Bank and the Belt and Road Initiative to coordinate a broader international response.

This study consists of six sections. It first describes basic research methods before examining the "culture" of political economy in China in section two. The third part of the study then reviews four distinct fiscal constitutions that emerged during the long sweep of Chinese history. Section four consists of four historical case studies of crisis behavior that focus on the Song (1000-1279 CE), late Ming (1618-44 CE), late Qing (c. 1850-1911 CE), and Nationalist (1937-1949 CE) eras, respectively. In part five, the study then identifies five "lessons of history" based on an analysis of these case studies. The sixth and final

Dr. Stephen R. Halsey (s.halsey@miami.edu) is Associate Professor of Chinese History at the University of Miami and works on issues of statecraft, political economy, business, development, and the environment in modern China.

section then presents a series of predictions about China's behavior during future fiscal crises.

Research Methods and Assumptions

Macroeconomic models alone cannot serve as a guide to China's behavior in a future fiscal crisis. Instead, a qualitative assessment of past conduct must complement the tools of the "dismal science" if policy-makers seek a complete understanding. History never repeats itself, but examining the record of the country's past will throw patterns of continuity and change into sharp relief. The following analysis will review four successive fiscal crises through the case study method, including the Song (c. 1000-1279 CE), late Ming (1618-1644 CE), late Qing (c. 1850 CE-1911 CE), and Nationalist (1937-1949 CE) eras. It will draw conclusions based on an *inductive process* of gathering historical evidence, distill them into a more abstract form, and encourage policy-makers to apply these lessons in *deductive* ways. History cannot predict the future, but past experiences can create distinct "cultures" of both political economy and of crisis behavior likely to reappear again.

The "Culture" of Political Economy in China

Two thousand three hundred years ago, Chinese statesmen developed a tradition of statecraft that recognized the material basis of political and military power. Questions of political economy and fiscal administration loomed large in debates about good governance, and philosophers and rulers alike identified the economy as a legitimate arena of state action. Kings and later emperors assumed responsibility for the economic welfare of their subjects and implemented policies to promote the creation of wealth. They understood that prosperous subjects rarely rebelled and could also pay their taxes to support a powerful military. Implicit in these practices was the idea that the state and its proxies could serve as positive agents of economic change under the proper conditions. Government intervention was not an economic problem but an important key to wealth and power (富强).

In contrast, European states played a far more limited role in economic life until the sixteenth century, when countries such as England, France, and the Dutch Republic adopted the mercantilist

policies characteristic of the early modern period (c. 1500-1750 CE). These practices included the creation of asymmetric or coercive markets, government investment in infrastructure and strategic industries, the promotion of scientific and technological knowledge, and the protection of trade routes through powerful navies. During the late eighteenth century, the free market ideas of Adam Smith and David Ricardo supplanted this mercantilist paradigm, and they continue to exercise an important influence on the discipline of economics even today. Many contemporary analysts and politicians still view the state as an impediment to economic growth, a phenomenon best left to "free" market forces.

In sum, early in its history China developed a distinct culture of political economy at once more statist and more self-reflective than its European counterparts. Although most rulers, officials, and thinkers accepted these broad principles, they often disagreed about the best strategy for implementing them. These debates led to the development of several different fiscal constitutions during the long course of imperial Chinese history (221 BCE-1911 CE).

Fiscal Constitutions in Imperial China

Scholars identify four distinct political-economic paradigms in China's past, but it is important to remember that these represent a repertoire of concepts, practices, and policies rather than a linear evolution over time. Rulers mixed and matched elements of these ideal types as circumstances demanded even if a single framework tended to dominate in a given period. Crisis conditions in particular often triggered an urgent shift in approach to enhance the flow of revenues to the imperial treasury. Although these fiscal constitutions may appear remote in time, elements of each of them continue to shape patterns of political economy in contemporary China.

Militarist-physiocratic Regime (c. 390 BCE-220 CE). China's early kingdoms and empires adopted a military model of society, exerting control over individual households through an invasive system of civil registration, record keeping, and bureaucratic communication. For example, the Han dynasty (202 BCE-220 CE)

knew the name, age, occupation, gender, and location of every one of its fifty million subjects, and it used this information to levy its principal taxes in the form of universal military service and *corvée* labor. In contrast, agricultural duties remained light at one-thirtieth of crop yields, and the state itself managed most forms of commerce and industry, including lucrative salt and iron monopolies. In short, direct taxation of labor served as the cornerstone of the militarist-physiocratic regime of political economy in early imperial China.

Cooperative-mercantilist Regime (c. 763-1279 CE). During the latter half of the Tang dynasty (c. 763-906 CE) and most of the subsequent Song era (960-1279 CE), the state adopted a fiscal constitution based on close cooperation with the private economy. Rulers relied on indirect taxes on commerce and consumption to raise the largest share of their income, and people increasingly paid their obligations in bronze coin. At the same time, authorities invested much more heavily in public goods such as water control and schools than during previous periods. These policies stimulated economic growth so rapid after 1000 CE that scholars describe these changes as a “commercial revolution.” During these centuries, government officials acknowledged the autonomy of the market economy but also used it to mobilize the resources necessary to protect China against foreign threats. “State and merchant” best summarizes this method of fiscal governance.

