

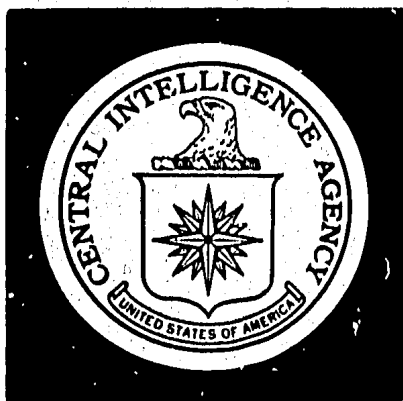
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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

*Communist China: Recent Trends In Earnings
From Hong Kong*

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
October 1970

INTELLIGENCE MEMORANDUM

Communist China: Recent Trends In Earnings
From Hong Kong

Introduction

In the past decade, hard currency earnings in Hong Kong have enabled Communist China to finance sizable purchases of industrial goods and grain from the Industrial West.* China's imports from the Industrial West, particularly Japan, are up substantially thus far in 1970 and should reach a record level for the year. The enormous trade deficit with the Industrial West is likely to increase still further. As a result, foreign exchange earnings from Hong Kong will continue to be of major importance to China's pattern of foreign trade and economic development.

This memorandum examines the magnitude and composition of China's hard currency earnings from Hong Kong since 1964. Three major components are discussed: trade earnings, remittances from overseas Chinese, and remitted profits from businesses owned by the Chinese Communists in Hong Kong. An overview of these earnings is then presented to depict the importance of Hong Kong to China for financing current and future imports from the Industrial West.

* *The term Industrial West refers to Western Europe, Japan, North America, and Australia.*

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research.

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SECRETTrade Earnings

1. Whereas Hong Kong is China's largest export market, Chinese imports from Hong Kong are small. The result is an annual trade surplus of more than \$400 million. About 25% of Chinese exports to Hong Kong are reexported to third countries. Textiles and clothing make up about one-half of the reexports. Foodstuffs and traditional Chinese medicines are also important reexports, but Hong Kong retains most of these Chinese exports for local consumption.
2. The entrepôt function of Hong Kong provides a convenient method for marketing Chinese goods, especially in Southeast Asia. Indonesia, Singapore, and Japan are the largest recipients, absorbing about one-half of the total. Through reexports from Hong Kong, such countries as Taiwan, South Vietnam, and South Africa import a few million dollars worth of Chinese goods each year, primarily traditional medicines and specialty items; the political difficulties of trading with these countries are thereby circumvented.
3. China's export surplus grew rapidly through 1966 but dropped sharply in 1967-68 when the Cultural Revolution disrupted the Mainland economy and disturbed China - Hong Kong political relations. The fall in Chinese exports in 1967-68 seems to have been caused by: (a) supply problems within China, perhaps associated more with difficulties in the planning and distribution system than at the source of production; and (b) China's apparent withholding of some goods from the Hong Kong market and diverting some of the reexport business to Singapore in the aftermath of the 1967 disturbances in Hong Kong. The figures for China - Hong Kong trade, 1964-70, are given in Table 1.
4. Expansion of exports to Hong Kong was renewed in 1968 and has continued in 1970. Trade figures for the first seven months of 1970 show Chinese exports to Hong Kong of \$249 million, an increase of about 5% over the same period in 1969. If this rate of increase holds for the entire year, China's exports to Hong Kong would reach \$465 million, still short of the 1966 peak. This lag in

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Table 1
Communist China: Trade with Hong Kong

	Million US \$						
	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>Preliminary 1970</u>
China's imports	<u>10</u>	<u>12</u>	<u>12</u>	<u>8</u>	<u>7</u>	<u>6</u>	<u>10</u>
Imports from Hong Kong	2	3	3	1	1	1	4
Hong Kong reexports from third countries	8	9	9	7	6	5	6
China's exports	<u>345</u>	<u>406</u>	<u>485</u>	<u>397</u>	<u>401</u>	<u>445</u>	<u>465</u>
Retained by Hong Kong	260	306	376	290	312	326	345
Reexports by Hong Kong	85 a/	100 a/	109	107	89	119	120
China's export surplus	<u>335</u>	<u>394</u>	<u>473</u>	<u>389</u>	<u>394</u>	<u>439</u>	<u>455</u>

a. Reexports estimated for 1964 and 1965.

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recovery rests with the Chinese exports retained in Hong Kong, not with goods reexported to third countries. Hong Kong merchants have apparently regained much of the business diverted to Singapore in 1967. Thus, at a time when Hong Kong's imports from all countries have been growing by 19% each year, China's share of the Hong Kong market has fallen, from 27% in 1966 to 18% in 1969 and perhaps even lower in 1970. Since 1968, Japan has supplanted China as the leading exporter to Hong Kong.

5. The commodity composition of China's exports, shown in Table 2, indicates that the principal items shipped to Hong Kong are foodstuffs, textiles, light manufactures, and various specialty products. It also indicates that textiles have been the main laggard since 1967, with meat, animals, and fish being slightly above the level of 1966.

