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BOOK FOR SECRETARY OF COMMERCE TRIP 1979-1980

FOIA

M09-299/1

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COLLINGS

40

ID	Doc Type	Document Description	No of Pages	Doc Date	Restrictions
92856	POSITION PAPER	RE HONG KONG AND THE MTN <i>R 6/21/2012 M299/1</i>	3	ND	B1
92857	MAP	RE HONG KONG	1	ND	B1 B3
92855	BACKGROUND PAPER	RE PRC/HONG KONG RELATIONS <i>R 1/19/2011 M299/1</i>	2	ND	B1
92858	BACKGROUND PAPER	RE US POLICIES TOWARD ADVANCING DEVELOPING COUNTRIES: HONG KONG <i>R 6/21/2012 M299/1</i>	1	ND	B1
92859	BIO		1	5/1/1979	B1 B3
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Briefing Book for ^{Sec. of Commerce} Juanita Kings
Trip - 1979-80

HONG KONG ISSUES BOOK

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A





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Position Paper

HONG KONG FOOTWEAR EXPORTS

ISSUE:

While imports of nonrubber footwear from Taiwan and Korea are limited by orderly marketing agreements (pursuant to the President's directive following an injury determination from an escape clause investigation), imports from Hong Kong have surged. There is little indication that the recently instituted certificate of origin system is serving to slow down footwear imports from Hong Kong.

U.S. POSITION:

Imports of nonrubber footwear from Hong Kong must decrease substantially from the 1978 import level to prevent disruption of the nonrubber footwear orderly marketing agreements between the United States and Korea and Taiwan.

HONG KONG POSITION:

Hong Kong may cite its export statistics to indicate that shipments of nonrubber footwear to the United States are decreasing. Hong Kong probably will indicate that the certification of origin system is sufficient to lower the U.S. footwear import level from Hong Kong.

TALKING POINTS:

1. Even though the January Hong Kong export statistics and the February U.S. import statistics showed a decrease in Hong Kong shipments of nonrubber footwear to the U.S. from the several preceding months, the decrease is not large enough to bring the import level down to around 15 million pairs annually. (Hong Kong traditionally shipped 6-8 million pairs of footwear to the U.S. until last year when 28.3 million pairs were entered into the U.S.)
2. Imports in the first two months of 1979 totaled 4.8 million pairs. At this rate, imports would total over 28 million pairs in 1979.

3. Hong Kong must take steps immediately to decrease its shipments of nonrubber footwear to the United States, or we will have to find alternative actions.
4. The U.S. will not permit nonrubber footwear shipments from any third country to circumvent the OMA's we have with Taiwan and Korea. The United States has communicated with other governments, including the Italian, concerning surges in U.S. imports of nonrubber footwear.

BACKGROUND:

A. Orderly Marketing Agreements

On April 1, 1977, following a unanimous decision by the U.S. International Trade Commission of import-caused injury to the domestic footwear industry, the President directed the Special Representative for Trade Negotiations to seek orderly marketing agreements with the appropriate footwear supplying countries. In June, 1977 orderly marketing agreements were concluded with Korea and Taiwan. These agreements limit U.S. imports of nonrubber footwear from Korea and Taiwan for four years. Included in these agreements is an "equity clause" which assures Korea and Taiwan of equitable treatment vis-a-vis other major exporting countries. Other countries were informed that, if shipments of nonrubber footwear were to increase rapidly to the disadvantage of Korea or Taiwan, the United States may utilize its right to take appropriate remedial measures.

B. Administrative Action

Imports of nonrubber footwear from Hong Kong increased drastically in the first half of 1978. These imports totaled 14.1 million pairs in the January - June 1978 period, an increase of 267 percent from the comparable period in 1977. Because of this large increase, consultations were held between the United States and Hong Kong. It was determined that a large portion of this surge in trade resulted from imports into Hong Kong of components from Taiwan and subsequent shipment of finished footwear to the United States, this being a circumvention of the orderly marketing agreement. Consequently, it was agreed that administrative actions would be taken by Hong Kong and the United States, whereby the United States will deny entry to nonrubber footwear exported from Hong Kong on or after November 27, 1978 that has not been issued a valid certificate of origin. This certificate of origin is to be issued by Hong Kong only if all shoe components are made and assembled in Hong Kong. At the time the administrative action was instituted, it was agreed that if this system

did not reduce U.S. imports of nonrubber footwear from Hong Kong to 8 - 15 million pairs a year, an alternative solution would have to be found. Total imports from Hong Kong last year were 28.2 million pairs.

