

Lessons from the 1930s for a rising renminbi

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Last weekend China, under relentless US pressure to end the renminbi's peg to the dollar, once again blew hot and cold by announcing that it would ["enhance" exchange rate flexibility](#), later adding that the rate would remain "basically stable". It is an issue that has bedevilled US-China relations for longer than most people think. In fact, the peg to the dollar was a major source of friction in the 1930s, although at the time the two sides' positions were reversed.

The 1934 Silver Purchase Act, passed under relentless political pressure from an alliance of silver producers, banker-bashers and inflation proponents, obliged the US Treasury to buy up the metal and boost its price. The practice wreaked havoc on the Chinese currency, which was tied to silver – long treasured in the country, even though there was no indigenous supply. Chinese silver stocks were smuggled out of the country and sold abroad, reducing the money supply and triggering deflation, credit contraction and a slump.

The Chiang Kai-shek government pleaded with the US to change its policy. Henry Morgenthau, the Treasury secretary, was sympathetic, as he considered the silver act a major headache. But he had little political room for manoeuvre.

In October 1935, the Chinese ambassador, Alfred Sze, told Morgenthau his country was abandoning its silver standard and offered to sell its stock of the metal to the US in lieu of dumping it on the world market. The Treasury secretary's main economic adviser, Harry Dexter White, backed the idea, but with China undertaking a reciprocal commitment to peg the yuan to the dollar.

This, of course, reverses the present monetary stand-off between the US and China. But the aim is the same: a lower dollar. In the 1930s, the problem was that China was conducting the greater portion of its trade in sterling. As the pound was falling against the dollar, it was dragging the yuan down with it. Pegging to the dollar would mean a stronger yuan and more competitive US exports.

Then, as now, China would not budge. Morgenthau fired back at Sze: "We have our politicians and our public and our future to think of. We are not going to invest \$65,000,000 and you tie your money to sterling. You people are playing poker and you are bluffing."

In the end, with the president's approval, Morgenthau blinked. But instead of acquiescing to China's request that the US buy 100m ounces of silver, Morgenthau offered to take only half. The deal was done.

Morgenthau remained concerned that China would do a similar deal with Britain in return for a yuan link with sterling. Monetary diplomacy continued throughout May 1936, with Chinese emissary K.P. Chen importuning Morgenthau to buy more silver and Morgenthau repeatedly complaining that the yuan was moving in lockstep with sterling. In words that could comfortably emanate from Tim Geithner today, Morgenthau emphasised that the US "feel[s] it is very important to the world peace to help China strengthen her currency".

Chen promised to end the system of quoting the yuan in terms of sterling, which, he acknowledged, gave the appearance of there being a sterling peg. Morgenthau finally agreed to an arrangement between the American and Chinese treasuries whereby the former would buy a further 75m ounces of silver in monthly instalments until January 1937, with proceeds to remain in New York and used by the Chinese exclusively to stabilise the yuan's external value. Details were to be kept confidential.

[Charles Schumer](#), the New York senator and long-time opponent of China's dollar peg, is once again threatening large tariffs on Chinese goods if the renminbi does not rise significantly. Together with Senator Lindsey Graham, he explained in 2006 that "one of the fundamental tenets of free trade is that currencies should float". Such a "tenet" would, of course, have been considered incomprehensible to Morgenthau and White, who devoted so much of their energies in the 1930s and 1940s to convincing the world's governments to maintain or adopt a dollar peg, in the service of increasing international trade. What unites senators Schumer and Graham with Morgenthau and White is the eternal quest for a weaker dollar.