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**Ideology and the Contours of Economic
Changes in Modern China during
1850-1950**

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Abstract

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Ideology and the Contours of Economic Changes in Modern China during 1850-1950

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Abstract:

What explains economic changes or lack-thereof in modern China during 1850-1950? This paper highlights the critical role of ideology and ideological change induced as a response to Western impact following Qing China's forced opening during the mid-19th century. I argue that Imperial Qing's highly centralized and absolutist political regimes and traditional dominance in a China-centred world order have led to a closure of mind to new intellectual resources and initial failure to recognize impending crisis in the new world order. By laying out the quantitative profile of Chinese economic change during 1850-1950 and reviewing the main historiography, this paper builds a new analytical framework linking ideology with economic changes. It delineates three phases of economic changes in light of the specific timing of intellectual and ideological transformation during this period and embed our narrative with two specific cases of commercial and financial developments.

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Ideology and the Contours of Economic Changes in Modern China during 1850-1950

Debin Ma

When visited by the British trade mission led by Lord George Macartney, who aimed to show off the best of Western trade and technology, the Qianlong emperor of Qing China was known to have famously replied in 1792 that “Our Celestial Empire possesses all things in prolific abundance and lacks no product within its borders. There is therefore no need to import the manufactures of outside barbarians in exchange for our own produce.”² Qianlong’s statement came at the height of Qing’s glory, overseeing a remarkable tripling of population and a doubling of territory between the 15th and 18th centuries. No single political entity at the time achieved such size in both geography and population under such stability and durability.

Qianlong’s self-conceit was shattered only five decades later by China’s humiliating military defeat to the much smaller polity of England in the infamous 1842 Opium War and in turn reduced the mighty Qing to a semi-colonial status through the treaty port system. The mid-19th century confrontation symbolizes the clash between a highly centralized singular Chinese empire and a fragmented and competitive European state system empowered by centuries of waves of commercial, financial, political, technological, and scientific revolutions. In the tumultuous century after China’s forced opening in mid-19th century, China’s mixed economic record, especially in relation to her neighboring Japan, raises the more pertinent question of why it took so long for China to industrialize after the Industrial Revolution had been well underway elsewhere.

Despite China’s unprecedented economic growth during the last four decades and her emergence as the world’s second largest economy, the myth of the once mighty Qing made a curious comeback with the increasingly popular claim that current Chinese economic success

² Quote from https://en.wikipedia.org/wiki/Macartney_Embassy, accessed August 14, 2016.

marked only a triumphant return to her 18th century glory. The claim is as misleading as a misconstrued conflation of total GDP with per capita GDP. In per capita terms, the 18th century China probably remained a poor agrarian economy and gained her status as the world's largest economy purely owing to her sheer population size and that per capita income differences in the pre-industrial world were relatively small before the onset and spread of the Industrial Revolution. Hence, it may be the largest but not the leading economy, having only limited impact in external trade and investment.³

Writing before the onset of China's current boom, earlier generations of scholars had to explain China's historical economic stagnation, often due to the prevalence of nepotism, corruption, and other elements of Chinese social structure and behavior that prevented a dynamic response of the sort attained during Japan's Meiji era (1868-1912). But China's recent reversal of fortune seemed to have generated a tide of scholarship that now advance the opposite view, attributing recent Asian prosperity to the same "cultural values" formerly thought to have obstructed economic dynamism or even advanced the view there was little difference in economic structure or per capita income between the most commercialized regions of China and Europe prior to the British industrial revolution and there were no fundamental shortfalls in China's political, legal, or other institutional traditions. The key argument, most clearly articulated in Pomeranz' influential book on "The Great Divergence" (2000), is that there was little difference in economic structure or per capita income between the most commercialized regions of China and Europe prior to the British industrial revolution. Furthermore, Pomeranz argues that Britain's head start in industrialization arose from its domestic supplies of cheap coal and because its colonies provided superior access to land-

³ It is true that there is substantial trade in the exports of Chinese silks and tea and inflow of Latin American silver ingots and coins as well as New World crops such as maize and potatoes.

intensive goods rather than from any advantage linked to political, legal, or other institutional factors.⁴

For the period of 1850-1949 under study, this chapter emphasizes the fact that ultimately Industrial Revolution in modern East Asia started with borrowed institutions and ideology. This takes us back to the much older conceptual framework of modernization known as “Western impact and Chinese response” in the Chinese or East Asian context. In particular, this chapter reasserts the peculiar and unusual importance of the external or Western influence to a large country like China. Developing a new conceptual framework, I argue that given the dual monopoly of ideology and power under the Qing, political and economic changes often had to be initiated from the impact outside the empire. Openness and external influence could act as a constraint to a polity lacking internal checks and balances. The external represents a new source of alternative power that breaches the monopoly of power and ideology. However, how much could external exert impact depends on how much they affect formal institutional and ideological change in the domestic context.

In this regard, I show that rather than resource endowments such as coal, or even the discovery of the New World resources, what impeded China’s progress in the globalized world is what some historians of China called the scarcity of “intellectual resources” 思想资源 or what sometimes is all referred to as ideology.⁵ However, the scarcity of intellectual resources in mid-19th century Qing China is of a particular sort, that of confronting a rapidly advancing West being transformed by Industrial Revolution. This Chinese

⁴ Brandt, L., Debin Ma and Thomas Rawski (2014). “From Divergence to Convergence: Re-evaluating the History Behind China's Economic Boom”. *Journal of Economic Literature* 2014, 52(1), 45–123.

⁵ These ideological or intellectual resources represent our ways of understanding, interpreting and theorizing about the world we live in and the ways we interpret the past, construct the present and imagine the future. They both support and constrain our institutions, policies and day-to-day decisions. See Wang Fanshen 王汎森 “戊戌前后思想资源的变化：以日本因素为例” (Changes in Intellectual Resources Before and After the Hundred Days’ Reform) , 《二十一世纪》 (Twenty First Century), Feb. 1998, No. 45.

scarcity can be overcome through massive borrowing, learning and importing of Western ideology and institutions which is partly what Meiji Japan succeeded in doing. These intellectual resources allowed late-industrializer to construct an entirely different set of political governance, economic systems and social organization.⁶

I argue that both the capacity and willingness to borrow and learn itself is endogenous to China's pre-existing political institutions and geo-political position in East Asia. In this regard, China's highly centralized and absolutist political regimes and traditional dominance in a China-centred world order have not only led to a closure of mind to new intellectual resources but also initial failure to even recognize or perceive impending crisis and threats. Hence, the process of economic change is not automatic, requiring complicated but some risky feedback process between experiments, institution and ideology. This chapter links this complicated process of Western impact and Chinese response with changing incentives of economic changes on the ground and shifting ideologies of elites at the top. It delineates the contours of economic changes in light of the specific timing of intellectual and ideological transformation during this period and embed our narrative with two specific cases of commercial and financial developments. Section 1 lays out the quantitative profile of Chinese economic change during 1850-1950. Section 2 turns to historiography and builds a new analytical framework linking ideology with economic changes. Section 3 examines the three phases of economic changes based on the new analytical framework.

1. Chinese Economy in 1842-1949: Stagnation or Take-off?

⁶ See Wang Fanshen 戊戌; Wang Fanshen 王汎森 (2015) *权力的毛细血管作用, 清代的思想、学术与心态*, (The Penetrating Role of Power, Ideas, Academics and Moods in Qing). Beijing Daxue Chubanshe. Jin Guantao 金观涛 and Liu Qingfeng 刘青峰 (2011). *兴盛与危机, 论中国社会的超稳定结构* (The Cycle of Growth and Decline, On the Ultrastable Structure of Chinese Society). Beijing: Falu Chubanshe. Jin Guantao 金观涛 and Liu Qingfeng 刘青峰 (2011). *开放中的变迁, 再论中国社会超稳定结构* (The Transformation of Chinese Society (1840-1956), The Fate of Its Ultrastable Structure in Modern Times). Beijing: Falu Chubanshe. Ge Zhaoguang 葛兆光 *十八世纪中国的盛世危机*“ (Crisis in China's Glorious Eighteenth Century) Feb. 19th 2019. <http://www.ftchinese.com/author/%E8%91%9B%E5%85%86%E5%85%89>.

Stagnation or Take-off?

Our analysis on Chinese economic record starts with the aggregate economic indicator of GDP. However, despite a new wave of historical GDP research, estimates before the 1930s still need to be treated with caution and used with hesitation given the controversies on long-term statistics as basic as population and agricultural acreage.⁷ Nonetheless, few would disagree that China of the 19th and 20th centuries is a traditional agrarian economy with a 60-70% share of her GDP in the agriculture sector.

