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CENTRAL INTELLIGENCE AGENCY
NATIONAL FOREIGN ASSESSMENT CENTER

22 December 1978

MEMORANDUM

THE WEST EUROPEAN/CHINESE CONNECTION

Overview

The Chinese and the West Europeans view their steadily expanding relationship from very different perspectives. For Peking, two considerations are dominant: rapid economic development and greater security vis-a-vis the Soviets. After years of insisting that China must rely mainly on its own resources for development, the Chinese are now making up for lost time. Their delegations are crisscrossing Europe with long shopping lists (including military items), economic agreements are proliferating, and hundreds of students will be sent to Europe over the next few months. In the security area, Peking is making clear at every opportunity the importance it attaches to the containment of the Soviets and its concern that weakness in the Atlantic Alliance is undermining this effort.

For the Europeans there are many secondary motives, but the driving force is commercial. Few Europeans suffer from the illusion that there is a vast and easily exploited market in China, but they all know that significant opportunities do exist; and given Western Europe's current economic situation, the opportunities look particularly enticing to them. To the extent that security considerations enter their calculations, the lessons they draw are

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ambivalent. They recognize that bolstering the Chinese makes sense in terms of the international power balance--and also could open up diplomatic opportunities for them in their relations with the Soviets. At the same time, many of them are concerned over the possibility of an adverse reaction from Moscow. [redacted]

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Nowhere is West European ambivalence more noticeable than in the area of arms sales. These are often particularly lucrative, and they have an obvious appeal to those who emphasize Europe's interest in helping China become a more effective counterweight to the Soviets. Yet deals in this field have the greatest potential for producing an unpleasant Soviet response. [redacted]

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[redacted]

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The Soviets probably recognize that they will be unable to prevent the expansion of Sino-West European ties, including those in the arms field. The pace of expansion is likely to be gradual for other reasons, however, and China will remain a small market for European industry. The Chinese have consistently proven to be sticky negotiators, and they are asking for things which the Europeans will often be reluctant to give: the sale of weapons production technology, for example. Even more important, China's ability either to pay for or to absorb the goods it wants is limited. Both the Chinese and the West Europeans, moreover, have other foreign policy concerns that loom much larger than Sino-West European relations, and neither the leaders in Peking nor those in Europe are likely to put too much faith in a nexus of this sort. [redacted]

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But the expansion, gradual though it may be, also seems irreversible--barring another sea change in Chinese policy. The Europeans will remain nervous about the Soviets, and while recognizing that they are in competition with

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each other (and with the United States), they will at the same time be reluctant to move too far ahead of each other in such a sensitive field as arms. Commercial advantage will remain the dominant consideration, however, and a slow growth in Sino-West European commerce in such sensitive fields as weapons technology and nuclear power is almost certain. West Germany, France, the UK, and Italy will probably get the lion's share of China's business, both military and otherwise, but smaller countries such as Switzerland and the Nordic countries will also obtain a piece of the action.

The pace of the expansion is not likely to be affected much by the establishment of diplomatic relations between China and the United States. If anything, this development is likely to accelerate the Europeans' efforts, both because they will consider that it enhances the respectability of doing business with Peking and because they almost certainly anticipate more active competition from the US in the future.

* * *

This memorandum has 11 different sections, beginning with a look at Western Europe from China's perspective, at trade ties with China, and at some organizational aspects (EC and NATO) of the Chinese/West European link. These three sections are followed by discussions of the following countries' relations with China: France; West Germany; UK; Italy; Greece, Turkey and Cyprus; Canada; and Malta. The last section discusses Moscow's view of Sino-West European relations.

* * *

From China's Perspective

China expects to draw heavily on Western Europe as a source of modern industrial equipment, technology, and expertise and to use the region as a vital element in a strategy of counterbalancing the USSR on a global scale. Chinese officials miss few chances to warn the West Europeans about the peril Moscow poses to the West and to encourage a strong, united Western Europe firm in its opposition to Soviet expansionism. Conversely, the Chinese are quick to criticize what they interpret as the slightest sign of "appeasement" on the part of the West Europeans.

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This encouragement of anti-Sovietism goes beyond European regional concerns to encouragement of greater West European cooperation with the Third World, particularly in Africa and the Middle East. For example, earlier this year the Chinese were approving of French aid to President Mobutu to repel the second Katangan invasion of Zaire. Peking also hopes for closer relations between Western Europe and Japan in the interest of containing the Soviets. [REDACTED]

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This does not mean that Peking wants to encourage West European unity, strength, and independence at the expense of Western European ties to the United States. On the contrary, though uncertainty about US steadfastness produces an occasional note of ambivalence in Peking's statements, the Chinese generally emphasize the indispensability of the United States, in the maintenance of NATO and the defense of Western Europe. "Neutralization" of the region, with its concomitant damage to US - Western European relations, would be a severe blow to Peking. [REDACTED]

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The anti-Soviet orientation of China's attitude toward Western Europe has contributed to Peking's continuing ambivalence toward the major "Eurocommunist" parties. Although there have been tentative signs this year that the Chinese are rethinking their policy toward these parties, Peking's suspicion of their continued links to the Soviets has continued to inhibit Chinese-Eurocommunist rapprochement. [REDACTED]

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Increasing Sino - West European trade, with the prospect of greater increases to come, provides tangible content to the more problematical and slower developing political relationship. So far this year Peking has signed a trade agreement with the EC and a long-term economic cooperation agreement with France. Various types of long-term agreements with Italy, West Germany, and Great Britain are under consideration. During the same period, China also has concluded scientific and technical cooperation agreements with France, Italy, West Germany, and Britain. Chinese delegations of all sorts have crisscrossed Europe in increasing numbers. China also is turning to Western Europe as a source of education necessary to improve and expand its pool of scientists and engineers. Large numbers of Chinese students eventually will study at European institutions. [REDACTED]

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Western Europe will continue to be a major supplier of plants and equipment for China's modernization drive, although the Europeans face stiff competition from Japan and--potentially--the United States. Peking is interested in purchasing a wide range of industrial goods, including steel mills, petrochemical plants, thermal and nuclear power stations, truck plants, and mining equipment. By purchasing technology from various West European countries the Chinese will avoid overdependence on one source, gain access to US technology produced in Western Europe

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under license, and promote competition in price and financing terms among potential suppliers. They also hope to encourage West European governments to press for revision of strategic trade controls. [REDACTED]

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China's military interest in Western Europe goes beyond urging that the region look to its own military strength vis-a-vis the USSR. Peking is interested in purchasing modern arms and military technology, including such items as antitank missiles, helicopters, and combat aircraft. During the past year, Chinese military delegations have visited every major national armaments industry in Western Europe. Moreover, China is attempting to create the impression of a military relationship between Western Europe and China through visits by West European military delegations to Peking, exemplified by the publicity given by the Chinese press to the visit last April of the chief of the British defense staff. [REDACTED]

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China's opening to Western Europe still faces major economic obstacles, and there remain important differences over political subjects, particularly detente. Nevertheless, barring a political upheaval in Peking that might bring to power a more inward looking, less pragmatic leadership, the opening is likely to continue and will probably widen. [REDACTED]

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EC-China Trade [REDACTED]

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A spate of contacts, rumored deals, and negotiations on trade agreements highlights the European Community's scramble to profit from China's decision to turn again to Western suppliers for technology and equipment. The two-way flow of commodities and cash, however, remains small. Increases implied in recent agreements are on the order of 15-20 percent per year through the mid-1980s--a feasible target starting from current low levels. [REDACTED]

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Except for the problems involved in sales of military equipment and nuclear technology, constraints on increased EC-China trade are largely on the Chinese side--primarily China's limited ability to pay for and absorb the goods offered. While China may now be willing to accept conventional foreign credits, Peking still wants to offset imports with exports of Chinese commodities. [REDACTED]

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For the West Europeans, the key obstacle to meeting trade goals will be finding suitable Chinese products at competitive prices. Soviet displeasure with growing EC-China trade, and particularly with the prospect of Chinese arms purchases, may affect EC relations with both China and the USSR. The West Europeans will consider the Soviet angle, as well as US policy, in responding to Chinese requests for goods considered sensitive. Although a turning point appears to have been reached,

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frustratingly long and difficult negotiations loom for the West Europeans; regardless of the outcome, China will remain a small market for West European industry. [REDACTED]

