

No. 9

AMERICAN CONSULATE GENERAL,
Shanghai, China, January 5, 1948.CONFIDENTIAL

SUBJECT: Observations of the Commercial Attache on current conditions and outlook for industrial and other developments in Hong Kong and in Kwangtung Province of South China

The American Consul at Shanghai has the honor to transmit herewith a memorandum on conditions and outlook in Hong Kong and in Kwangtung Province of South China dated January 5, 1948, prepared by the Commercial Attache as a result of a brief stop-over in Hong Kong and Canton when returning from the ECAFE conference at Baguio. Although Mr. Calder had been authorized to spend considerably more time in that area, he was recalled to Shanghai on other more pressing business.

It is believed that the observations and information will be of interest both to the Department and the Embassy.

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Enclosure:

1. Memorandum dated January 5, 1948 entitled "Visit to Hong Kong and Canton - December 1947".

Original and hecto to Department;
Copy to American Embassy, Nanking.

JAN 21 1948

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the signed
original.
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Despatch #9,
American Consulate General,
Shanghai, China,
January 5, 1948. General,
January 5, 1948.

January 5, 1948.

MEMORANDUM

VISIT TO HONG KONG AND CANTON - December 1947

Prepared by Commercial Attaché

A. Bland Calder

A. Bland Calder

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Enclosure #1 to
Despatch 59,
American Consulate General,
Shanghai, China,
January 5, 1948.

January 5, 1948.

I arrived at Hong Kong Sunday noon¹ en route back to Shanghai from the South conference at Beiping, and spent three days in Hong Kong in discussions with officials of the Chinese government regarding the

VISIT TO HONG KONG AND CANTON - December 1947

On the last day I prepared by Commercial Attaché

I was asked by **A. Bland Calder** to prepare a report on the economy of Hong Kong and its prospects during the period of the Chinese Civil War. In light of our trade promotional representation at the 1947 conference, I was interested particularly in the prospects for Hong Kong concerning the pre-war production of consumer

SUMMARY

Hong Kong, while gradually recovering pre-war production of a variety of consumer goods which competed with similar Japanese goods in Far Eastern trade, is circumscribed in its outlook for industrial expansion due to the necessity for importing nearly all foods and all fuels, and cannot readily increase power output. The free conditions for trade, as compared with the situation at Chinese ports, are now threatened with limitations because of Chinese pressure for restriction on movements of goods smuggled to or from China. While labor costs are still low as compared with the situation in Western countries, they are considerably higher than pre-war and higher than levels at Canton and Shanghai. There is some belief locally that labor troubles are directed by underground influences at British enterprise.

The suppression of bandits and Communists appears to be item one on the program of the Kuangtung Provincial authorities. While there are various versions as to why Dr. T. V. Soong was appointed Governor, some business interests have great expectancy that conditions will improve in South China as a result of T. V. Soong's assignment as Governor of Kuangtung in command of military as well as civil affairs. While there is a good deal of discouragement and scepticism with regard to early success, some are optimistic that Dr. Soong will first rid the area of bandits, then resume the industrial development program which had registered some considerable progress in the 1930s prior to the Japanese invasion,--also that larger allocations of import quotas will be given to South China than has hitherto been the case.

¹December 15, 1947.

General

Industrial

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General Comment on Hong Kong's Entrepot Trade and Its Distribution and Source Area

I arrived at Hong Kong Sunday noon* en route back to Shanghai from the ECAFE conference at Baguio, and spent three business days in Hong Kong in discussions with officers of the Consulate General with regard to our needs in the way of weekly, quarterly and annual report material to include in over-all surveys for China and Hong Kong.

I was more interested also in the aspects of developments with regard to recovery of Hong Kong's former entrepot trade with areas other than China. In light of our trade promotional resolution at the ECAFE conference, I was interested particularly in the prospects for Hong Kong recovering its pre-war production of consumer goods which might be useful in the development of greater trade activity between the various entities and areas of the Far Eastern and Asian region embraced in ECAFE's territorial scope. Discussions on this subject were held with personnel of the Consulate General as well as with other contacts.