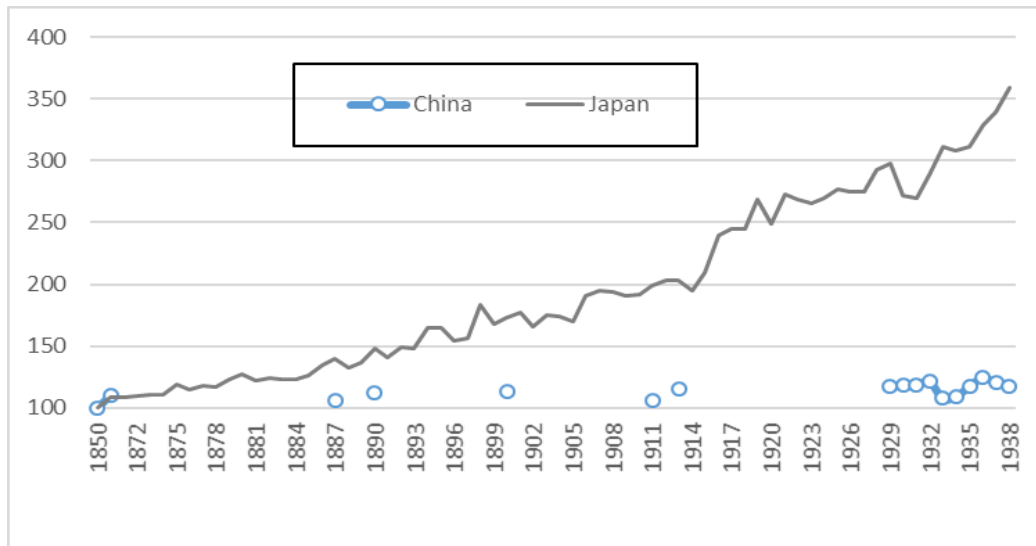
Figure 1 plots China's real per capita GDP index set against that of Japan. The Figure reveals a sluggish performance of Qing and Republican China relative to Japan's transformation. Although the indexing of the level of the per capita GDP of two economies at 1850 both at 100 seems arbitrary at first sight, it actually turns out to be consistent with a comprehensive study based on the reconstruction the 1930s benchmark Purchasing Power Parity Estimates which places a Japanese per capita GDP level at about three times of that of the Chinese level during the 1930s, a ratio of difference that broadly matches that in figure 1.⁸ Projecting this 1930s' three to one ratio back to 1850 with the trend growth rates of these two countries leads to a comparable level of per capita GDP between the two countries around the mid-19th century in Figure 1. Hence, our implicit estimate of a common starting point between these two countries in 1850 presumes the divergence between Japan and China only started

⁷ See S. Broadberry, Hanhui Guan and David Daokui Li (2018). "China, Europe, and the Great Divergence: A Study in Historical National Accounting, 980–1850". *Journal of Economic History*, Volume 78, pp. 955-1000, Ma, Ye and Herman de Jong (2019). "Unfolding the Turbulent Century: A Reconstruction of China's Historical National Accounts, 1840–1912". *Review of Income and Wealth*, Volume 65, Issue1, pp. 75-9. Xu, Yi, Zhihong Shi, Bas van Leeuwen, Yuping Ni, Zipeng Zhang, and Ye Ma, 'Chinese National Income, ca. 1661-1933', *Australian Economic History Review* Volume57, Issue3 November 2017 Pages 368-393. Maddison, Angus. (2007). *Chinese Economic Performance in the Long Run*. 2nd ed, rev. and updated. Paris: Development Centre of the Organization for Economic Co-operation and Development. For problem with data, see discussion in Ma, D., (2008). "Economic Growth in the Lower Yangzi Region of China in 1911-1937: A Quantitative and Historical Perspective". *The Journal of Economic History*, 68 (2), 385-392. Rawski, T. G. (1989). *Economic Growth in Prewar China*. University of California Press, Berkeley.

⁸ Fukao, K., Ma, D., Yuan, T. (2007). "Real GDP in pre-War East Asia: a 1934-36 Benchmark Purchasing Power Parity Comparison with the U.S." *Review of Income and Wealth* 53 (3), 503-537.

only after being forced open by Western Imperialism forces rather than before. This contradicts the recent claim of the so-called little divergence within Asia before the mid-19th century.⁹

Figure 1. Real Index of Chinese and Japanese per capita GDP (1850 = 100)



Data sources: Maddison Project database at: <https://www.rug.nl/ggdc/historicaldevelopment/maddison/releases/maddison-project-database-2018?lang=en> but data base re-indexed at 100 in 1850.

But was the Chinese economy as stagnant as revealed as in Figure 1 and specifically how well did aggregate GDP statistics capture the overall pattern of economic change during this era? Thomas Rawski (1989) noted the jarring mismatch between the rapid pace of growth in modern sectors such as trade, modern industry, banking and monetary aggregates against the relatively stagnant GDP profile in figure 1. The reason behind this mis-match is that the share of modern sectors is tiny as a share of the GDP dwarfed by traditional agriculture and handicrafts sectors. For example, the modern factories production – which recorded 8% annual growth between 1912-1936 - were only 3.4 percent of the total GDP even in the 1930s.¹⁰ The

⁹ According to a recent estimate by Jean-Pascal Bassino, Stephen Broadberry, Kyoji Fukao, Bishnupriya Gupta, Masanori Takashima “Japan and the great divergence, 730–1874.” *Explorations in Economic History*. Volume 72, April 2019, Pages 1-22, Japanese per capita GDP in 1990 dollars stood 904 against China’s 600 in 1850. This led them to the claim of “little divergence“ within East Asia before being opened to Western colonialism. This would be inconsistent with the growth rates data extended to the 1930s in figure 1.

¹⁰ Ma, *Economic Growth*, p. 364.

attempts by Rawski to raise the agriculture growth rate in order to make a case for overall economic growth between 1912 and 1936 were - as he himself admitted - based on strong assumptions. In another attempt of reconciliation, Ma (2008) derived regional GDP estimates and argued that increased per capita output and structural changes of the sort associated with Simon Kuznets' concept of modern economic growth only occurred in two major regions of the Lower Yangzi and Northeast (Manchuria) where foreign investment and institutions were quite important.¹¹ In this chapter, rather than attempt to reconcile the aggregate with the sectoral statistics, I intend to reconstruct a new narrative as revealed by the statistics on the timing, magnitude and nature of economic changes in modern China.

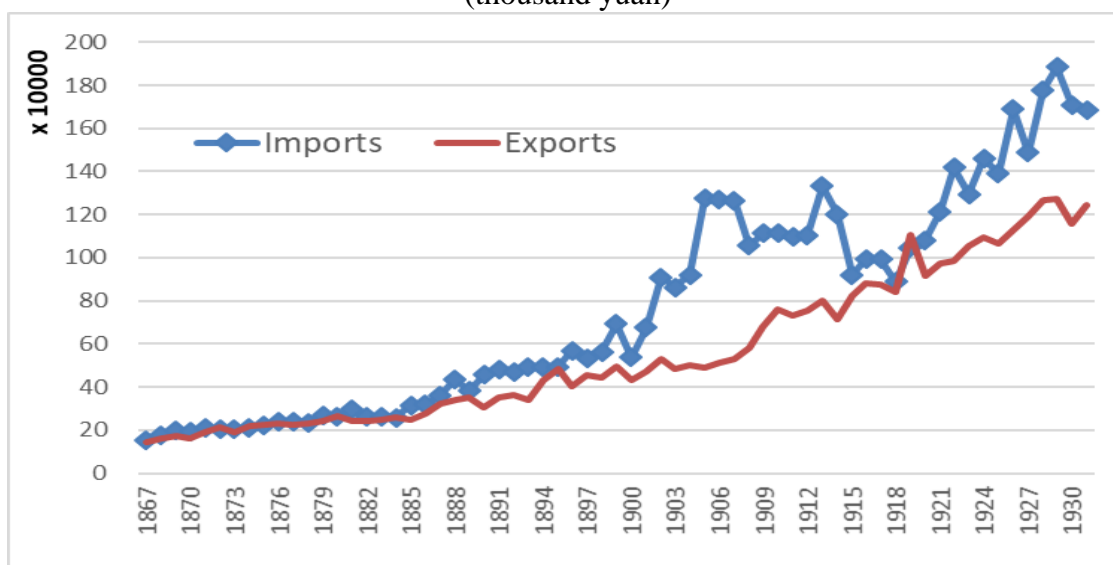
External Trade, Industry, Infrastructure and Capital Accumulation

We first start out with one of the most reliable and continuous economics statistics for the entire period of 1865-1949, the import and export data as recorded by China Maritime Customs.¹² In contrast to aggregate GDP statistics, Figure 2 reveals a remarkable expansion of China's international trade with real Chinese import and export increasing by eight to ten fold between 1867 and 1932. However, external trade did not take off right away after China's forced opening in the mid-19th century. While the increase in external trade was continuous, there was clearly an acceleration from the 1880s and 1890s onward, raising Chinese share in world trade to a peak of more than two percent of global trade flows in the late 1920s, a ratio that was not regained until the 1990s. So, the dream of China as a huge market for British manufacture – “every Chinaman wears a cotton cloth of the Lancashire factories” – barely came into fruition until three decades after Britain's forced imposition of free trade.

¹¹ Ma, Economic Growth.

¹² See Shiue, C. & Keller, W. (2022). “Foreign trade and investment”, chapter 12 in *Cambridge Economic History of China Vol. 2* edited by D. Ma. & R. Von Glahn. forthcoming Cambridge University Press. See Kaske, E. & Lin, M. (2022). “Public finance”, chapter 8 in *Cambridge Economic History of China Vol. 2* edited by D. Ma. & R. Von Glahn, forthcoming Cambridge University Press.

Figure 2. Real Value of Chinese Imports and Exports at 1933 constant prices (thousand yuan)



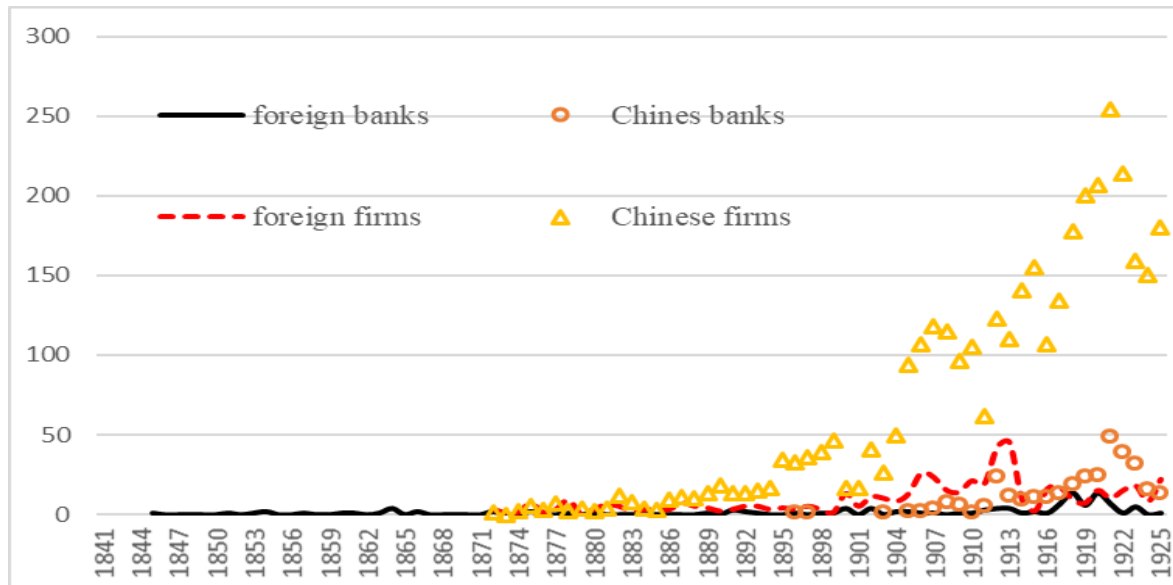
Source: Minami, R. and Makino, F. 南亮進、牧野文夫 (2014) アジア長期経済統計 (3) 中国。Asian Historical Statistics: China. Tokyo: Toyo Keiza Shinbunsha. Table 6.1.9.