EC-China Trade Ties

The EC Commission has sole authority to set general rules for trade between member states and outsiders. Commercial arrangements are left up to individual member states whose bilateral accords cannot specify or eliminate quotas or provide for preferential trading arrangements. In November 1974, the EC offered to negotiate trade agreements with state-trading countries, including China. Following mutual diplomatic recognition in 1975, China responded favorably to the EC invitation. An agreement was tentatively approved in September 1977 and formally signed in Brussels last spring. The five-year, nonpreferential agreement contains a weak most-favored-nation clause; a "balance trade" clause, according to which the two sides promise to make "best efforts" to expand trade at similar rates; a safeguard clause, which provides for "friendly consultations" in case of EC difficulties with Chinese goods and which tacitly recognizes an EC right to apply specific restrictions if difficulties persist; and a clause designed to prevent Chinese sales at prices well below market levels. [REDACTED]

The agreement allows the EC to maintain its current restrictions on selected Chinese goods while calling for the Community to liberalize imports from China as much as possible. For its part, China promises to take imports from the EC into "favorable consideration," a promise hailed by the West Europeans as a Chinese concession not previously granted to any trading partner. The agreement also establishes a joint EC-China Economic Commission to review progress in promoting trade. The initial meeting of the Commission will be held in the first half of 1979. [REDACTED]

Exports from the EC to China reached \$1.4 billion in 1975 but by 1977 had fallen back below \$1 billion. Even in 1975, however, exports to China represented less than 0.5 percent of total exports by EC countries, or about 1 percent of sales outside the Community. China's share of imports by EC countries was only about 0.3 percent. Both market shares were well below the levels of the early 1960s. [REDACTED]

Over the past two years, a flurry of Chinese delegations has descended on Western Europe. At each stop, the missions have looked, poked, prodded, and made various--sometimes overlapping or contradictory--promises to government and business officials. Very few major contracts have been signed. Nevertheless, a quiet but sharp increase in trade has occurred. In the first half of 1978, EC shipments to China ran close to

the total for all of last year. Over the full year, EC exports to China no doubt have broken the 1975 record. [REDACTED]

Major European Traders

West Germany

The West Germans have been less active than their EC partners in obtaining an all-encompassing trade agreement with China, possibly because West Germany outsells the rest of its EC partners combined. Nevertheless, West Germany agreed in November to begin discussions leading toward an economic cooperation agreement. West Germany recently won the first major West European contract from the Chinese since the current buying round began. It calls for a West German consortium to provide approximately \$4 billion in know-how and equipment to modernize the Chinese coal mining and coal mining equipment industries. While financing details still must be worked out, a West German bank consortium apparently will provide credit with five- to 10-year terms. The West Germans have also signed contracts for the construction of five petrochemical plants. A rumored \$14 billion contract for West German construction of an integrated steel complex will probably be split among suppliers in several countries, including Japan and perhaps France, the UK, and Italy. [REDACTED]

France

France's independent foreign policy stance makes Paris the obvious first point of contact for the Chinese in Western Europe. As with Franco-Soviet ties, however, the "special relationship" provides only limited trade advantages for France. Although at the forefront in negotiations and publicity, the French consistently run a poor second to West Germany when final contracts are signed and deliveries made. [REDACTED]

In the current round of Sino-European trade talks, France was the first to obtain formal signature of a new bilateral trade agreement. The pact, signed in Peking on 4 December by French Foreign Trade Minister Deniau, calls for total two-way trade of \$13.5 billion in 1979-85. The agreement also stipulates that "best efforts" be made to balance trade, and France has promised to make \$6.75 billion worth of credits available for its exports, probably at interest rates of 7.25-7.50 percent. The credits, reportedly repayable in 10 years, will be made available only as contracts are signed. [REDACTED]

Specific sectors mentioned in the agreement as being of priority interest to the Chinese include steel, electrical energy (nuclear, hydroelectric, and thermal), mining research, hotels, port facilities, aviation, agricultural machinery, rail transport, and oil. Projects

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listed as being in advanced stages of negotiations--and for which French firms will receive "preference" from Peking if all competitive and technical considerations are equal--include a steel complex, a magnesium plant, a specialty steels plant, a sugar refinery, and an aluminum complex. The most publicized project connected with the trade package is a Chinese commitment to purchase two nuclear power plants, which would be built by the French under US license. France has pledged not to sell the plants until US approval is obtained. China is pushing for French arms sales not spelled out in the agreement, particularly deliveries of missiles and possibly Mirage aircraft. [REDACTED]

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United Kingdom

A draft UK-China trade agreement was drawn up during Chinese Deputy Premier Wang Chen's visit to the UK in November. The draft contains a target of \$10 billion in total two-way trade during the period 1979-85. The signing of the agreement is planned for Industry Minister Eric Varley's trip to Peking next April. The pact lists 12 sectors of key interest to the Chinese, largely duplicating the French-Chinese list. One potential problem is that conclusion of the agreement may hinge on a British decision to sell the vertical-takeoff Harrier aircraft. [REDACTED]

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The full extent of British credits apparently is still being worked out. A consortium of banks reportedly agreed on 6 December to lend the Bank of China a total of \$1.2 billion, with repayment in about five years and an interest rate of 7.25 percent. According to the press, the funding will work exactly like a standard buyers' credit, with the money released to the Bank of China and then to British companies as sales are made. The credits will be guaranteed by the British Government. [REDACTED]

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Italy

Italian companies have a relatively long history of activity in China, particularly in oil and petrochemical equipment sales. Italy was the first EC member to sign a trade agreement with China, in 1971. That three-year agreement contained a general list of goods to be traded, provided most-favored-nation treatment (with exception for EC obligations), and established a joint commission to meet at least once a year to review progress. No specific trade target was set. [REDACTED]

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The Italians are negotiating a new trade agreement with China and hope to conclude it early next year. Given the French and British precedents, a target two-way trade goal will probably be specified through 1985. One deal currently being discussed with the Chinese would involve Fiat construction of a tractor plant. In the long term, Fiat hopes to participate in a complex producing trucks and diesel engines. The Italian state oil company, ENI, hopes to play a role in Chinese oil

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development. Italy has already offered China a \$1 billion line of credit, although details have not been worked out and probably will not be decided until specific contract negotiations are further advanced.

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Sorting Out the Potential Market

A summation of current Chinese agreements and negotiations involves the danger of double-counting. The Chinese are not averse to--and are rather adept at--negotiating with several countries for the same items at the same time. For example, aluminum and steel complexes head the lists of potential contracts with both France and West Germany. France appears to have the inside track on the initial aluminum contracts while, within Western Europe, West Germany could be the first to supply steel equipment. Both the UK and France hope to participate in coal modernization plans, but West Germany has already won the lion's share of the early contracts in this field. France and Italy both are confident of winning vehicle plant contracts, and all major EC countries are bidding on oil development projects--areas in which the United States and Japan hold sizable leads. [REDACTED]

Even after allowing for double-counting, China's 1976-85 modernization plan could entail a substantial amount of business for all the large EC countries. The plan lists 120 major projects, including:

- Ten steel plant complexes.
- Nine nonferrous metal plants.
- Eight coal fields.
- Ten new oil and gas fields.
- Thirty electric power plants.
- Six major railway networks.
- Five major ports. [REDACTED]

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Compensation and Balanced Trade

Compensation and balanced trade are constant themes in talks with the Chinese. Most negotiations commence with Chinese offers to pay for oil exploration and equipment with crude oil, for coal mining equipment

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and technology with coal, and so forth. Western Europe's response has been skeptical, questioning just how much China has to offer. While China's crude oil reserves, for example, may be great, the West Europeans note that Chinese crude is not well suited to their refineries because of its high paraffin content. In addition, Peking thus far refuses to discount its price to make Chinese crude competitive with Arab oil that is closer to Western Europe. Italy and France have agreed to buy small test shipments of Chinese crude and both have hinted at larger purchases in the future. Italy has mentioned the possibility of taking up to 20,000 barrels per day in 1979. A truly significant increase in purchases, however, depends on West European refining results and Chinese price decisions. [REDACTED]

Peking has naturally raised questions about increased West European imports of Chinese manufactured goods and liberalization of Western Europe's tariff and quota restrictions on Chinese products. Despite the EC-China trade agreement, liberalization will be slow in coming. It is likely to be particularly slow for textiles, a sector in which West European firms are already suffering from foreign competition, over-capacity, and high unemployment. [REDACTED]

The possibility of West European firms obtaining access to China's huge and presumably low-cost labor force for subcontracting and assembly operations--somewhat along the lines of the Taiwan, South Korea, and Hong Kong models--is being explored. Although the Chinese until now have disdained such operations, associating them with colonialism and exploitation, these activities could offset a growing share of the cost of Chinese purchases. [REDACTED]