Hong Kong's 1,750,000 population (which figure includes that of Kowloon and the New Territories on the mainland of the Asiatic Continent) subsist mainly upon the profits from entrepot trade, whether legitimate or involving smuggling. Its trade in normal times was conducted with Kwangtung, Kwangsi, Hunan, and Yunnan Provinces of China, and with French Indo-China, Siam, the Malay States, the Netherlands Indies, and the Philippines, which areas are populated by approximately 175,000,000 people. Its deep water harbor has long made it the only good transhipment point for cargoes arriving from South China ports and destined to other parts of the world, as well as for trade moving in the reverse direction. Prior to the commencement of the Pacific War, in the years when Japan was slackening in its output of consumer goods to Far Eastern areas and was concentrating on war industry, Hong Kong's production and trade in a considerable range of consumer goods was on the increase. Cotton and woolen knitted wear, canvas rubber soled shoes, soap, cigarettes, leather goods, thermos flasks, flash lights and batteries, rattan furniture, and other products were being supplied to China and to other Far Eastern areas, as well as to more remote markets, including the United Kingdom. Manufacturers in England were even reported to have raised objections in 1938 to the influx of Hong Kong goods, manufactured with cheap Chinese labor, entering freely under "Empire preference" trade arrangements.

*December 14, 1947.

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Industrial Recovery in Hong Kong and Problems Involved in any Hoped for Expansion - Fuel and Food Situation

It is well known that in 1946 and in 1947 there has been some flight of industry from China to Hong Kong because of the many obstacles to industrial and trade activity in China. Conditions have been freer, although not without difficulties, in Hong Kong. Local opinion in Hong Kong obtained on a previous trip (April 1947) held that high wages and high living costs would heavily retard recovery and former output or expansion in the various light industries which had contributed to the pre-war export trade in local manufactures. The costs of materials at that time (Spring of 1947) were reported to have increased 5-1/2 times (on the average) and the labor costs 5 times, as compared with pre-war. However, the increased costs of materials in many cases were world wide, and in some cases were much more favorable than prices in China. Labor costs elsewhere were also up. It appeared, therefore, that relative to the then current conditions elsewhere conditions were more favorable than indicated by comparisons with pre-war figures. It appeared also, however, that the advantage might disappear or diminish when conditions elsewhere improve.

In the Spring of 1947, it was estimated that about 60 percent of the pre-war capacity of Hong Kong's cotton knitting and weaving industry was operable, although not necessarily operating, that cotton yarn was being supplied from Japan through SCAP and that some quantities were also coming in under arrangements with the Chinese Government from Shanghai. Due to the higher wage level, however, there were indications among industrial plant owners of sentiment favoring greater mechanization of processes in order to offset the greater labor costs. Hong Kong's shipbuilding industry had not recovered due both to war damage and to shortages of supplies of steel from usual world sources. Its sugar refining industry had suffered heavy war damage and could not operate. There is a question as to whether it can compete with a South China sugar industry if and when plans for such materialize.

In December 1947, there were evidences that the shipbuilding industry had recovered being limited only by the availability of steel products from abroad, that cotton spinning had developed (75,000 spindles with 25,000 more en route) as an industry due to diversions of cotton mill equipment originally intended for Shanghai to Hong Kong, that some handicraft work formerly performed in China was being developed in Hong Kong because of the handicaps to export from China, and that there was some prospect for a further recovery and expansion in consumer goods industries generally. (Activity in the canvas rubber soled shoe industry had been upped considerably due to orders from the

Chinese

Chinese Army, for example.) There was still some pessimism as to the extent to which consumer goods production as a whole in Hong Kong could expand in a manner to affect materially the demand for incentive goods for uses in the Far Eastern countries where consumer goods shortages affect and limit production and movement of raw materials for export, a factor which freezes portions of the trade of wide areas of Asia and the Far East,-- a situation which may require some time to remedy due to the world wide shortage of the products of industry.