It turns out that the 1880/1890 turning point in Chinese foreign trade was not entirely coincidental. In the absence of comprehensive economic statistics for the entire period, we can gauge economic activities from the meticulous firm and banks data compiled by generation of scholars, which culminated in the works of Du Xuncheng.¹³ Figure 3 plots the number of newly established Chinese and Western firms and banking institutions from the 1840s. Du classified his firms as the so-called nationalist capitalist enterprise, which are basically Chinese modern firms connected with the use of Western technology and production methods. Not surprisingly, following the signing of the Nanjing treaty in 1842, Western firms and banks took the lead in establishing trade and financial enterprises in the designated treaty port areas with a steady pace of growth marked by a small uptick from the 1890s for Western firms. While Western firms and banks were leading the way, the Chinese follow-up or catch-up in terms of the

¹³ I want to thank James Kung for alerting me to the use of this set of data for this purpose.

number of firms remained modest until the 1890s, when an outburst of growth completely overtook Western establishments. The peak of the establishment of modern Chinese banks occurred during the 1910s and 1920s after modern banks were permitted from the turn of the century following Qing legislation.

Figure 3. Western Impact and Chinese Response:
the Number of Newly Established Modern Firms and Banks



Sources: Du, Xuncheng 杜询诚 (1991) 民族资本主义与旧中国政府, 1840-1937. Chinese Capitalism and the Old Chinese Government: 1840-1937. Shanghai: *Shanghai Shehui Kexueyuan Chubanshe*. Huang, Guangyu 黄光域 (1995). *Waiguo Zaihua Gongshang Qiye Cidian* 外国在华工商企业辞典. Dictionary for Foreign Industrial and business Enterprises in China. Sichuan: *Sichuan Renmin Chubanshe*.

Although a very problematic measure of actual economic activities, the number of firms and banks turned out to capture quite accurately both the timing and the turning point of Chinese industrialization. Calculations from the data compiled by Du Xuncheng showed that the nominal annual industrial investment by Chinese nationals in the period of 1914-1925 was 11 times that of the 1840-1911 period.¹⁴ Similarly, Rawski’s figure for “Modern-oriented” fixed investment (calculated from consumption of cement, steel, and machinery) grew at an

¹⁴ Du used 1911 as the cut-off period, the contrast of industrial expansion versus stagnation would be even sharper if the cut-off period was the mid-1890s. Throughout this period, Chinese monetary standard was silver-based with moderate inflation. See Ma, Economic Growth.

average annual rate of 8.1 percent between 1903 and 1936, outpacing Japanese gross domestic fixed capital formation in mining, manufacturing, construction, and facilitating industries, which advanced at an annual rate of 5.0 percent. Likewise, between 1902 and 1931, inflows of foreign direct investment also grew at annual rates of 8.3 percent, 5 percent and 4.3 percent for Shanghai, Manchuria and the rest of China, respectively.¹⁵ Transport development measured by China's railway track length increased sharply from a mere 364 kilometers in 1894 to over 21,000 by 1937.¹⁶

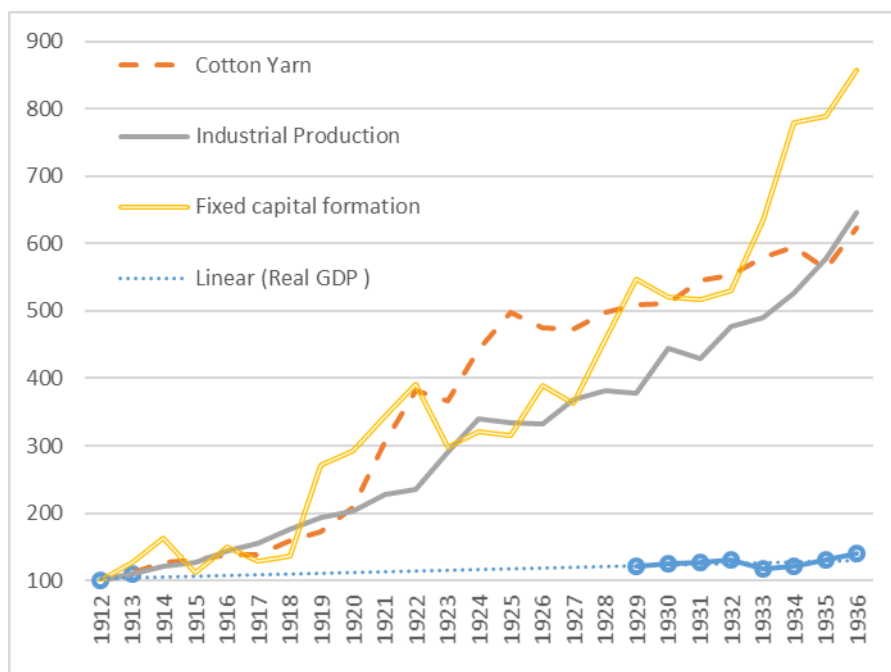
Figure 4 plots the real production indices of machine-produced cotton yarn, modern industrial production and capital stock. They grew by a magnitude of between six and eight fold between 1912 and 1936 against a largely stagnant real GDP for the same period. These statistics was consistent with historical narrative. Beginning at the very end of the 19th century, activity in mining and manufacturing accelerated sharply from its small initial base. Factory production, initially focused on textiles, food processing, and other consumer products, concentrated in two regions: the lower Yangzi area, where both foreign and Chinese entrepreneurs pursued factory expansion in and around Shanghai, and China's northeast or Manchurian region, where Japanese initiatives predominated. By 1935, Chinese factories, including some owned by British or Japanese firms, produced 8.0 percent of the world's cotton yarn (more than Germany, France or Italy) and 2.8 percent of global cotton piece goods production. Despite the importance of foreign investment in Shanghai and especially in Manchuria, Chinese-owned companies produced 73 percent of China's 1933 factory output. Growing production of light consumer and industrial goods, combined with the accumulation of experience in operating and repairing modern machinery, generated backward linkages that

¹⁵ See Brandt, L., Debin Ma and Thomas Rawski (2014). "From Divergence to Convergence: Re-evaluating the History Behind China's Economic Boom". *Journal of Economic Literature* 2014, 52(1), 45–123.

¹⁶ See Köll, E. (2022). "Transport and communication infrastructure", chapter 13 in *Cambridge Economic History of China Vol. 2* edited by D. Ma. & R. Von Glahn. forthcoming Cambridge University Press.

spurred new private initiatives in machinery, chemicals, cement, mining, electricity, and metallurgy.¹⁷

Figure 4. Real Production and GDP Indices (1912 = 100)



Source: Minami, R. and Makino, *アジア長期経済統計*, Table 4.D.1 for cotton yarn and Table 4.2.1 for Industrial Production. Fixed Capital formation Rawski, 1989, tab. 5.2, p. 245.

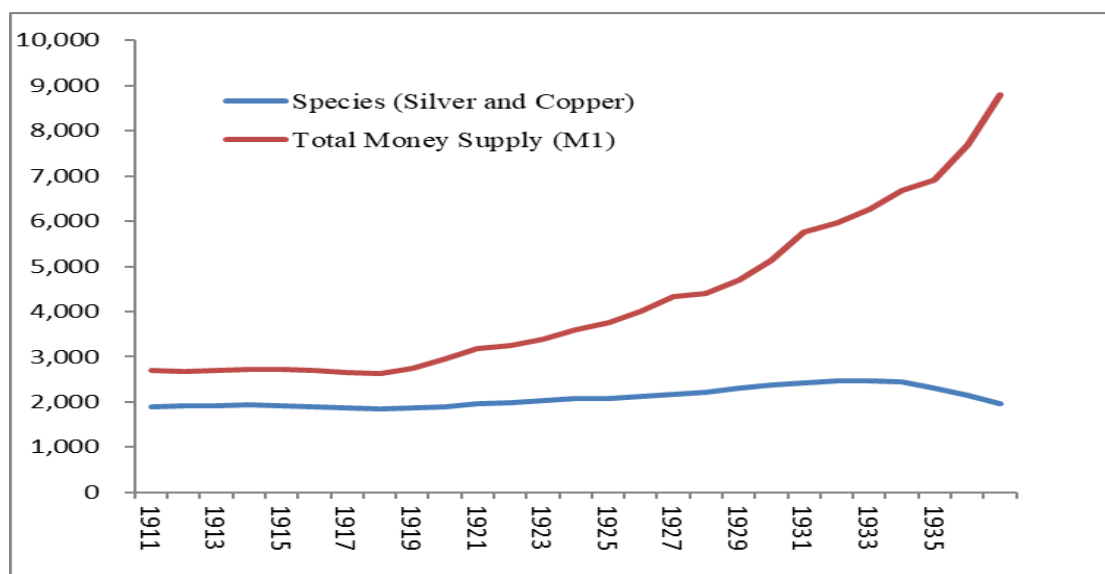
A Financial Revolution

The spectacular growth of Chinese banks from the 1900s as revealed in Figure 3 was the outcome of a remarkable triumph of a free banking version of the silver standard championed by largely privately held Chinese banks, foreign financial institutions and traditional money shops. Figure 5 shows that while total species as measured by silver bullion, dollars and copper cash barely registered any increase during 1911-1936, total money supply (M1) which includes species increased at an annual rate of 5% between 1911-16 and 1931-36. This is only possible because the bank notes and deposit components of M1 surged at a remarkable annual rate of 9.5% during the same period. As a result, the estimated share of notes

¹⁷ See Rawski, *Economic Growth*, chapter 2.

and deposits in M1 money supply rose from 22.3–34.6 percent in 1910 to a minimum of 40.4 percent in 1925 and 83.2 percent in 1936 with the turning point marked by an uptick in M1 around 1917-18.¹⁸ Overall Chinese banks - mostly Modern but also including Native Banks - accounted for the lion share of the growth in this period. The deposits held by Chinese Modern Banks relative to foreign banks increased from about two times in the 1910s to about four in 1930-35. The same ratio for banknotes held by Chinese over foreign banks increased from 1.5 times to about 3 times for the same period. Remarkably, price level remained stable whereas total money supply nearly tripled between the 1910s and 1930s when annual GDP growth registered no more than two percent during the same period, indicating a heightened degree of monetization and financial deepening. These growths translate into what Ma observed as nothing short of financial revolution as demonstrated in Figure 5.¹⁹

Figure 5 Metal Currencies (Silver and Copper) and Money Supply in China in 1911-1936 (in Million Yuan)



Notes: See footnote 15.