Command-mercantilist Regime (141 BCE-87 BCE; 1067-1126 CE). During two brief but important interludes, Chinese rulers experimented with a form of political economy predicated on state control of the commercial economy. In this system, authorities attempted to replace the mercantile classes with state-sponsored institutions rather than maintain a synergistic relationship with the empire’s growing markets. The government also sought to regulate commodity prices, established lucrative monopolies on salt, iron, and tea, and intervened in capital markets to reduce rural debt and ensure a more equitable distribution of wealth. Finally, authorities invested in hydraulic infrastructure to revitalize the agricultural base of society and provided extensive famine relief to promote

political stability. Although this framework overlapped in certain ways with more collaborative forms of mercantilism, “state not merchant” rather than “state and merchant” served as its guiding principle.

Agrarian-paternalist Regime (1368-c.1850 CE). During the later imperial era, officials envisioned an agrarian state committed to the benevolent pursuit of the “people’s livelihood” (民生), particularly the prosperity of the individual family farm. They believed that rulers could best serve their subjects if they maintained a light fiscal touch. Direct agrarian taxes (地丁税) supplied the bulk of government income but remained low at only 5-10% of total crop yields. The Qing dynasty (1644-1911 CE) adopted a *laissez faire* attitude toward commerce and industry, imposing few taxes beyond a native customs tariff collected at certain trade entrepôts. As a result, the state lacked the financial resources for extensive investments in public goods aside from key hydraulic projects such as the Grand Canal and a system of “Ever-Normal” Granaries (永平仓) to help regulate grain prices. A small bureaucracy of some 70,000 officials sat atop society rather than extending its tendrils of power to the village level. Less was more in this minimalist conception of statecraft, at least until European gunboats reached China’s shores in the 1800s.

Case Studies: Fiscal Crises in Chinese History
This section will review in detail four successive fiscal crises that span the last millennium of Chinese history. These include the Song (1000-1279 CE), late Ming (1618-1644 CE), late Qing (c. 1850-1911 CE), and Nationalist (1937-1949 CE) eras. It demonstrates how statesmen invented, interpreted, modified, combined, and often abandoned China’s various fiscal constitutions under the extreme pressure of events. Seemingly remote in time, these stories about the past also illustrate the development of a distinct “culture” of crisis behavior in China. This inductive reading of country’s past will help point toward a set of abstract conclusions described in the next section. The first and third case studies on the Song and Qing crises, respectively, will receive disproportionate coverage because rulers in each

period established a perpetual wartime fiscal regime.

The Song Fiscal Crisis, c. 1000-1279 CE. Song statecraft proved far more innovative than its dynastic successors, navigating crisis conditions and preserving the regime for more than two centuries. What caused this severe fiscal crisis, and how could it last so long? More importantly, what steps did the Song rulers take to address it?

The power of the steppe empires reached its zenith in the early centuries of the second millennium CE. Mounted warriors from Central Asia attacked sedentary agrarian societies such as China with impunity, no longer intent on conducting raids but instead determined to annex territory, subjugate populations, and mobilize resources over the long term. In time, these nomadic peoples expanded their military capabilities even further by recruiting experts in siege warfare from China and the Middle East and developing rudimentary artillery weapons. Defensive fortifications such as the Great Wall increasingly failed to protect the northern borders of the Song, and the dynasty found itself at war with groups such as the Liao, the Western Xia, the Jin, and the Mongols for more than two centuries. As early as 1004 CE the Liao inflicted a severe defeat on Song troops, and the Western Xia later assaulted the empire's northwestern frontiers from 1040-44. Both steppe confederations imposed a large annual indemnity of silver and silk payments on China, extorting resources in exchange for a dubious promise of peace. By the 1060s and 1070s, the Song armies swelled to 1.4 million men, and military expenditures soon consumed 80% of the central government's income. Enormous defense spending held China's enemies at bay until 1126, but the Jin conquered the entire north China plain during that year, and the Mongols overran the remaining Southern Song (1126-1279 CE) in Hangzhou in 1279. Yet preventing this collapse for over two centuries was a remarkable achievement, and few other states could have accomplished it.

The Song rulers expanded state power and developed a cooperative-mercantilist regime in response to the extreme fiscal demands of perennial warfare. They also experimented with a

command-mercantilist system under the chancellorship of Wang Anshi and his successors (c. 1066-1126), but this approach (described below) yielded poorer results than pursuing state-market synergies. The quest for additional revenues led the Song to create a new Finance Commission (三司) divided into departments of revenue (度支), salt (盐铁), and the census (户部). This autonomous agency institutionalized the shift toward functional specialization within the fiscal bureaucracy and encouraged the growth of a distinct career path based on fiscal expertise. At the same time, the dynasty established a network of thousands of revenue depots throughout the empire to collect commercial taxes, founded a Commodity Monopoly Bureau, and appointed Fiscal Intendants to supervise the disbursement of locally generated revenues, especially to provision the armies. In short, this fiscal crisis resulted in the institutional elaboration of the bureaucracy or, in scholarly jargon, the “growth of governmentality.”