6. An examination in detail of these two broad categories for the years 1966 and 1969 indicates more specifically the types of commodities that have been moving to Hong Kong from China in smaller amounts in recent years. These data are presented in Table 3.

7. Several factors may explain the lag in exports of textiles and meat products to Hong Kong: (a) supply problems within China, (b) a shift to alternate suppliers by Hong Kong, or (c) a shift in Hong Kong's demand for specific commodities as well as a slow growth in demand for the major items of Chinese exports. While the first factor undoubtedly was valid in 1967-68, it no longer seems to be very important. China's total exports to the Free World of these commodities were higher in 1969 than in 1966. Thus the principal cause would seem to lie within the Hong Kong market itself, even though it cannot be precisely specified. In the case of meat products, Hong Kong's total imports since 1966 have risen relative to those from China, indicating some shift to alternate suppliers for these products. But the principal shift is indicated by the drop in Hong Kong's total imports of cotton fabrics -- commodities that China supplies -- and the jump in imports of synthetic fabrics coming from other countries, Japan in particular.

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Table 2

Communist China: Commodity Composition of Exports to Hong Kong ^{a/}

	Million US \$						
	1964	1965	1966	1967	1968	1969	Jan-Jul 1970
Foodstuffs	<u>179</u>	<u>203</u>	<u>224</u>	<u>198</u>	<u>206</u>	<u>229</u>	<u>129</u>
Of which:							
Meat, animals, and fish	86	108	117	102	102	121	66
Grain	19	16	19	20	23	24	13
Fruit and vegetables	28	36	39	38	43	44	26
Crude materials, fuels, and edible oils	<u>17</u>	<u>23</u>	<u>34</u>	<u>31</u>	<u>28</u>	<u>27</u>	<u>16</u>
Of which:							
Oil seeds	2	1	3	3	3	3	2
Textile fibers	-	1	1	1	1	1	1
Plants for medicine, perfume, etc.	8	9	14	15	13	14	9
Chemicals	<u>6</u>	<u>7</u>	<u>11</u>	<u>8</u>	<u>10</u>	<u>10</u>	<u>6</u>
Manufactures	<u>142</u>	<u>172</u>	<u>215</u>	<u>159</u>	<u>156</u>	<u>178</u>	<u>92</u>
Of which:							
Textiles, yarn, and fabrics	67	70	104	66	68	71	41
Clothing	16	24	17	12	14	16	9
Human hair	1	Negl.	2	15	13	25	-
Other	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>6</u>
<i>Total</i>	<i>345</i>	<i>406</i>	<i>485</i>	<i>397</i>	<i>401</i>	<i>445</i>	<i>249</i>

a. Including reexports by Hong Kong to third countries.

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Table 3

Hong Kong: Imports of Textiles and Meat Products

<u>Commodity</u>	<u>Million US \$</u>			
	<u>Imports from China</u>		<u>Total Imports</u>	
	<u>1966</u>	<u>1969</u>	<u>1966</u>	<u>1969</u>
Textiles	<u>104</u>	<u>71</u>	<u>293</u>	<u>422</u>
Of which:				
Cotton fabrics	63	33	102	70
Wool fabrics	5	1	26	29
Silk fabrics	7	3	8	7
Synthetic fabrics	7	6	48	125
Household linens of cotton	16	13	17	17
Meat products	<u>117</u>	<u>121</u>	<u>149</u>	<u>168</u>
Meat	22	29	33	47
Live animals	73	64	82	76
Fish	22	28	34	45

Overseas Remittances

8. Many Chinese living outside the Mainland maintain ties with their homeland by sending funds to relatives still living in China. The individual amounts are small, but the total each year is substantial and provides a significant portion of China's foreign exchange earnings. About 55% of the remittances come from Chinese living in Hong Kong and Macao. The other 45% originates in Southeast Asia and other parts of the world. Almost all of these funds are believed to flow through the Hong Kong banks, with most of the remittance business handled by the Chinese Communist banks in Hong Kong. Remittances are deposited with the banks in the Colony or come to them from banks outside Hong Kong. These banks in turn transfer these funds to the Hong Kong branch of the Bank of China which actually remits them to the Mainland.

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Very few remittances are believed to be sent directly to the Mainland.

9. The following tabulation shows the estimated level of total remittances from Overseas Chinese from 1964 to 1969:

<u>Year</u>	<u>Million US \$</u>	<u>Year</u>	<u>Million US \$</u>
1964	110	1967	110
1965	90	1968	110
1966	110	1969	140

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Remittances are estimated to have been fairly constant until 1969. Most reports indicate that the Cultural Revolution had little effect on them. The \$140 million in 1969 represent a 25% increase over the 1968 estimate and is the highest total since 1952. Possible factors in this rise are increased prosperity in the Chinese communities of Southeast Asia and increased requests from relatives, perhaps stimulated by the "war preparations" campaign in China.*

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Remitted Profits

10. Communist China owns many businesses and has investments in many other enterprises in Hong Kong. A portion of the profits from these businesses is remitted back to the Mainland each year providing a third source of hard currency earnings from Hong Kong. There are 12 banks owned by Chinese Communists, headed by the Hong Kong branch of the Bank of China. Among their services, these banks handle the remittance business and much of the financing of China - Hong Kong trade. China Resources Company and other Chinese-owned trading

* *It is also possible that the 1969 figure is a more comprehensive estimate than the earlier ones.*

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firms in Hong Kong conduct much of the China - Hong Kong trade. Several large China products stores have been established in the Colony offering Mainland goods, including some quality souvenirs and art objects for tourists. Other enterprises not directly involved in commodity trade include travel services engaged in Hong Kong's booming tourist trade, insurance companies, movie theaters, publishing houses, and newspapers.