¹⁸ Rawski Economic Growth, p. 157.

¹⁹ See “The Rise of a Financial Revolution in Republican China in 1900-1937: a Survey and New Interpretation” *Australian Economic History Review* Vol. 59, No.3, Nov. 2019, pp. 242-262. See Li, D. & Yan, H. (2022). “Money and macro-economy”, chapter 7 in *Cambridge Economic History of China Vol. 2* edited by D. Ma. & R. Von Glahn. forthcoming Cambridge University Press.

Nonetheless, the fact that most of the transformations were connected with China's modern and foreign sectors have led to the rise of what many called as a dualistic economy characterized by a sharp divide between the small pockets of modern cities or treaty ports and vast rural hinterland, a phenomenon famously described by R.H. Tawney as "small islands of privilege at the seaports and on the great rivers. . . a modern fringe. . . stitched along the hem of the ancient garment".²⁰ Rhodes Murphey went further to describe the impact of treaty port on China like "... a fly (who) could ultimately irritate its host enough to provoke a violent counter-reaction, but not to change the elephant's basic nature".²¹

However, as I will argue below, because of political economy and institutional spill-over, the impact of the external and modern sector cannot be measured by quantitative effects alone. To understand this peculiar pattern of economic change, namely an economic take-off around the end of the last century after a hiatus of four decades being opened to Western imperialism, I turn to a review of historiography and build a new conceptual framework to link intellectual evolution with economic cycles.

2. Paradigms and Frameworks

Western Impact and Chinese Response: a review of historiography

Among the most important modernization paradigms that explains the modern Chinese development is the so-called Western impact and Chinese Response framework championed by the sinologist John Fairbank. Writing in 1954, Teng and Fairbank remarked:

"Since China is the largest unitary mass of humanity, with the oldest continuous history, its overrunning by the West in the past century was bound to create a continuing and violent intellectual revolution, Throughout this century of the "unequal treaties," the ancient

²⁰ R. H. Twaney, *Land and Labour in China*, London: Allen and Unwen Ltd. 1932, p. 13.

²¹ Cited on p. 166 in Motono, Eiichi *Conflict and Cooperation in Sino-British Business, 1860-1911, The Impact of the Pro-British Commercial Network in Shanghai*. (New York: St. Martin's 2000).

society of China was brought into closer and closer contact with then dominant and expanding society of Western Europe and America. This Western contact, lent impetus by the industrial revolution, had the most disastrous effect upon the old Chinese society. In every sphere of social activity the old order was challenged, attacked, undermined, or overwhelmed by a complex series of processes – political, economic, social ideological, cultural – which were set in motion within China as a result of this penetration of an alien and more powerful society. The massive structure of traditional China was torn apart.... The old order was changed within the space of three generations.”²²

To some degree, for China, as for many other non-Western countries, modernisation is nearly equivalent to Westernization and in this regard, the Chinese record is a partial failure in comparison with Japan, the only non-West country that succeeded in that time. However, this Fairbankian impact and response framework itself was challenged by Fairbank’s own student, Paul Cohen. In his widely acclaimed book “Discovering history in China”, Cohen argues that the challenge and response framework may inadvertently lead to an amplification or simplification of the Western influence in China, neglecting the role of Chinese agency and China’s internal dynamics. Indeed, as Cohen argued, much of the so-called Chinese response to or embrace of the West may well be superficial and reflected more the domestic dynamics. There were also regional and temporal variation of the Western influence, which could be highly visible or even predominant among certain social groups and the treaty port zones or more specifically in what Cohen referred as the Hong Kong / Shanghai corridor, but largely absent from the vast Hinterland. In short, Cohen calls for a return of Sinology discipline back to China and view China on her own terms.²³

²² Written by SSu-yu Teng and John K Fairbank cited on p. 9-10 in Cohen, Paul (1984), *Discovering History in China: American Historical Writing on the Recent Chinese Past*. New York: Columbia University Press.

²³ Cohen, *Discovering History*.

Cohen's "discovering history in China" approach offers a powerful corrective to what some would see as the Eurocentric tinge in the Fairbank framework and a possible inspiration to the recent California School's emphasis on China's own superior indigenous initial conditions in living standards, commercial and contractual traditions, human capital before the mid-19th century onset of Western imperialism in China. Most interestingly, the Lower Yangzi region which the California school championed as having comparable living standards and developments as England or the Netherlands during the eighteenth century also hosted the treaty port of Shanghai which was to become the leading financial and industrial city of the 19-20th century. In this regard, the Shanghai "economic miracle" of the 20th century can be viewed as much an import from the West as attributable to his own superior native roots.²⁴

This overseas intellectual inward turn towards a China "on her own" forms an interesting contrast to Chinese historiography within the mainland China, which at least from the 1950s had long built a dogmatic version of the Marxist narrative that posit a uni-linear, universal – ironically highly Eurocentric – version of the law of societal evolution, progressing from the lowest stage of Slavery in ancient times, to Feudalism, Capitalism, to Socialism and Communism. In this historiography with the 19-20th century Chinese economy and society characterized as semi-colonial and semi-feudal, the encroachment of Western imperialism – although a national humiliation - represents a progress or an assault on a backward "feudalist" Qing China by a more advanced and productive capitalism system.²⁵ In this regard, the paradigms of modernization and Marxism converge.

Very curiously, one offshoot of this mainland Marxist historiography is a lively debate on the so-called Sprouts of Capitalism". Inspired by Mao Zedong's claim in 1939: "The

²⁴ See Ma, "The Rise of a Financial Revolution" for the Shanghai miracle.

²⁵ Xu, Dixin 许涤新 & Wu, Chengming 吴承明 (1993) *中国资本主义发展史, 第一卷 中国资本主义的萌芽*. A History of Capitalist Development in China, Vol 1 Sprouts of Chinese Capitalism. Beijing: Remin Chubanshe.

development of China's commodity economy within her feudal society has spawned the sprouts of Capitalism. Even without the influence of Western capitalism, China will gradually develop into a capitalist society on its own."²⁶ Generations of Chinese scholarship labored on discovering those so-called traces or "sprouts" of capitalist production relations in traditional Chinese agriculture, handicraft and commerce. Despite coming from different or opposite ideological and institutional background, this emphasis on indigenous sources of Chinese tradition saw an interesting confluence with the California school. Just as China might have progressed "naturally" to capitalism without the on-slaughter of Western imperialism, Industrial Revolution may have equally eluded the West or England had they not stumbled up coal deposit or the discovery of the New World.

The idea that eighteenth century China may already be on the cusp of or on a natural progression towards modern capitalism or Industrial Revolution seems inconsistent with the Chinese aggregate economic record of the 19-20th century as partly revealed in Figure 1. While it is beyond the scope of this chapter to evaluate the entire literature on pre-19th century China's initial conditions, I argue that it was the scarcity of intellectual resources rather than natural source endowment that better explains the patterns of economic changes or lack-thereof in both the pre-modern and modern eras.

Ideology and Economic Changes: a New Framework

Although an ethnic minority from China's semi-nomadic north-eastern frontier, the ascendancy of Manchu rule under the Qing, actually marked the culmination of a millennia long evolution and maturing of a highly centralized, unitary Chinese political regime governed by an absolutist emperor at the top of the power pyramid. Aided by a formal bureaucracy recruited through a highly structured nationwide (national-metropolitan-provincial) Civil

²⁶ Xu and Wu *中国资本主义发展史* p. 4.

Service Examination rooted in Confucian classics, imperial China could implement a system of direct administrative rule (郡县) with mostly educated officials assigned to directly govern over one thousand counties nationwide over her vast territories on a 2-5 year rotating basis. Hence, the combination of direct administrative rule with the legitimacy of imperial personnel appointment became a potent instrument of political control and rule that no or few other traditional regimes had mastered.²⁷ In this regard, Chinese rulers managed to break free from the constraints of feudal and local autonomous institutions that had characterized Europe and much of the rest of the world for that matter. Beyond the borders of empire where they could not implement direct rule, the Qing, like previous dynasties, constructed a China-centred international order through the so-called tributary states trade system. This system engulfed neighbouring small states or territories in East and Southeast Asia as near protectorates that would pose no major military or political threat. Hence, absolutism Chinese-style curtailed inter-state competition and weakened independent vested interests, civil society or autonomous political and social groups, all to serve the purpose of minimizing any potential threat to the throne from below.²⁸

In this system, imperial or political legitimacy hinged on the state's capacity to suppress internal dissent and external challenge. Although military superiority or repressive capacity remained paramount to political legitimacy, they were insufficient by themselves and were only resorted to under extreme cases of threat. Hence, crucial to this legitimacy is the development of a consistent ruling ideology or belief system that would be - in our case -

²⁷ Two caveats were important to this system. First, however much impersonality and neutrality characterized China's imperial regime, they were frequently compromised by the emperor's personal rule, his personal entourage of eunuchs, consort and other inner court staff. Second, the highly centralized personnel appointment co-existed with a very decentralized delegation of economic resources at the local level. See Ma, D., (2012). "Political Institution and Long-run Economic Trajectory: Some Lessons from Two Millennia of Chinese Civilization". In M.Aoki, T.Kuran and G. Roland, eds., *Institutions and Comparative Economic Development*. Basingstoke: Palgrave Macmillan, pp.78-98.