C. Hong Kong Export Data and U.S. Import Data

Quantity (1,000 pairs)

	<u>Hong Kong Exports</u>	<u>U.S. Imports</u>
November 1978	2,066	2,802
December 1978	2,371	2,628
January 1979	1,703	2,698
February 1979	n/a	2,098

U.S. Imports From Hong Kong, 1971-78

	Quantity (1,000 pairs)	Value (\$1,000)
1971	6,003	4,963
1972	6,814	4,774
1973	6,647	4,658
1974	5,580	5,027
1975	5,943	4,817
1976	6,684	7,819
1977	8,714	12,553
1978	28,342	39,239

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Position Paper

HONG KONG AND THE MTN

ISSUE:

The United States tabled an industrial tariff offer in the Multilateral Trade Negotiations (MTN) in Geneva which will be of significant value to Hong Kong as the principal or substantial supplier of these industrial commodities to the U.S. As an appropriate contribution in return, the United States is seeking Hong Kong's adherence to the nontariff measure (NTM) codes negotiated in the MTN, especially the code concerning subsidies. In addition, the United States has several product-specific requests of Hong Kong which were not responded to in the MTN. These are still of importance to the United States.

U.S. POSITION:

1. The United States tabled an industrial tariff offer in the MTN which will provide windfall benefits to Hong Kong exports to the United States worth approximately one billion dollars.
2. In order to provide appropriate reciprocity for the sizable United States tariff offer, the United States believes that Hong Kong should adhere to the NTM codes, particularly the subsidy code.
3. The United States is interested in revenue duty reductions and bindings by Hong Kong for several products already raised in the MTN context. A list of these products and the U.S. requested action were tabled in the context of the Tropical Products Negotiations. If Hong Kong does not find it possible to agree to reduce these revenues duties by 50 percent, the United States could consider a fallback position including a smaller duty reduction or a GATT binding alone.

HONG KONG POSITION:

1. Although the United States has tabled an industrial tariff offer to Hong Kong of sizable trade coverage, significant portions of that offer have been affected by recent U.S. withdrawals, especially textiles.
2. Hong Kong is unable at present to commit itself to adherence to the NTM codes and requires additional time to determine if the codes will provide net benefits to Hong Kong.

3. Hong Kong has offered to consider in the MTN context a commitment, regarding the revenue duties on products of interest to the United States, that in the event of a future increase in the duty, it would apply equally to both imported and domestically produced products. However, the reduction of the revenue duties is a request which requires further consideration.

TALKING POINTS:

1. Despite recent withdrawals the United States industrial tariff offer in the MTN benefits Hong Kong significantly.
2. The United States recognizes and strongly commends Hong Kong's liberal import regime. In order to facilitate further movement towards trade liberalization and increased international discipline the United States believes that Hong Kong should adhere to the NTM codes, particularly the subsidy code.
3. The United States wishes to indicate again its interest in revenue duty reductions and bindings for three products already raised in the MTN context. (A list of these is provided as an attachment to this paper.)

BACKGROUND:

The U.S. industrial tariff offer to Hong Kong, while large in terms of trade coverage, was affected by recent U.S. withdrawals, especially in the textile area. The three U.S. product requests currently being raised with Hong Kong (see attached table) have previously been requested in the MTN. The United States was principal supplier in 1977 on all three products, representing trade valued at \$45.2 million, \$45 million of which is accounted for by Hong Kong imports of U.S. cigarettes. Hong Kong maintains an extremely liberal import policy, levying duties for revenue only on liquor, wine, beer, industrial alcohol, hydrocarbon oils, and unmanufactured and manufactured tobacco. Consequently, the U.S. requests take into consideration Hong Kong's liberal import policy.

Hong Kong has offered in the MTN context a commitment that any future revenue duties would be imposed equally upon imports and domestically produced goods. The United States does not regard this offer as acceptable and seeks both the reduction and binding of the revenue duties on the three products of export interest to the United States. If Hong Kong is unable to reduce its revenue duties by 50 percent the United States could accept a smaller reduction or GATT bindings on the current duties. While Hong Kong does maintain an open import regime, its adherence to the new rules and international discipline of the NTM codes is important to the United States in light of Hong Kong's status as an advanced developing country and its position in the international trading system.

Attachment

U.S. Requests Made to Hong KongDuty Reductions and Bindings

<u>PRODUCT</u>	<u>CURRENT DUTY</u>	<u>US REQUESTS,</u>
Cigarettes	HK\$20.15 per pound	HK\$10.07 Bind Duty Reduction
Rum	HK\$95.50 per gallon	HK\$47.75 Bind Duty Reduction
Distilled Alcoholic Beverages, NES	HK\$95.50 per gallon	HK\$47.75 Bind Duty Reduction

US\$1.00=HK\$5.26 (April 18, 1979)



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HELPFUL HINTS

There are no unusual customs or special ground rules that an American visitor in Hong Kong needs to know. Although the Hong Kong scene presents an exotic appearance, the U.S. traveler quickly feels at ease and can go about much as he might in a large American city. Tourism is big business in Hong Kong and the local population is quite accustomed to seeing large numbers of foreigners in their midst. In their contacts with strangers, the Hong Kong Chinese are typically affable but businesslike.