As we have seen above, the cooperative-mercantilist system generated income through indirect taxes on commerce and consumption. The state sought not only to capture revenues from the expanding market economy but also to actively encourage growth through investment in public goods. These included transportation infrastructure, communications networks, irrigation and flood control works, schools, and famine relief, areas suffused to a new and unprecedented degree by state power. In addition, the Song maintained profitable monopolies on salt, tea, and later liquor, selling licenses on the distribution and sale of these commodities to private merchants. Tax payments in kind increasingly gave way to the use of bronze coin (贯 and 文), minted in vast quantities by the ruling dynasty and later supplemented by the world's first paper currency. Production peaked around 1080 CE at six billion coins per year, and estimates for the entire Northern Song period (960-1126 CE) amount to 260 billion coins. “State and merchant” served as the principal concept of this approach to fiscal governance, a framework so successful that it fostered an economic breakthrough during an existential

security crisis. Paradoxically, a permanent wartime fiscal regime was good for the economy.

During the last decades of the Northern Song era (1067-1126 CE), the dynasty adopted a command-mercantilist constitution, and its eventual failure accelerated the conquest of north China by the Jin Empire in 1126-27 CE. The statesman Wang Anshi (1021-1086 CE) implemented a series of New Policies (新法) in 1067 designed to exercise greater state power over the commercial economy and curb the influence of the mercantile and seigniorial classes. A State Trade Bureau seized control over wholesale markets in major urban centers, set commodity prices, supplied the imperial court and government agencies with requisitioned goods, provisioned frontier armies, and provided financing to shopkeepers and petty retailers. In addition, the state tightened its regulation of foreign trade and turned private brokers into licensed government agents. In rural regions, a new “green sprouts” (青苗) program provided low interest loans to poor farmers to reduce indebtedness and income inequality. The state bureaucracy grew from 24,000 officials to 34,000 thirteen years later, and the budget for civil service personnel increased ten-fold during the same period. Wang’s policies eroded the power of rentier landowners and merchant cartels, but they also proved controversial. In time, a number of measures failed because of their intrinsic flaws, while others provoked resistance by entrenched interests. After the Song court retreated south of the Yangzi River to Hangzhou in 1126 CE, it returned to its earlier collaborative relationship with market actors, ensuring the survival of the dynasty for another century and half.

Song statecraft defied the military odds through fiscal innovation. By linking fiscal governance to the dynamic commercial economy, rulers sustained an astronomical level of spending on imperial defense for more than two centuries. Equally importantly, they recognized that the economy could grow over time and took steps to ensure that outcome. Only the Qing dynasty managed to replicate this feat in the late 1800s but with less success than their Song predecessors.

The Ming Fiscal Crisis, c. 1618-1644 CE. Ming rulers managed the fiscal crisis of the early seventeenth century with astonishing incompetence, losing power to another dynasty in a few short decades. What caused the swift collapse of the Ming? Why did they fail to raise the necessary revenues to sustain their hold on power? Why did the Song approach work better?

The power of the steppe receded for a time after the collapse of the Mongol Yuan dynasty in 1368, but in the early seventeenth century a semi-nomadic people called the Manchus threatened China’s northeastern frontiers. These mounted warriors killed the regional Ming military commander in battle in 1618 and over the next two decades inflicted a series of defeats on the dynasty’s armies. Dynamic leaders constructed a dangerous federation of Inner Asian groups, wrested the northeastern provinces from Ming control, and encouraged the defection of Chinese officials and soldiers to their cause. Defense spending surged, and Ming officials soon faced the prospect of an empty treasury and unpaid troops.

At the same time, political dysfunction in Beijing, domestic rebellion, and environmental disasters compounded the empire’s problems. The eunuch factions that dominated court life proved incapable of formulating a decisive response to either foreign invasion or rebel uprisings. On their part, peasant armies sacked granaries and yamens throughout China, their livelihoods endangered by rising taxes, poor governance, and natural calamities. Famines, floods, crop failures, epidemics, and persistent cold weather afflicted much of the Eurasian continent in the 1600s, confronting states like the Ming with the continual danger of subsistence crises. Ming emperors had to add the costs of famine relief and internal military operations to their unpaid bills for imperial defense.

The Ming emperors embraced an agrarian-paternalist approach to fiscal governance, drawing the lion’s share of revenues from direct taxes on agriculture. Yet tax quotas remained unchanged over time even as crops yields increased and inflation rose with the importation of vast quantities of New World silver. As a result, real

revenues probably *declined* between the fourteenth and seventeenth centuries, ensuring that Ming rule rested on a weak fiscal base. As a triple crisis of foreign invasion, domestic rebellion, and natural disasters engulfed Ming China after 1618, desperate officials imposed an escalating series of emergency taxes, particularly a host of surtaxes on agriculture. Silver revenues quadrupled between 1617 and 1637 before increasing by another 50% in 1639. Yet military spending in this period far outstripped these new sources of government income, and heavy taxes helped to intensify popular violence among a population struggling with subsistence concerns. Efforts to extract additional resources from a relatively inelastic agrarian base led to widespread tax resistance and eroded the legitimacy of the ruling dynasty. A sudden, convulsive, and uncoordinated expansion of state power produced, in the end, the opposite result, and in June 1644 the Manchus occupied the Dragon Throne in Beijing in the name of the new Qing Empire.

A better approach would have linked fiscal governance to the dynamic market economy of the Ming period from the early sixteenth century onward. Failing that, the emergency taxes of the early seventeenth century should have targeted commerce and consumption rather than China's limited food supply. In sum, the fiscal minimalism inherent in the agrarian-paternalist constitution left the Ming without the flexibility to address unexpected threats, a problem that recurred in the mid nineteenth century.