Credits and Direct Investment

For many years China has adamantly refused to accept overt foreign credits. Suppliers' credits, euphemistically referred to as "deferred payments" by the Chinese, have been used to finance plant purchases. The Chinese, however, have now agreed to buyer's credits from France and the UK. In addition, a thinly disguised form of debt has operated fairly efficiently, whereby the Bank of China has accepted foreign currency in interest-paying deposits and drawn on the deposits to pay for imports. Although deposits have been limited to about one year, two-five year deposits are now being considered; five-10 year credits of this type may result from current contract and financing negotiations. [REDACTED]

Just how far China will go in accepting standard commercial credits and other financial schemes cannot be predicted. The Chinese have given conflicting signals on the issue, probably because the leadership is still formulating a decision. West European bankers and government

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officials would prefer to use standard commercial loans or lines of credit rather than the deposit scheme. With a regular line of credit, West European banks would have use of the funds until called upon by the Chinese, and government guarantees would be easier to obtain. West European banks, businesses, and governments will be flexible on the financing issue, and few deals will fall through because of credit problems. [redacted]

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EC: Share of Trade With China*

	Percent	
	<u>Exports</u>	<u>Imports</u>
1960	0.79	0.53
1970	0.41	0.30
1973	0.50	0.31
1974	0.35	0.29
1975	0.48	0.27
1976	0.41	0.28
1977	0.24	0.26
1978 (1st half)	0.39	0.26
1985 (illustrative)	2.0 - 2.5	2.0 - 2.5 [redacted]

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*Figures include intra-EC trade. China's trade share excluding intra-EC trade would be about double the figures shown. Data cover all nine current EC members--Belgium, Denmark, France, Ireland, Italy, Luxembourg, the Netherlands, the UK, and West Germany.

The possibility of direct Western investment in China appears more remote than conventional trade financing, although again Peking's signals are conflicting. A French business and banking delegation in Peking last month reported that China formally proposed that a vehicle manufacturer, Peugeot-Citroen, and an aluminum and specialty steel firm, Pechiney-Ugine-Kuhlmann, invest directly in Chinese projects. According to the press, the only stipulation was that Chinese capital represent at least 51 percent of the total investment and ownership. The Japanese report similar proposals. These reports should be treated cautiously, for they may reflect nothing more than China's increased willingness to discuss alternative financing possibilities. [redacted]

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PRC: Trade With Selected Countries

million US \$

	<u>1975</u>		<u>1976</u>		<u>1977</u>	
	Exports	Imports	Exports	Imports	Exports	Imports
Total	7,180	7,395	7,265	6,010	7,955	7,100
EC	703	1,637	825	1,475	875	1,040
Japan	1,459	2,369	1,306	1,746	1,473	2,036
Hong Kong and Macao*	1,400	35	1,630	30	1,795	45
Eastern Europe	485	525	435	550	600	625
United States	158	334	202	149	203	188
Singapore	251	44	254	41	262	62
USSR	150	129	179	238	177	161
Communist Far East**	540	200	460	160	420	210

*Including entrepot trade.

**North Korea, Mongolia, Vietnam, Cambodia and Laos.

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From The EC/NATO Perspective [redacted]

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25X1 The story of increasing Chinese - West European relations has unfolded in multilateral organizations as well as in the bilateral dealings of individual West European states with China. The West European approach so far has been positive but cautious, largely out of fear that West European relations with the Soviet Union might be damaged. The West European treatment of Chinese relations in the EC and NATO--and China's approach to these organizations--has, naturally enough, differed because of the differing purposes the organizations themselves are designed to serve. [redacted]

In the case of both the EC and NATO, China has voiced strong support for the organizations' goals: increased integration for the Community and a strong defense against the Soviets for NATO. With the EC, however, it has been both necessary and desirable from the Chinese point of view to go beyond verbal support: necessary, because the EC Commission must negotiate trade agreements with outsiders; desirable, because the Chinese think a more economically, politically, and militarily integrated Europe cannot help but be troublesome to the Soviets. [redacted]

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The West Europeans, for their part, are interested in trade with China and intrigued by the Chinese support for integration; at the same time, they are aware of the potential for irritating the Soviets that is inherent in stronger EC-Chinese ties. Hence the caution in the West European approach. There is a sense that the proper amount of EC dealings with China might actually make the Soviets more cooperative, while too rapid movement toward closer ties could only alarm Moscow and produce specific negative results. The problem, of course, is finding the magic point at which the positive disappears and the negative begins. Whatever the course of West European - Chinese trade relations, however, the EC provides a useful framework within which they can develop. [redacted]

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In the military sphere, there is no organization readily available to structure and contain West European - Chinese relations. This has led some West Europeans to suggest that, to the extent they consult each other on arms sales to the Chinese, they should do so in the EC. Others have thought that specific arms sales could be considered by COCOM--the Western committee that approves sales of items based on advanced technology to Communist countries. Most, however, agree that neither the EC nor COCOM can treat properly the military dimension of the subject--which leads, almost inevitably, to NATO. [redacted]

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From the West European point of view, however, NATO is far from the ideal forum. For one thing, deliberations would be heavily influenced by the United States: a common NATO policy for selling arms to China

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25X1 would not necessarily coincide with an ideal common European policy. Another problem is that NATO, loose association of states that it is, has traditionally had a difficult time defining itself in relation to other parts of the world (except, on most occasions, the USSR). So it is difficult to arrive at common external policies. Common arms sales policies are particularly difficult to arrive at because national economic as well as security interests are involved. In the Chinese case, the glaring implications for East-West relations increase the complexity of attempts to act in common. [REDACTED]

25X1 For many of these reasons, NATO has dealt with the Chinese problem in the most general way. At the North Atlantic Council meeting on 20 November--the most thoroughgoing recent discussion of China in a NATO forum--the West European caution on selling arms to the Chinese was evident. Most of the Ambassadors agreed that the Soviet reaction should be a primary consideration of NATO countries in their dealings with the Chinese. Some speakers pointed to the possibility of future political turmoil in China; others highlighted the practical constraints on Chinese economic development. [REDACTED]

25X1 The Dutch had little success recently in proposing that NATO go beyond general discussion and consult on arms sales to China. While the Italians and Canadians were willing, the British and French--both of whom had possible military sales in the works--were opposed. [REDACTED]

25X1 Arms sales will continue on a purely bilateral basis for the foreseeable future. This is not merely because the political rhetoric about caution conflicts with economic interest. It is, rather, that some NATO members feel themselves to be perfectly capable of exercising caution in selling arms to China--without detailed Alliance discussion. And yet it is possible that as more arms are sold (or look as if they might be sold) to the Chinese, other members may feel the need for more specific consultations. For instance, discussions might be held on the implications of a particular sale, with the understanding that the results of the discussion were in no way binding on the seller. Or an attempt might be made to arrive at a definition of what it is proper to sell--bilaterally--to the Chinese: defensive weapons only--or some offensive weapons as well? However, anything resembling a common policy on arms sales seems a distant dream. [REDACTED]

France [REDACTED]

25X1 Most French officials see the Chinese opening to Western Europe as an opportunity that should be seized upon for maximum advantage--not only because of its economic potential but also as another way of enhancing French leverage with the USSR. According to this thesis, the Soviets--feeling themselves in danger of encirclement by a Chinese-West European-

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US alliance--will be more inclined to accommodate European interests in hopes of securing their Western flank. A minority view in the French foreign office holds that an increase in Chinese activity and influence in Western Europe--particularly if Moscow perceives it as fostered by the West Europeans--could provoke unforeseen and possibly dangerous Soviet reactions. Thus, the French reaction to China's probes has two predominant themes: an avid interest in the possibilities, mingled with anxiety over the reactions of the superpowers--particularly in such areas as arms sales and nuclear exports. [REDACTED]

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A more active China on the Soviets' eastern border suits French foreign policy. France is interested in keeping the Soviets off balance, in reducing their ability to involve themselves militarily in Africa and elsewhere, and in easing their military pressure on Europe. At the same time, France does not want to antagonize the USSR by aligning itself too closely with the Chinese. In its more grandiose moments, France sees itself as a sort of Zubin Mehta, orchestrating the superpowers' relations with the Third World. One of its main goals is to bring China into the concert of nations, provided that China does not try to play first violin and provided its contribution contains sufficient nuances. [REDACTED]