Merchandise in large department stores carries fixed prices, but bargaining is common in owner-operated shops, including those in the large shopping complex in the Kowloon ocean terminal building.

Tipping practices are not greatly different from those in the United States, although service charges are commonly added to bills. U.S. currency can be exchanged for Hong Kong dollars at hotels or numerous exchange dealers. The rate, which varies slightly on the free market from day to day, is currently about US\$1=HK\$5.26.

From mid-April to September the weather tends to be hot and sticky with frequent rainstorms. Lightweight dresses are needed, with a wrap or jacket for air-conditioned places, and raincoats and umbrellas.

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92857	MAP RE HONG KONG	1	ND	B1 B3

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HONG KONG KEY INDICATORS*

1978 GDP at Current prices	US\$13.6 billion
1978 GDP at Constant prices	US\$ 6.2 billion
1978 GDP per Capita, current prices	US\$2,947
1978 Real growth rate	10%
1979 Projected real growth rate	7%
1978 Inflation rate	6-7%
1979 Projected inflation rate	8-12%
1977 total U.S. investment (book value)	US\$1.4 billion
1978 Hong Kong Imports**	US\$13,432.2
From the U.S.	US\$ 1,602.9
Market Shares (1978):	
Japan	24%
People's Republic of China	17%
United States	12%
1978 Hong Kong Exports**	
Domestic Exports	US\$8,675
To U.S.	US\$3,223.6
Re-Exports	US\$2,811 million
To U.S.	US\$ 262.6
Market Share (1977)	
United States	38.7%
West Germany	10.5%
United Kingdom	8.7%
1973 Balance of Trade	US\$(1.9 billion)

*In US\$ million unless otherwise noted.

**Hong Kong statistics.



GENERAL BACKGROUND

Area, Geography, Climate

The British Crown Colony of Hong Kong, with an area of about 404 square miles, consists of Hong Kong Island; the Kowloon Peninsula; the New Territories (leased until 1997); and various surrounding islands. The colony was established officially when China ceded Hong Kong Island to Great Britain in the 1842 Treaty of Nanking. The Kowloon Peninsula was added in 1860 with the signing of the Treaty of Peking. Britain in 1898 obtained a 99-year lease on the New Territories, which comprise about 90% of the area of the colony.

Hong Kong Island, the site of most of the colony's governmental, commercial, and financial activities, has an area of about 32 square miles. The island's population center is the city of Victoria, commonly called Hong Kong, which faces the harbor and mainland. The Consulate General and all American official housing is on this island.

Kowloon is on a 2-mile-long peninsula directly across the harbor from Victoria. It is separated from the New Territories by a series of hills, the highest of which rises to more than 3,000 feet. It is Hong Kong's major industrial area as well as a residential and shopping center. Many of the colony's hotels are in Kowloon, as are numerous shops which cater to tourists.

The New Territories consist of an area of some 355 square miles between Kowloon and China and of some 235 small offshore islands. They account for most of the colony's agricultural activity. The rustic character of the New Territories has undergone dramatic changes in the past several years as the government implements its plans to construct major satellite towns.

Hong Kong's climate is governed by the monsoons. During the summer monsoon, mid-April to September, the weather is hot and humid. The average annual rainfall is 85 inches; the mean relative humidity exceeds 80% from mid-February to early October.

Population

Hong Kong's population is slightly more than 4.5 million. An estimated 90% are Chinese. More than 50% of the colony's Chinese residents were born in Hong Kong; others emigrated from China during the last 25 years. The rest of the community includes mainly expatriate government officials and business persons of all nationalities. Cantonese is the lan-

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guage of the urban area and the mother tongue of most of the colony's Chinese. Both English and Cantonese are official languages.

Most people follow traditional Chinese religious beliefs. The two main religions are Buddhism and Taoism. About 8,000 Hong Kong Chinese are followers of Islam. The Hindi community, which has been part of the colony since its earliest days, numbers more than 6,000. About 10%, or 440,000 people, are Christian; slightly more than half of these are Roman Catholic and the rest are Protestant.

Public Institutions

Hong Kong is a British Crown Colony administered by the Hong Kong Government. The Government is headed by a governor who is subject to the supervision of the Secretary of State for Commonwealth Affairs in London and governs with the advice of the local Executive Council. Legislation for the colony is enacted by the Legislative Council. Membership of both councils consists of ex officio government department heads and appointed notables. British Government policy is to enact no major constitutional change.