11. Little precise information is available about total Chinese Communist investment in Hong Kong and the degree of ownership of many enterprises. Likewise, little is known about the level of profitability of the enterprises or about what portion of profits is actually remitted to the Mainland. [redacted] earnings from Communist businesses and investment in Hong Kong at about \$30 million in 1969, including \$2.8 million in payment by the Hong Kong government for water from the Mainland. While there is little concrete information with which to judge the validity of this estimate, it seems to be a reasonable "ball-park" number. In any case, China's net business and investment earnings from Hong Kong probably reached a new peak in 1969, even though trade earnings did not. Thus, if the \$30 million is a reasonable estimate for 1969, the counterpart earnings for earlier years would be lower. Finally, while information is not available on the portion of net earnings remitted to the Mainland, it is believed that the remittance estimates noted earlier include part, if not all, of each year's remitted profits.

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Significance of Earnings from Hong Kong

12. China's hard currency earnings from and through Hong Kong provide the prime offset to the trade deficits with the Industrial West. Table 4 shows the pattern of the earnings and of China's trade deficits with the Industrial West since 1964. For the period as a whole, China's earnings from Hong Kong have exceeded the trade deficits with the Industrial West. But the general upward trend in earnings has been much less steep than the rising trend in the trade deficit. In 1964-66, total earnings from Hong Kong exceeded considerably

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Table 4

Communist China: Earnings from Trade with Hong Kong
Versus Trade Deficit with the Industrial West

	Million US \$							
	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>Preliminary 1970</u>	<u>Total</u>
Trade surplus	335	394	473	389	394	439	455	2,879
Overseas remittances	110	90	110	110	110	140	140	810
<i>Total earnings</i>	445	484	583	499	504	579	595	3,689
Trade deficit with the Industrial West	-269	-360	-435	-710	-630	-560	-700	-3,654

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the trade deficits with the Industrial West; since 1966, the reverse has been true, except in 1969 when the two were roughly equal. The 1967-68 situation may be largely a reflection of difficulties created by the Cultural Revolution, but the 1969-70 data suggest that something more enduring may have set in. China's earnings are barely back to the level of 1966, but the trade deficits with the Industrial West are much higher than they were in 1966.

13. The lag in recovery lies in the Chinese exports retained in Hong Kong for local consumption, which have yet to regain the 1966 level. To the extent that this reflects supply difficulties on the Mainland or the loss of a portion of the Hong Kong market for these commodities to another supplier, the problem may be transitory. To the extent that it reflects a slow growth in Hong Kong's demand for the major items in China's export bundle, however, it will restrict China's ability to increase its earnings from this trade. It might be noted that China's internal investment policy implies the postponement of modernizations of China's light industries, whereas Japan and other competitors in the Hong Kong market are better able to meet the demands of an increasingly affluent Hong Kong society. A marketing problem with Hong Kong might seriously constrain China's ability to expand its imports from the Industrial West. Nevertheless, regardless of problems, Hong Kong will continue to be the key source of hard currency for China for some time to come.

Conclusions

14. Hong Kong has been China's prime source of hard currency earnings needed to finance the large deficits in trade with the Industrial West. Trade earnings, including entrepôt trade, comprise about three-quarters of China's total hard currency earnings from Hong Kong. The remainder consists of remittances handled by the Hong Kong banks from Chinese residing in Hong Kong, Southeast Asia, and other parts of the world and of profits remitted back to the Mainland by Chinese

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Communist-owned businesses and investments in Hong Kong.

15. Total earnings of foreign exchange from Hong Kong from 1964 to 1970 are equal to about \$3.7 billion, slightly more than the sum of China's trade deficits with the Industrial West for these seven years. However, the pattern of earnings and deficits has changed significantly over this period. Earnings from Hong Kong exceeded the deficits with the Industrial West in 1964-66; the reverse has been generally true for 1967-70. For 1967-68 the disruptions of the Cultural Revolution may have had the greatest effect. For 1969-70, the lag in recovery of export earnings suggests some problems for Chinese products in the Hong Kong market. Chinese exports to Hong Kong have been rising again since 1967, although at a slower rate than before. Hong Kong's demand has fallen off for cotton fabrics in recent years and will likely grow slowly for other major categories of Chinese exports, especially foodstuffs. Accordingly, China's earnings from Hong Kong, while still large, seem likely to grow slowly and thereby to place some constraint on Peking's ability to expand industrial imports from Japan and Western Europe.