The Qing Fiscal Crisis, c. 1850-1911 CE. China began the transition to a modern regime of public finance in the late nineteenth and early twentieth centuries, and yet the ruling Qing dynasty fell from power in 1911 CE. What caused the late Qing fiscal crisis, and why did official responses to it yield mixed results? What kind of conceptual legacy has late Qing statecraft left behind, and in what ways does it continue to shape official thinking in contemporary China?

Western gunboats appeared in Chinese waters in the mid nineteenth century, inaugurating a security crisis that placed unprecedented strains on the imperial treasury. Conflict with the European powers began with the First (1839-42 CE) and

Second Opium Wars (1856-60 CE) and resulted in the imposition of a series of unequal treaties on the Qing Empire. This system guaranteed signatories most favored nation status, rights of extraterritoriality, and commercial access to a number of ports in China. It also fixed Qing import tariffs at low rates to provide markets for Western manufactures and permitted Europeans to reside in foreign enclaves in certain coastal cities. Europeans, Americans, and later the Japanese established a diplomatic presence in Beijing and worked to create profitable trading opportunities for their nationals even in distant inland regions. Christian missionaries preached their gospel throughout the empire, often provoking a violent local response that embarrassed the Qing court. Subsequent defeats by France (1884-85 CE), Japan (1894-95 CE), and a coalition of eight great powers (1900 CE) led to the division of the empire into informal spheres of influence and the demand for enormous indemnity payments totaling US \$480 million (about 27,000 tons of silver). Once again, an existential security crisis threw imperial finances into utter disarray, and defense spending soon spiraled out of control. Like the Song, the late Qing rulers found themselves on a kind of permanent wartime fiscal footing.

To make matters worse, the earlier stages of this catastrophe overlapped with a period of intense civil warfare and natural disasters in China. The largest rebellions in human history to that point erupted in the 1850s, killing thirty million subjects of the Qing dynasty, displacing tens of millions more, and destabilizing eighteen of China's two dozen provinces. Armies of the millenarian Taiping movement occupied the empire's commercial and agricultural heartlands, while Muslim revolts roiled its peripheries in the northwest and southwest. At the same time, the cumulative effects of overpopulation, deforestation, and soil erosion produced severe ecological repercussions, including a change in the course of the Yellow River that inundated much of north China in the 1850s. The Chinese described this bleak situation as "internal catastrophes and external disasters" (内忧外患).

Authorities soon abandoned the agrarian-paternalist policies of the early and high Qing eras (1644-c. 1850 CE) in favor of a neo-mercantilist

statecraft based on the new idea of sovereignty. This framework replicated certain features of the collaborative Song fiscal regime, but it rested in part on a different conceptual base. The military victories of the great powers shook the cultural self-confidence of the Chinese, and they began to construct a narrative of “humiliation” at the hands of the Western barbarians (西方之夷). Neo-Confucian commitments to popular welfare gave way to frantic efforts to amass the sinews of power and preserve China’s independence. Commentators called on Beijing to wage commercial warfare (商战) on Europeans, Americans, and the Japanese in order to reclaim the right to economic profits (利权). Above all, they urged officials to defend state sovereignty (主权) through investments in advanced military technologies, new forms of infrastructure including railways and telegraphs, and modern industries such as shipping and mining. By the early years of the twentieth century, thinkers started to link these extreme concerns about sovereignty to a novel form of “grievance nationalism.” They blamed China’s problems in part on hostile external forces, demanding an end to the unequal treaties and calling for a transformative process of national rejuvenation (复兴).

The Qing reforms differed from the Song in another important respect; they were not as successful. The weakness of the central government after 1850 ensured that the growth of state power often took irregular, overlapping, or inefficient forms. The imperial court lacked the influence to coordinate a comprehensive crisis response, and regional or local officials filled this vacuum with creative efforts of their own. New fiscal bureaucracies emerged at the provincial level in the 1850s and 60s, extracting additional sources of revenue but also relying on tens of thousands of informal collection agents. An Imperial Maritime Customs Service served as an important instrument of change across fields as diverse as finance, trade, navigation, postal administration, and weather reporting, but European and American employees occupied most of its important leadership posts. After 1900, police and fire brigades altered the size and nature of municipal administration in China’s cities, but

village governance in the countryside remained largely unchanged. New armies and navies guarded the Qing Empire from attack, but they performed poorly against foreign adversaries and answered to their commanders rather than the court in Beijing. Once again, a fiscal crisis had caused the “growth of governmentality,” in this case a halting, partial, and tentative transition to modern forms of governance and fiscal administration in China.

Like the Song, the late Qing relied on the market to mobilize the enormous resources necessary for military spending, infrastructure investment, and, after 1895, the repayment of foreign loans. Indirect commercial taxes in the form of customs tariffs (海关税) and an internal transit duty or *lijin* (厘金) expanded the state’s fiscal base beyond its narrow agrarian foundation. Takings from the combined land-poll tax (地丁税) increased as well but constituted a falling share of government income in the late nineteenth and early twentieth centuries. Total revenues tripled or even quadrupled in inflation-adjusted terms in the six decades after 1850, but only a portion of these monies found their way into the coffers of the central government. During the last few years of the dynasty, Beijing attempted to resolve this problem by creating forerunners of the ministries of finance and commerce within a reformed cabinet structure and by developing an annual budget. At the same time, the late Qing state sponsored a network of modern business enterprises in shipping, telegraphy, mining and smelting, and banking. These parastatal firms relied on private merchants to raise capital and manage business operations but also received start-up funds and a range of legal and financial privileges from the government. Their profitability varied over time, but these companies reflected an effort to revive a version of the concept of “state and merchant.”