Although Hong Kong's foreign relations are the responsibility of the British Government, the Hong Kong Government has been allowed considerable autonomy in the area of commercial relations. For example, negotiations with developed countries concerning Hong Kong's exports of sensitive items such as textiles are carried out between the Hong Kong Government and the foreign governments concerned.

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Background Paper

PRC/HONG KONG RELATIONS

Peking's Present Stance Toward Hong Kong

Peking has undertaken to assuage concern in Hong Kong over the colony's future, concern which has been rising as the treaty expiration date approaches (1997). While the People's Republic of China has not retreated from its "principled stand" that Hong Kong (like Macau and Taiwan) is an integral part of China that will one day be reclaimed, Peking's assurances indicate that it still values highly the economic benefits of the present situation.

After several years of official silence on Hong Kong, Trade Minister Li Chiang raised the issue in an authoritative article in October 1977. That article (and other official commentary since that time) was clearly intended to signal to local and foreign interests in Hong Kong -- which include the more than 500 U.S. firms represented by trade offices and investments there -- that Peking is not preparing to destabilize the relationship.

If anything, Peking seems bent on further exploiting the benefits of Hong Kong. Hong Kong already provides 40 percent of China's scarce foreign exchange through a lopsided PRC trade surplus and through substantial non-trade revenues, for example, remittances by Overseas Chinese. Much of its international banking, shipping, and commercial activities is handled in the colony. PRC investments in Hong Kong, moreover, are steadily increasing. Peking is also paying closer attention to the production and commercial practices of foreign companies in Hong Kong and has shown interest in establishing joint venture corporations there. The PRC leadership may feel more secure experimenting with lucrative capitalist practices in Hong Kong, where they are less likely to "contaminate" the masses.

The Long Term

Britain's effective and unobtrusive administration of Hong Kong, combined with London's refusal to challenge China's ultimate authority over the colony, have made the continuation of Hong Kong's present status tolerable to Peking.

However, Hong Kong has yet to receive a clear signal as to when, and in what manner, Peking will try to effect a permanent solution. With a decade or more required to amortize new investments in Hong Kong, business interests will grow increasingly uncomfortable as 1997 approaches, without an unambiguous assurance from Peking that they will be able to continue their operations on a long-term basis.



Background Paper

HONG KONG ECONOMY

1978 Performance

1978 was a good year for the Hong Kong economy. Real GDP grew by an estimated 10%. Nevertheless, the year was not without problems. While exports and re-exports showed strong growth, imports grew at a faster rate, causing a record trade deficit of US\$1.9 billion. High consumer demand, caused mainly by rising real incomes and a growing middle class, led to increased imports of consumer products. Imports of raw materials for export and construction industries also increased. Stable market conditions abroad and a weakening trend of the Hong Kong dollar contributed to improved export performance over the previous year. Re-exports were a leading factor in the positive export performance.

Inflation was a matter of concern in 1978. The aggregate of all consumer price indices showed an inflation rate of about 6-7%, although some businesses estimated the rate at about 10%. Exceptionally large increases in the money supply aggravated the inflationary situation created by high consumer demand. A labor shortage led to higher wages; demand in the construction and manufacturing sectors was a major contributing factor. Construction booms in both private and public housing stimulated construction sector growth, accompanied by an unprecedented 50% increase in public works spending.

With the lifting of the 12-year moratorium on the entry of branches of foreign banks into Hong Kong, the number of licensed foreign banks increased from 74 to 101, reflecting both official endorsement of Hong Kong's expanding role as a financial center and confidence of foreign banks in the future of Hong Kong.

Outlook for 1979

In light of the slow economic growth predicted for the United States and Western Europe and the possibility that poor economic expectations may inspire protectionist policies (to which Hong Kong is particularly vulnerable), the real increase in Hong Kong's GDP in 1979 is expected to be about 7%, compared with the 10% recorded for 1978.

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The Government of Hong Kong, which produced a healthy budget surplus in 1978, has announced that it will reduce public spending in fiscal year 1979-80 to help unwind the economy and decelerate inflationary pressures.

Exports are expected to grow about 12-14 percent, with order books for exports such as textiles and garments, electronic goods, watches, and toys already full for the first half of 1979. Hong Kong's export-oriented economy is heavily dependent on the United States, which as Hong Kong's largest customer bought about 40% of its total exports in 1978. It is also influenced by trends in the economies of other developed countries such as Germany, the U.K., Japan and Australia, which together with the U.S., account for 70% of Hong Kong's exports.

