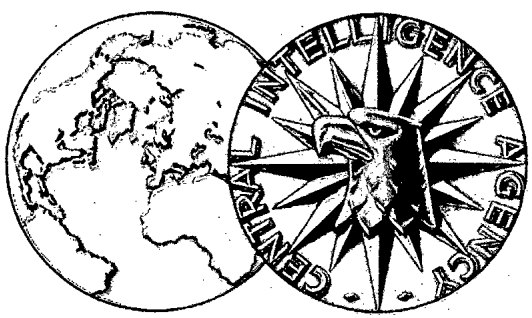


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Co py No. 80

WEEKLY SUMMARY



Number 31

17 DEC 1948

Document No. ~~012~~ /
 NO CHANGE in Class.
 DECLASSIFIED
 Class. CHANGED TO: TS S C
 DDA Memo, 4 Apr 77
 Auth: DDA REG. 77/1763
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H I G H L I G H T S

Chinese Communist forces have, by successfully containing all the effective Nationalist units south of Hsuehou, virtually finished the battle for Central China. While the Communist armies pause momentarily along the north bank of the Yangtze River in order to regroup and resupply, the Nationalist military offices in Nanking are beset with despondency and confusion (see page 10). Nationalist political leaders are similarly afflicted with despair and uncertainty and apparently have not made any systematic plans for the removal of the Government following the loss of Nanking.

The firm intention of the Netherlands Government to proceed unilaterally in the establishment of an interim government for all Indonesia has been deflected, at least temporarily, by the conciliatory letter recently addressed by Indonesian Premier Hatta to the UN Good Offices Committee (see page 11). Meanwhile, the Indonesian Republic is continuing its efforts to win both domestic and foreign support for an eventual showdown with the Dutch.

In Moscow, the Kremlin is currently holding discussions with Satellite economic delegates in what appears to be an effort to bolster Satellite economies under increased Soviet control (see page 5). The serious deterioration of the vital Czechoslovak economy has largely prompted the holding of the conferences at this time.

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SECRET**WESTERN EUROPE****GERMANY**

Soviet Withdrawal Although the USSR in the near future may officially propose quadripartite withdrawal from Germany, such a proposal would be primarily for propaganda purposes in view of the still inadequate Communist control over eastern Germany. Soviet propaganda has persistently advocated such a withdrawal since the Warsaw Conference in May, and the Kremlin may now wish to strengthen this propaganda campaign with an official proposal. Meanwhile, the USSR has created the framework for an eastern German state and has hinted that after its recognition the USSR would sign a separate peace treaty involving a partial withdrawal of Soviet troops from Germany. Implementation of these plans, however, would be preceded by a far more vigorous propaganda campaign in the hope of convincing the German people that the USSR stands ready to keep faith with Germany whereas the western powers insist upon continued occupation. Regardless of what propaganda proposals are made, the Kremlin cannot risk withdrawal of its forces from eastern Germany until the Communist position there has been sufficiently consolidated, probably not before the summer of 1949.

Inflationary Trends Inflationary symptoms now appearing in western Germany may eventually imperil its financial structure, the morale of the population, and the industrial production upon which much of western European recovery depends. The inflationary tendencies are being strengthened by the easy credit policy of the banks and by the large operating deficits of most of the Laender governments and the Bizonal Economic Council. Despite widely-proclaimed intentions by the German governments to economize,

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GERMANY

practically no attempt is being made to bring government expenditures into line with revenues. Credit expansion and the release of blocked accounts since the currency reform have increased the money in circulation from 11 to 14 billion marks. This increased money supply has raised prices, thereby encouraging the reappearance of hoarding, the black market, and pressures for wage increases.

ITALY

Italian Colonies Although the UN has postponed until April discussion of the controversial Italian colonies question, the maneuvering which preceded this decision underscored the difficulty of reaching a generally acceptable solution and has already produced repercussions in Italy and North Africa. In Italy, bitter reaction to the lack of US and British support for the return of the colonies to Italy will probably cause Premier De Gasperi to soft-pedal temporarily his efforts to gain popular support for an Italian bid to join the proposed Atlantic Pact. De Gasperi's pro-west position is already opposed by neutrality-minded left-wing members of his own Christian Democratic Party, as well as by moderate Socialists, extreme leftists, and other nationalist elements. In French North Africa, French support of Italy's claim to a trusteeship over Tripolitania has, by revealing France's intention to maintain indefinitely the colonial status quo, sharply increased Arab nationalist resentment against France.

