

OMC, Coordination Area

ECONOMIC DEFENSE DIVISION

MISSION

The Economic Defense Division is responsible for providing economic intelligence regarding the Soviet Bloc and its relations with other countries as needed for policy decisions and operating programs by agencies of the U.S. Government charged with the administration of economic defense legislation and policy directives.

FUNCTIONS

The Economic Defense Division shall:

1. Provide intelligence for the development and application of export controls and ancillary economic defense measures against the Soviet Bloc.
2. Develop intelligence on current transactions which are, or are suspected of being, in evasion of free-world economic defense measures; and maintain a central inter-agency reference service on such transactions.
3. Mobilize intelligence about foreign firms and individuals engaged in financial or foreign trade transactions with the Soviet Bloc contrary to U.S. security interests.
4. Furnish the Chairman and Secretariat of the Intelligence Working Group.
5. Furnish Agency representation on inter-agency committees and working groups in the economic defense field.
6. Prepare collection requirements in support of the functions outlined above and evaluations of intelligence materials as requested.

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D R A F T

Project No. 110.1

Determination and Portrayal of Clandestine
West-East Trade Centers, Channels, Traders
and Techniques

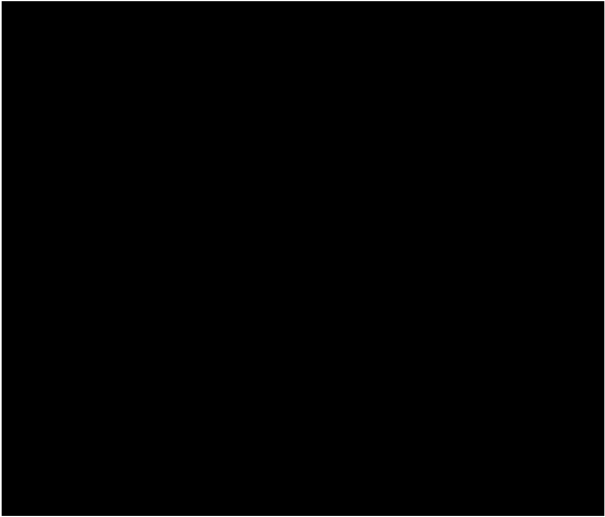
Section on
Financing of West-East Trade

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Financing of West-East TradeIntroduction:

Less intelligence is available on the financing of clandestine West-East trade than on any other facet of this extensive traffic. This lack of information is due principally to the existence of rigid bank secrecy laws in most countries which prohibit the furnishing of information on clients' accounts to unauthorized persons. An "eye" in such banks is consequently a very sensitive source, and, in Switzerland for example, would be liable to prosecution under the espionage laws. Furthermore, round-about processes of financing which are fundamental to any foreign trade transaction, and particularly to clandestine trade, are most carefully guarded secrets of the W/E traders. Moreover, lack of technical financial background on the part of the source often results in "garbled" reporting which is of little assistance in tracing the actual financing of a transaction.

In spite of the above mentioned difficulties it has been possible to obtain some indications as to how the Soviet Bloc has been paying for clandestine shipments of strategic commodities including the principal centers and banks involved and the changing tactics employed. Several thousand documents have been examined covering W/E trade transactions over the past two years, but emphasis has been placed on the period of the last eighteen months.

As background for understanding the role of financing, the following description is offered of the mechanics of West-East trade in strategic commodities that pass in transit states through any of the "free-port" countries of Europe. Although specifically referring to Belgium, it is of such general applicability that it warrants citing as a very logical pattern. ✓

✓ Army Intelligence Report R 94-53, 14 July 1953.

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The Communists rarely purchase strategic materials directly; rather they maintain individuals, companies, or banks abroad which have secret funds at their disposal. These individuals or firms employ agents who contact western firms which, in the hope of a good profit will agree to sell for delivery to the Soviet Bloc. Often these latter collaborating firms are well-known and well-considered. They justify their action by the fact that legislation and commercial treaties do not prohibit this trade with the East and it is advantageous to their national economy as well as very profitable to themselves.

Certain disadvantages
In order to avoid/consequences of this trade (black list, refusal of visas, etc.), these respectable firms often organize covert selling companies of not too sound a nature or a corporation with a ridiculously small capital managed by a trusted person such as a former employee.