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France has long seen itself as the industrial nation best qualified to deal effectively with the Third World. Paris aspires to be more than just a principal source of technology for Peking; it hopes to be China's main interlocutor and primary point of contact on the European continent. [REDACTED]

The French think that the public way in which the Chinese have sought West European technology is intended to create the impression that the West Europeans are aligned with Peking in the Soviet-China dispute and are not averse to furthering that impression within limits. [REDACTED]

Accordingly, France is happy to be supportive of China's effort to expose many of its senior officials to Western organization and work methods--provided the Chinese do not venture into areas the French consider sensitive. Paris, for example, expects almost 500 Chinese students to arrive in France, starting in February 1979. But the Chinese had proposed that over 200 be accepted for advanced studies at certain scientific research centers that are considered sensitive by the French. According to a Quai official, the French refused. [REDACTED]

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Moreover, the French have not yet taken a firm position on the transfer of computer technology to the Chinese because of its military ramifications and because it might incur Soviet displeasure. Some 13 delegations of Chinese technicians visited the French computer research center during 1978. The French do not want to be put in the position,

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25X1 however, of providing a few high-technology items, while more profitable contracts for less advanced items go to their competitors. In fact, the main return the French expect for the time they spend satisfying Chinese interest in such technology is to open the door to a wider array of French goods. [REDACTED]

25X1 The seven-year bilateral trade agreement signed in Peking in early December was a psychological boost to French ambitions in China and a signal from the Chinese that they are willing to expand their trade with France in at least certain areas. At the moment, France is more interested in economic and commercial sales to China than in arms sales. France has no illusions that China will become a major export market in the near future--the ambitious new agreement projects an eight-fold increase over 1977 in French-Chinese trade through 1985. France is starting from a low base, however: France's share of the Chinese import market was less than 2 percent in 1977. France in the past five years dropped from fourth to 12th among China's trading partners because of its inability to move beyond occasional one-shot capital equipment contracts into a wide spectrum of high volume repeat sales of consumer goods. France feels that, as a late-starter in the newly opened and potentially important Chinese market, it must hurry to establish its share against competition from Japan, UK, West Germany, and the United States. In addition to more work for its own industries, France hopes that China will become a significant supplier of raw materials. The signing of what is a framework agreement signals a turning point in French-Chinese economic relations, but France must now quickly table some highly competitive offers in order to exploit the political and psychological momentum the accord has generated. [REDACTED]

25X1 Projects that might reach fruition quickly are those involving hydroelectric power as well as China's agreement in principle to buy two nuclear power plants from France--the first such sale of nuclear technology to China by a Western power. If approved by the United States, the highly coveted order will go to Framatone, a nuclear plant construction company financed by the French Government (COGEMA) and another private firm, Altshom-Atlantique. The sale has yet to be approved formally by the Coordinating Committee for Export Control (COCOM), an organization set up by industrial nations to screen the sale of sensitive technology to Communist countries, but France foresees no objections from other COCOM members since China is already a nuclear power. The sale, however, requires US approval since it is a Westinghouse license. The French have received an "exclusively peaceful use" guarantee from the Chinese and have asked the United States for approval prior to 23 December, a deadline the Chinese have set. Other details of the sale remain to be worked out. [REDACTED]

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France has not yet signed a major arms agreement with China, although the French are ready to sell defensive weapons and the Chinese ready to buy. Guided missiles are the most likely sale to be consummated, but quantities and financial terms still must be worked out. Given the complexities involved--and the fact that both the Chinese and the French are prudent traders--agreement on terms will most probably be time-consuming. But it is likely that some French weapons systems--probably defensive--will be ultimately sold. The French claim that they are picking and choosing from the Chinese wish-list and that they have no desire to help China achieve strategic objectives. The French, in fact, may be trying to condition military sales on economic sales. [REDACTED]

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[REDACTED]

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The Soviets have given the French several sharp warnings against selling arms to the Chinese, most recently in a letter from Soviet President Brezhnev to French President Giscard last month. France's stock reply to Moscow is that France is a sovereign nation and will act in its own national interest. France is, however, sensitive to Soviet concern and will not deliberately strain its relations with the USSR. The French think they are on safe ground by confining sales to defensive systems, although they admit that it is not always easy to determine the difference. [REDACTED]

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In addition to the economic and nuclear agreements, the French have concluded a scientific and technical accord with the Chinese and now hope to add high fashion to the list. Designer Pierre Cardin has accepted a Chinese invitation to organize two fashion shows to be held in Peking and Shanghai next March. Cardin, who in previous seasons showed a modified version of the Mao tunic as part of his collection, now hopes to persuade the Chinese to discard their "grotesque" clothes and adopt international fashion. There is undoubtedly a great deal of wishful

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thinking and a bit of cultural chauvinism in the French optimism about the future Chinese market, but the race for the embourgeoisement of the Chinese is on.

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[REDACTED]

West Germany

[REDACTED]

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A responsible German foreign policy may not give in to the temptation to play up Soviet-Chinese differences. (West German Foreign Minister Hans-Dietrich Genscher, 23 August 1978)

[REDACTED]

25X1

The West Germans are clearly pleased, yet somewhat uneasy, about the rapid expansion of political, economic, and technical relations with the People's Republic of China that has occurred during the past year. The "Chinese breakthrough," as dubbed by the Soviet media, has resulted in a steady stream of high-level Chinese visitors to Bonn, the virtual doubling of West German exports to China, and the conclusion of several technical and development accords. Not since the early heyday of Ostpolitik have top leaders in West German industrial and government circles been so acutely eastward-oriented.

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[REDACTED]

The growing China trade has added an economic dimension to the already delicate political balancing act inherent in Bonn-Peking-Moscow relations. The Soviets have indirectly warned the West Germans about overplaying the economic gains to be had in the Chinese opening to Western Europe. West German officials are in fact worried about possible economic retaliation by the Soviets for the sharp increase in West German economic ties with China.*

[REDACTED]

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Some West German officials are concerned the government will be unaware of or unable to control commercial deals that could trigger some sort of adverse Soviet reaction. Many of the major deals under consideration are for the modernization of specific Chinese industrial sectors, such as petrochemicals, which Moscow could conceivably view as directly threatening Soviet interests. Such package deals do not require approval

**It can be argued that the West Germans actually have a measure of economic leverage with the Soviets. West Germany in 1977 supplied nearly one-fourth of Soviet machinery and equipment for the chemical industry, metal-cutting and forge press equipment, and auto production. It would be hard for the Soviets in the short term to switch to alternate suppliers; if they did so, they probably would not get the delivery terms and the technology they prefer.*

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by the West German Government. The West Germans, particularly Chancellor Schmidt, have gone to great lengths in recent weeks to assure Moscow that such trade ties are simply part of the process of building normal relations with China. Nevertheless, the West Germans believe that the Soviets are irrational on the subject and see little possibility of completely assuaging Soviet fears about the Bonn-Peking connection.

[Redacted]

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Hints of possible West German "arms sales"* to China are apt to be as unsettling to West German officials in Bonn as they are to Soviet officials in Moscow. During the past year the Chinese have feted a variety of West German political and retired military figures, many of whom are connected with aircraft and arms-related industries. The West German Government would have to license or approve deals involving specific armaments, but has little to say about the end use of ostensibly nonmilitary hardware, such as trucks and communication gear, which the Soviets tend to lump in the armaments category.

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[Large Redacted Block]

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West German private industry clearly has become less reticent about hosting Chinese arms shoppers, but continues to be reluctant to conclude any deals without some sort of official sanction.

