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INTELLIGENCE BRIEF

THE ROLE OF CREDITS
IN CHINESE COMMUNIST PURCHASES
FROM THE INDUSTRIAL WEST AND JAPAN.

DIRECTORATE OF INTELLIGENCE

Office of Research and Reports

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THE ROLE OF CREDITS
IN CHINESE COMMUNIST PURCHASES
FROM THE INDUSTRIAL WEST AND JAPAN*

Summary

Current negotiations to purchase a steel complex valued between \$140 million and \$175 million from a West European consortium represent the largest and most recent Chinese Communist transaction to acquire industrial installations from the Free World. If this contract is signed, the value of Chinese purchases of industrial installations from the Free World since 1963 will be almost twice the present total of more than \$180 million. None of these purchases has involved long-term credit; like the one currently under negotiation, most of them have been financed by medium-term (up to five years) bank credit backed by government guarantee.

In addition to approximately \$90 million of medium-term industrial credits, against which China so far has drawn \$43 million, China has received from the West more than a billion dollars in short-term (to 18 months) credit covering the purchase of Western grain and miscellaneous other short-term credits of around \$170 million. All of the credits together have financed almost one-third of China's imports from the Free World during the period 1961-65.

The credits received thus far, however, have done little to relieve the pressure on China's hard currency payments. The large volume of repayments due each year has reduced net drawings to less than \$35 million annually, and repayments in 1966 should about equal, and may even exceed, new drawings. Conclusion of contracts for the steel complex alone would cause drawings against medium-term credits of perhaps \$20 million to \$30 million annually over the 1967-70 period, thereby helping China to sustain new drawings roughly on a level with repayments for a few more years.

* The estimates and conclusions in this brief represent the best judgment of this Office as of 22 March 1966.

The fact that China's leaders thus far have not sought long-term Western credits probably indicates their uncertainty over China's long-run hard currency payments position -- particularly over future grain import requirements -- and possibly a reluctance to pay the higher interest charges associated with long-term borrowing. Should they decide to seek some long-term financing during the course of the current five-year plan (1966-70), it seems likely that such credits will be forthcoming.

1. Introduction

Since the beginning of 1961, when Communist China began diverting its trade from the Communist to the Free World, the Chinese have drawn down almost \$1.4 billion in short-term and medium-term credits extended by Western industrial countries and Japan. Such credits, most of which have involved government guarantees to commercial banks, have financed a large share of Communist China's purchases from the Free World (see Table 1).

Table 1

Role of Short-Term and Medium-Term Credit
in Communist China's Imports from the Free World
1961-65

<u>Commodity</u>	<u>Million US Dollars</u>		
	<u>Drawings Against Credits</u>	<u>Imports from Free World</u>	<u>Percent of Imports Financed by Credit</u>
Grain	1,167	1,955	60
Capital equipment	43	300	14
Fertilizer	147	375	39
Other	20	1,915	1
Total	<u>1,377</u>	<u>4,545</u>	<u>30</u>

Although by far the larger part of the credit was supplied by Canada and Australia as short-term financing for China's heavy imports of wheat, medium-term credits to purchase Free World capital equipment have become increasingly important. Known extensions of such credit total at least \$90 million, against which the Chinese already have drawn \$43 million or more. Complete industrial installations account for the bulk of these credits, which have been extended by at least seven Free World industrial countries.* West Germany, the United Kingdom, and Japan

* Of the forty or more contracts for industrial installations known to have been signed since 1963, at least 20 were concluded in 1965. Most of these have involved credit.

together have supplied some two-thirds of this total. None of the credits made available thus far has exceeded five years, and a number of the smaller ones have had two-year terms (see Table 2).

2. Current Negotiations for a West European Steel Plant

The largest and most recent transaction of this type is the just-announced Chinese negotiation with a consortium of West European industrial firms to purchase a steel complex valued at between \$140 million and \$175 million. If this contract is signed, it will almost double the present value (more than \$180 million) of industrial installations purchased by China since 1963.

This complex, which currently is under negotiation with DEMAG, A. G., the Ruhr corporation heading the consortium, consists chiefly of two rolling mills and possibly a rail or pipe mill. The greater part of the equipment is to be supplied by West German firms, which very recently received their government's agreement to guarantee a five-year credit of as much as \$87.5 million to finance their share of the complex. It is believed that French, Italian, Swiss, and British firms may be involved in supplying the remainder. Although the West German firm Schloemann A. G. signed the first contract for a \$17 million cold-strip rolling mill last December, contracts for the remaining facilities may not be concluded for several months.

3. The Impact of Credit

Credit has played an important role in financing Communist China's imports from the industrial countries of the Free World, but all of the credits received thus far have been relatively short-term. Grain credits have been for 18 months or less, credits for capital equipment have been from two to five years' duration, and fertilizer credits generally have been on 12-month terms.