On their side the Communist firms and their agents also often form covert or front companies which attempt to establish relationships with the regularly established companies which have a reputation of willingness to engage in operations returning a good profit.

In addition to the participation of commercial firms and banks, trade with the Soviets requires the cooperation of maritime agencies for the transportation of merchandise. The Communists have friendly shipping agents in every maritime country, often supported by financial assistance, but there are also respectable maritime agencies which lend themselves to irregular operations in exchange for good commissions.

The purchase and forwarding of strategic merchandise is usually accomplished in the following manner: The end purchaser, that is, the Communist purchasing organization, asks the Communist controlled firms or agent

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to procure from the western companies strategic items indispensable to the USSR or Satellites.

On assurances that the strategic merchandise is supposedly destined for a NATO country or a neutral country, the "respectable" company in any country (which often knows very well that the items will go to the East) will offer the product directly or through a covert or front company, let us say in Belgium, (with all necessary export documents, licenses, invoice, etc.) The sale is made CIF Belgium or CIF transit Belgium. Meantime, the selling company receives notification that the merchandise has been sold to a company established in a country other than that of the primary destination and the selling company is asked to send the merchandise CIF transit Belgium for Denmark, Switzerland, Iran, etc. Of course the company to which the merchandise is resold has a confidential relationship with the Communist agent.

At this juncture, the original purchasing company receives a notice of credit from the end purchaser and gives a guarantee of delivery, which is generally two per cent. As soon as the guarantee of delivery is given, the original purchaser converts the credit to a sight draft.

The original Communist buyer (identity of which is often hidden from seller) prefers to buy FOB Europe with payment on receipt of shipping documents. As the destination of overseas merchandise sold CIF Europe must be indicated on departure and since the Communist buyer only gives a sight draft on receipt of shipping documents FOB Europe, a bank must participate to finance the operation covering embarkment by the selling company and re-embarkment by the original or secondary purchasing company to point of final destination. Such banks exist and they finance the operation for a two percent commission.

As is seen from the above summary, the original purchase of strategic material is perfectly legal and expedition to a European port is also effected

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in a legal manner. Once the sale is consummated, and while the goods are in transit, the original buyer sells the goods to a second company, often fictitiously. This latter company, which must necessarily be located in a country other than the one to which the goods were sold and shipped, advises the maritime agency that the goods have been resold to a Satellite and that the destination previously indicated no longer holds good. The maritime agency therefore does not make a debarkation declaration for the country designated by the original seller, but transfers the goods FOB to the shipper of the primary buyer. As long as Port of Customs authorities receive no complaint, they do not intervene because the operation does not concern their country.

The first legally guilty party is the secondary purchaser which gave the maritime agency the order to change the destination of the goods knowing that the goods had originally been purchased for a NATO or neutral country. The second guilty party is the maritime agency which transfers the goods to an Eastern destination knowing that according to the shipping documents of the original purchaser, the goods were destined for a NATO or neutral country. There are graver cases also, as for example when the maritime agency delivers fictitious shipping documents to the second purchaser showing destination as a NATO port and transfers the goods to the East. This is done to eliminate the financing bank and increases profits for the selling company.

The above outline of a W/E trade transaction appears to be entirely credible, but as in most reporting of W/E transactions, the actual financing is glossed over in a summary manner.

Various methods of payment have been utilized ranging from simple barter transactions, gold payments, settlement in U.S. Dollar currency,

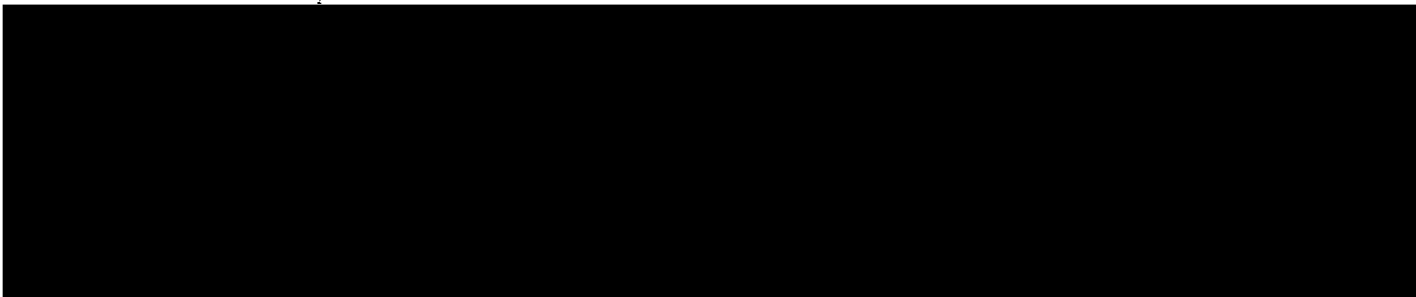
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payment by check or bank draft, to complicated credit arrangements usually involving some type of letter of credit.

