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Prime Minister

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PRIME MINISTER $\frac{4}{3}$

The Economic Value of Hong Kong to China

I attach a copy of the summary of a draft JIC report on the economic value of Hong Kong to China. The draft report has not yet been formally approved by the Economic Assessments Sub-Committee of the Joint Intelligence Committee, but you may like to have the summary before your meeting with Sir Edward Youde and Sir Percy Cradock. The complete draft report should be available on Monday morning, 7 March.

2. The report assesses that China's foreign exchange earnings from Hong Kong are increasing in absolute terms and probably amount to about \$7 billion per annum. But in relative terms the territory's share of China's total convertible currency earnings has declined from 36 per cent in 1978 to 30 per cent in the last two years. These figures can be looked at in another way by excluding the earnings from those Chinese exports to Hong Kong which are then re-exported. In this case the proportion of China's foreign currency earnings represented by Hong Kong has fallen from 28 per cent to 20 per cent during the last four years.

3. The decline in land and property values in Hong Kong, and the economic recession, will continue to restrict returns from China's existing banking and investment facilities in Hong Kong. The economic situation also means that there is little likelihood of a substantial expansion either in remittances to China or in travel to China by Hong Kong residents. Hong Kong may also have passed its peak as a source of foreign investment for the modernisation of China.

4. The conclusion is that Hong Kong's economic value to China has declined as the latter's relations with the West have expanded and this trend is expected to continue.

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5. The report incorporates the comments of Whitehall Departments and of our Missions in Hong Kong and Peking.
6. Copies of the summary have also been sent to the Foreign and Commonwealth Secretary and to Lord Belstead.

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ROBERT ARMSTRONG

4 March 1983

CONQUEROR

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THE ECONOMIC VALUE OF HONG KONG TO CHINA

PART I: SUMMARY

1. Hong Kong was developed as a commercial centre and major port linking China with the West. It relies on China for the major part of its imports of food and raw materials. Hong Kong currently accounts for 28 per cent of Chinese exports to convertible currency countries and 11 per cent of its imports. Over 40 per cent of the goods imported from China are re-exported while some 70 per cent of those exported by Hong Kong to China were produced elsewhere. During the last 5 years Chinese trade with Hong Kong has increased substantially in line with its expanded world trade. There has been little change in the relative importance of the territory as an importer of Chinese products but its role as an entrepot for Chinese import requirements has increased significantly from a low base.

2. It is too early to judge the effects of Chinese plans to develop and expand the effectiveness of their own port and transport facilities. In the longer term this may detract from the current importance of Hong Kong's port facilities. In the immediate future however these will remain of considerable value and Hong Kong will remain the best deep water port serving Southern China for some years.

3. China has consistently run a substantial surplus on visible trade with Hong Kong (about US \$3.4 bn in 1982). This contrasts with a deficit on trade with the rest of the world until 1981. The foreign exchange earned from China's exports to the territory now exceed \$5 billion. Without re-exports the figure is about \$3 billion. When invisible earnings from remittances and travel by Hong Kong residents and returns from China's investments and services are added, we estimate that the total is some \$7 billion compared to less than \$3 billion in 1977. Despite this rise, earnings from Hong Kong as a share of China's total foreign exchange earnings have declined from 36 per cent in 1978 to 30 per cent reflecting the rapid growth of China's exports to the rest of the world. If China's exports re-exported by Hong Kong are excluded, earnings from the territory amount to 20 per cent of China's world earnings, showing a decline from 28 per cent in 1978.

4. China plans to increase both its exports and imports over the next few years at least and earnings from Hong Kong should continue to grow. Because of the current economic recession in Hong Kong there is little likelihood of a substantial expansion either in remittances to China or in travel by Hong Kong residents within that country. Similarly new land and property investment by China in Hong Kong, which peaked in 1979, have declined substantially since then and remained depressed. The decline in land and property values in Hong Kong coupled with economic recession will restrict returns from China's existing investments and banking facilities in the territory. The combination of economic and political uncertainties in Hong Kong together with the expansion in China's earnings from other countries has reduced, and seems likely to continue to reduce, Hong Kong's relative importance to China as a source of foreign exchange.

5. Although Hong Kong has proved the primary source of foreign investment for joint venture projects in China since 1978, funding has declined sharply since its peak of 1981. Hong Kong businessmen have invested very largely in small, short-term, low-risk projects in the neighbouring Shenzhen Special Economic Zone. Current uncertainties in Hong Kong, the move by China to encourage foreign investment in areas other than Shenzhen and perhaps most importantly an increased emphasis on substantial, long-term funding for high technology energy, infrastructure and mineral exploitation projects, are likely to result in a continued decline in Hong Kong's relative importance to China as a source of foreign investment.

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From the Private Secretary

SIR ROBERT ARMSTRONG

The Economic Value to Hong Kong to China

The Prime Minister has seen your minute of 4 March and the attached draft JIC report on the above subject.

A. J. COLES

10 March, 1983

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