SECRET**FRANCE**

Budget Deficit The budget deficit problem will require the full attention of the Queuille Government during the next few weeks if it is to survive politically and at the same time further the progress of France along the road to economic recovery. In its efforts to bring expenditures into line with revenues, the Queuille Government will be confronted with: (1) opposing pressures from powerful political, economic, and labor groups for relief by government action; and (2) conflicts between France's immediate fiscal needs and US European recovery objectives. Any sound solution to France's budgetary problem must now take into account US decisions involving such matters as the size of ECA dollar aid for 1949 and French investment program commitments under the European recovery program. Meanwhile, the internal problems of the Queuille Government are best demonstrated by the divergent official policies of two of its political supporters, the Radical Socialists and the Socialists. The Radical Socialists demand, among other things, massive cuts in government expenditures, a lessening of governmental controls over business, and lowered taxes to encourage production. The Socialists, in contrast, oppose reduction of the civil service, seek stronger government control over prices and production, and urge a re-distribution of the tax burden, which would mean higher taxes for business. Confronted with the task of retaining the support of both these opposing forces and at the same time reducing the budget deficit, the Queuille Government must either find a compromise course or face a vote of non-confidence from its own dissenters as well as from the Communists and Gaullists.

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SECRET**E A S T E R N E U R O P E**

Satellite Economy **Strengthened Kremlin control over the Satellite economies will probably result from current discussions in Moscow between Soviet officials and economic delegates from all the Satellites except Albania. The presence of top political and economic leaders from Czechoslovakia and rumors of an impending visit to Moscow by a high-level Polish delegation reflect the importance the Kremlin attaches to the development of the industrialized economies of Czechoslovakia and Poland. In fact, the rapid deterioration of the highly-important Czechoslovak economy since the February coup may have prompted the Kremlin to consider immediate drastic steps to alleviate the ailing economic situation in the Satellite area. Realizing that two years of ruthless Soviet exploitation of Satellite resources, coupled with a curtailment in east-west trade, may finally be threatening economic dislocation in eastern Europe, the Kremlin may have decided to exercise more direct control over the economies of the Satellite nations and to implement a more closely integrated plan for their economic development. The USSR is probably also motivated by the necessity to improve the economy of eastern Europe in order to counter the growing economic recovery in western Europe.**

SOVIET UNION

Israeli Policy **Although the Kremlin is unlikely to alter its basic policy toward Israel before the 25 January Israeli elections, the recent marked change in Czechoslovakia's earlier friendly attitude toward Israel may reflect an impending change in Soviet tactics in the Near East. Czechoslovak authorities have cancelled the Israeli military training program and the Government has allegedly forbidden unscheduled**

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SECRET**SOVIET UNION**

air flights to Israel. This latter move, by curtailing clandestine arms shipments, represents an obvious financial loss to Czechoslovakia and was probably dictated by the Soviet Union. The USSR may estimate that the establishment of Israel as a disruptive force in the Arab world has now been accomplished and that further military aid to a country of basically pro-western sympathies would ultimately prove prejudicial to Soviet interests in the Near East. Nevertheless, the Soviet Union, in the faint hope that Israel's pro-western alignment may change after the 25 January Israeli elections, has not yet altered its basic policy of politically supporting Israel.

GREECE

Guerrilla Activities Although neither the Greek Army nor the guerrillas have undertaken large-scale operations, they have continued their efforts to search out the other's weaknesses and to maneuver for position. Significantly, guerrilla logistics appear to be as satisfactory as ever. Supplies are being trucked into the Vitsi triangle from both Albania and Yugoslavia, and the Grammos area, laboriously cleared by the Greek Army last summer, is again serving as a supply link between Albania and central Greece. Czechoslovak 75 mm. Skoda artillery pieces have been found among recently captured guerrilla equipment.

The guerrillas have meanwhile continued their propaganda efforts. In the battle zone, they have begun to use artillery to fire their leaflets. Behind the front, Markos' radio broadcasts to the Greek Army are emphasizing conciliation and urging the formation of unit "reconciliation committees" which would act to stop the war. Although the Greeks cannot believe that Markos honestly wishes a reconciliation with the

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GREECE

Athens government, the successful guerrilla performance at Grammos and Vitsi is causing many of them to wonder if they were right a year ago in believing that Communist "peace" efforts were prompted entirely by weakness.