Paris appears unquestionably as the principal center of Soviet financing, with London in second place. The Soviet controlled banks in these two cities maintained much of the financing all over the world and arrange for intermediate financing in other countries. Many Swiss banks have been involved, as well as banks in Rotterdam, Antwerp, Brussels, Beirut and numerous other places, which will be mentioned later, but in most cases the financing was initiated in Paris or London. Banks in Hongkong usually participate in financing of shipments to Communist China. The intermediary banks are sometimes Soviet controlled but generally are banks anxious to make a "fast dollar" without regard to destination of the shipment. Often banks with excellent reputations also participate in such financing. In this connection, it must be remembered that as far as most banks are concerned, the financing of such transactions is quite legal as few countries have financial controls to prohibit it, and even when certain controls are in effect, loopholes in the law can often be found. Unfortunately, however, many of the banks collaborate even to the extent of falsification of documents. In the following pages an attempt will be made to show the role

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Communist China

Although Soviet Bloc countries, as such, have not been treated individually in this paper, Communist China is a special case in view of the ^{multilateral} stricter controls against China ~~that have been multilaterally agreed upon~~, than against other Bloc countries, and also because of the U.S. Foreign Assets Control regulations applied following the aggression of the Communist Chinese in Korea in 1950.

The Bank of China, Peiping, (which has various branches in other countries) is under the direct control of the Chinese Communist Ministry of Finance. Through its branch in Hongkong it controls various subsidiary banks in that city. The most important of these banks in Hongkong owned and operated by the Communist Chinese Government are:

1. Bank of Communications
2. Chekiang Bank of Commerce
3. Nanyang Commercial Bank
4. Shanghai Commercial Bank
5. Pao Sheng Bank

The Pao Sheng Bank, in turn, controls the following Hongkong banks:

1. China and South Seas Bank
2. China State Bank
3. Kincheng Banking corporation
4. National Commercial Bank
5. National Industrial Bank of China

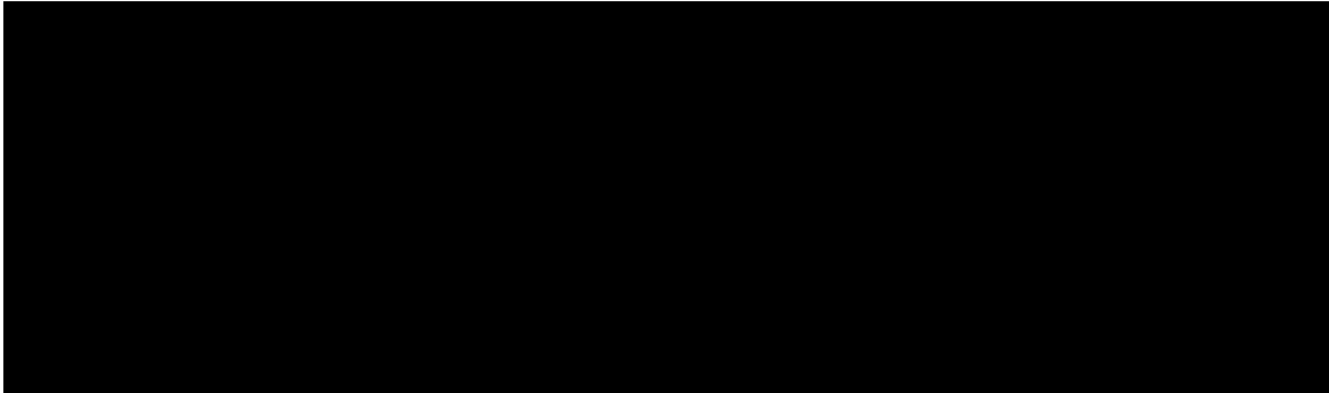
150/ Paris, Repto A 29 to London, (Info. Wash. A 14), 13 Aug 1953.