In sum, the late Qing reforms met with mixed success, extending the life of the dynasty by sixty years and laying the initial foundation of a military-fiscal state. In the late 1800s, China began its transition to modern forms of fiscal governance but also developed an extreme sensitivity to questions of sovereignty. By the

early decades of the twentieth century, many politicians, officials, and intellectuals had combined this sense of existential threat with a volatile nationalism predicated on a belief in lost greatness and foreign humiliation. Despite subsequent changes of regime, these ideas continue to provide a conceptual matrix for the formulation of the country's fiscal and foreign policies even today.

The Nationalist Fiscal Crisis, 1937-1949 CE. The Nationalist (KMT) government introduced a stable currency, pioneered the practice of public borrowing in China, and persuaded the great powers to begin revising the unequal treaties in 1927. What caused the fiscal crisis of the following decades and why did the regime collapse in disarray in 1949?

In the late 1930s, Jiang Kai-shek complained that China suffered from both a disease of the limbs and of the heart. He referred in the first instance to the massive invasion of Japanese armies in 1937 and the subsequent expansion of the conflict into World War II. In addition, a civil war between the Nationalists and Communists simmered while both parties confronted Japan, but these parties soon renewed their hostilities after Tokyo's surrender in August 1945. Intent on expanding its colonial empire, Japan unleashed more than a million troops on the Republic of China in 1937 and by early 1940 occupied the eastern third of the country. Jiang's KMT government retreated inland after a string of military defeats to the southwestern city of Chongqing, leaving behind their capital in Nanjing and the economic and cultural heartland of China with it. Authorities confronted soaring defense spending at the same moment as they lost control of their fiscal and political base in southeastern China. At the same time, popular commitment to Chinese nationalism reached fever pitch as a result of Japanese aggression, becoming one of the few assets that any political regime could draw upon without limit.

The Nationalists regained their lost territories in 1945, but their best troops had died in battle against the Japanese at the beginning of the war. In contrast, the Communists revitalized their party-state in the remote northwest between 1937

and 1945, emerging from their base in Yan'an after the war ready to fight. The Chinese civil war dragged on for another four years, and the KMT never regained either its political or fiscal footing. A series of decisive military engagements in Manchuria in 1948 determined its outcome and brought a new Communist government led by Mao Zedong to power. Over a decade of constant warfare had imposed relentless financial pressure on Jiang's government, and in 1949 it fled to the island of Taiwan in defeat.

Prior the Second Sino-Japanese War (1937-45 CE), the Nationalist regime permitted local and provincial authorities to retain the proceeds from agrarian taxes while funding the central government through customs tariffs and miscellaneous consumption taxes. Yet revenues from import tariffs fell by 58% during the first year of the war, and Jiang Kai-shek turned instead to a shipment tax (转口税) assessed on the movement of goods between Chinese ports. After 1942 this "interport duty" gave way to a "wartime consumption tax," in essence a modified version of the transit fees known as *lijin* in the late Qing era. KMT officials intervened in the commercial economy not only through this tax regime but also by consolidating state control over industry. By 1942, some 70% of the manufacturing sector outside the occupied territories came under government management. In addition, Washington pumped US \$2 billion in aid into the Chinese economy between 1941 and 1945 and then a similar sum during the subsequent four years of civil war.

Despite these measures, revenues never met expenditures, and annual deficits grew from 1.5 billion yuan in 1937 to 685.4 billion eight years later. In the absence of credible borrowing options, the Nationalists financed these growing shortfalls by printing money. Known as *seigniorage*, this practice resulted in a period of hyperinflation, with the price index rising 1600-fold between 1937 and 1945. Once credited with fiscal and monetary miracles, the KMT regime ended its life on the mainland of Asia by behaving like a banana republic. In its hour of greatest peril, the Nationalist government adopted policies that Song statesmen might have dimly recognized, coping with an impossible situation in ways that drew on

both cooperative and coercive forms of mercantilism.

Finding Patterns in the Past

By examining the written record of China's past, a set of patterns, resonances, and paradigms comes into clear focus. At times, these take the form of direct parallels between different eras, while at others they appear instead as contrapuntal variations on a principal melody. Of course, human societies also change and develop over time, but even then new and old elements tend to recombine in recognizable ways. The past possesses a certain inertia, including established ways of thinking and acting that persist over time. This is one simple definition of "culture," and it applies as much to the economic sphere as to literature or the arts. An inductive reading of history helps to identify not only a distinct culture of political economy but of crisis behavior in China as well. What are the most important patterns of the Chinese past?

First, warfare with foreign powers tended to provoke the most serious fiscal crises during the last millennium of Chinese history. Prior to the mid nineteenth century, existential threats came from the steppe empires of Central Asia, but the country's maritime frontiers became a new source of danger with the arrival of European, American, and later Japanese gunboats. In each of the case studies considered above, the demands of defense spending placed intense pressure on the state's fiscal bureaucracies. Rulers had to pay, provision, house, and transport their troops, manufacture or purchase weapons, build warships, and often pay foreign indemnities. In the Song and Qing cases, authorities developed a perpetual wartime fiscal regime appropriate to their particular historical conditions. During the late 1800s, China's rulers also laid the initial foundations of a military-fiscal state, an institutional form centered on the capacity for war-making.