²⁸ See Ma "Political Institutions", Ma and Rubin, "The Paradox of Power".

Confucianism or neo-Confucianism that rationalized Chinese style absolutist imperial rule. To establish the monopoly of this ideology over the interpretation of political and social events, systematic control and manipulation of information or alternative ideologies was an essential part of the system as characterized by the widespread incidence of literary inquisitions and intellectual persecutions²⁹. Although this system was effective in perpetuating imperial rule and the status-quo, it stifled the possibilities of endogenous development of ideological and institutional transformation from within and from below, leading to what Jin and Liu termed as super-stable structure of the Chinese empire before the mid-19th century.³⁰ Changes or even revolutions can happen in this system. But without corresponding intellectual development in new political and institutional ideologies, it just meant that violent revolution or dynastic overthrow (as happened very often in Chinese history) only led to regime or dynastic changes and cycles without fundamental institutional revolution.

The link between the stagnation of ideology and the limits to institutional change is echoed by another intellectual historian. Wang Fanshen contends that the contours of China's traditional intellectual resource endowments define the boundaries of political and social changes and the horizon upon which Chinese intellectual could hover over for solutions. The most outstanding examples are the late Ming early Qing Confucian scholars such as Huang Zhongxi (黄宗羲) and Gu Yanwu (顾炎武) whose penetrating insights and attacks on the ills of Ming's absolutist and repressive regime were resurrected in the late 19th century as China's enlightenment sages. However, when it came to proposals for reform, the Huang and Gu of the 17th century could only conceive of a passionate call to return to Chinese antiquity

²⁹ Wang Fanshen 权力. Jin Guantao 金观涛 and Liu Qingfeng 刘青峰 (2011). *兴盛与危机，论中国社会的超稳定结构* (The Cycle of Growth and Decline, On the Ultrastable Structure of Chinese Society). Beijing: Falu Chubanshe. Ge Zhaoguang 葛兆光 十八世纪中国的盛世危机“ (Crisis in China's Glorious Eighteenth Century) Feb. 19th 2019. <http://www.ftchinese.com/author/%E8%91%9B%E5%85%86%E5%85%89>.

³⁰ Jin and Liu 兴盛.

and classics. These atavistic attitudes are, as Wang argues, are typical of Chinese elite intellectuals of the time in general.³¹

By the mid-19th century, however, a vast and unexplored intellectual horizon resources have opened up but they were from an alien Western tradition, written in Western languages that few if any Chinese intellectuals mastered or even heard of at the time. But it is not merely the scarcity of foreign language talents or the suitability of Western ideology to Chinese reality that poses the problem. Rather it was something far more basic and fundamental: the willingness and capacity to first, recognize cognitive dissonance within China's existing system and following that, the need for a paradigmatic change. As eloquently stated by historian of thought Ge Zaoguang: it was precisely the glory of Qing's so-called triumphant 18th century that sowed the seeds of her failed response to Western challenge in the mid-19th century. Qing's success in the control of a vastly expanding and diverse empire increasingly through repression of intellectual dissent and unity of ideology has left her with a unique sense of grandeur and confidence that she could only treat the outside world with nothing but sheer ignorance and arrogance. In that regard, Qianlong's reply to Lord Macartney in 1792 is quite gracious by that standard. This is echoed by Wang Fanshen: until a major political and social-economic crisis can be keenly perceived, the Chinese intellectual soil – thoroughly soaked in a deep cultural self-confidence of the traditional literati – were simply not fertile enough for the transplant of new intellectual resources.³²

In comparison, Tokugawa Japan's relatively decentralized feudal system, peripheral geo-political position in the China-centred world order and with a with long tradition of absorbing foreign (mainly Chinese) culture and ideologies engenders a different cultural attitude towards Western impact and ideology during the mid-19th

³¹ Wang, 戊戌。

³² Ge, 十八世纪; Wang, 戊戌.

century. For example, catalytic events such as the 1842 Sino-British Opium War did not propel immediate institutional or political changes in Qing China, but did send a powerful warning of the impending Western threat to the elites of neighboring Tokugawa Japan. Indeed, China's defeat in the 1840s and subsequent failures may have so alarmed Tokugawa Japan that in a couple of decades, China switched from once being a model admired by Japan to a lesson to be avoided.³³

But effectuating paradigmatic changes carry risks and uncertainties as they upset the traditional ideological equilibrium. They are more likely to take place through other successful examples or the arrival of new ideas or paradigms that provides a new and consistent framework to explain the cognitive dissonance. In this regard, China's defeat in the 1894-96 Sino-Japanese War provoked greater reaction for Chinese reform than the initial Western Imperialism partly because Meiji reform seemed to have offered the way forward as a newly Westernizing Asian nation. Hence, the Meiji successful experiment with Western models stirred up cognitive dissonance on her giant and once slumbering neighbor.

In this sense, institutional change requires time, experiments (or sometimes historical accidents) and a feedback loop between events, experiments and ideas. We arrive at a model towards explaining why reform had twists and turns with that particular temporal and regional patterns as described in section 2. Our framework is consistent with some of the theoretical and historical works of Timur Kuran, Joel Mokyr, Murat Iyigun and Jared Rubin, that emphasizes the importance of ideas and the multiple equilibria of divergent paradigms as well as cumulative progress, or sudden surge forward or slide backward. Our emphasis on ideology and ideological change pushes us beyond just the paradigm of institution as emphasized by the advocates of institutionalism.³⁴

³³ Wang, 戊戌.

³⁴ For models of ideology and ideological change, see Iyigun, Murat and Jared Rubin (2017) "The Ideological Roots of Institutional Change" working paper. Timur Kuran *Private Truths, Public Lies, The Social Consequences*

Western Impact and Chinese Response Again

With our new framework, we return to the Western Impact and Chinese response paradigm with an important twist: the impact of the West is critically important, but only to a degree and manner in which Chinese (or Japanese) manage to respond. We emphasize the role of Chinese agency in utilizing, adapting and eventually re-designing new rules and institutions to propel economic change.

In the nineteenth and twentieth centuries, Western imperialism did not fully subjugate China, but manifested itself through the acquisition of trading rights, leased territories, and treaty ports, as well as extraterritoriality and spheres of interest. In the early twentieth century, when central control was weakened, Western treaty ports expanded rapidly at the expense of Chinese sovereignty. The expansion of these privileges and extraterritorialities in an era of political chaos and national disintegration turned out to be a blessing in disguise for two reasons.

First, some of these “privileges” happened to coincide with necessary conditions for growth, namely, the maintenance of peace and public order, the security of property rights and contract enforcement, the freedom from arbitrary taxation or official exaction, and the right to transparent rules and predictable jurisprudence. Second and more importantly, as shown later, foreign “privileges” in the treaty ports were often taken advantage of by Chinese business and residents.

Here, we examine the evolution of two key consequences of Western intervention. First is Shanghai, China’s largest treaty port, particularly its International Settlement, which resulted from a merger of all Western (and later Japanese but excepting the French) concessions

of Preference Falsification. Harvard University Press, 1997. For the importance of ideas and feedback loop, see Mokyr, Joel. (2002) *The Gifts of Athena, Historical Origins of the Knowledge Economy*. Princeton University Press. For an overwhelming emphasis on the role of institutions, see Acemoglu, D., Simon Johnson and James Robinson, “Institutions As the Fundamental Cause of Long-Run Economic Growth“, in *Handbook of Economic Growth*, editors Philippe Aghion and Stephen Durlauf, North Holland, 2005.

operated with the governance structure akin to a European type of self-governing incorporated urban community. Shanghai's foreign residents organized a Municipal Council with members elected by an association of tax-paying Western, later Japanese and eventually (in 1928) Chinese residents. The Council operated with rule of law vested in its own mini-Constitution, levying taxes and fees, running its own prison, police and volunteer army, and providing public goods such as roads, utilities and port facilities. The power and territory of the International Settlement greatly expanded in the wake of the 1911 Qing collapse with full territorial jurisdiction over all its residents including the Chinese.³⁵

The second key institution - China Maritime Customs – had similar origin and trajectory. The low fixed tariffs imposed by Western powers were initially collected by Chinese customs officials, but increasingly overseen by foreign consuls who set up the China Maritime Customs in Shanghai in 1854. Although nominally an Imperial Chinese organization, the Customs gained autonomy with Britons dominating its senior staff, which gradually came to include large numbers of Western and later Japanese staff, with the promotion of Chinese nationals into senior positions only starting in 1929.³⁶ With over 20,000 staff in forty main Customs Houses across China, the Customs rapidly emerged as China's most stable and efficient centralized hierarchic bureaucracy even as China herself descended into political disintegration. Following the Qing collapse in 1911, the Maritime Customs effectively took over the collection of the Customs charges and the distribution of the net revenue.

The insertion of these colonial institutions unintentionally ruptured China's long-standing imperial monopoly of power. The resulting gaps in imperial control created room for newly emergent Chinese business interests, many with deep links to foreign businesses, to

³⁵ See Ma, *Economic Growth*; Ma, *The Rise of a Financial Revolution*, Isabella Jackson *Shaping Modern Shanghai, Colonialism in China's Global City*. Cambridge University Press, 2018.

³⁶ Hans Van den Ven (2014) *Breaking with the Past: The Maritime Customs Service and the Global Origins of Modernity in China*. New York: Columbia UP.

create new networks of power and wealth that intensified growing pressure for formal political and institutional changes, especially following China's defeat in the 1894-96 Sino-Japanese War. However, the institutional changes arising from Western influence can only have nationwide effects after they trigger intellectual and political responses from Chinese elites, which is where we turn to now.