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6. Sin Hua Trust
7. Wo Shing Bank
8. Yian Yieh Commercial Bank
9. Young Brothers Banking Corporation
10. Chiya Banking Corporation
11. Hongkong and Swatow Commercial Bank
12. Kwangtung Provincial Bank

All of these banks are responsible, under direction of the Bank of China, for sponsoring illegal trade with western countries and between Hongkong and China. They make funds available to their branches on the mainland to pay for controlled goods illegally imported. 151/ They also maintain close contacts with many Communist-controlled import-export firms in Hongkong and either open letters of credit for them directly or through Western banks.

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Sterling and Swiss Francs are the main currencies used for payment, US dollars being used less and less for fear of blocking of accounts by the U.S. under Foreign Assets Control regulations. Barter transactions also appear importantly in Chinese Trade.

Similar to other Soviet Bloc countries, China has a national purchasing agency, the Chinese National Import-Export Company (GNIEC) with Head Office in

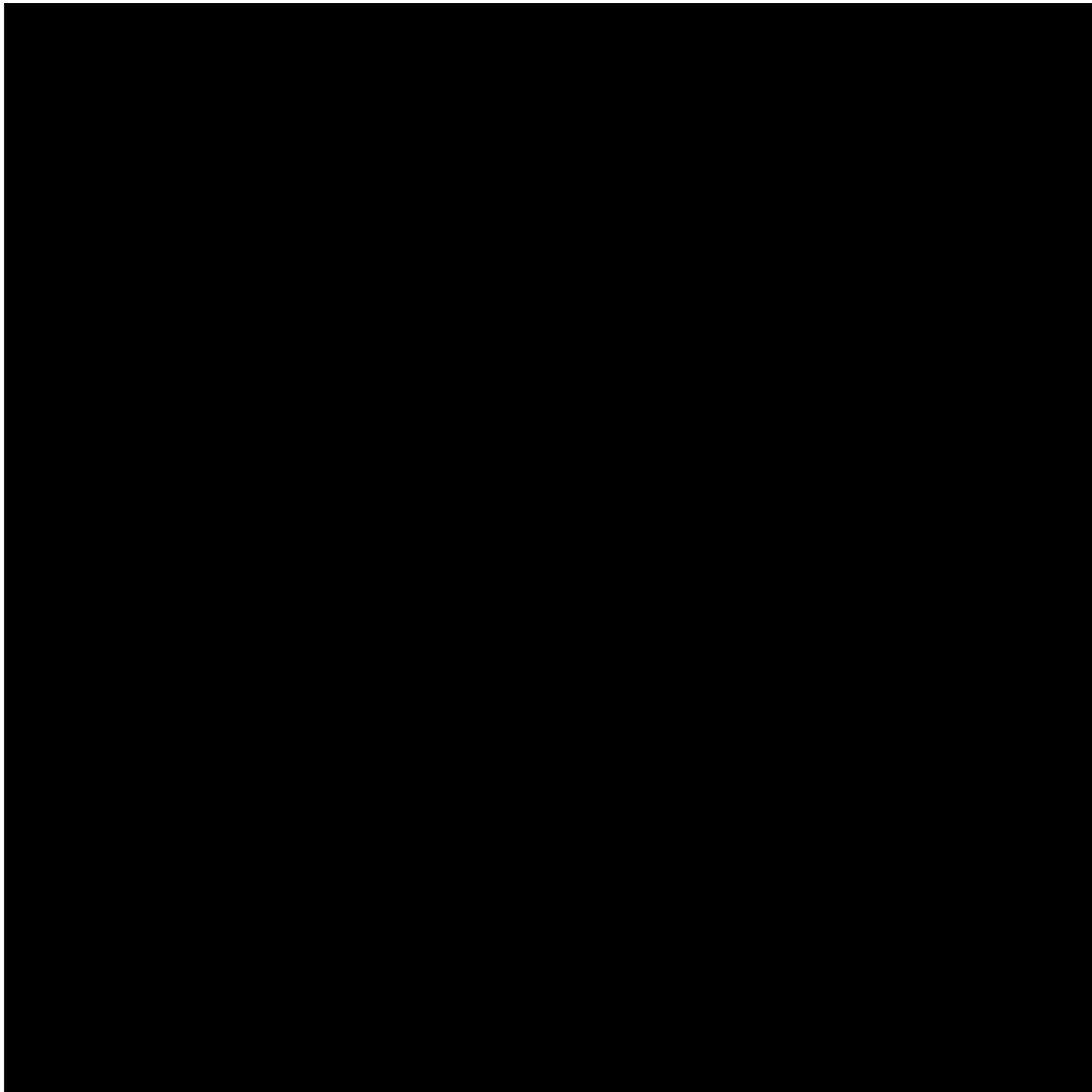
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Peiping and a vitally important office in East Berlin where western procurement has centered. Recently it has been reported that an office has been opened in London where close collaboration is maintained with the Bank of China. The CNIPC