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SECRET**N E A R E A S T - A F R I C A****INDIA-PAKISTAN**

Military Operations The impending departure on 15 January of General Sir Roy Bucher, the British officer now commanding the Indian Army, increases the possibility of full-scale open warfare between India and Pakistan. General Bucher has exerted a moderating influence on Indian military policy and, in cooperation with his British opposite number in Pakistan, has held to a minimum direct encounters between the Indian Army and Pakistan's regular troops in Kashmir. His successor, Lieutenant General K. M. Cariappa, is reportedly vain, temperamentally unstable, and lacking in sound military judgment. In attempting to give palatable military advice to the Indian Government, he may fail to give due consideration to all of the military and political factors involved and may use his new position to seek the personal glory that a speedy termination of the Kashmir campaign would provide. The need for a prompt political solution of the Kashmir problem is underscored not only by General Cariappa's appointment but also by the prospect that weather conditions will be more favorable for military operations after 1 January 1949. Even if India does not start a clear-cut offensive operation, increased Indian pressure may cause an already nervous Pakistan to launch a "preventive" offensive.

TURKEY

Arab Relations Turkey has demonstrated the seriousness of its desire for an Arab-Zionist settlement by its willingness to serve, at the risk of incurring Arab displeasure, on the UN's three-power Palestine Conciliation Commission. Already confronted with hostile powers

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SECRET**TURKEY**

along a considerable portion of their frontier, the Turks have necessarily placed great stress on maintaining good relations with their Arab neighbors. Turkey voted against the partition of Palestine in 1947 and in its subsequent actions has been careful to avoid any steps which might provoke Arab hostility. At the same time, however, Turkey has been concerned over the deleterious effect the Palestine dispute has had on Near East stability and the resulting opportunities for Soviet agitation. During the past year the Turkish Government has sought on a friendly, informal basis to persuade the Arabs that their interest would best be served by a Palestine settlement. Now Turkey, along with the US and France, will have to take the blame for any acts of the Commission to which the Arabs object (see page 14).

SOUTH AFRICA

Government Rift A growing split between the Nationalist and Afrikaner Parties has weakened Prime Minister Malan's coalition government and raises the possibility of new general elections. The rift has developed as a result of differences between the leaders of the two parties over the allocation of seats for the March provincial elections and over constitutional questions connected with the bill for depriving colored persons of representation in the Assembly. Prime Minister Malan apparently has the choice of risking a new election or of paying the price for continued cooperation of the Afrikaner Party, led by N.C. Havenga. In the case of new elections, Havenga might join with Smuts' United Party, a development which has been facilitated by the death of Smuts' successor-designate, J. C. Hofmyer.

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SECRET**F A R E A S T**

Economic Conference The recent, unharmonious meeting of the UN Economic Commission for Asia and the Far East (ECAFE) chiefly centered around: (1) renewed efforts by Asiatic delegates to secure US backing for a "Marshall Plan" for Asia; (2) continued discord between colonial and anti-colonial powers; and (3) Soviet attempts to exploit these differences. The US-Dutch attempt to bar the Indonesian Republic from membership in ECAFE was soundly defeated by an 8-2 vote. US refusal to sponsor a "Marshall Plan" for Asia has created an anti-western sentiment which the USSR is exploiting, along with the quarrel over seating the Indonesian Republic, as proof that "imperialist western nations" seek to keep the Asiatic economy in a "semi-colonial" state. On the other hand, the USSR itself suffered a propaganda defeat when the Commission emphatically voted down a Soviet amendment to an ECAFE resolution favoring import of foreign capital.