[Redacted]

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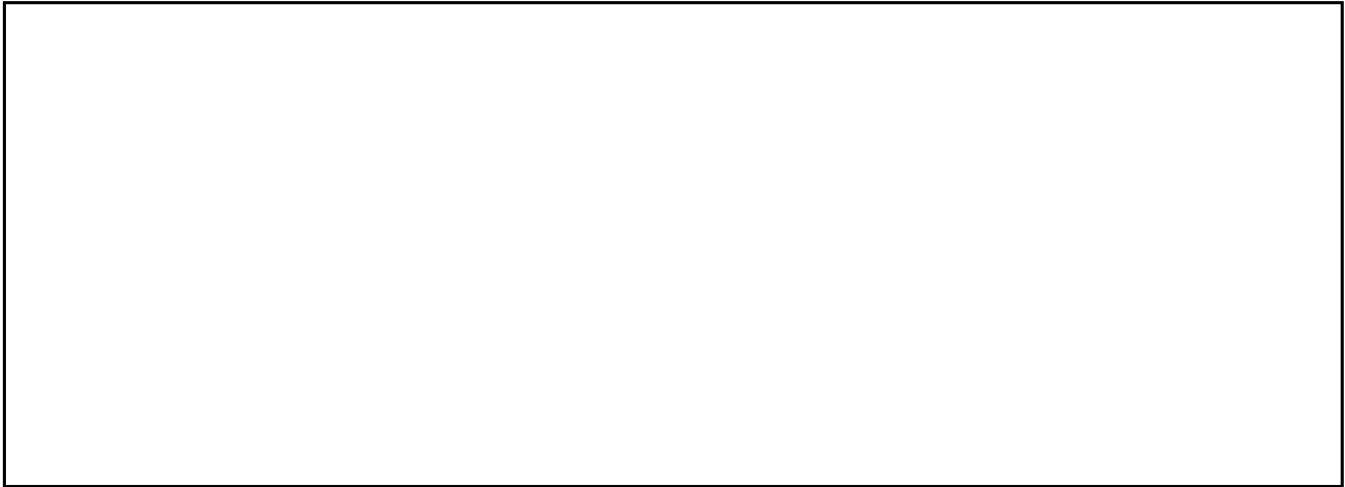
**Since 1971 the West German Government has banned the export of armaments to so-called areas of tension. Although senior officials of both coalition parties--the Social Democrats and Free Democrats--have defended specific sales to countries not directly affected by "tension," such as Iran, they have also stated their intention to maintain a restrictive arms export policy, at least for the foreseeable future.*

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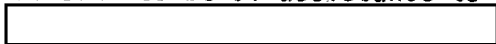
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The West German Government must also contend with the line on arms sales espoused by the opposition parties, the Christian Democrats and their Bavarian ally, the Christian Social Union. Both parties publicly claim that they would be less reluctant than the present government to sell armaments to the Chinese.



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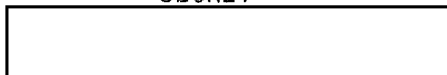
In October, the Christian Democrats' spokesman in the Bundestag for defense policy publicly called for a "deliberate development" of a "community of interests" between NATO and China. He also said that West German policy should "spare no effort" to be of assistance to the Chinese in their modernization efforts.



Regardless of whether the present social/liberal coalition stays in power or is replaced by a conservative government, the West Germans will remain constrained for some time to come from too actively playing the "China card." Although the Soviets appear to have resigned themselves



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25X1 to the growing economic links between Bonn and Peking, Moscow would certainly seek to retaliate against any sort of arms deals at the present time.

25X1 [redacted] Even here, however, Bonn will need to weigh carefully the possibility of an adverse Soviet reaction which could damage the hard won and fragile benefits of Ostpolitik. For their part, the Chinese are sensitive to West German concerns about the Soviets and have purposely played down anti-Soviet polemics in the West German - China context. For Bonn, however, there remains the tough question of determining the limits of Soviet toleration before they are exceeded.

25X1 [redacted] UK [redacted]

25X1 Relations between the UK and China, which began both to increase and improve in the mid-1970s, will expand even more rapidly during the next decade. Although stepped-up bilateral contacts have been confined mostly to talk, some concrete deals have been made during the past three years and, more importantly, the groundwork has been laid to broaden cooperation in such diverse areas as trade, culture, education, public health, industrial technology, energy resources, politics, and defense. As Peking intensifies its contacts with the outside world, particularly the West, the new era in Anglo-Chinese relations will become increasingly important for both countries.

25X1 From the Chinese perspective, the step-up reflects the desires of the post-Mao leadership to broaden contacts with the West generally and specifically to speed up Peking's development program with sophisticated Western technology and equipment. From London's perspective, future economic and trade pacts are the most important aspect of cooperation with China, since agreements in these areas hold open the prospect of a vast new market that could give the British economy a much needed boost. Despite the existence of certain limiting factors related to the ability of the Chinese to finance and absorb Western goods and technology, British leaders see the prospect of a large-scale market as an opportunity that cannot be missed.* The British already have offered the Chinese

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extensive lines of credit, including possible government-to-government loans, and will conclude phased agreements geared to the Chinese capability to absorb. Bilateral trade already has picked up significantly and tentative agreement has been reached to bring two-way trade to between \$8 and \$10 billion by 1985. [REDACTED]

Arms sales will play an important part in future Anglo-Chinese relations, both because the UK is willing to supply Peking with weapons and military technology and because the Chinese have linked the question of expansion in other areas with London's willingness to sell arms.* Peking has expressed an interest in purchasing a varied and substantial amount of military hardware, such as tanks, guns, naval vessels, radar systems, missiles, aircraft, as well as the spare parts and know-how. If agreement can be reached, the most significant and controversial deal--symbolically, if not militarily--will be to sell the Hawker-Harrier jump jet fighter to China. The British Government is presently considering a Chinese request for the plane, but London will move cautiously before making a final decision. [REDACTED]

The sale of weapons--particularly offensive weapons--is a sensitive issue that Prime Minister Callaghan wants to defuse. He points out that any broad economic or trade agreement will emphasize British industrial and commercial goods and that military hardware and technology will assume a much smaller role. Callaghan's rationale is that nonmilitary sales probably would be more lucrative in the long run. More importantly, he recognizes that military sales could have a negative effect on relations with the other Western Allies and the USSR, as well as on domestic politics. [REDACTED]

Callaghan has indicated that the UK does not want to be China's lone supplier of military goods and prefers a coordinated Western approach. Therefore, London has announced that arms sales to China will be handled on a case-by-case basis and in full consultation with Britain's allies.

**During the mid-1970s the sale of the Spey engine, including license to produce it in China, for a Chinese-designed aircraft was the single most important deal between Britain and China. That agreement has recently been updated, another jet engine agreement has been made with Vickers, and a deal to supply China with marine turbine engines for high-speed naval vessels is near completion. The earliest deal between London and Peking was for the Trident jet and, although it is primarily a civilian aircraft, some have been adopted for military purposes.*

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25X1 The sale of defensive weapons does not appear to bother the UK's West European allies who are themselves involved in arms deals with China or the United States, but London believes that Washington, if not the other allies, would be more skeptical about offensive arms. [REDACTED]

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25X1 The step-up in Anglo-Chinese relations and the possibility of major arms deals have brought a sharp reaction from the Soviet Union. Soviet President Brezhnev, in a recent blunt letter to Prime Minister Callaghan, warned the UK to exercise caution in selling arms to China, since Peking is "not part of arms control talks and follows an aggressive ideology." The Soviet initiative, which climaxed a campaign to dissuade the British from selling the Harrier to China, warns that UK-USSR relations could be damaged by this and other weapons deals. [REDACTED]

The letter actually may have increased the likelihood of an agreement on the Harrier. Callaghan and Foreign Secretary Owen, not wanting to appear to be pressured by Moscow, have indicated that they support moves toward detente, but will not permit the Soviets to interfere with growing British-Chinese relations or with a specific arms deal. A stiffening attitude in Westminster is likely to increase tensions between London and Moscow, which already are high because of Soviet human rights policy, adventurism in Africa, and the Warsaw Pact arms build-up. Nonetheless, Soviet anxiety, which is taken seriously by the Callaghan government, is one of the most important reasons for delays in completing a Harrier deal and, along with the concerns of Britain's allies, will be a major consideration in future arms deals. [REDACTED]

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25X1 The expansion of British-Chinese relations is supported by the Labor and Conservative parties, although Labor's left wing has strong reservations about arms deals because it fears that they will lead to an increase in Chinese-Soviet and Anglo-Soviet tensions. The Conservatives see little chance for a thaw between the UK and the USSR and favor strengthening China primarily as a counterweight to growing Soviet power as long as the Chinese do not pose a threat to the security of Britain or Western Europe. For this reason the Tories are particularly anxious to see major agreements concluded, and have charged that the Callaghan government--because of fear of Soviet reaction--has deliberately dragged its feet on the Harrier deal. [REDACTED]

25X1 British policy toward China will continue regardless of which party wins the next general election. If a Tory government is returned, however, the policy--particularly its military aspects--will be pursued even more vigorously, and anti-Soviet undercurrents are likely to be more blatant. [REDACTED]

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Italy

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During the past year, bilateral contacts and agreements between Italy and the People's Republic of China have burgeoned in several key areas. Rome has welcomed the opportunity to capitalize on a potentially significant export market as well as to strengthen ties between China and Western Europe--particularly Italy--on all fronts. At the same time, Italian initiatives have been complicated by problems related to possible Italian arms sales to Peking clearly the most controversial aspect of relations between the two countries.