Liang Qichao (梁启超), China's foremost intellectual and reformer of the era, succinctly summarized the Chinese response. Writing in 1923, Liang surmised that changes or reforms could not even get started until the Chinese were willing to recognize and acknowledge there were problems to begin with. During 1842-1894, Qing saw firsthand the power of Western military equipment used to suppress the Taiping Rebellion (1851-64). This opened the door to the introduction of Western (particularly military) technology, machines or in Liang's phrase: materials things, 器物 (qiwu).

China's 1894-96 naval defeat by Japan shattered her confidence in her own systems terminated this initial stage and inaugurated a second stage of introducing new "institutions" - 制度 (zhidu). This process, which continued for two decades until roughly 1917/8, brought the comprehensive import of Western style government, law, along with modern corporate enterprises and financial institutions. The third stage followed the recognition that institutional transfers cannot succeed without understanding and absorption of their underlying cultural and ideological foundations. Reform demands changes in both spirit and form. The result was the New Cultural movement, which brought the massive introduction of Western culture and ideology or 文化 (wenhua), even leading to the radical abrogation of Confucian ideology.³⁷

Building on the insights of Liang, Yang Nianqun added a geographic dimension to Liang's temporal stages of reform, matching each of these three reform sequences with

³⁷ Liang, Qicao 梁启超 五十年中国进化概论 (A Summary of Fifty Years of Chinese Evolution), 饮冰室文集点校 第五集 (Selected Articles of Yinbinshe Collection, Vol. 5) Yunnan Jiaoyu chubanshe. Pp. 3247-3252.

distinctive regional political elites and with Ming-Qing schools of Confucianism, centered in the provinces of Hunan, Guangdong and Jiangsu-Zhejiang, corresponding to China's Middle-Yangzi, Lingnan and Lower Yangzi macro-regions respectively.³⁸ Yang's regional study drew inspiration from Paul Cohen's early work on late Qing reform, that emphasized the regional dimension of Western influence and highlighted the major cultural divide separating China's littoral and hinterland. More importantly, both Liang and Yang point to China's own intellectual endeavour in absorbing Western impact, as Cohen would put it, on her own terms. These intellectual and ideological responses by the intellectual and political elites paralleled practical efforts on the part of new economic actors and networks who took advantage of Western privileges to push the boundaries beyond the traditional structure.

3. Patterns of Economic Change: from Machines to Institutions to Ideology

The Age of "Machines"

The mid-19th century marked by the encroachment of Western Imperialism on Chinese shore started off disastrously for the Qing dynasty. Qing's defeats in Opium War (1842) and other military battles or even the devastating Taiping Rebellions which saw a calamitous cumulative loss of 60-80 million lives did not shake elites' faith in traditional ideology and institutions.³⁹ Political elites from China's agrarian Mid-Yangzi heartland of Hunan and Anhui such as Zeng Guofan (曾国藩) and Li Hongzhang (李鸿章) rose to national prominence following their success in mobilizing fiscal and military resources from their home provinces to eventually suppress the Taipings. Closely aligned with the official ruling ideology, the

³⁸ Yang, Nianqun 杨念群 (1997). 儒学地域化的近代形态: 三大知识群体互动的比较研究 (The Modern Form of Regional Schools of Confucius – A Comparative Research into the Interaction of Three Intellectual Groups) . Beijing: Sanlian Chubanshe.

³⁹ For the controversies among Qing officials' interpretation of the Opium War defeat, see Mao Haijian 茂海建 天朝的崩溃 鸦片战争再研究 (The Fall of the Celestial Empire, a Re-examination of the Opium War), Beijing: Sanlian Shudian (2013) .

Tongzhi Restoration (1861-1875) - what Mary Wright famously called the last stand of Chinese conservatism - engineered a remarkable economic recovery through the revitalization of traditional institutions: the reinstatement of Confucian orthodoxy, the restoration of the National Civil-Service Examination (largely interrupted during the Taiping Rebellion), and the temporary exemption from land taxes to lure cultivators to resettle war-torn agricultural regions.⁴⁰

As a natural extension of the Tongzhi Restoration, the Self-Strengthening movement (1860-1894) initiated programs that aimed to expand Chinese military strength by developing a small number of Western-style, capital-intensive enterprises financed or sponsored by the state and directed by prestigious officials or merchants with official connections. Although these enterprises, which included arsenals, factories, and shipyards, were fraught with inefficiency and corruption, they did record modest achievements.

Nonetheless, the overall ideological orientation during this period remained backward looking. In contrast to the concurrent Meiji reform in Japan, there was no reforms that touched the fundamentals of the traditional regime: no introduction of a modern constitution or commercial law; no reform in the currency system; modern banks or modern infrastructures such as railroads were expressly prohibited; steamships were limited to the Yangzi and other major rivers.

Foreign Trade in the Age of “Machines”

Although the treaty port system accelerated the arrival of new technologies and institutions, industrialization lagged far behind the opportunities opened up by the inflow of trade and technology. Attempts by Chinese and European entrepreneurs to take advantage of

⁴⁰ Mary Wright (1962) *The Last Stand of Chinese Conservatism: the Tung-Chi Restoration 1862-1874*. Stanford University Press.

opportunities linked to new technologies and trade arrangements reveal the presence of powerful obstacles to innovation within China's late-Qing economy. These are most clearly visible in the obstacles confronting private efforts to introduce new technologies and business structures.⁴¹

These obstacles existed precisely because the legality of traditional Chinese commercial and business activities rested on patronage rather than universal property rights. Often commercial guilds and organization acquired monopoly privileges in exchange for paying a fixed tax quota to the government and hence, some form of shelter from arbitrary exactions. This institutional arrangement, according to Eiichi Motono, formed the structural foundation of traditional Chinese merchant groups and networks under the official patronage.⁴²

However, the Western presence established a new source of power and authority in China. The "unequal treaties" granted every foreigner the right to trade and own property in the treaty ports, most importantly, subject to Western legal system. The imposition of "free trade" and extraterritorial privileges turned out to have unintended consequences. The treaty port system imposed by Western "free trade" imperialism set Chinese trade tariffs at a modest 3 or 5 percent during this period. To shelter their trade from the arbitrary native transit taxes known as *lijin*, the Westerners insisted on a flat transit tax when their goods moved through China's interior. These transit levies were assessed and after 1911, collected by the foreign-controlled China Maritime Customs.⁴³

Chinese merchants soon found opportunities to benefit from these "Western" privilege through false registration of their produce as destined for export (rather than domestic use), outfitting their ships (or junks) with Western flags, and investing their capital in foreign-owned

⁴¹ See Brandt, Ma and Rawski, "From Divergence to Convergence".

⁴² Motono, Eiichi *Conflict and Cooperation in Sino-British Business, 1860-1911, The Impact of the Pro-British Commercial Network in Shanghai*. (New York: St. Martin's 2000).

⁴³ See Kaske, E. & Lin, M. (2022). "Public finance", chapter 8 in *Cambridge Economic History of China Vol. 2* edited by D. Ma. & R. Von Glahn, forthcoming Cambridge University Press.

businesses or simply registering their businesses as owned by foreign nominees.⁴⁴ More critically, the so-called what Motono referred as English speaking Chinese merchants began to develop their own commercial networks outside the traditional commercial groups who had relied on the payment of native transit taxes as a means to acquire monopoly privileges. Motono identified the late 1880s – a timing that corresponded well with the first surge of Chinese firms as revealed in figure 2 - as the key turning point when traditional Chinese commercial organization began to crumble.⁴⁵ Motono argues convincingly that these merchant-official nexus forged through tax-farming arrangements formed the structural foundation of traditional Chinese merchant groups and networks. The Western presence, although small in relation to China’s national economy, constituted a new source of power and authority in China that drew away Chinese merchants and eroded the imperial system’s long-standing monopoly over political power, just like “a great dike may be breached by tiny termites.”⁴⁶ He sees the transit pass system as a vehicle for eroding the authority of mercantile guilds, fracturing traditional group solidarity among members of particular trades, and enhancing the property rights and security available to Chinese businesses.

By cooperating with, utilizing or embracing Western extraterritorial privileges, mostly in the treaty ports, these forces formed powerful pressure points that eroded the power base of traditional vested interests. Or as more effectively put by Motono, it was the Chinese themselves who promoted a Western impact on China.⁴⁷ But being confined largely within the treaty port zones and Western sphere of influence, this “Western impact” generated a “dual track” system which often placed Chinese business interests in an unfavourable position. They

⁴⁴ See Motono, *Conflict and Cooperation*.

⁴⁵ See Motono, *Conflict and Cooperation*, pp. 166-170.

⁴⁶ See Motono, *Conflict and Cooperation*, p. 169.

⁴⁷ Motono, *Conflict and Cooperation*, p. 167.

caused backlashes and pushbacks and stirred up currents for calls for formal political, institutional and changes within China to level the playing field.

These trickles and leakages turned into torrents following China's defeat in the Sino-Japanese War of 1894-1895 and the signing of the Treaty of Shimonoseki, which granted foreigners the right to establish factories in the treaty ports. Previously, foreigners only had the "privileges" to engage in trade and finance but not manufacture. This new arrangement imposed by the Treaty of Shimonoseki opened floodgates of foreign direct investment and pushed the Qing to accept and grant much broader property rights and protection to all Chinese not just in business but also in manufactures. This forms the essence of the 1903-1911 Late Qing legal reform in commercial law and the promotion of chamber of commerce.