It was also pointed out that continued operation of present plant capacity and any expansion of industry would have to be contingent upon availability of power. Limitations upon ability to obtain coal from Japan are serious. Twenty percent of the coal supply for power production could consist of anthracite coal from Tonkin, French Indo-China, but even that percentage is not obtainable because mines there have not recovered, having been flooded and partly destroyed. New machinery from abroad will be necessary before the mines can be brought back to pre-war output. While some of Hong Kong's power production capacity has been converted to oil fuel, companies and source countries which supply the oil cannot promise continuing or adequate supplies if further conversions and expansion in power production are to involve oil fuel. Thus, the power problem is serious in any hoped-for expansion of industry in Hong Kong with the outlook uncertain in the immediate future with regard to fuel supply and precarious from an investment standpoint in light of the political outlook if power capacity is to be expanded. Also, Hong Kong's ultimate ability to compete with areas which do not have to import fuel would be dubious. The advantage might remain only so long as conditions are disturbed elsewhere with shortages and high prices in prospective markets for the products of industry.

The various factors in Hong Kong's outlook include also the economic conditions of the colony, the availability of capital, and the considerable amount of unutilized labor available now throughout the country.

It was pointed out to the writer that Hong Kong had subscribed to agreements at the recent International Labor Organization conference at New Delhi which will oblige the Colony to restrict female employees in the cotton textile industries to no more than two eight-hour shifts daily. The necessity for employing men and boys (less adaptable and less efficient than women in the textile industry) for the third eight-hour shift would add to already high production costs, and would place Hong Kong at a disadvantage *vis à vis* certain other countries of the region, which, while they had signed the agreements, would probably not live up to them, whereas Hong Kong would observe them to the letter.

It was also pointed out by Hong Kong informants that labor costs in Hong Kong are at present 50 percent

higher

higher than in Shanghai and 90 percent higher than in Canton, figured at black market rates of exchange between Hong Kong dollars and Chinese National currency. This is true because Hong Kong must import most of its foodstuffs. Rice must be bought in black markets here and there. In December 1947 rice was costing in Hong Kong about double the price prevailing in nearby Canton.

There is some belief in Hong Kong that labor troubles experienced since V-J Day are, in part at least, and more noticeably lately, directed at British-owned enterprises and less at Chinese-owned establishments.

There is also some belief in Hong Kong that labor troubles experienced since V-J Day are, in part at least, and more noticeably lately, directed at British-owned enterprises and less at Chinese-owned establishments.

Hong Kong's Trade Situation and Outlook

An advantage possessed by Hong Kong which makes it attractive to traders is the fact that the Colonial Government does not impound the foreign currency acquired from exports. Thus, there are free supplies of exchange for imports. But even this advantage appears due to diminish as the Chinese authorities are constantly pressuring Hong Kong for cooperation in eliminating the smuggling trade between Hong Kong and nearby Chinese territory. Late news appears to indicate that Hong Kong has agreed to cooperate by prohibiting exports of goods of Chinese origin upon which China has not acquired the export exchange. If this measure is adequately enforced Hong Kong is bound immediately to lose some of the prosperity it has enjoyed as a result of the smuggling trade through Hong Kong between China and the outside world. On the other hand, this loss is offset by indications that Hong Kong's entrepot trade with other Far Eastern areas is recovering.

The adverse factors in Hong Kong's outlook include also the strong likelihood that as soon as peaceful conditions can be achieved in South China and considerable amounts of capital be directed toward new developments, it will be Chinese policy to develop a rival deep water port which will be designed to eliminate the need for any further transhipments at Hong Kong as related to China's external trade. This subject is ever-present in Chinese political thinking.

There appeared to be a strong belief in Chinese business circles that Hong would demand for South China a greater share of all China's quota imports decided upon by VISIT TO CANTON Board at Shanghai. The tendency up to now has been to allot most of the

I went from Hong Kong to Canton by rail on Thursday morning, December 17, 1947, in order to discuss reporting activities and our needs in Shanghai for material for our annual report, also to familiarize myself so far as possible with the developments in the region.

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In Canton Local Views with Regard to the Scope of
of Foreign T. V. Soong's Authority in the South,
to prospects and with regard to Prospects
now, in regard for Improved Business as a result of
Result of His Assignment.

There is much gossip in both Hong Kong and Canton to the effect that T. V. Soong's appointment as Governor of Kwangtung Province with both civil and military powers is a preliminary step toward preparing for evacuation of the Capital from Nanking (should such be necessary as a result of Communist incursions in the Shanghai-Nanking area) to Canton. Dr. T. V. Soong's authority is said to extend over four Provinces, namely- Kwangtung (including Hainan Island), Fukien, Kwangsi and Yunnan. Chinese business contacts of long standing assert that he has the real say for even wider areas including nearly all territory south of the Yangtze. Usually well informed Chinese contacts seem to think it strongly likely that Dr. Soong will invest his personal capital to some extent in promising ventures in Kwangtung and Hainan Island and that any ventures which private interests may wish to make in the region will have to be undertaken with his blessing, so to speak, i.e. possibly in participation with him as a partner.