Second, fiscal crises in China became more severe when exacerbated by internal rebellion and natural disasters. It is tempting to label foreign factors as the "primary drivers" of fiscal crises in China's past and assign domestic issues a secondary role. In a sense, this is true. Yet a more nuanced perspective sees them as mutually constitutive,

connected through a complex web of historical causation. Historical events such as the downfall of the Ming dynasty appeared like a chaotic powerball jumble to contemporary observers, but analysts can discern clear patterns of cause and effect in hindsight. For example, subsistence crises like those of the late Ming tended to produce profound social turmoil, raising the costs of providing internal security in China. Environmental disasters, too, could spark widespread discontent and force authorities to divert their limited resources to domestic policing. Above all, fiscal crises like the Ming reached an acute stage when their foreign and domestic dimensions began to overlap and intensify one another as time passed.

Third, China's rulers tended to expand state power in important ways in response to fiscal crises. New bureaucracies enhanced their capacity not only to extract additional resources from society but also to regulate, coordinate, or control strategic sectors of the economy. At times, the government pursued a collaborative relationship with mercantile and later industrial elites, placing these classes in the service of its goals with a minimum of coercion. In other instances, authorities seized direct control over key components of trade and industry, replacing elements of a private market economy with public institutions. A "growth of governmentality" in the economic sphere also had broader "spillover effects" in Chinese society on more than one occasion. This might take the innocuous form of providing additional public goods, such as a fire brigade in a dense urban neighborhood. Yet it could also mean that ordinary people confronted new types of social surveillance, political coercion, and state intrusion in their daily lives. Most learned to accept the state's new powers or at most engaged in passive resistance when they could avoid risk to themselves.

Fourth, *protracted and unresolved* fiscal crises resulted in the collapse of the state. At first glance, this conclusion appears to contradict the previous finding about an expansion of government power in times of emergency. Yet it is important to remember that both the Song and the Qing dynasties developed at least partial solutions to the urgent fiscal problems they faced. The former

resisted the steppe empires for two and a half centuries, while the latter clung to the throne for six decades after the cataclysms of the mid 1800s. In contrast, the Ming and Nationalist regimes failed to develop viable strategies to meet rising defense expenditures, turning to agrarian surtaxes and *seigniorage*, respectively, to finance the growing costs of war. Moreover, these two governments also attempted to enhance their administrative capacities, but the sudden, violent, and haphazard character of their initiatives instead accelerated the process of political disintegration. The Ming lasted only three decades after the onset of acute crisis conditions, the KMT a total of twelve years.

Fifth, the crises of the Qing and Nationalist eras produced a lingering distrust of foreign powers and an attendant sense of cultural and political eclipse. Modern Chinese governments have demonstrated an extreme sensitivity to issues of state sovereignty and often wedded these concerns to a virulent form of nationalism. Thinkers in the late Qing era first introduced these ideas to China, and by the mid twentieth century ordinary people viewed themselves as part of a national community that had suffered profound injustice at the hands of the great powers. In part, these sentiments are justified given the troubling record of Western imperialism in China. Yet the current communist regime has also promoted the narrative of “a century of national humiliation” to shore up popular support and justify its own monopoly on power. In fact, its own achievements rest to a significant extent on the state-making efforts of the preceding Nationalist and Qing governments. Whether authentic or cynical, these beliefs inform, inflect, and constrain the range of policy options that authorities in China could pursue in a future fiscal crisis.

Applying the Lessons of History

History cannot predict the future, but it can instruct, inform, and guide its students. The past never repeats itself, but it remains a living presence in the present. It narrows and often distorts the scope of future possibilities, making certain outcomes more probable while forestalling others. An inductive process of gathering historical evidence in the last sections has enabled us formulate a set of abstract principles about

China’s crisis behaviors. It is now time to apply the lessons of history, describing how China will act in a future fiscal crisis.

First, policy-makers should remember that the most severe fiscal crises in China tend to have a political rather than an economic origin. The country weathered the “Great Recession” (2007-09 CE) without difficulty because it remained a purely economic problem amenable to traditional fiscal and monetary measures. Yet foreign wars, domestic political disorders, and environmental disasters could give rise to a fiscal emergency as easily as the vagaries of global capitalism. At times, these problems can overlap in time, deepening their political, economic, and social consequences. A multi-faceted crisis would become more dangerous not only because of its complexity but because Beijing would likely struggle to address its political dimensions. For example, deficit spending and lower interest rates might not appease a Chinese middle class impoverished by a sudden collapse of housing and stock prices. In fact, they might very well riot in the streets. Beijing has few instruments aside from coercion to manage political protests, and under these circumstances repression would cause the flight of foreign capital and worsen macro-economic conditions. In sum, the political elements of a multi-dimensional fiscal crisis might create a kind of positive feedback loop, intensifying pressures on the regime.

Second, a *protracted and unresolved* fiscal crisis could destabilize the political order and threaten the Communist Party’s (CCP) hold on power. Its legitimacy depends on continued economic growth and a kind of grievance nationalism, but in an emergency political dissidents might direct their feelings of exploitation, injustice, and rage at the CCP rather than foreign bogeymen. Officials understand that, like the sorcerer’s apprentice in Goethe’s story, the party has summoned a psychic force that it may struggle to control. To mix metaphors, if the economic pillar of CCP rule crumbled, its sole remaining foundation—nationalist ideology—might collapse as well. This scenario is unlikely but not impossible. Communist rule will probably prove durable, flexible, and at times even creative if the country remains insulated from severe and extended

shocks. Yet a multidimensional fiscal crisis could pose a particular danger because it would call the regime's fundamental legitimacy into question.