The Age of Institutions and China's Turning Point

China's defeat in the Sino-Japanese War of 1894-1896 by Japan, a nation long regarded as a student rather than an equal, inflicted a profound mental shock on Chinese elites and the public at large. It marked the end of the Self-Strengthening movement and led to sudden surge of interest in the Japanese experience. Huang Zunxian (黄遵宪), the Qing ambassador to and keen observer of Meiji Japan wrote a landmark study of Japan's transformation in 1887. Despite being delivered to Zeng Guofan and Li Hongzhong, Huang's work circulated privately and drew little attention even when it was printed in 1895. But China's stunning defeat in 1896 turned this book into an instant best seller, leading one gentry man to lament that had we all paid attention to Huang's book earlier, China would have been spared over two hundred million silver taels of war reparations – something equivalent to five times of the Qing state's annual peacetime revenue - extracted by Japan following her military victory.⁴⁸

⁴⁸ Jin and Liu, 开放中的变迁 p. 66.

Intellectual historian Ge Zhaoguang marks 1896 as China's key intellectual turning point. He shows that during the three hundred years before 1894, Japan translated 129 Chinese works while the Chinese translation of Japanese works only amounted to 12. This trend reversed in the decade after 1896 with 958 Chinese translations of Japanese works but only 16 translations in the other linguistic direction.⁴⁹ Indeed, when Japan became the first Asian society to translate Western materials, the shared vocabulary of Chinese characters quickly installed Japan as the natural intermediary in transmitting Western culture to China, especially because of the inflow of massive numbers of Chinese students and the outflow of Japanese advisors and teachers to China.⁵⁰

China's naval defeat directly triggered the Hundred Days' reform in 1898 backed by the young Guangxu emperor (r. 1875-1908). Although centred in Hunan – the heartland of Self-strengthening bureaucrats – the reform's intellectual leaders came from Guangdong based elites such as Huang Zungxian, Kang Youwei (康有为) and Liang Qichao who had prior exposure to Western influence. Although the reform was quickly crushed by conservatives surrounding the emperor's aunt, Dowager Empress Cixi, the agenda of the failed Hundred Days reform formed the core of the Qing constitutional movement of 1903-1911, modelled directly on Japan's Meiji reforms.

Beyond military victories, Meiji Japan offered a remarkable example of a nation with similar (or humbler) cultural heritage but managed to implement a comprehensive and thorough reform agenda when confronted with a common Western threat. Through the successful adoption of gold standard in 1897 and recovery of extraterritoriality in 1899, Japan's Westernizing reform actually kept Western capital and influence at bay.⁵¹

⁴⁹ Ge, *中国思想史*, p. 478.

⁵⁰ Marius Jansen (1980) "Japan and the Chinese Revolution of 1911, chapter 6 in J. Fairbank and K. Liu (eds.) *Cambridge History of China*. Cambridge University Press. Wang, 戊戌.

⁵¹ Yoshiie Yoda, *The Foundations of Japan's Modernization, a Comparison with China's Path Towards Modernization*. (translated by Kurt W. Radtke) Leiden, Brill, The Netherlands, 1996.

China's new reform effort heavily influenced by Meiji was comprehensive and ambitious. It aimed to prepare China for a constitutional monarchy by drafting a formal Constitution that would establish national, provincial and local parliaments. Military modernization was high on the reform agenda. Administrative reforms sought to modernize public finance and adopt a national budget. The reform initiative gave birth to new Ministries of Education, Trade and Agriculture and encouraged the founding of local chambers of commerce. Policy initiatives aimed at currency reform, the establishment of modern banks, and the expansion of railroads and other public infrastructure. The abolition of the millennia-old Civil Service examination in 1905 opened the door to a modern school system, giving birth to what is today China's best-known universities.

Although the resulting political decentralization may have inadvertently hastened the Qing collapse, the rise of the new Republic opened the door to a massive Chinese experimentation with new ideology and institutions from the West. This indeed began China's age of modernity, a genuine experiment with Constitutionalism, the rise of regional cosmopolitanism, the introduction of modern company law and of such new business techniques as double-entry bookkeeping.⁵²

Growing local autonomy fostered by political decentralization encouraged the growth and maturing of civil society and, more importantly, boosted political and ideological competition across different provinces and towns as well as treaty ports. The comprehensive data presented in chapter 11 of this volume by James Kung showing the turn of the century breakpoint in education, missionaries, and numbers of treaty ports which partly became the institutional foundation underpinning the rise of modern industry, banking, public finance, and monetary regime as discussed in section 2.

⁵² Dikötter, F. (2010). *The Age of Openness, China before Mao*. Hong Kong: Hong Kong University Press.

The Rise of Financial Revolution in the Age of Institutions

The temporal retreat of central imperial power opened new possibilities for the rise of a quasi-political structure that rested on the institutional nexus of Western treaty ports (most notably Shanghai) and Maritime Customs service.⁵³ Both these institutions were all intimately connected with Western institutions or Western imperialism in China, which initially only served to protect the limited Western or foreign business interests in the context of extra-territorial privileges. However, in the wake of 1903 constitutional reform and Qing's collapse in 1911, this mechanism began to be transferred to China domestically.

The financial revolution that emerged during the politically chaotic 1910s and 1920s illustrates the interplay between Western Impact and Chinese Response. Shanghai's free-trade extraterritorial status had long attracted what later became some of the world's premier Western banking institutions such as Hong Kong & Shanghai Banking Corporation (HSBC) and Chartered Bank. But modern Chinese banks, which only started near the end of the 19th century, also found their homes there.⁵⁴ Even traditional family owned Native Banks increasingly chose to locate inside the Western controlled Settlement. The relocation of the Shanghai Native Bankers' Association from the Chinese part of the city to within the Settlement in 1917 and the founding of the association of modern Chinese banks in 1918 marked the rise of Shanghai's Chinese banking community as the leading force in China's macro-economy, monetary and financial regulation within a largely self-regulated free-banking framework.

Initially, when Chinese government borrowed from the foreign market, its obligation to repay can be partly enforced through the coercive power of Western gunboats and through the important intermediary institution of China Maritime Customs, the agency relatively

⁵³ Ma, *The Rise of a financial revolution*.

⁵⁴ In particular, the jurisdictional autonomy of the Settlement which sheltered the Bank of China Shanghai branch from Beijing government's ruinous fiscal demand in 1916 highlighted the value of independence of the Settlement. See Li, D. & Yan, H. (2022). "Money and macro-economy", chapter 7 in *Cambridge Economic History of China Vol. 2* edited by D. Ma. & R. Von Glahn. forthcoming Cambridge University Press.

insulated from the threat of the Chinese imperial government. When in 1911, the Maritime Customs directly took over the collection and remittance of the Customs revenue, it opened an account with HSBC which eventually became the custodian bank of that portion of Customs revenue pledged as security for the service of the government's foreign debt.⁵⁵

This institutional mechanism for external borrowing was soon to be transferred to become the cornerstone for a domestic market for Chinese governmental bonds through the intermediary of large Chinese public banks. China's domestic public debt originated in 1914 with the new Republican government in Beijing setting up an independent committee composed of Chinese and Western bankers and Maritime Customs officials. This mechanism ensured that tax revenue earmarked for debt repayment was remitted to special revenue account set up in the Western banks and later in Chinese banks headquartered in Shanghai's International Settlement. Maritime Customs revenue formed the most secure form of central revenue for a weakened Beijing government and therefore the most reliable collateral for servicing the government's foreign debt. The new viability of domestic public debt spawned a vibrant secondary market in the 1920s and 1930s.

This key nexus offered an unusual but credible commitment for the security of bondholders' property rights and the repayment of government obligations, which laid the institutional foundation for a financial revolution. The emergence of a quasi-political institution was an anomaly in view of China's long history of centralized and absolutist political rule that had been inimical to the kind of financial innovation associated with the rise of autonomous cities and merchant elites in Western Europe. In a sharp departure from the traditional political regime that left credibility at the mercy or benevolence of a strong and stable state, management of the state's obligations to bondholders now rested with an institutional mechanism that had grown autonomous from the center. It was that particular

⁵⁵ Ma, *The Rise of a Financial Revolution*.

mechanism that allowed Chinese bankers and bondholders to place some constraint on the power of the government with regard to public finance and, by doing so, enabled the Chinese government to tap into the private wealth of Chinese citizens for borrowing without coercion.

The Age of Culture and China's Fateful Ideological Turn

In 1923, barely four years into China's new age of cultural movement kicked off by the May 4th mass movement, Liang Qichao wrote with exuberance that Chinese understanding of Western ideology and culture had gradually but irreversibly progressed since the days of Self-strengthening. It was only in 1876 that a remark by Guo Songtao (郭嵩焘), China's ambassador to England, that the new Western "barbarians" confronting China currently - unlike previous Asian threats – also had two thousand years of civilization, caused a huge uproar and was roundly condemned as near blasphemy. Under Self-strengthening, despite the recognition of Western military and technological superiority, Western knowledge came to China only in drips through a limited number of indirect translations of Western works commissioned at various governmental arsenals.

This changed rapidly following China's military loss to Japan. Liang quipped that the first generation of advocates of Western learning were great classic Confucians scholars – himself included - who knew nothing of any Western language. The same was true of the next generation of Western learning advocates, most of whom were Chinese students returned from study in Japan. By the 1920s, a third generation of young scholars, many returning from studies in Europe and North America finally took over the baton of Western learning and at certain cases carried it to the extreme that, as Liang claimed, Karl Marx was now vying for equal status with Confucius.

Liang's exuberant banter about China's intellectual transformation conceals a wrenching process of intellectual change that occurred in Japan as well as China. In both

countries, the first step involved efforts to extend or reinterpret Chinese classics in ways that legitimized the pursuit of Western learning.