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After establishing diplomatic relations with China in 1970, Rome sought persistently to increase Italian trade with Peking but experienced uneven success as a result of Mao's commitment to autarky. But the signing of a trade agreement with China in 1971 placed Italy in the forefront of EC nations dealing with China. The agreement provided for an annual mixed commission meeting to review the progress of bilateral trade, numerous exchanges of technical delegations, and participation in reciprocal trade fairs. As a result of the treaty, Italy agreed to provide China with items such as machine tools, agricultural machinery, chemical products, and motor vehicles in return for textiles, food products, and handicrafts. The volume of this trade, however, was strictly limited by the Chinese preference for deferred or installment payments over the extension of export credits--a fact dictated by Peking's chronic shortage of hard currency and its desire to keep exports and imports balanced.

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Improving Trade Prospects

The current Chinese leadership's more outward looking policies have greatly improved the prospects for Sino-Italian cooperation, especially in the industrial and technological fields. This attitude was underscored by Chinese Foreign Minister Huang Hua's unofficial visit to Italy in early October. Although Huang signed bilateral cultural, scientific, and technological agreements while in Rome, Italian Foreign Ministry officials viewed his trip as having three broader objectives: to heighten West European perceptions of the Soviet threat, to use that as a basis for greater Sino - West European cooperation, and to arrange West European participation in China's 20-year development plan.

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The most recent Sino-Italian trade statistics give some idea of the dimensions of the new Chinese opening to the West. In the past year, for example, the Chinese sent four trade delegations to Italy, and during the first half of 1978 Italian exports to China increased by over 300 percent, compared to the same period in 1977. The total value of Italian exports to China--\$70 million--now slightly exceeds the value of

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their imports for the first time in three years. Despite the improvements, the current level of trade is still not commensurate with Rome's ability to supply or with China's ability to consume Italian products. A significant expansion of bilateral trade can only be achieved if the Italians convince the Chinese to buy entire "turn-key" industrial plants, to accept lines of export credits, or to agree to trades involving industrial plants or production for Chinese energy-producing supplies such as coal and oil.

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[Redacted]

Last February, Italian Foreign Ministry officials recognized their country's potential to play a role in China's master plan, especially those aspects involving improved transportation and increased agricultural mechanization. There were signs, for example, that the Chinese were interested in having Fiat build a proposed truck and diesel engine factory--at a total cost of \$8 billion. At that time, Italian Foreign Minister Forlani even ventured to suggest to Ambassador Gardner that such projects could, over the long term, mark the reorientation of Italian trade away from the Soviet bloc and toward China.

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[Redacted]

Italy wasted no time reacting to the apparently favorable Chinese attitude. In recent months, several high-level Italian delegations--representing both government and industry--have visited Peking. One of the most significant trips was led by the Italian Minister of Transportation, who returned with the impression that China wanted to sell some of its oil to a West European country. Subsequent negotiations culminated last November in the first large-scale petroleum contract between Peking and a West European country. Although the amount of oil involved--100,000 metric tons--is relatively small, the deal could conceivably result in much broader trade agreements involving entire Italian industrial plants in exchange for more substantial amounts of Chinese oil.

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The Italian Foreign Trade Minister also prepared the groundwork for a trip to Italy next

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spring by his Chinese counterpart--giving rise to speculation that they might then conclude a bilateral economic and industrial cooperation agreement. In the meantime, negotiations over such diverse projects as the construction of a tractor manufacturing facility, a coal slurry pipeline, and long-distance power transmission lines suggest the potential for a further expansion of Sino-Italian relations. [Redacted]

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The Question of Arms Sales

The one area in which bilateral relations seem stalled is the question of Italian arms sales to Peking. Italy faces a dilemma: On the one hand, arms exports traditionally have contributed to the improvement of the trade balance and the expansion of employment opportunities in the fragile Italian economy. On the other hand, the Italian Government is constrained by fear of an adverse reaction on the part of the Soviets, the United States, and the Italian Communist Party. [Redacted]

[Large Redacted Area]

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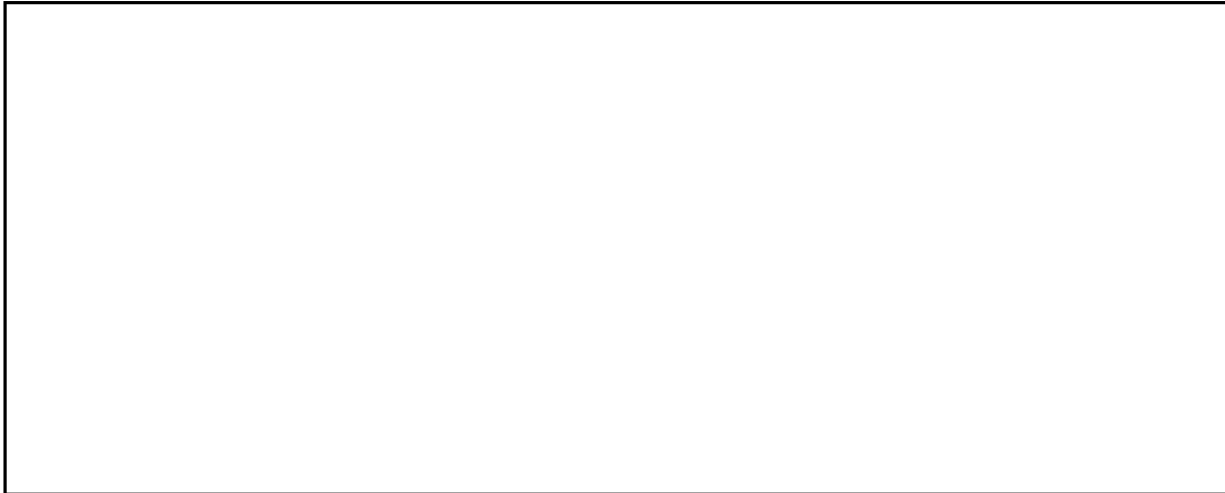
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The PCI's Position

The question of arms sales to China is a complex one for the Italian Communists. They have recently shown a keen interest in reestablishing party-to-party relations with the Chinese. Such a move would also serve to emphasize to domestic and foreign audiences the PCI's independence from the Kremlin. 

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Chairman Hua Kuo-feng's trip to Yugoslavia last fall produced rumors that the Chinese were willing to reestablish relations with the Italian Communists. The PCI reacted warmly and also took a positive view of Foreign Minister Huang Hua's subsequent visit to Italy. But despite the PCI's apparent willingness, little concrete progress has been made in improving relations between the Italian and Chinese parties. This probably reflects Peking's continuing skepticism of the PCI's independence as well as its desire to pursue relations on a state-to-state basis with the Italian Government. 

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The Italian Communists hope to improve their ties with the Chinese without needlessly antagonizing Moscow. The PCI might thus be inclined merely to look the other way--particularly if an arms deal with Peking included mainly defensive weapons and was concluded quietly. Sales through third-country outlets or international arms traffickers might permit the PCI to disclaim responsibility. But if the Italian Communists were forced to make an official public record of their position on arms to Peking, there is a greater chance they would oppose the deal to keep peace with the Soviets. 

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Outlook

As a result of China's expanding commitments to internal development and foreign contacts, bilateral relations and trade with Italy will

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probably improve significantly in the future. There appears to be a convergence of interests centering on Rome's ability to provide large-scale industrial plants and technology in return for Chinese energy supplies. Any significant expansion of trade, however, is dependent on Peking's willingness to accept a line of export credits tied to purchases of Italian goods. And although the Chinese desire for Italian arms is a key element in the relationship, Italy will remain reluctant to deal with the Chinese unless it can convince its EC partners to adopt a common position on the issue while avoiding developments that would force the Italian Communists to take a public stance. Under these circumstances, the prospects for mutually beneficial ties between Italy and China appear virtually unlimited.

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Greece/Turkey/Cyprus

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China's contacts with Greece, Turkey, and Cyprus had been quite limited before the visits of Foreign Minister Huang Hua to Ankara and Athens earlier this year. They now promise to increase as China seeks to counter Soviet influence in the region and as the eastern Mediterranean countries try to exploit Peking's interest for political, economic, and even security benefits. China's positions on issues affecting the region underscores its greater interest in recent years in a strengthened Western Europe able to cope with any Soviet threat.