As a result, China has been faced with a large volume of repayments due each year (see Table 3). Beginning in 1962, repayments on past credits have almost equalled drawings against new credits, and net drawings have amounted to less than \$35 million annually. Indeed in 1966, when a large repayment against 1964 grain credits falls due, payments will probably exceed drawings.

4. Prospects

China has not sought long-term (more than five-year) credits from the Free World but has financed a growing volume of imports from the

industrial West and Japan through rising exports and medium-term and short-term credit. Although China's exports to hard currency areas are expected to continue to grow over the 1966-70 period, it is also likely that China's requirements for industrial goods will generate a rising demand for hard currency imports. This increased demand, together with continuing large-scale grain imports, should absorb the expected increase in Chinese export earnings.

It is not known how much medium-term industrial credit China will assume over the next several years. The DEMAG steel contract, alone, is expected to result in drawings probably on the order of \$20 million to \$30 million a year during the 1967-70 period. If drawings against other industrial credits amount to \$30 million to \$45 million annually -- that is, at or up to 50 percent higher than the 1965 level of around \$30 million -- then total drawings against medium-term industrial credit will be roughly \$50 million to \$75 million a year. Unless the Chinese decide to seek long-term or even further expanded medium-term credits, their net credit position vis-à-vis the industrial West and Japan will then approximate that shown in Table 3. If they decide to continue expanding medium-term industrial credit, they would postpone for only a few years the time when repayment would surpass new drawings, and, after that, payments would rise sharply. It is more likely that the Chinese would seek long-term financing for a substantial increase in purchases of industrial equipment from the West.

China's failure to seek long-term credits from the Free World reflects chiefly the uncertainty of the leadership over the long-run Chinese payments position, and especially over future requirements for Western grain. Although a certain level of more or less revolving short-term and medium-term debt can be managed, the leaders apparently have been unwilling to assume a burden of long-term debt, for which China's repayment capability remains in doubt. Furthermore, it is consistent with the Chinese Communists' conservative banking practices, which have included prepayment of certain debts even during a payments crisis, to avoid the higher interest charges associated with long-term credits.

Should the Chinese reverse their position and seek long-term credits, there is little doubt that such credits would be made available. Japanese and West European competition for what is widely viewed as a potentially lucrative market would lead quickly to long-term offerings, at least on a scale consistent with China's capabilities to repay. Indeed, China may well seek a modest volume of such credit, once its agricultural and export prospects become clearer.

Table 2

Communist China: Purchases of Industrial Installations
from the Free World
1963-66

Type of Plant or Equipment	Value (Millions US \$)	Payment Terms	Country of Origin
<u>1963</u>			
Vinylon plant	20	25 percent down; 75 percent credit over 5 years	Japan
Urea plant	7	25 percent down; 75 percent credit over 5 years	Netherlands
Ammonia plant	7	Credit over 5 years	United Kingdom
Petroleum refinery	5	15 percent down; 85 percent credit over 5 years	Italy
Chemical fertilizer plants (two plants)	15	90 percent down; 10 percent credit over 3 years	Italy
Total 1963	<u>54</u>		
<u>1964</u>			
Alcohol plant	3	Credit over 3 years	France
Palm oil plant	2	N. A.	Netherlands
Acetylene generating equipment	Negl.	N. A.	Japan
Crude oil cracking and olefin separation plant	11	N. A.	West Germany
Synthetic fiber plant	2	N. A.	West Germany
Polyethylene plant	13	25 percent down; 75 percent credit over 5 years	United Kingdom
Equipment for petroleum exploration	2	N. A.	France
Polypropylene plant	7	N. A.	United Kingdom

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- 6 -

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Table 2
(Continued)

Type of Plant or Equipment	Value (Millions US \$)	Payment Terms	Country of Origin
<u>1964</u> (Continued)			
Micrometer manufacturing plant	1	80 percent down; 20 percent credit 18 months after delivery	Japan
Plant for the manufacture of porous silica material	2	N. A.	Sweden
Total 1964	<u>43</u>		
<u>1965</u>			
Plant for the manufacture of oil pressure equipment	2	85 percent down; 15 percent credit 1 year after delivery	Japan
Banknote printing equipment	1	N. A.	United Kingdom
Acrylonitril plant	5	N. A.	West Germany
Iron-mining equipment	6	N. A.	Sweden
Copper-mining equipment	6 to 8	N. A.	Sweden
Plate-glass manufacturing plant	2	65 percent down; 35 percent credit over 3 years	West Germany
Truck manufacturing plant	N. A.	Credit for 3-1/2 years	France
Oxygen manufacturing plant	3	20 percent down; 80 percent credit for 5 years	West Germany
Condenser manufacturing plant	2	N. A.	Japan
Wire-drawing plant	5	1 year deferred payment	Japan
Carbide electric furnace	1	85 percent down; 15 percent credit in 1 year	Japan
Acrylic fiber plant	8	Credits over 5 years	United Kingdom
Synthetic fertilizer plant	6	N. A.	Netherlands
KD-9 computer	2	N. A.	United Kingdom
Instrument plant	1	N. A.	United Kingdom