Both in Hong Kong and Canton there appeared to be considerable opinion in Chinese business circles that, with T. V. Soong's appointment as Governor, affairs would begin to improve. Chinese contacts stated that Dr. Soong had brought some highly capable men to Kwangtung with him, and were optimistic in the belief that affairs of the region would be "looking up" from now on. Some of them say that Nanking has been treating the South as a "colony" up to now, and that prospects for better participation in the trade and economy of the country are now better. On the other hand, there is of course some belief that T. V. Soong was sent to this southern post to head off a separatist or local autonomy movement which appeared to be incipient. The press has publicized Nanking's version to the effect that the policy will be gradually to place provincial authority in the hands of qualified civilians rather than to maintain military commanders in control of Provinces.

There appeared to be a strong belief in Chinese business circles that Soong would demand for South China a greater share of the all-China quota imports decided upon by the Export-Import Board at Shanghai. The tendency up to now has been to allot most of the quotas for capital goods and raw materials to Shanghai, and but a meager quantity to the South. Hundreds of firms have sought recently to qualify by registration with the Canton Regional Export-Import Board as qualified importers in the various categories of Schedule II commodities (mostly raw materials). Some Shanghai Chinese firms are said to be opening offices

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in Canton. Certainly, representatives (in Hong Kong) of foreign suppliers seem to be giving more attention to prospects for increased business in Canton. However, it remains to be seen whether and to what extent these expectations may be realized.

Efforts and Plans for Promoting the Sugar Industry in Canton Delta Region

Last Spring when I visited Hong Kong and Canton a Chinese contact which was endeavoring (as representative of American sugar mill equipment manufacturers) to further a sugar mill enterprise in the Canton delta region, assured me that the enterprise had every promise of success because it included not only provincial and national officials, but national and provincial bankers, other local influential persons, as well as the local bullies or gangsters who necessarily had to be cut in on the partnership if the enterprise were to avoid sabotage and failure. Farmers in the immediate vicinity of the plant would be favorable to the development of the enterprise because they would be paid for cane deliveries in sugar which they could immediately exchange for cash.

These who were to furnish the U. S. dollars needed for purchase of a mill in Hawaii to be dismantled and shipped to China planned to purchase the dollars in the black market. The arrangement was to involve payments in installments up to US\$600,000 when the dismantling of the plant would begin, continuing payments to meet the entire cost of about US\$1,000,000 before final delivery and setting up of the plant for operation. The plan also involved technical experts accompanying the plant, to supervise its re-installment in Kwangtung and to serve in an advisory capacity until the plant could be operated for a sufficient length of time for Chinese thoroughly to acquire the "know-how".

I learned, in December 1947, that while the contract was signed in April 1947, and an option fee of US\$25,000 had been paid to close the deal, the purchasers lost interest over the next few months and no further payments had been made, - hence the expiry date had passed without fulfillment of the payments scheduled.

From the same interests it was learned that a plan has now been laid before Dr. Soong which will involve the investment of an initial amount of US\$20,000,000 over the first five years in a self-liquidating developmental program which is calculated by the end of ten years to involve the installation of 40 percent of the JCS south. The mill, on the sale of