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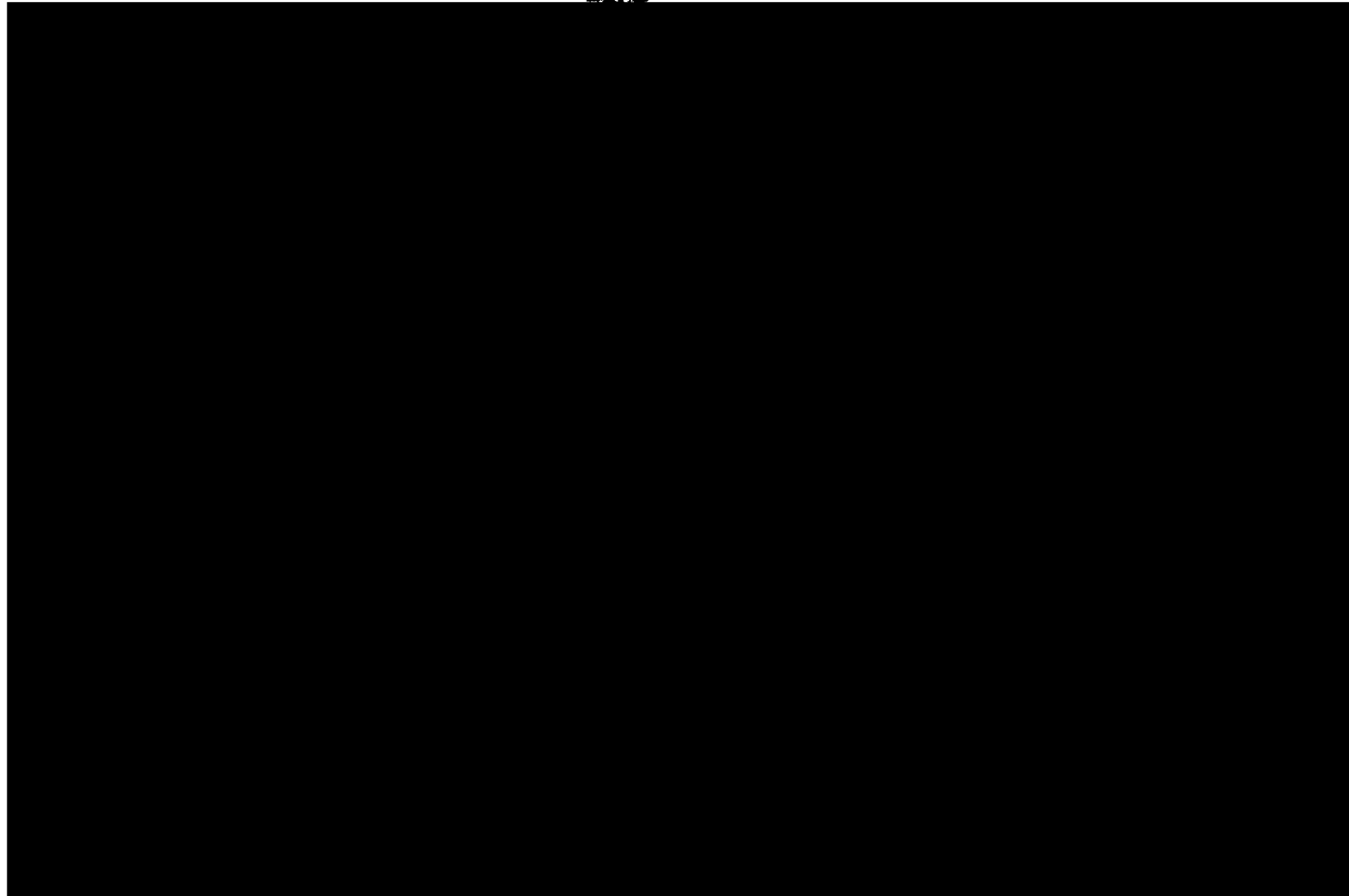