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- 7 -

S-E-C-R-E-T

Table 2
(Continued)

Type of Plant or Equipment	Value (Millions US \$)	Payment Terms	Country of Origin
<u>1965</u> (Continued)			
Tube-expanding pipe plant	3	Cash	Italy
Bleaching plant	N. A.	N. A.	Finland
Straw cellulose factory	N. A.	N. A.	Finland
Steel plant	12	N. A.	Austria
Cold-strip steel rolling mill	17	Credit over 5 years	West Germany
Total 1965	<u>82 to 84</u>		
<u>1966</u>			
Plant to manufacture petrol engines	2	Cash	Japan
Steel complex <u>a/</u>	125 to 175	Negotiations underway; West Germany will guarantee credits up to \$86 million for a period of 5 years	West Germany and other West European producers

a. Including a \$17 million cold-strip that rolling mill, for which a contract was signed in 1965.

S-E-C-R-E-T

- 8 -

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Table 3

Communist China: Drawings and Repayments
Against Short-Term and Medium-Term Free World Credits
1961-70

Million US \$

Year	Credit Drawings <u>a/</u>	Payments			Total	Net Receipts <u>c/</u>
		Repayments	Interest	Advance <u>b/</u>		
1961	128	2	5		7	121
1962	256	214	10		224	32
1963	352	322	15	3	340	12
1964	388	362	20	5	387	1
1965	253	212	15	-6	221	32
1966	265 to 275	270	18	10	298	-23 to -33
1967	275 to 300	275	20	-10	285	-10 to 15
1968	275 to 300	240 to 245	22	0	262 to 267	8 to 38
1969	275 to 300	255 to 260	24	0	279 to 284	-9 to 21
1970	275 to 300	265 to 275	25	0	290 to 300	-25 to 0

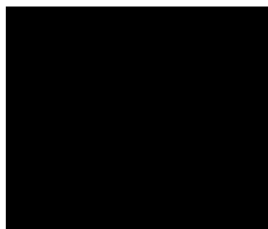
a. Drawings from 1966 through 1970 are based on the assumption of annual drawings of \$225 million to finance grain imports, which have been assumed to amount to somewhat more than the \$400 million level of such imports in 1965, and the remaining drawings to finance industrial installations and miscellaneous machinery, including drawings against DEMAG steel complex credit currently under negotiation.

b. Advance payments are made at the time of signing contracts. A negative amount in this column indicates that deliveries against advance payments (which were made in earlier years) are greater than new advance payments.

c. A negative sign indicates "net payments".

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28 March 1966

MEMORANDUM FOR: Chief, Dissemination Control Branch, DD/CR
FROM : Chief, Publications Staff, ORR
SUBJECT : Transmittal of Material, CIA/RR CB 66-7,
The Role of Credits in Chinese Communist
Purchases From the Industrial West and
Japan

1. It is requested that the attached copies of subject report be forwarded to the recipients indicated on the attached covering memorandum. A list of the addressees is attached for your records.

2. It is further requested that this transmittal be handled as expeditiously as possible.

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Attachments:

Copies #9 - #17 of CB 66-7

ACTION COMPLETED

The dissemination requested by
memorandum has been completed.

BY: *sfj*
Date: *28 Mar. 66*

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CENTRAL INTELLIGENCE AGENCY
WASHINGTON, D.C. 20505

28 MAR 1966

MEMORANDUM FOR: (See attached list of addressees)

SUBJECT : The Role of Credits in Chinese Communist
Purchases from the Industrial West and
Japan

1. The attached report, summarizing the role of credit in Communist China's trade with hard currency areas, provides some perspective on current negotiations for the purchase of a Western steel complex.

2. The report concludes that credit has played an important role in financing Communist China's imports from industrial countries of the Free World. Nonetheless, it has done little to relieve the pressure on China's hard currency payments. Over the next five years requirements for industrial goods will generate a rising demand for hard currency imports. This increasing demand, together with continuing large-scale grain imports, should absorb the expected increase in China's export earnings. The Chinese have not yet sought long-term credits from the Free World, but if long-term financing were requested it seems likely that such credits would be forthcoming.

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Director
Research and Reports

Attachment:
CIA/RR CB 66-7 (Subject Report)

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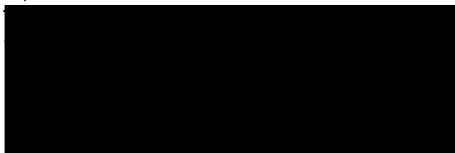
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