The normalization of U.S.-China relations and China's modernization program should help Sino-Hong Kong relations, increase trade and investment, and enhance Hong Kong's position as a focal point for banking, shipping, and communications. Hong Kong-PRC trade is forecast to increase by 20% in 1979, to reach \$2.5 billion.

Hong Kong's dependence upon developed country markets, especially the U.S., makes it sensitive to protectionism. Continuing problem areas for the U.S. are exports of Hong Kong textiles (still the colony's largest domestic export industry) and non-rubber footwear. (Position papers on these two topics are included in the briefing book, although it is not anticipated that the Secretary will have occasion to discuss these technical subjects in detail; she may wish to express the Administration's concern that such restraints on U.S. imports are necessary. Generally, Hong Kong attributes such problems to economic problems in the domestic U.S. industries and not to Hong Kong's exports; however, Hong Kong acknowledges the attendant political sensitivities.)

Hong Kong itself imposes virtually no restrictions on imports. It has no customs tariff (revenue duties on three commodities only: alcohol, tobacco, and petroleum products) and very few, if any, restrictions which could be classified as non-tariff measures.

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FOREIGN ECONOMIC TRENDS REPORT

HONG KONG

APRIL 1979

KEY ECONOMIC INDICATORS: HONG KONG

Values in US\$ millions
unless otherwise stated
Percentage change calculated
from HK\$ figures in parenthesis

Exchange Rates:

1978 Jan-Dec US\$1.00 = HK\$4.692
1977 Jan-Dec US\$1.00 = HK\$4.662
1976 Jan-Dec US\$1.00 = HK\$4.905

	1976	1977	1978	% Change '78 Over '77	
<u>INCOME, PRODUCTION, EMPLOYMENT</u>					
GDP @ Current Prices (\$ Billion)	9.60	11.70	13.60	16.2	(16.7)
GDP @ Constant Prices (\$ Billion)	4.81	5.70	6.20	8.8	(10.0)
GDP per Capita, Current Prices (\$)	2192.00	2594.1	2947.4	13.6	(14.3)
<u>PRODUCTION (=EXPORTS)</u>					
Garments	2910.0	2983.4	3347.8	12.2	(12.9)
Textile Fibers	479.6	414.3	467.2	12.8	(13.5)
Toys and Dolls	443.6	597.7	656.4	9.8	(10.5)
Transistor Radios	339.8	459.8	324.6	-29.5	(-29.0)
Watches and Clocks	246.2	363.3	582.6	60.4	(61.4)
Metal Manufactures	172.1	212.6	239.6	12.7	(13.4)
Electronic Components, Transistor Diodes	166.6	228.4	236.4	3.5	(4.1)
Registered Industrial Employment ('000)	646	758	791	4.3	
Registered Industrial Vacancies ('000)	31	36	62	72.0	
Real Average Daily Wage Index	107-109	113-116	121-125		
Tourist Arrivals ('000)	1560	1757	2050	16.7	
<u>MONEY AND PRICES</u>					
Money Supply (M2 \$ Billion)	9.87	12.54	15.64	24.7	(25.6)
External Public Debt*	412.70	597.40	735.30	23.1	(23.9)
Prime Lending Rate (%)	6-6.5	4.75 -5.5	4.75-8.75		
Hang Seng Consumer Price Index	109.7	116.6	125.4		(7.6)
<u>FOREIGN TRADE</u>					
Domestic Exports	6652.2	7508.4	8675.0	15.5	(16.3)
To U.S.	2290.8	2906.9	3223.6	10.9	(11.6)
Re-Exports	1820.2	2108.3	2811.0	33.3	(34.2)
To U.S.	174.3	189.4	262.6	38.6	(39.5)
Imports	8826.2	10446.4	13432.2	28.6	(29.4)
From the U.S.	1082.4	1306.9	1602.9	22.6	(23.4)
<u>TRADE WITH U.S. JAN-DEC 1978</u>					
Exports: Clothing	1335.8		Imports: Cotton fibers & waste	176.2	
Toys and dolls	340.7		Electrical Machinery,		
Watches, Clocks & Photo			Apparatus & Appliances	159.1	
Equipment	225.5		Machinery (Other than		
Radios & Sound Equipment	222.5		Electric)	134.1	
Electrical Machinery	206.3		Electronic Components	128.7	
Electronic Components	158.9		Fruits and Vegetables	113.9	
Textile Fabrics	101.4		Tobacco Products	69.9	
			Misc. Manufactured Goods	60.8	

* includes M.T.R. debt

April 9, 1979

Hong Kong

Summary and Outlook

1978 proved to be a good year for the economy. Real Gross Domestic Product (G.D.P.) grew by an estimated 10% which was only marginally lower than that of 1977 (11.40%). Consumer demand and construction which were the key contributors in 1977 maintained relatively high growth levels in 1978. While exports and re-exports showed strong growth, imports grew at a faster rate, causing a record trade deficit of \$1.9 billion. The trade deficit, the weakening of the Hong Kong dollar and increased inflation have caused some concern.