Third, Beijing would likely respond to a *manageable* fiscal crisis by deepening its commitment to authoritarian, nationalist, state-directed, and state-centered forms of development. Resources would flow to the country's State Owned Enterprises (SOEs) not only because of their economic importance but because the party views them as an expression of national sovereignty. Authorities would also work to consolidate SOEs, restrict or proscribe private companies' access to strategic economic sectors, and strengthen state control over private enterprises. Cadres describe these policies as "state companies advance; private companies retreat" (国进民退), a phrase that often appeared in official discourse during the Great Recession. China would also resort to a greater degree of trade protectionism to insulate domestic markets from foreign competition and might manipulate exchange rates if it believed that a weaker *yuan* would boost exports. In short, Beijing would likely move several steps away from a position of "state and merchant" toward a stance of "state not merchant."

Fourth, the expansion of state power would likely "spill over" into areas of Chinese society unrelated to capital, commerce, and industry. Beijing would pioneer new forms of social surveillance and enlarge the scope, duration, and intensity of its nationalistic propaganda campaigns. In addition, officials would tighten their regulation of non-governmental organizations, arrest dissidents, and revive Maoist-era efforts at thought control in twenty-first century guise. State intrusion into ethnic minority regions such as Xinjiang, Tibet, and Inner Mongolia would likely gain momentum and officials strengthen their efforts at cultural and linguistic assimilation. China's historical past suggests the probability of such a "growth of governmentality" in crisis conditions, but more recent experiences also point toward a broader official presence in society. For example, government bodies drafted the initial blueprint for a social credit system (社会信用体系) in 2007-08

CE, just as the effects of the global economic crisis made themselves felt in China. In short, critics of China describe an on-going transition from traditional authoritarianism to techno-fascism, and a fiscal crisis would likely accelerate the development of Orwellian mechanisms of social monitoring and control.

Fifth, China would likely prove reluctant to adopt regional or global solutions to the crisis perceived to impinge on its own sovereignty. It views the neoliberal economic order led by the US as a useful evil but has already begun to develop an alternative set of practices and institutions. As a result, China might develop a "go it alone" strategy under certain conditions. If Beijing embraced a broader transnational approach to a fiscal crisis, it would attempt to coordinate its efforts through the China Development Bank, the Export-Import Bank of China, and various Belt and Road Initiatives (BRI). This would afford the CCP a much greater measure of control, help to consolidate political relationships with aid recipients, and enable the regime to brandish its economic power on the world stage. In fact, the ruling party used its BRI program to export a portion of the country's excess industrial capacity during the 2007-09 global economic downturn. In this sense, a crisis can also offer an opportunity to expand Beijing's influence at the expense of its foreign rivals. Both China's domestic and international responses would assume a nationalist, dirigiste, and partially authoritarian form because of the nature of its historical experiences and political system.

China's past explains its present and helps to provide clues about its future. Several millennia of recorded history not only produced a distinct culture of political economy but also recurring patterns of behavior during fiscal crises. Using the case study method, we have discovered the centrality of statist, mercantilist, and nationalist concepts to China's management of crisis conditions in previous eras. The legacy of this past will continue to shape the country's conduct in the future as well, and American policy-makers can predict with some accuracy Beijing's moves and work to counter them. Crises only seem sudden to the unprepared.