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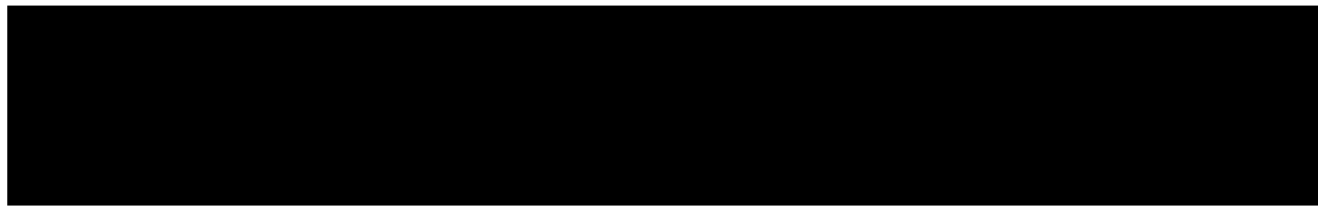
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Any discussion of Communist Chinese trade requires some mention of the Portuguese colony, Macao. Branches of Chinese banks in Macao, particularly the Nan T'ung Bank & Nam Kwang Co., participate in arranging the financing of shipments of strategic commodities from the west, many of which eventually find their way into China. Although it is well known that a great deal of smuggling takes place between Macao and Communist China, the extent of this traffic is difficult to estimate. 161/

25X9A1 Communist China has been attempting to carry on as much trade as possible on a so-called barter basis. Actually Ls/G and Ls/C are used but



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often the western supplier must agree to accept a similar value of commodities before the CNIEC will agree to the contract. This is often very unsatisfactory to the western trader because of the limited market in Europe for China's few exportable commodities.

China's trade with Japan is conducted almost exclusively on a barter basis but in cases involving credit or cash payment, the medium of exchange utilized is pounds sterling. The Japanese Ministry of International Trade and Industry reported in 1953 that no transactions denominated in dollars between Japan and Communist China were permitted. In trade with Japan under "Escrow barter," China is required to deposit with banks, either Japanese or foreign, in Japan the amount of money for the entire barter settlement plus 50 percent of the sum as security. Another method of financing is a back-to-back letter of credit in Sterling. Under the back-to-back L/C, Communist China must deposit with a bank of a third country in Hongkong the amount of money for the entire barter settlement plus 50 percent of the sum while Japan deposits the sum for the barter payment only with the bank. Under this formula Japanese traders may make shipments prior to the arrival of collateral from Red China. 162/

Increased embargo restrictions and the U.S.'s fight against the smuggling of strategic goods to China forced the Soviet purchasing organization, "CANSF" (the initials of the Russian name for this agency) in 1953 to take some counter

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Recent Developments

No mention has been made in the foregoing description of W/E financing of the important role played by Soviet sales of gold bull on which have taken on increased importance during the past year. This has been done purposely as the subject is of sufficient significance to warrant a separate study, currently being undertaken elsewhere in the agency. Nevertheless, this paper would be incomplete without some reference to these transactions. During the past two years it has become more and more difficult for the USSR and its satellites to export in sufficient quantities the commodities wanted by western nations. As a result the bloc has not earned enough foreign currency to pay for its current import program, propaganda activities, etc. in the West. Consequently, increasing amounts of Soviet gold have been sold in London, Paris, Amsterdam, and in Switzerland to replenish depleted reserves of sterling and other currencies.

Past patterns of W/E trading and financing could alter radically during the coming months depending on the outcome of present negotiations in COCOM on western controls against the European Soviet bloc and forthcoming negotiations in CHINCOM on controls against Communist China. If controls are relaxed appreciably, as appears likely at present, it may be unnecessary for the Soviet bloc to go through the circuitous processes now employed to obtain embargoed goods except on a very short list of commodities that will be retained for embargo and/or quantitative control. The life of W/E traders would accordingly be greatly simplified.

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