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of 40 sugar mills and 4 refineries, all of which can be paid for out of operations by the end of ten years with a sizeable amount of cash profit to boot. The plan is designed to bring sugar production of the region (mostly Canton delta but possibly including Hainan Island) up to 1,000,000 tons of 2,000 lbs. per annum. By the end of 10 years the promoters estimate that sugar will be worth US\$100 per ton, thus that the industry will have developed to the US\$100 million stage and will supply employment to 500,000 people. (Our agricultural attache believes that this is too ambitious a program involving as it does one crop in one area - to assure a well-balanced regional economy. It would throw a lot of rice land out of production and would involve increased transport problems to bring rice from other areas to the sugar growing area. The Province is already a deficit area in rice production. A great deal of fertilizer would probably be required to achieve the sugar production envisioned. While it would make China much more self sufficient in sugar, the problem of transport for its distribution would also have to be solved during the period of production. There is no indication that the plan has been co-ordinated with that of Formosa or Szechwan, or with sugar production in other parts of the Far East.) It should be noted that the promoters believe the sugar, even at the end of the 10 year period, would be competitive in price in markets outside China, should distribution within China prove a great obstacle at that time. There appears some expectancy that T. V. Soong himself, together with associates and probably with overseas Chinese capital participating, may go into this venture, but it is not known whether he would plan to go into it to the full scale represented as feasible.

Promoters now endeavoring to interest Governor Soong in the early re-development and expansion of the sugar industry are enthusiastic as to the cane yield possible in the delta region, placing it at 80 piculs (of 153-1/3 lbs.) per mow (1/6th of an acre). Five catties of sugar are recoverable from 100 catties of cane, a far greater percentage than is obtained by crude pressing methods employed by farmers. Two types of cane are grown - a so-called light bamboo cane on higher ground and a heavier type on low land. Kwangtung sugar production is now said to be proceeding at the rate of US\$38 million per annum, figured at US\$300 per ton. It costs approximately US \$25 per mow (1/6th acre) to plant and raise a cane crop. The farmers in exchanging cane for sugar at the mill could realize the equivalent of US\$46 per mow on sale for their share of the sugar at current prices (December 1947) were it not for the fact that middlemen and rascals get in between the farmer and wholesaler and grab part of the proceeds such that the farmers profit on operation of the land is only 30 to 40 percent of the \$25 cost. The mill, on its sales of

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its portion of the sugar produced, can realize prices equivalent to between US\$250 and US\$300. It has its own selling agents, some of whom are speculators and hoarders. The net profit of the Shun Tak sugar mill is said to be 36.6 percent after deducting depreciation. Sales of molasses pay the administrative costs of the plant, amounts obtained from sales of the sugar thus being clear profit. The molasses is sold to soy sauce and local pickle factories. The entire current cost of the administration of the Kwangtung Provincial Government and of the Canton Municipality are said to be met from the earnings of this one sugar mill. This, however, would not include the bandit suppression (military) expense of the Province.

Comments on Kwangtung's Pre-war Industrial Development and Recovery thus Far

There is a historical basis for believing that Kwangtung's agricultural and industrial potential can be developed under peaceful conditions. In the early and mid-nineteen-thirties when Chen Chi-tang was Governor an industrialization program was begun. In that period also the long unfinished gap in the Canton-Hankow railway was completed (involving construction of many tunnels through mountains in northern Kwangtung and southern Hunan), thereby making rice supply from the Hunan surplus area to the Kwangtung deficit area easier. By the time the Sino-Japanese hostilities started near Peking and at Shanghai in 1937, some 28 plants had been developed mostly as Kwangtung Provincial enterprises. Fourteen or more were sugar centrals. Other types of enterprises included an alcohol plant, cotton and woolen spinning and weaving, a cement mill, a paper mill, leather tannery, a sulphuric acid works, a caustic soda plant, a fertilizer factory, and a soft drink bottling works. The Canton municipality developed a 30,000 KW electric plant to meet demand for increased industrial power. Some of the sugar mill and other equipment was obtained from Czecho-Slovakian and other suppliers on credit. The power equipment was apparently secured from Germany on promissory notes signed by the Mayor of Canton. British interests were figuring on an iron and steel plant installation on the basis of securing both coking coal and iron ore from mainland sources of Kwangtung Province. This project, however, did not reach the developmental stage. Early operation of some of the plants was unsuccessful, so the provincial authorities (particularly with regard to some of the sugar centrals) turned them over to Dutch and Czecho-Slovakian management, pending the time when the debt to the suppliers could be liquidated and when Chinese managerial ability and efficiency might develop and "squeeze" be eliminated or reduced.

From Chinese contacts it was learned that the former bottling works, the caustic soda plant, the

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paper mill and the cement mill which were functioning in the vicinity of Canton before the war have resumed operations, and were all working in December 1947. One sugar mill with a capacity of 10,000 tons of sugar in the four months annual grinding period was also in condition to operate and has been operating.