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Background

Relations between the three countries and China date back to 1971-72, when Ankara, Nicosia, and then Athens recognized Peking. At that time, the unexpected abstention of Cyprus on the vote to bring China into the UN--as well as the yes votes of other so-called ministates--was one of the factors leading to Peking's entry into that body sooner than either its opponents or its supporters had expected. In establishing ties with Peking, none of the three countries felt it was doing more than conforming to the growing view in the West that China could no longer be ignored. On a more positive note, Greeks and Turks were hoping for profitable commercial ties with Peking and for diplomatic support of their respective cases on the Cyprus problem. For the Chinese, the eastern Mediterranean connection was yet another effort to increase their legitimacy and to match the Soviet presence in the area.

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Ties Developing Slowly

The Hua visits to Ankara and Athens were in fact aimed at countering Soviet initiatives such as the invitations to Turkish Prime Minister Ecevit and Greek Foreign Minister Rallis and Moscow's proposals for a

far-reaching Soviet-Turkish "political document." In addition to delivering warnings in both capitals about Soviet intentions, Hua agreed in Ankara to the activation of a dormant committee to consider greater economic cooperation. In Athens, he signed a cultural cooperation agreement--the first of its kind with a West European country--that provides for scientific, educational, and cultural exchanges. Greek and Chinese leaders also agreed to look into the possibility of broadening their economic cooperation, particularly in the maritime field. Hua invited Ecevit and Greek Prime Minister Karamanlis to visit China. [REDACTED]

Prior to the Hua visit, neither Peking nor any of the three countries, except perhaps Cyprus, had shown much interest in developing political and economic ties. Close party ties were not feasible because the Communist parties in Greece, Turkey, and Cyprus are generally pro-Soviet, and pro-Chinese splinter groups are insignificant. To be sure, Peking signed trade agreements with all three countries during ministerial and, in the case of Cyprus, presidential visits to Peking between 1972 and 1974, but these did not significantly advance commercial ties. In 1977, for example, Greek, Turkish, and Cypriot trade turnover with China only amounted to \$5 million, \$7 million, and \$300,000 respectively, most of it in the form of Greek and Turkish exports of agricultural products and raw materials to China. [REDACTED]

China Neutral on Regional Disputes

If the economic gains of the Peking connection have been disappointing for the Greeks and Turks, so too have been the diplomatic payoffs for their respective cases on the Cyprus and Aegean disputes. Peking has pursued an evenhanded policy on both, generally abstaining on the Cyprus issue in the UN and listening without comment to the Greek and Turkish views on the Aegean. Such commentary as they have made portrays these issues as yet another example of superpower--particularly Soviet--machinations in the region. [REDACTED]

Eastern Mediterranean Connection Highlights Sino-Western Rapprochement

Hua and other Chinese officials have in fact shown more concern about the adverse effect the disputes are having on NATO. In a policy that differs little from that of the Western allies of Greece and Turkey, the Chinese have urged both countries to show a spirit of compromise and patch up their differences so as to strengthen the Western defense system. [REDACTED]

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[redacted] Peking has urged Greece to return fully to NATO, and Hua expressed satisfaction at the Karamanlis government's recent moves in that direction. [redacted]

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Hua also praised Karamanlis for his efforts on behalf of West European unity and expressed support for Greece's bid to join the EC. Similarly, the Chinese have welcomed Karamanlis' initiatives on behalf of Balkan cooperation, which they see as an antidote to Soviet influence in the region, particularly in the post-Tito era in Yugoslavia. [redacted]

25X1

Outlook

Relations between Peking and the three countries are likely to improve further, but the process is apt to be slow. Although Greeks and Turks appreciate Peking's new interest in their region and in a strengthened Western Europe, they continue to view their relationship with the Soviet Union and their more immediate Communist neighbors as more important politically and economically. And while they welcome China's presence as a counter to Soviet influence, they are also concerned about the possible adverse consequences of the intrusion of the Sino-Soviet rivalry into their area. China, for its part, gives greater priority to improving its ties with the larger and technologically more advanced West European states, from which it hopes to secure arms and the means to rapid modernization.

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[redacted]
Greeks and Turks do, however, appreciate China as a potential market for their products, and this appreciation is apt to grow as their export capabilities develop. And if the USSR adopts a more active foreign policy in the region in the post-Tito era, both the eastern Mediterranean states and Peking may see it in their interests to strengthen their ties. [redacted]

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Canada [redacted]

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[redacted]

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Canadian Prime Minister Pierre Trudeau made an extensive private visit to China in 1960 before he became involved in Canadian politics. The country fascinated him, and as part of his campaign to be prime

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minister eight years later, he promised to work toward establishing diplomatic relations. China was already a major market for Canadian wheat, and Canada had high hopes for both expanding the bilateral relationship and for playing a special role in convincing the Chinese to broaden their contacts with the rest of the world. [REDACTED]

Diplomatic relations were established in 1970 and a steady stream of Canadian officials visited China to discuss trade and other matters. The high point of these early years was Trudeau's official visit in 1973. He concluded a wide range of bilateral agreements that covered consular relations, most-favored-nation treatment, establishment of a joint trade committee, a long-term wheat sale, and a unique family reunion program. Under the program, some 3,000 Chinese have joined relatives in Canada. Trudeau talked extensively with Premier Chou En-lai and met Chairman Mao Tse-tung for two hours in what the New China News Agency described as "a friendly atmosphere." The Canadians took this to mean that China highly favored Canada. [REDACTED]

The opening to China fit nicely into Trudeau's "Third Option," set out in 1972, which was an attempt "to create counterweights" to the heavy US influence in Canada and to develop a distinct identity in international politics. The Canadian public--almost as fascinated with China as Trudeau--also favored this move. The US Embassy in Ottawa surmises that in the Chinese view, part of the attraction was toward Canada as a strategically placed window on North America. [REDACTED]

But the Canadians became disappointed with the relationship. China was mainly interested in buying wheat, and last year wheat still accounted for 83 percent of Canada's exports to that country. Finished goods represented only .3 percent of total sales to China in 1977. After Trudeau's trip, four years passed before another cabinet-level minister visited China, again to sell wheat. Canada concluded that its limited relationship was probably as close "as it is possible for a Western country to have with China." [REDACTED]

The new outward-reach policy of China has reinvigorated Canadian interest. This time the Chinese are the initiators of delegations and agreements. In October 1977, Chinese Foreign Minister Huang Hua, former Ambassador to Canada, chose Ottawa for his first visit abroad as Foreign Minister. A steady stream of other delegations followed, including Chinese experts who have been quietly scouring Canada for advanced technology. Canadian officials see these trips as evidence of a concentrated Chinese effort to absorb Western know-how. They point to the Chinese push to train thousands of students in the West--up to 500 of them in Canada--as part of this effort. [REDACTED]

25X1

Canadian businessmen also got the message. A high-level Canadian industrial and commercial delegation in Peking in October received a "promise of over \$10 billion of trade between now and 1985," up from about \$2.2 billion over the past six years. One observer estimated, however, that this jump would be just enough to maintain Canada's current share of 2 percent of China's external trade. [REDACTED]

25X1

Canadians, concerned that the 7 to 1 trade imbalance in favor of Canada would inhibit the Chinese from making further deals, are busily devising ways to keep the imbalance within bounds China will find acceptable. There are few Chinese products that Canada wants to buy, but businessmen are exploring other methods, such as "triangulating" trade (receiving payment in goods that Canada then sells to a third country), to encourage China to deal with Canadian companies. [REDACTED]

25X1

As a member of NATO, Canada has been concerned about the security aspects of other countries selling arms to China, and has no visible intentions to do so itself. Fear of Soviet reaction could play a part, but would not weigh nearly as heavily as it does on West Europeans, who face the Russian bear on their doorstep. [REDACTED]

25X1

The Canadians, eager to share in the boom in sales to China, take comfort from the Chinese assurances that they will favor Canadian goods over those of the US, given comparable technology and price. These assurances will probably not hold good in light of the normalization of relations between the United States and China. Observers point out, in addition, that the US generally outperforms Canada in most areas, that Japan is already far ahead of everyone else in trade with China, and that West European industrialists have also made inroads. Thus, while Canadians believe that they were a contributing factor in China's emergence from isolation, they realize with regret that Canada can no longer lay claim to the best relationship with China of any Western country. [REDACTED]

25X1

25X1 [REDACTED]
[REDACTED]
Malta [REDACTED]