Works Consulted

- Bastid, Marianne. 1985. "The Structure of the Financial Institutions of the State in the Late Qing." S.R. Schram, ed. *The Scope of State Power in China*, 51-79. London: School of Oriental and African Studies.
- Boecking, Felix. 2017. *No Great Wall: Trade, Tariffs, and Nationalism in Republican China, 1927-1945*. Cambridge, MA: Harvard University Asia Center.
- Bonney, Richard, ed. 1999. *The Rise of the Fiscal State in Europe, c. 1200-1815*. Oxford: Oxford University Press.
- Brewer, John. 1988. *The Sinews of Power: War, Money, and the English State, 1668-1773*. Cambridge, MA: Harvard University Press.
- Brook, Timothy. 1998. *The Confusions of Pleasure: Commerce and Culture in Ming China*. Berkeley: University of California Press.
- . 2013. *The Troubled Empire: China in the Yuan and Ming Dynasties*. Cambridge, MA: The Belknap Press of Harvard University Press.
- Cheng, Linsun. 2003. *Banking in Modern China: Entrepreneurs, Professional Managers, and the Development of Chinese Banks, 1897-1937*. Cambridge, UK: Cambridge University Press.
- Chin, Tamara T. 2014. *Savage Exchange: Han Imperialism, Chinese Literary Style, and the Economic Imagination*. Cambridge, MA, Harvard University Press.
- Deng, Gang Kent. 2015. "Imperial China Under the Song and Late Qing." In Andrew Monson and Walter Scheidel, eds., *Fiscal Regimes and the Political Economy of Premodern States*, 308-42. Cambridge, UK: Cambridge University Press.
- and Lucy Zheng. 2015. "Economic Restructuring and Demographic Growth: Demystifying Growth and Development in Northern Song China, 960-1127." *Economic History Review* 68.4: 1107-31.
- Dunstan, Helen. 2006. *State or Merchant?: Political Economy and Political Process in 1740s China*. Cambridge, MA: Harvard University Asia Center.
- Epstein, S. R. 2000. *Freedom and Growth: The Rise of State and Markets in Europe, 1300-1750*. London: Routledge.
- Feuerwerker, Albert. 1984. "The State and Economy in Late Imperial China." *Theory and Society* 13.3: 297-326.
- Halsey, Stephen. 2013. "Money, Power, and the State: The Origins of the Military-Fiscal State in Modern China." *Journal of the Economic and Social History of the Orient*, 56.3: 392-432.
- . 2015. *Quest for Power: European Imperialism and the Making of Chinese Statecraft*. Cambridge, MA: Harvard University Press.
- Hartwell, Robert. 1988. "The Imperial Treasuries: Finance and Power in Song China." *Bulletin of Sung-Yuan Studies* 20: 18-89.
- He, Wenkai. 2013. *Paths toward the Modern Fiscal State: England, Japan, and China*. Cambridge, MA: Harvard University Press.
- Hoffmann, Philip T. 2015. "What States Do? Politics and Economic History." *Journal of Economic History* 75.2: 303-32.
- Huang, Ray. 1974. *Taxation and Government Finance in Sixteenth Century Ming China*. New York: Cambridge University Press.
- Kuhn, Dieter. 2009. *The Age of Confucian Rule: The Song Transformation of China*. Cambridge, MA: Harvard University Press.
- Liu, William Guanglin. 2015. "The Making of a Fiscal State in Song China, 960-1279." *Economic History Review* 68.1: 48-78.
- Mann, Susan. 1987. *Local Merchants and the Chinese Bureaucracy, 1750-1950*. Stanford: Stanford University Press.
- North, Douglass C. 1981. *Structure and Change in Economic History*. New York: W.W. Norton.
- O'Brien, Patrick. 2012. "Fiscal and Financial Preconditions for the Formation of Developmental States in

- the West and the East from the Conquest of Ceuta (1415) to the Opium War (1839)." *Journal of World History* 35.1: 1-18.
- Parthasarathi, Prasannan. 2011. *Why Europe Grew Rich and Asia Did Not: Global Economic Divergence, 1600-1850*. Cambridge, UK: Cambridge University Press.
- Pomeranz, Kenneth. 1993. *The Making of a Hinterland: State, Society, and Economy in Inland North China, 1853-1937*. Berkeley: University of California Press.
- , 2000. *The Great Divergence: China, Europe, and the Making of the Modern World Economy*. Princeton: Princeton University Press.
- , 2008. "Chinese Development in the Long-Run Perspectives." *Proceedings of the American Philosophical Society* 152:1: 83-100.
- Puk, Wing-kin. 2016. *The Rise and Fall of a Public Debt Market in 16th-Century China: The Story of the Ming Salt Certificate*. Leiden: Brill.
- Rawski, Thomas. 1989. *Economic Growth in Prewar China*. Berkeley: University of California Press.
- Reinert, Eric S. and Sophus Reinert. 2005. "Mercantilism and Economic Development: Schumpeterian Dynamics, Institution-Building, and International Benchmarking." In K.S. Jomo and Eric S. Reinert, eds., *The Origins of Development Economics: How Schools of Development Have Addressed Development*, 1-23. London: Zed Books.
- Rosenthal, Jean-Laurent and R. Bin Wong. 2011. *Before and Beyond Divergence: The Politics of Economic Change in China and Europe*. Cambridge, MA: Harvard University Press.
- Sheehan, Brett. 2003. *Trust in Troubled Times: Money, Banks, and State-Society Relations in Republican Tianjin*. Cambridge, MA: Harvard University Press.
- Smith, Paul Jakov. 2009. "Shen-tsung's Reign and the New Policies of Wang An-shih, 1067-1085." In Denis Twitchett and Paul Jakov Smith, eds., *The Cambridge History of China*, vol. 5, *The Sung Dynasty and its Precursors, 907-1279*, 347-483. Cambridge, UK: Cambridge University Press.
- Tilly, Charles. 1990. *Coercion, Capital, and European States, AD 990-1990*. London: Blackwell.
- Twitchett, Denis. 1963. *Financial Administration under the Tang Dynasty*. Cambridge, UK: Cambridge University Press.
- von Glahn, Richard. 2020. "Modalities of the Fiscal State in Imperial China." *Journal of Chinese History*, 4: 1-29.
- , 2016. *The Economic History of China: From Antiquity to the Nineteenth Century*. New York, Cambridge University Press.
- , 1997. *Fountain of Fortune: Money and Monetary Policy in China, 1000-1700*. Berkeley: University of California Press.
- Wong, R. Bin. 1997. *China Transformed: Historical Change and the Limits of European Experience*. Ithaca: Cornell University Press.
- Yun-Casalilla, Bartolome and Patrick K. O'Brien, eds.. 2012. *The Rise of Fiscal States: A Global History, 1500-1914*. Cambridge, UK: Cambridge University Press.
- Zelin, Madeleine. 1984. *The Magistrate's Tael: Rationalizing Fiscal Reform in Eighteenth Century Ch'ing China*. Berkeley: University of California Press.