In the 1930s banditry was (as now) a serious problem in the Province and it was necessary for the provincial authorities to make heavy demands on the Central Government for military assistance and for bandit suppression funds. There were strong local autonomy tendencies in the South in the 1930s. Kwangtung Province placed a 15 percent import duty upon imports of products both from abroad and from other Chinese areas into the Province in order to protect the new provincial enterprises. The major portion of the new development was destined to be destroyed or badly damaged by Japanese bombing which ultimately extended to the south ending in actual Japanese occupation of the region in late 1938.

Chen Chi-tang's Interest in Kwangtung as ~~Guangzhou~~ ~~City, for~~ a Possible Capital Investor

Chen Chi-tang, former Governor of the Province, is still in Canton and has been negotiating with certain American interests for technical supervision, and other arrangements in connection with a proposed program to be developed apparently along private lines (partly to be financed by himself and partly by the American interests). A representative of the American interests concerned asked me, in Hong Kong, on December 16, 1947, to endeavor to find out during my trip to Canton why Chen Chi-tang had failed to sign basic contracts to which he had agreed in principle a month previously. It seems that the discussions were held over a number of months, that there appeared no points unsettled, therefore that the Americans concerned could not understand why there should be further delay. Apparently the proposed deal involves a master plan for joint enterprise in developing several industrial projects.

In endeavoring to secure some reactions on this situation from Chinese contacts in Canton, I learned that Chen Chi-tang apparently has a number of advisors around him who are turning over part of his capital in quick deals in which the inflationary situation makes for large profits; that so long as such profits are possible there appears little incentive to invest funds in long-range enterprises such as sugar mills and other new industrial plants involving large foreign currency advances and long waits for delivery of equipment, installation and final operation. It also ap-

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peared quite possible that Chen Chi-tang may be engaged in negotiations of the same sort with other foreign interests, which might well delay conclusion of any agreement with Americans; that he may also be waiting to see how the local and national political situation develops and that he may not yet have reached a sufficiently good understanding with T. V. Soong to feel confident in going ahead. Pure conjecture, based on experience, would indicate also the possibility that Chen Chi-tang may be waiting to see whether actual large American aid to China may develop out of the deteriorating China situation in which the projects could be developed with his participation but without risking his own U. S. dollar capital. Any one or all of these situations could well account for the delay plus possibly an intention to ask some further advantage in the mutual deal, best obtainable by keeping the American interests waiting longer.

Interview with T. V. Soong at Canton

In Canton I called upon T. K. Ho, lately Secretary-General (Vice Mayor) of the Shanghai Municipality, for many years a professor and lecturer on economic subjects at various universities in Shanghai, a personal acquaintance of many years standing, and apparently a person who has had the confidence of T. V. Soong for many years, as he is now a chief advisor to Dr. Soong. Mr. Ho asked many rapid fire questions in an effort to elicit my opinion on the outlook with regard to possible hostilities between the United States and the Soviet Union, whether there is any change in the American attitude with regard to aid for China, and regarding American policy in Japan. I was of course unable to give conclusive replies, but the questions illustrate what is patently uppermost in the minds of certain of the leading Chinese at this time.

Mr. Ho sent my card in to Dr. Soong and I was shown in after a very short delay. I had not had occasion to meet him since shortly before his resignation as Premier, in early 1947. At that time he appeared worried, harassed and tired. Now (December 18, 1947) he appears fit, rested, objectively interested in his work, and cheerful. Part of the snap and go exhibited both by Dr. Soong and Mr. Ho may have been due to a chill blast which had swept down from Siberia during the day, bringing the temperature in Canton down to 46 degrees F. Dressed only in ordinary clothes and a raincoat, I was shivering, although I noted that both Dr. Soong and Mr. Ho, dressed in foreign neck suits, were apparently oblivious to the cold despite the fact that the windows of the Governor's large office were open and that no heating devices were in evidence. Upon inquiry I found that both were wearing long woolen underwear. Dr. Soong greeted me cordially and invited

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as for family dinner that evening where I had an opportunity to converse with him after dinner.