25X1

Prime Minister Mintoff has always emphasized Malta's links with the Third World and with most Communist countries except the USSR. It is not surprising, therefore, that he agreed to China's request for diplomatic recognition in 1972 or that he accepted Peking's terms: the severance of relations between Valletta and Taipei. Since then, Mintoff has traveled to China three times and economic relations between China and Malta have deepened. Chinese assistance to Malta is substantial and has had a significant impact on the country both economically and politically. [REDACTED]

25X1 [REDACTED]
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SECRET
[REDACTED]

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Economic Ties

Shortly after diplomatic recognition, China agreed to grant Malta a \$45-million interest free loan, with no conditions attached. A \$4.6 million line of credit was also included in the package. The \$45 million loan is being used for a variety of projects, but the most important is the construction of a drydock facility that will be capable of servicing 300,000 ton vessels; when completed it will be one of the largest facilities of its kind in southern Europe. There are approximately 100 Chinese technicians involved in the project, which has been plagued with a variety of problems ranging from language barriers between the Maltese and Chinese to the inexperience of both sides in building a facility of this size. [REDACTED]

Meanwhile, China has emerged as one of Malta's major trading partners, accounting for about 30 percent of Valetta's transshipment business. The percentage will increase, moreover, under the terms of a May 1978 agreement calling for more Chinese ship visits. The Chinese have also contracted for more ship repair visits and for the construction of a variety of small vessels; two 5,700 ton petroleum carriers have already been delivered. The carriers are Malta's most significant export to China, but do little to correct the heavy trade deficit with the Chinese.

Domestic Impact

Projects such as the drydock construction help shore up Mintoff's domestic political base. With the British military forces scheduled to withdraw from Malta on 31 March 1979, unemployment is certain to increase and Mintoff--who depends on Malta's labor movement for much of his political strength--could become more vulnerable politically. The new drydock's increased capacity for ship repair and modification should offset some of the unemployment potential since it will be inaugurated next March. The threat of unemployment in Malta's present drydocks should be reduced by further contracts for a variety of vessel construction.

Even the Nationalist opposition, which had been cool to China when it was in power, has been compelled to take notice of China's economic contribution to Malta. In July 1978, at Chinese invitation, a Nationalist delegation headed by opposition leader Fenech Adami paid a five-day goodwill visit to China. The Chinese invitation to the Nationalists is a clear signal to Mintoff that China has no qualms about dealing with his opposition if this would facilitate blocking an eventual Soviet presence in Malta. [REDACTED]

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Chinese Objectives

Keeping the Soviets out of Malta is clearly the main Chinese motive in establishing strong economic and diplomatic links with Valletta. Since the Soviets lost their Egyptian bases, it has become more difficult to resupply and refit their Mediterranean naval squadron. Obviously, the Soviets would like a replacement for these lost facilities. Malta possesses everything they need--strategic location, drydock facilities, and a skilled labor force to man it. [REDACTED]

25X1

China will probably continue to support Mintoff as long as he maintains his current policy of neutrality--with an emphasis on aloofness toward the Soviets. And given his excellent relations with Peking, Mintoff would have to think long and hard before yielding to Soviet overtures. [REDACTED]

25X1

The Soviet Response [REDACTED]

25X1

With each demonstration of Western receptivity to overtures from the Chinese, Moscow professes to be more alarmed. In even the most minor incidences of conciliation or cooperation, the Soviets perceive an unsettling new alignment of international forces, an alignment directed primarily against themselves. But the increasing stridency of their warnings and threats against this Chinese-Western rapprochement is doubtless accompanied by a growing realization among the Soviet leadership that there is little--if anything--they can do to prevent it. [REDACTED]

25X1

The Soviets condemn China's growing connection with Western Europe in all its manifestations, from innocuous cultural exchanges to suggestions of overt military support. Party-level dealings--for example, Chinese Premier Hua Kuo-feng's recent visit to Romania and Yugoslavia and the favorable reactions of the Italian and Spanish Communist parties--complete the threat posed by warming state relations and the evident willingness in some West European capitals to balance their Soviet connection with their new Chinese one. The Soviets have closely monitored the nature and development of each country's relationship with China, particularly those whose governments are considering sales of military hardware. The Soviets see multiplying Western sales and investments in China as strengthening the Chinese not only economically, but--most significantly--politically. They appear to realize that any genuine military impact would be further down the road. [REDACTED]

25X1

It is unquestionably the political impact of West European arms sales to China that disturbs the Soviets most profoundly, particularly the global perception of the success of China's anti-Soviet policies.

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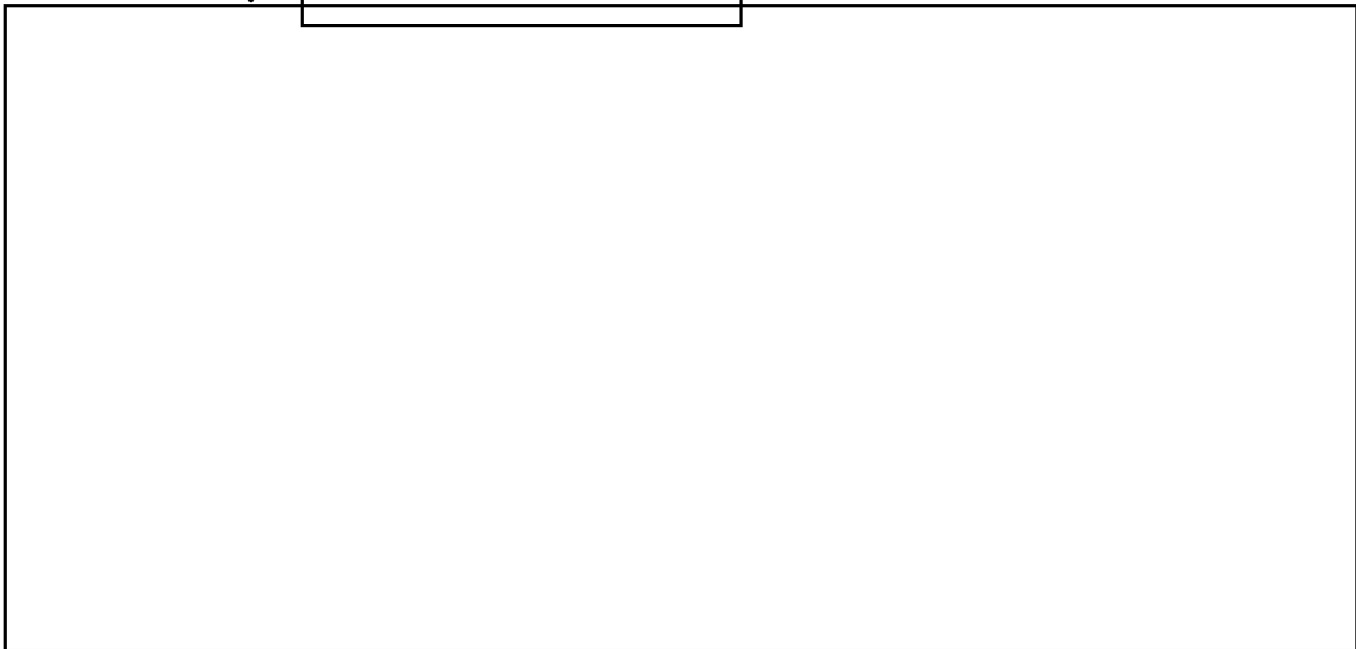
But while they have said they would regard such sales as "unfriendly acts," they are clearly unwilling to risk alienating the West Europeans with strong-arm tactics. Moscow may also have concluded that arms sales to the Chinese--of defensive weapons, at least--are inevitable, and that a moderate approach on the Soviets' part may induce the West Europeans to place some limitations on their dealings with the Chinese. Soviet Embassy officials and military attaches in West European capitals are energetically seeking information on possible Chinese military purchases. It is also possible that Moscow will attempt to enlist some Third World countries to support its position.

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The tone of Soviet diplomatic demarches to West European governments concerning arms sales to the Chinese has been cautionary, the theme being China's warlike intentions and the certain damage to international detente. This was the approach taken by Soviet President Brezhnev during his talks with West German Chancellor Schmidt in Bonn last May and by Soviet Foreign Minister Gromyko on his visit to Paris in late October. The Soviet media ceaselessly echo this warning, only more stridently.

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The Soviets can be expected to maintain and amplify their outcry against arms sales. It is doubtful, however, that Moscow will take stronger measures if such measures threaten to harm Soviet interests without ensuring the desired impact on West European policy. SALT, MBFR, or bilateral economic arrangements could well prove to be the next forum the Soviets choose to express their displeasure over the West's Chinese connection.

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