The significant rise in PRC investment in Hong Kong's commercial, industrial, and real estate markets in 1978 has markedly enhanced Sino-Hong Kong relations. In 1978, significant increases were recorded for Hong Kong's imports from China (31%), exports (159%), and re-exports (22%). In step with China's modernization program, Hong Kong anticipates an expansion of trade as well as continual growth as a vital center for shipping, banking and communications services.

For 1979, real GDP has been forecasted to grow by a slower 7%. Besides the problems outlined above, other economic uncertainties face Hong Kong. Further trade restraints imposed by importing countries may adversely affect future textile and clothing exports. Also, as Hong Kong develops as a financial and services center, the competition for land and human resources with the export sector will increase. Thus if industry is to continue to play a major role in creating export earnings so vital to Hong Kong's economic survival, then possibly the Hong Kong Government must increase its participation in, and assistance to industry. The Government's recent decision to sell a proportion of industrial land at preferential prices with a condition that developers provide 50% of the buildings appears to be a step in the right direction.

The United States will continue to be a major supplier of electronics, machinery, consumer foodstuffs and semi-manufactured goods, as well as cotton for Hong Kong's textile industry. Opportunities are growing for U.S. exports of fabrics as well. Finally, normalization with China should open new opportunities for U.S. exports via the Hong Kong entrepot.

CURRENT ECONOMIC SITUATION AND TRENDS

Record Trade Deficit But Strong Export Performance Leads to Balanced Growth

1978 was a good year for trade in Hong Kong. Exports grew at a higher rate (16%) than the previous year (13%) contributing significantly to the real growth in GDP, estimated to be 10% in real terms. Stable market conditions abroad and a weakening trend of the Hong Kong dollar have helped to improve export performance. While exports and re-exports showed strong growth, imports grew at a faster rate, causing a record trade deficit of \$1.9 billion. The trade deficit has been partly generated by high imports of consumer goods as a result of increased real incomes in Hong Kong together with a significant rise in tourist expenditure during the year. Also, imports of raw materials for the export and construction sectors have grown with the increased activity in these sectors.

FOREIGN TRADE

Exports: Despite tight labor market conditions throughout the year, Hong Kong's export performance for 1978 showed a significant growth of 16%. This was achieved within the framework of the new bilateral textile trade agreements with the U.S. and the E.E.C. and reflects Hong Kong's determined efforts to develop new markets and export products (e.g. electronic toys). Additionally some existing exports are constantly upgraded (e.g. garments). An analysis of export figures show increases for Hong Kong's top six customers: the U.S. 11%, Germany 21%, U.K. 30%, Japan 31%, Australia 19% and Canada 6%. With the exception of transistor radios, the major commodities exported also recorded healthy growth: garments and textile fibers 13%, toys and dolls 11%, watches and clocks 61% metal manufactures (largely cutlery and household utensils) 13%, and electronic components 4%. Interestingly, Hong Kong overtook Switzerland to become the world's top watch exporter in terms of quantity in 1978.

The strong export performance and an increase in manufacturing employment by 4 percent over the previous year may indicate a return to an export-led growth trend for the economy in the future. However, certain factors are likely to threaten a good export outlook in 1979, primarily: Hong Kong's inflationary and tight labor force situation, slower economic growth in the U.S. and the OECD countries, and an increased severity of the bilateral trade restraints with the U.S. and the EEC. A slower growth of 12-14% has been forecasted for exports in 1979.

Fortunately, there are factors in Hong Kong's favour. The normalisation of U.S.-China relations will improve Hong Kong-PRC trade which has been forecasted to increase by 20% in 1979 to reach \$2.5 billion. Hong Kong's exports to China in 1978 grew by 159% though the likely emphasis for the future may be on the re-export trade between the two countries. Further, joint-venture schemes with China, especially in such areas as the electronics industry, instead of being a threat to the local industry may serve to complement it and thus boost production/exports. This is especially plausible when labor conditions in Hong Kong are tight since China has an abundant supply of semi-skilled labor. Finally, some of the efforts made by the Trade Development Council to promote trade in Asia, Central & South America are likely to come to fruition this year. Already, exports to countries such as Saudi Arabia (42%) and Egypt (33%) have increased significantly in 1978.

Re-Exports: Re-exports emerged as a leading contributor to Hong Kong's positive export performance. The most important sources of re-exports were China, Japan, and the U.S. which together supplied about 55% of all the re-exports from Hong Kong.