The gist of such information as he conveyed to me in conversation was to the effect that his first objective is to rid the Province (Kwangtung) of "bandits and Communists". He stated that the Province had suffered corrupt administration and bad management for a long period and that there is much to be done to rectify past abuses. He also expressed the view that no worthwhile progress can be made in any line until the Province is rid of bandits. He stated that along one strip of river approaching Canton, for example, there are some 14 illegal stations where bandits exact tribute from all passing watercraft, --hence that it is necessary to put these gangs all out of business.

I ventured the view that it would probably be necessary, in view of the Province's basic poverty, to do everything possible to improve the condition of the people, starting with agricultural improvements and adequate food supply as a means of doing away with the causes for banditry. I cited the enormous agricultural productivity which the Japanese had developed in Formosa, which is in the same latitude as Kwangtung, as illustrative of what should be possible in Kwangtung with similar persistent effort over a sufficiently long period, asking what prospects there were for obtaining supplies of fertiliser and of developing proper training of farmers in its use. He said that the nearest phosphate rock is in Yunnan and that only meager supplies of fertilizer can be hoped for from world sources in the immediate future.

Hoping that I might lead the Governor out on his views or plans with regard to industrial development, I inquired whether there is any plan for increasing employment through work projects or other developments. He stated that sections of river dyke which had been washed out in the summer floods were about to be reconstructed and would employ a fair number of people. (A fund of some tens of billions of CN dollars was according to press reports donated by several cities of China, including Shanghai, in mid and late summer 1947, and it appears likely that this fund will be used for the purpose this winter, although the fund was not mentioned. Part of it was contributed from Hong Kong.) Dr. Soong also stated that as no significant industrial recovery or expansion of industry can go forward until Canton has an adequate coal supply, he intends to build a railway to cost CN\$100 billion from coal mines in the northern part of the Province to Canton, emphasizing that this would furnish employment. He vouchsafed no details of this plan, nor did he mention when the work would start or whence and how the equipment would be obtained. As an aside, it was mentioned that the Canton-Hankow Railway has 22 different specifications of rail sections in its restored and have become so concatenated to passing upon the track

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track and heterogeneous rolling stock from other lines. He reiterated the theme that before anything can be done the bandits and Communists must be suppressed-- his present major concern, and one which is being actively pursued, financed, I inferred, by the Central Government. He emphasized that the task, however, is not unduly large, stating that bandits and Communists are estimated to number no more than 30,000. He did say, however, that the importance of an agricultural program could not be overlooked and that he would like the assistance of agricultural experts and would appreciate anything I could do to that end. (Officers in our Consulate General at Canton evaluated this suggestion as merely polite acquiescence to my suggestions, holding that the Governor already has access to agricultural experts in UNRRA and in educational institutions in Canton.)

DR. Soong indicated by several of his remarks that he intends to develop the area under his control "on his own", since he saw little prospect for obtaining American relief or other forms of American aid or participation. He indicated that there is no inducement for private capital to enter the area under present conditions but that after he establishes a peaceful situation plenty of overseas Chinese capital would come in. He stated, furthermore, that he is not even encouraging his friends to go ahead with any private projects until the outlook for peaceful conditions is good. (Officers in our Consulate General at Canton evaluated this statement as shaped to convey the notion that self-help is getting under way in China as a pre-requisite to American aid.)

At dinner, plans for a trip to Hainan Island were being discussed and Dr. Soong invited me to accompany him on the trip by air on the following Sunday, December 21. I accepted the invitation, but on the following morning I received a telegram from Consul General Davis indicating that he was scheduled to leave China December 24. I also learned from Mr. T. K. Ho that the Hainan Island trip was being postponed a day or two. As I wished to confer with Consul General Davis during his last two or three business days in Shanghai, I hastened back to Hong Kong by rail that afternoon, having spent only 28 hours in Canton, and returned to Shanghai by air the next morning. Even though I had so few hours in Canton, I felt that I had acquired much useful background.

Some Aspects of the Banditry Situation

One informant stated that the increase of banditry arises from the reorganization of the Army which involves discharge of those over 30 years of age. Men who have been long in the Army, he contends, are not useful for other purposes. They know only Army methods and have become so accustomed to preying upon the

countryside

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countryside that they are not disposed to settle down to work of a productive sort. Thus, on dismissal they are prone to organize themselves into small bands for robbery, for smuggling operations, for exacting "protection money" from villages, thus exploiting their nuisance value. The Chinese have a saying: "If a man has been a soldier for three years he is no good"; and, also "if he has been a quartermaster in the Army, he should be shot".