CHINA

Military Debacle Despondency and confusion pervade Nanking military offices as complete military defeat comes nearer, and the Chinese public, long fed a diet of "victories" and "strategic withdrawals," must soon be confronted with the stark fact that shattering reverses are being suffered by the Nationalist forces south of Hsuchou. The position of the encircled Nationalist forces southwest of Hsuchou and west of Kuchen is virtually hopeless. Although the Pangfou Nationalists will probably attempt to withdraw south of the Yangtze river, it is doubtful that many of these forces can be salvaged to bolster the weak Nanking defenses. The only chance for a breathing spell for the Nationalists lies in the possibility

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SECRET**CHINA**

that the Communist armies will have to pause to re-group and replace expended materiel. In North China, the Nationalist position is also deteriorating rapidly. Fu Tso-yi has withdrawn from most of his outlying positions to the cities of Peiping and Tientsin, and Communist advance guards have already reached the outskirts of these two Nationalist bastions. Present indications are that a political, rather than a military, decision will effect a transfer of power in the area.

Manchurian Autonomy Hints in the Chinese Communist press of Dairen that Manchuria will have a special status, under Communist control, are substantiated by the Communist radio announcement of a new, unified currency for all of "liberated" China except Manchuria. Although such special status for Manchuria may be motivated, in part, by a desire to keep the relatively unstable north and central China economy from debilitating that of the Manchurian area, the special status arrangement may also be the first step in setting up a Manchurian People's Republic similar to that of Soviet-dominated Outer Mongolia. The Dairen press release carried plans for setting up the judicial, administrative, and executive departments of a "People's Republic," and commented that the Communist Party must completely direct the affairs of the government.

INDONESIA

Dutch Plans Dutch plans to proceed without the Indonesian Republic in the establishment of an interim government for all Indonesia have been delayed at least temporarily. The conciliatory letter addressed by Premier Hatta of the Republic to the UN Good Offices Committee has, by making the Dutch attitude appear stubborn and arbitrary in contrast, given the Dutch Government pause. Public sen-

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INDONESIA

timent in the Netherlands strongly favors a move by the Government to push ahead with its Dutch-sponsored federal movement in Indonesia. The Government will encounter resistance from its constituents if, in response to the pressure of the UN and world opinion, it delays this program further or renews negotiations with the Republicans.

Meanwhile, the Indonesian Republic is attempting to marshal both internal and foreign support for an eventual showdown with the Dutch. The Republican Government claims that, if forced to flee by Dutch police action, it will move to southern Sumatra and, if necessary, will establish a government-in-exile in India. Indian support in such an eventuality may also include denial to the Dutch of air landing rights and an embargo on all Dutch shipping. The Republican government is also intensifying its efforts to win the support of non-Republican nationalists.

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WESTERN HEMISPHERE

ARGENTINA


Economic Policy Argentina's failure to take effective measures to relieve its unfavorable economic position apparently is resulting from a conflict between leading personalities of government and finance. That Peron permits such behind-the-scenes maneuverings to nullify government action on such a vital matter--adjusting Argentina's foreign trade policies to what is becoming an international buyers' market--indicates that Peron does not yet consider economic deterioration to be an immediate threat to his internal position. (His party obtained a strong majority in the 5 December elections.) As Argentina's internal economic crisis becomes more acute, however, Peron may be forced to intervene in these backstage maneuvers to the extent of initiating negotiations leading to a broad understanding with the US.