Re-exports of textile yarn, fabrics and made-ups have expanded along with the recent growth of textile and clothing industries in South East Asia. Luxury goods such as diamonds, pearls and semi-precious stones and watches and clocks have been re-exported via Hong Kong mainly because of its free port status and ideal geographic location. Hong Kong's role as an entrepot is most likely to increase with China's modernisation program because Hong Kong's trade infrastructure, harbour facilities, airport, railway and highways, telecommunications, banking and financial services is **more advanced**. The future pattern will probably divert from consumer and raw materials to focus on capital goods needed in China's oil and industrial joint venture programs.

The major markets for re-exports in 1978 were the neighbouring countries of Japan, Singapore, and Indonesia which together take 40% of the market share.

Imports: With the exception of Singapore (9%), the strong import demand meant substantial increases for Hong Kong's major suppliers: Japan (25%), China (37%), U.S. (23%), Taiwan (28%), U.K. (36%). Germany (42%), and Switzerland (61%). Import values of textile yarn, fabrics and made ups grew by 31%, iron and steel 47%, electrical machinery 32%, non-electrical machinery 30%, automobiles 50% and miscellaneous manufactured articles 40%. Local demand for imported consumer goods is likely to be dampened in 1979 by the presence of higher interest rates and more stringent official control over the money supply and credit expansion. An offsetting influence however, could be the predicted increase in tourist expenditure on consumer goods.

Finally, demand for housing and building supplies is likely to continue strong in support of the building boom in the last two years.

Imports from the U.S.:

The U.S. ranking as Hong Kong's third most important source of imports behind Japan and China held 12% of the total import market for 1978. Both the U.S. and Japan's share of the market have fallen in favour of China's increased participation. The commodities showing significant growth were cotton fiber (27%), machinery (other than electric), including office machines (137%), textile yarn fabrics and made-ups (24%), plastics (56%), miscellaneous manufactured articles (25%) and all American agricultural produce (22%), including wheat (17%), fruit (28%), and candy (147%).

Balance of Trade

The trade deficit of \$1.9 billion in 1978 has caused some concern especially as it contributed towards the weakening of the Hong Kong dollar. However, there has been a slight improvement of the import content compared to 1977 as a good proportion of the increase in imports was comprised of raw materials for the export-sector. With the tightening of credit in 1979, the proportion of imports for final consumption is expected to decrease further, thus possibly leading to a decrease in the trade deficit.

Tourism

Tourist arrivals in Hong Kong increased by about 17% to exceed the 2 million mark. Americans form the third largest group (14%) of visitors after the Southeast Asians (26%) and the Japanese (24%). Tourist earnings rose by 18% to over \$1 billion and

hotel occupancy rates averaged 89% (against 85% in 1977). The Hong Kong Tourist Association has recently announced that about \$1.5 billion will be privately invested in the next few years in hotels, resort facilities, restaurants and entertainment amenities reflecting both an international commitment to the territory and a widespread optimism in the continued growth of tourism. Tourist data from Hong Kong to the United States for 1978 is not yet available.

Labor

In 1978, labor market conditions remained tight because of the higher demand from the export sector without any slowdown in demand from the already booming construction and housing sector. As the overall unemployment rate fell to 2.7% (4.1% in 1977), wages rose and the real daily wage index grew by about 8%. However, indicative of differential pressure of demand, construction wages rose by about 15% reflecting also the consequences of wage escalation clauses placed in the Mass Transit Railway contract

Consumer Prices

Inflation became a growing threat in 1978 and consumer prices, seasonally adjusted and measured by the Hang Seng Index for higher income families rose by about 7.6%.

The index for lower income groups which has a high emphasis on food costs rose by 7.4%. For middle income households, the index increased by 6.9%. In 1979, prices are expected to rise further (8-12% in average) in the face of rising world prices caused mainly by rising energy costs and the weakness of the Hong Kong dollar. The government has outlined steps to contain inflation at a one-digit level by: (a) cutting down government spending especially in selected areas of the construction and building sector. (b) Monitoring the money supply so as to reduce bank lending and consumer demand.

Money and Banking

Hong Kong's money supply (currency, demand and time deposits) was \$15.6 billion at the end of 1978, up about 25% from a year ago. The banking system remained highly liquid, with an average liquidity ratio of about 46% in spite of the growth in domestic bank loans by 43.3%. Overseas loans dropped by 12.7% for the year, partly reflecting the effects of the imposition of a new tax on profits accrued from Hong Kong-originated offshore loans. This is likely to change in 1979, with the increased opportunities for the syndication of off-shore loans for China in Hong Kong. Other new banking developments in 1978 included the law passed on the Deposit-Taking Companies Amendment Bill which called for closer monitoring of the monthly financial statements and minimum liquidity ratios of Deposit-Taking Companies. Twenty-seven new bank licenses were issued following the lifting of a 12-year moratorium on the entry of foreign banks into Hong Kong, bringing the number of fully licenced banks to 101. Additionally, there were 106 bank representative offices and 241 registered deposit taking companies.