Meiji Japan called upon the orthodox Zhuxi (朱熹) Neo-Confucian principles to legitimize the ouster of the Tokugawa shogunate and the reinstatement of Meiji imperium under a centralized bureaucratic system. In similar fashion, the rediscovery of China's long marginalized anti-mainstream Wang Yangming (王阳明) school of Ming Confucianism inspired generations of revolutionaries in Meiji Japan, China and East Asia in general. The most striking or audacious was Kang Youwei's so-called rediscovery and restoration of "authentic" Confucian classics which he claimed had been distorted and contaminated during the Han dynasty. These "genuine" - or rather, mostly fictitious- classics, Kang claimed, already contained the seeds of ideas that would support and legitimize Chinese reform agenda in the 1890s.⁵⁶

But by the 1920s, China's intellectual mainstream had moved far beyond this phase of atavistic nostalgia. Indeed, after the 1911 Qing collapse, there were no equivalent of the Ming loyalists like Gu Yanwu and Huang Zhongxi who had refused to serve the new Qing ruler despite their unrelenting assault on the ills of Ming absolutism. Similarly, there were few who retained the faith in Qing orthodoxy that had inspired leaders like Zeng Guofan and Li Hongzhang just a few decades earlier. China's Republican era ushered in a new generation that embraced Western learning and ideology with few nostalgic backward glances. But China's intellectual turn toward the West soon developed in unexpected directions.

The political reality following Qing's collapse in 1911 revealed the harsh and dark sides marked by the rise of warlordism, factionalism, civil and military strife, fiscal bankruptcy, leading to a rising sense of national disintegration and international humiliation. As initial

⁵⁶ Yan, Shaodang, 日本中国学史, pp.98-134.

euphoria turned into despair, the Beijing government largely abandoned parliamentary experiments soon after Liang penned in 1923 enthusiastically about the extent and durability of cultural change. Ravaged by the First World War, Western imperialism and liberal ideology went on retreat and the world saw a turn from “Woodrow Wilson towards Vladimir Lenin”.⁵⁷ Liang’s suggestion that Marx might rival the standing of Confucius in the eyes of Chinese elites suddenly acquired ominous weight as the rise of a domestic Communist movement and the Guomindang’s engagement first with the Soviet Union and then with Nazi Germany marked an increasing turn toward authoritarianism.

The founding of a national capital in Nanjing returned China’s political centre to the heart of its wealthiest region, which had long been distrusted by Qing court for its anti-Manchu sentiments. But by the 1920s, the Lower Yangzi had developed new elites associated with the Shanghai-based treaty port system, symbolized by the powerful Song family hailed originally from Guangdong but educated in Christian mission schools and American colleges, illustrated this new group. Another was the Nationalist leader Jiang Jieshi, who married one of the glamorous Song sisters. Jiang, a native of Ningpo in Zhejiang province with strong connections to Shanghai’s financial elites and underworld leaders, graduated from a military academy in Japan where he developed a life-long admiration for Wang Yangming. Although Jiang promoted modern innovations, he was raised on the traditional Confucian classics and became a faithful admirer of Zeng Guofan, the Taiping nemesis and upright architect of Self-strengthening movement. Under Jiang, the Nanjing regime was increasingly authoritarian but charged with a full 10-year national modernization agenda until interrupted by the 1937 Japanese invasion.

⁵⁷ Luo Zhitian 罗志田 “‘六个月乐观’的幻灭：五四前夕士人心态与政治” “The Disillusion of ‘Six Months of Optimism’: the Mood and Politics of Intellectuals on the eve of the May 4th Movement” 历史研究 Historical Research No. 4, 2006, pp. 105-191.

The End of the Financial Revolution or the Coming of Full Circle?

As the unexpected cultural turn takes China onto a curious return to her own authoritarian or absolutist roots with the twist of a modernization enlightenment. The paradox of this combination comes into full view in the continuing phase of financial revolution in the Nanjing era. In its earlier days, the newly established Nanjing-based Nationalist government in 1927 especially under the new pro-business finance minister Song Ziwen (宋子文) – the American educated brother of the powerful Song sisters - respected the institutional mechanism for public debt set up under the previous Beiyang regime. It succeeded in taking over the core institutional element of financial revolution through the establishment of an independent Sinking Fund Commission headed by representatives from the Shanghai banking community and government officials. They consisted powerful independent checks on government's promise to repay.

The domestic debt issued in 1927-1931 nearly doubled the total for the entire Beiyang era of 1912-1926. The ratio of domestic to foreign public debt, which stood at 1 to 7 during the Beiyang era, rose sharply to 6:4 during the decade following the 1927 creation of the Nanjing government. In this way, the nascent Nanjing government created favourable conditions that diffused the fruits of financial revolution in the form of new monetary and financial institutions and instruments unimaginable within the treaty port framework. An important consequence of banks' increased holding of securitized governmental bonds was the rapid increase in the banks' capacity to increase its issue of bank notes as China's banking regulations allowed modern banks to use securities – mostly governmental bonds – to serve as 40% of the reserves needed to issue notes. This serves as the critical anchor for China's financial revolution as it expanded the balance sheet of private banks, enhanced the rise of credible banknote issues as illustrated in Figure 5.⁵⁸

⁵⁸ See Ma, *The Rise of a Financial Revolution*; Also see Li, D. & Yan, H. (2022). "Money and

However, once the Nanjing regime consolidated its power, its leaders moved to re-establishing a more authoritarian system that would rein in the treaty port autonomy, particularly in Shanghai, China's commercial, financial and industrial capital. The nationalization of major Chinese banks and the establishment of a fiat currency in 1935 and 1936 respectively - but without the simultaneous establishment of an internal form of checks and balances and along with the waning of Western imperialism and its associated fiscal-financial nexus - set the stage for the rise of hyper-inflation in the 1940s.⁵⁹ The resurgence of a fiat-money based hyperinflation in the 1940s marked another coming of full circle to the eras of China's historical hyperinflation era of China's Song and Yuan dynasty whose issuance of paper money exploded under wartime pressure.

Japan's full-scale invasion in 1937 and China's drive for resource mobilization pushed toward the rise of a war-time command economy.⁶⁰ The ascendancy of Communist rule and ideology followed decades of gradual but increasing radicalization of modernization ideology. When the Communists took power, they were armed with another borrowed ideology from the Soviet Union. Marxism or Communism was established as the new ruling orthodox grafted onto China's authoritarian or totalitarian roots.⁶¹ Indeed, China's new Communist leader Mao Zedong, who spent his formative years in his revolution-inclined native Hunan, became a modernizer, but remained a great admirer of China's historic founders of often brutal absolutist

macro-economy", chapter 7 in *Cambridge Economic History of China Vol. 2* edited by D. Ma. & R. Von Glahn. forthcoming Cambridge University Press.

⁵⁹ See Ma, The Rise of a financial revolution. See Li, D. & Yan, H. (2022). "Money and macro-economy", chapter 7 in *Cambridge Economic History of China Vol. 2* edited by D. Ma. & R. Von Glahn. forthcoming Cambridge University Press. See Kaske, E. & Lin, M. (2022). "Public finance", chapter 8 in *Cambridge Economic History of China Vol. 2* edited by D. Ma. & R. Von Glahn, forthcoming Cambridge University Press.

⁶⁰ See Bian, M.L. (2022). "Development and expansion of central and regional state enterprises during the first half of the twentieth century", chapter 6 in *Cambridge Economic History of China Vol. 2* edited by D. Ma. & R. Von Glahn. forthcoming Cambridge University Press.

⁶¹ See Xu, C. (2022). "The origin of China's communist institutions", chapter 15 in *Cambridge Economic History of China Vol. 2* edited by D. Ma. & R. Von Glahn. forthcoming Cambridge University Press.

rule, Qin Shihuang (秦始皇) and Zhu Yuanzhang (朱元璋). Mao drew greater inspiration from Chinese classics than from Marxist theory. Most ironically, just as Confucianism was extended or rediscovered to legitimize Westernization and modernization in the early 20th century, Communism, the most radical ideological import from the West was then deployed to legitimize a newly invigorated and technologically enhanced version of Chinese absolutism.

Conclusion

This chapter builds explicit links between intellectual and ideological cycles and phases of economic changes in China. By incorporating ideology into the narrative of modern China's economic history, it emphasizes the importance of the Western impact but assigns a central role to the Chinese response and to Chinese adaptation of Western ideology and practice. This new narrative adds missing elements to the Great Divergence debate, which has considered initial conditions mainly in the form of institutional structures and natural resource endowments. By highlighting the importance of intellectual resources, this approach exposes limitations in the Great Divergence thesis, which may run the fallacy of projecting late development experience onto historical initial conditions or institutions and to ignore the dependence/reliance of East Asian industrialization on borrowed institutions and ideology. It is the greatest irony that both the Marxist discussion of sprouts of capitalism and the Great Divergence inquiry into why China failed to generate an early Industrial Revolution were founded on the implicit assumption the inevitability of Industrial Revolution, an assumption is fundamentally uni-linear or Euro-centric.

The problem of ideas looms particularly large in China's historical context of absolutist institutions. In the absence or "weakness" of domestic voice, "exit" options or leakages in the form of physical capital or intellectual resources from this monopoly of rule carried particular

weight and significance. Utilization and absorption of these leakages proceeded at the two levels: the bottom up process by rational economic agents who took advantage of Western extraterritorial privileges and top-echelon political and intellectual elites who eventually modified ideology to legitimize modernization policy at the national and political level. It was only when these two levels connect or meet that China saw the largest of transformations.

This process not only worked in the 19-20th century but also in the post-1978 reform era. There, ideology at the top echelon and experiments at the bottom interacted often with tension.⁶² Ultimately, it was a rapid convergence of ideology to meet the global standards and rules after China's joining WTO in 2001 that saw China's most phenomenal transformation. The regime at the centre were more willing to make compromise from arbitrary and unchecked power under the pressure to meet global norms. However, three decades of unprecedented growth have brought back a resurgence in confidence in China's existing ideology and historical legacy, a confidence reminiscent of Qing's glorious 18th century. Will this lead to a revival of Qing-style closure to information flow and restriction of independent thinking and a repetition of history?

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⁶² See Naughton, B. (2022). "Chinese economy in the reform era", chapter 20 in *Cambridge Economic History of China Vol. 2* edited by D. Ma. & R. Von Glahn. forthcoming Cambridge University Press. See Brandt, L. & Rawski, T. G. (2022). "China's great boom as a Historical process", chapter 21 in *Cambridge Economic History of China Vol. 2* edited by D. Ma. & R. Von Glahn. forthcoming Cambridge University Press.

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