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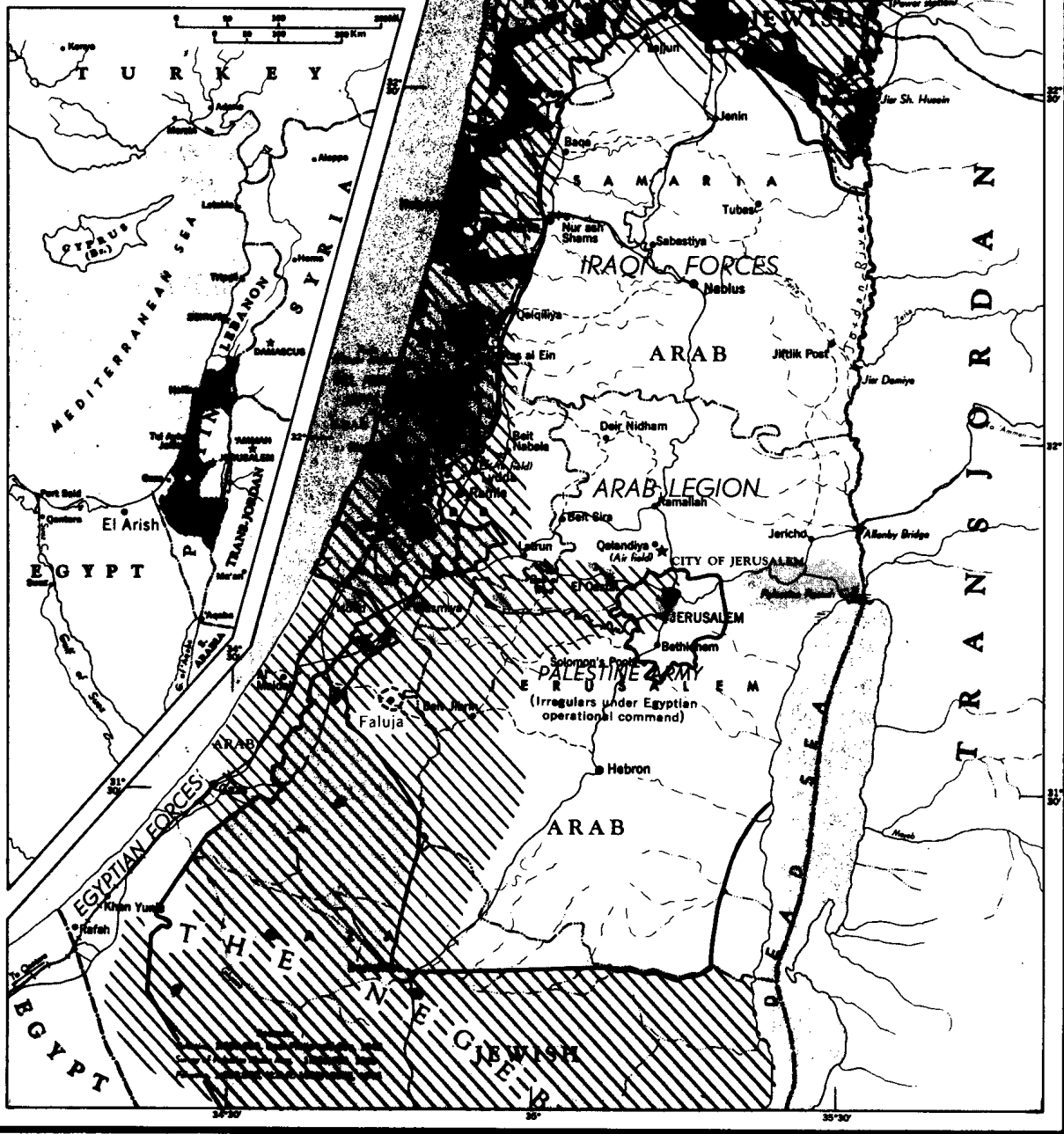
15 December 1948

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PALESTINE

 Approximate area under Israeli civil or military control, 15 December 1948

-  Partition Boundary (as accepted by the United Nations General Assembly, Nov, 1947)
-  International Boundary
-  District Boundary
-  Standard Gauge Railroad (4'6 1/2")
-  Narrow Gauge Railroad (3'5 1/2")
-  First Class Road
-  Second Class Road
-  Oil Pipe Line
-  Intermittent Stream
-  Jewish Communal Area



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SECRET**PROSPECTS FOR PALESTINE CONCILIATION COMMISSION**

Last-minute adoption by the General Assembly of an almost completely emasculated resolution on Palestine reflects: (1) the Assembly's unwillingness to define (as it did in the 1947 partition resolution) the terms of any solution which would require forceful imposition; and (2) a consequent decision to permit the situation to work itself out along the lines of the existing Israeli fait accompli. After events had pretty well run their course in Palestine, the GA finally adopted a resolution which simply established a Conciliation Commission (to be composed of representatives from the US, France, and Turkey) to assist the Arabs and Jews to achieve a settlement. The GA did not recommend a basis for settlement, and the Commission will be confronted with almost all of the multiple difficulties faced in turn by last winter's Palestine Commission, last summer's Truce Commission, by Count Bernadotte, and by Dr. Bunche, the present Acting Mediator.