Interest Rates

There were three adjustments of interest rates during 1978 mainly aimed at correcting the widening differentials between Hong Kong and the U.S. and the Euro-dollar markets. By mid-April 1979, the prime lending rate was 11.5 percent, the rate on savings deposits 6.25%, while time deposit rates for 3-month, 6-month and 12-month money were 6.25%, 7.50%, and 8.50% respectively. The interbank call rate averaged 6.5% for 1978, the highest in any of the previous three years and was running at 0.6 percentage points ahead of the prime rate average of 5.9%. In order to correct the inversion between the interbank and the prime rates, and to check the

growth of the money supply and inflation, the prime rate will continue to be closely monitored by the Exchange Bank's Association in 1979.

Exchange Rates

The Hong Kong dollar appreciated against the U.S. dollar by 4.4% in 1978, opening at US\$1=HK\$4.609 and closing at US\$1=HK\$4.81. The forecast for 1979 is for the HK dollar to depreciate within a range of 2-6% vis-a-vis the US dollar.

Stock Markets

The property market boom and general climate of increased prosperity from trade, together with good expectations from China's more positive foreign policy spun off into a stock market boom led by trading in property shares. However, due to the growing problems of inflation, a weakening of the Hong Kong dollar and a record trade deficit the boom could not be sustained. The market started to fall triggered by the dramatic increases in interest rates and baseless rumours about the financial problems of some publicly listed companies. By the close of the year the Hang Seng Index of share prices showed a 22.6% increase compared to the 1977 year-end index.

The property market has been particularly buoyant in 1978. The private housing boom was aided by real income growth and low interest rates prevalent for three-quarters of the year. This was matched by expenditure in the public sector which continued to remain strong because of the massive effort by the Mass Transit Railway to meet its completion dateline in 1979. In addition, there was an unprecedented 54% increase in Government capital-works expenditure. Prices for prime commercial and residential land rose significantly and a record price of \$2900 per sq.ft. was recorded during the year.

The gold exchange and the bank's bullion markets have also been very active mainly because of the speculation arising from uncertainties in the currency markets.

Government Budget

The Hong Kong Government ended its 1978 fiscal year with an estimated record surplus of \$341 million with an accumulated surplus standing at approximately \$1.4 billion.

For the financial year beginning April 1979, the Government has forecasted a surplus of about \$302 million with an estimated total expenditure of about \$2.6 billion to be divided between recurrent (\$1.7 billion) and capital (\$0.9 billion). The emphasis for recurrent expenditure is on social services which will absorb 42% of the total. The capital spending budget will continue to focus on housing (\$490 million) and infrastructure development (\$277 million). Financed outside the budget, Phase 1 of the Mass Transit Railway project, costing over \$1 billion and consisting of 15 stations, cross-harbour tunnel and covering a distance of 15 km. is scheduled to be opened in October 1979.

Implications for U.S. Businessmen

Hong Kong continues to prosper and American products should continue to sell well here. Additionally, the softening trend of the U.S. dollar means that U.S. products are competitive with comparable Japanese and German products whose prices have grown by an average of 20% in 1978 due to currency appreciation against the

Hong Kong dollar. Within the consumer product range, home furnishings including furniture & home appliances, processed & frozen foods and fruit & vegetables should continue to sell well here. Manufactured and capital goods offering good market prospects include items such as machinery and parts, data-processing equipment and office machines, general industrial machinery (air conditioning equipment), photographic equipment and apparatus, scientific and engineering instruments, health care equipment and housing supplies. The market for cotton fiber continues to expand.

Investment

Direct foreign equity participation in Hong Kong's manufacturing industries increased by 6.4% to reach \$449 million at the end of November 1978. With a total of some \$202 million spread among 123 manufacturing companies, the U.S. is currently the leading investor in Hong Kong, accounting for about 45% of the foreign investment, followed by Japan (19%) and the U.K. (7%). Roughly 50% of the U.S. involvement is with the electronic industry, with another 20% in the chemical industry and the rest in other areas, mainly the textile and toy industries.

Hong Kong and China

1978 was an outstanding year for Sino-Hong Kong relations with significant increases in P.R.C. investment in Hong Kong's commercial, industrial and real estate markets. With the normalisation of relations between the U.S. and China, Hong Kong is well positioned with her market connections, entrepreneurial skills, banking, financial and port facilities to be directly involved in activities such as hotel and other infrastructure development and joint-venture industrial projects in China.