Informants stated that Kwangtung Province has been divided into six bandit suppression districts. Many of the bandits now circulating in the Province have previously served under the officers now ordered to suppress them, a difficult situation. Chinese contacts indicate 50,000 is a low estimate of the number of bandits in the Province. They state that there are evidences that Communist underground workers are endeavoring to recruit the bandits and to organize them as an arm of the Communist Army. On the other hand, the provincial authorities will endeavor to enlist as many as possible in working corps for dyke repairs, but because of their characteristics, above stated, the results are not usually promising. Thus, the situation would appear to have many serious aspects, and to be very little different from what it was ten years ago. Banditry conditions are said to be equally bad or worse in Hainan Island, but General Chang Fu-kwei was ordered some months ago to suppress them. Part of the problem has to do with unruly aboriginal tribes. (It took the Japanese several decades to subdue such tribes in Taiwan.)

Rice Purchase from Kuangsi and Smuggling Activities

One usually well-informed Chinese contact stated that Kwangtung Province recently purchased 200,000 piculs of rice from Kuangsi Province for CH\$70 billion, and that the recipients of the amount converted it in black markets into Hong Kong dollars to be spent for goods in Hong Kong to be smuggled into Kuangsi through Macao. The types of goods which are being smuggled from Hong Kong into Kuangsi and Kwangtung are said to include refrigerators, candles, radies, cigarettes and various other consumer goods. A large number of Kwangtung people appear to live on the smuggling trade. A good deal of the rice involved in the above transaction was apparently for the purpose of providing food for the bandit suppression corps in the six districts of Kwangtung.

It is obvious that the whole China subject is poor and uncertain, and dependent upon the political pressure from without, the world political situation and pressures by ourselves etc. In Canton and Hong

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My feeling is that it will take some time for affairs to settle down in Kwangtung, Kwangsi, Hainan Island, and Fukien Provinces, which areas are now said to be under T. V. Soong's control. There is always the question whether peaceful conditions can be realized before capital can safely be invested, or whether the capital must be invested and economic conditions improved in order to bring about the settled conditions sought. Personally, I do not see how bandit suppression can be more than ephemerally successful, unless economic improvement, increased employment, higher production agriculturally and industrially, and some effort at social regeneration, all go along with it. If the people continue to be pinched by poverty, and if the ordinary necessities are difficult or impossible to procure, the conditions seem likely to continue disrupted. Bandits will spring up about as fast as they can be suppressed.

Anyone who is not willing to take very large risks, with his eyes open, would be ill-advised to invest large sums until there is reasonable promise for a return. At present I do not see how that promise can exist. Assurance of continuing American aid over a very long period would alter this conclusion, of course.

I think it will be a good many years before China as a whole can swing from a deficit status to one which would permit the unhampered remittance of profits or of recovered capital amounts. Only a large investment of money from abroad, including repatriation of large amounts of Chinese escape capital, and several decades of careful planning, and good management of plans in a politically free atmosphere, would make this possible, but that very fact seems to discourage foreign private capital investment. So long as emergency situations of large proportions exist I doubt whether either official Washington or the American tax payer will fall in line with demands for financing the long pull in China.

Continuing employment in Kwangtung will depend upon industrial developments which take time, -- hence the immediate outlook is far from promising. In my opinion a thoroughgoing agricultural improvement program is a priority essential to an improved economy.

It is obvious that the whole China outlook is poor and uncertain, and dependent upon the Communist pressure from within, the world political outlook, and prospects for American aid. In Canton and Hong

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Kong there is much talk of making Canton the capital of the country in case of Communist success in gaining wider control in the Yangtze Valley and in occupying the Shanghai-Nanking region especially. But if the latter contingency were to arise, it would appear that the encroachments would continue to move southward and that the ultimate position of Canton itself would not be good. Personally, I feel that real fighting will develop in protection of the Shanghai-Nanking area if threatened. News reports of plans for American aid on a considerable scale, if true, may alter the outlook considerably, as the moral value of such aid alone should be considerable.

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