Although the Provisional Government of Israel considers the present as a propitious time to negotiate a favorable settlement, most of the Arab governments concerned are unwilling to enter into early negotiations. The Lebanese Government refuses to talk while Israeli troops occupy areas of southern Lebanon. The present political crisis in Syria was caused in part by the failure of the government's Palestine policy, and it is extremely unlikely that any new government will either desire or be permitted to negotiate with Israel. Iraq still maintains about 15,000 troops in central Palestine, and the Iraqi Government continues to advocate concerted opposition to Zionism by the Arab states. The Iraqi Government does not dare bring home an army that has failed to defeat the Zionists; it is difficult, therefore, to imagine on what basis Iraq could negotiate with Israel. Egypt refuses to negotiate while Israeli troops continue to control the Negeb, occupy Beersheba, and hold as virtual prisoners an Egyptian brigade at Faluja.

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There is little doubt that Abdullah of Transjordan would like to negotiate a broad settlement with Israel. A local armistice in Jerusalem between Israeli and Arab Legion officers is working smoothly, and Abdullah has been urged by the recent conference of Palestinian Arab notables at Jericho to proclaim himself joint ruler of Arab Palestine and Transjordan. On the basis of these two developments, agreement between Israel and Transjordan might appear to offer hope for a broad settlement in Palestine.

Other members of the Arab League, however, strongly oppose the Jericho resolution. The Kings of Egypt, Saudi Arabia, and Yemen, Azzam Pasha (the Arab League secretary general), the influential council of Ulemas of Al-Azhar University at Cairo, and the governments of Syria and Lebanon have expressed their disapproval. Unless this opposition is modified, it is doubtful whether Abdullah will act, despite endorsement of the Jericho resolution by the Transjordan Parliament. Even if he were to assume the Palestine crown and attempt to negotiate with Israel against the express wishes of other League members, he would probably gain little territory initially. His Arab Legion occupies the Old City of Jerusalem and a relatively small area bounded by Ramallah on the north and by Hebron on the south. Abdullah is therefore in no position to negotiate either the Negeb or the Galilee issue. Moreover, he is not likely to receive encouragement at this time from the UK, which is anxious to avoid responsibility for any development opposed by most of the Arab League and also realizes that Abdullah's authority in Palestine would be greatly limited. Eventually, however, the other Arab states may decide that it would be to their best interests to withdraw and let Abdullah bear both the onus of treating with the Israelis and the responsibility for subsequent developments in Palestine.

Thus the Conciliation Commission faces a difficult task in trying to bring Arabs and Jews together in view of: (1) the absence of any basis for reaching a settlement; and (2) the refusal of most of the Arab states to negotiate with Israel. In

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effect, it will probably revert to a truce commission. It may be able to extend the present Jerusalem armistice into a demilitarization agreement for the area and establish an effective armistice in the Negeb and on the Iraqi front in central Palestine. However, it will probably have to ignore the question of boundaries and the continued presence of Israeli forces in southern Lebanon and Arab armies in Palestine.

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MAO TSE-TUNG, CHINESE COMMUNIST LEADER

Communist Leader Mao Tse-Tung, for 15 years the foremost champion of Chinese peasantry, has become the most powerful political leader in Asia. His stubborn, intelligent leadership is principally responsible for the steady growth of the Chinese Communist Party whose armies apparently are winning the final battle for control of the Chinese nation.

Mao's first ten years in the Chinese Communist Party, which he helped to found in 1921, were marked by obstinate insistence that Communism in China could only be achieved through an organized and armed peasantry, evolutionary gradualism, and moderate land reform. With the expulsion of the Communist Party from the Kuomintang, the "rightist" opposition to Mao was deposed. Following the failure of Li Li-san's "proletarian revolution" in 1931, Mao's advocacy of a peasant base for Chinese Communism became the Party's official program. To adapt Marxist Communism to his concept of China's needs, Mao continued to build his party and his army upon the base of a strong peasantry. His doctrine continues to include a moderate land policy and, for the present at least, cooperation with non-Communist elements and a conciliatory attitude toward western nations.

Although Mao's flexible pragmatism in adapting Communism to the Chinese situation has led many western observers to believe that his allegiance to Communism is only tentative, his recent statements in the Cominform Journal indicate that Mao will probably remain faithful to the USSR in all major issues. The possibility exists, however, that Mao at some future date will resist Soviet efforts to annex either Manchuria or the border provinces or to gain greater direct control over the Chinese Communist Party. Moreover, the return to Manchuria in 1945 of Li Li-san, an aggressive supporter of Soviet interests, might suggest that the Kremlin desires to strengthen Soviet control over the leadership of the Chinese Communist Party.

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