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INTELLIGENCE HIGHLIGHTS -- WEEK OF 13 JANUARY -- 19 JANUARY - 1998

GENERAL

New Zealand representative to UN criticizes the UN.

New Zealand's representative to the UN, Sir Carl Berendsen, has indicated to US representatives to the UN that he has reported to his Government that the first meeting of the Interim Committee was a "complete fiasco" and has criticized the US for failing to supply the interest and leadership expected by the members. Berendsen attaches little importance to the Committee except as a "backstop for failures by the Security Council." He feels that it will accomplish little on the veto question.

The only value he sees in the Interim Committee is that it might contribute through debate to a public understanding of the veto problem and that it might possibly become a bridge between the present ineffective UN and a future organization for collective security without Russia. However, should such an organization develop, Berendsen foresees two security systems competing for dominant power and ending in catastrophe.

Southeast Asia League plans mid-February meeting.

The Southeast Asia League, which was formed in Bangkok last September by "representatives" of Siam, Vietnam, Laos, Cambodia, Indonesia, Malaya and Burma, is reported as still planning to hold a mid-February meeting in Bangkok. The League, an unofficial association, apparently aims toward the establishment of an official Southeast Asian Federation which would represent the governments of the area. Its original motivation seems to have come from the Free Thais and "Free" Indochinese groups, but now that the Free Thai-dominated government of Siam has been ousted, the Siamese members of the League have dropped out and the Indochinese groups have assumed leadership. If the present Siamese Government proves hostile it is likely that the League will move to Rangoon where it has already been invited.

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JAPAN

Inflation in Japan. The progressively increasing issue of currency in Japan is leading to fears of uncontrolled inflation. By 21 December 1947, note issue had reached the staggering figure of 219,142,000,000 yen. This was just about double the note issue at the beginning of the fiscal year on 31 March 1947, and compares with approximately 12 billion yen in circulation in March 1946. It is reported that a note issue of 300 billion yen is expected by April 1948.

With industrial production at only about 40 percent of the 1930-34 level and showing little signs of substantial improvement, the increasing currency circulation is causing deep concern. This is particularly aggravated because of a large part of the increase in circulation is passing into the hands of the urban merchants, who are more likely to continue the notes in circulation, instead of the farmers who would be more likely to hoard the notes thus keeping them out of circulation.

Contributing to the inflation is the deficit financing of the government. The general account of the budget is approximately in balance but this is a misleading picture. Special accounts and prefectural balance are far in arrears. Demands by the Reconstruction Finance Bank whose major purpose is the financing for rehabilitation is also causing a substantial increase in currency.

Japan is undergoing a controlled inflation. Until the present time, this inflation has been serious but not as yet catastrophic. Although there has been some weakening of faith in the currency, flight of currency to available goods has not as yet become extraordinary. However, with prospects of increasing note issue, the danger of currency collapse increases. Unfortunately, there appears to be no immediate outlook for substantial output of goods which can "soak up" the currency. Unless the Government renders more effective its inflation control, Japan faces an economic crisis.

Fifty-one new commoners. One of the historic events of postwar Japan took place recently when 51 members of 11 Japanese Imperial families became commoners, thereby undoing another of the steps taken by Japan's empire builders. At the time of the Meiji Restoration (1868) the crown rested on the 16 year old Meiji, son of the Emperor and a commoner. Despite the common Imperial practice of adoption and the keeping of concubines, there were no other members of the dynasty who could ascend to the throne in the case of Meiji's death. Japan's empire builders needed a strong dynasty, so in addition to promptly marrying off the boy emperor, eleven families were raised to Imperial status. Nine of these families were descended from Mr. Fushimi Kuniye whose vague claim to Imperial status was based on descent from the 102nd Emperor, twenty-two generations earlier.

Japan's expansionists used these families to further their plans for aggression. The daughter of the last Tokugawa Shogun was married to a prince, thus binding the Shogun and his followers to the throne. After the Government had suppressed the civil war launched in 1877 by the Satsuma Clan in Kyushu and its cohort, the King of the Ryukyus, daughters of the head of the Clan and the King were married to Princes. Nagako, granddaughter of the King of the Ryukyus, became Hirohito's Empress. After the annexation of Korea, the heir to the throne was brought to Japan and married to an Imperial Princess as a means of helping absorb Korea into the Empire.

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The Imperial "second string", who have led secluded lives as virtual prisoners of the empire builders, are now thrust out to earn a living, shorn of their titles and most of their wealth. Those with military experience are subject to the same purge directives as other commoners. Members of the group have apparently had ambitions to replace the Elder Statesmen and the Privy Council. Being individuals of mediocre ability, however, it is not anticipated that the new commoners will become powers behind the throne.

KORSA

Significance of new Rightist "National Council". Recent reports indicate that Kim Koo has abandoned his intrigue for a coalition with North Korean leaders for the establishment of a unified Korean Government and has joined forces with Rhee Syngman in the latter's clamor for the early election of a separate South Korean Government. Kim's "trial-balloon" effort at a North-South "coalition" indicated that solid Rightist support for this move would not be forthcoming. Hence, Kim was able to perceive that he would not have sufficient strength to oust the Northern Communists from the future "coalition" government. Kim then apparently decided to merge his "National Congress" with Rhee's "Representative Assembly" in the formation of the new "National Council". The probable aim of this new Rightist coalition is to cooperate with the UN Commission in an attempt to induce the Commission to hold immediate elections in South Korea alone in the probable event of Soviet refusal to cooperate. Behind this support, however, is the thinly-veiled threat to the US, that if Soviet obstinacy results in protracted delay of a settlement on the part of the UN, the "National Council" will constitute itself the legal government of South Korea and agitate for immediate recognition.

It is evident that the internal political situation in South Korea is such that the US will be forced to hold an election in the near future, with or without UN observation. Any election held in South Korea within the calculable future will constitute nothing more than a confirmation of the "National Council's" claim to governmental authority.

The US will thus be in a position of authorizing the establishment of an independent South Korean Government for whose actions it cannot be responsible, and whose qualifications for safeguarding US interests in the area are certainly debatable. Indications are that Rhee would nominally head the government as "President" while Kim would wield effective control. Both have unbounded ambition and the latter is reportedly intriguing for Chinese support in his aspirations for eventual annexation of North Korea. This intrigue is apparently taking the form of offering immediate military aid to Chiang Kai-shek in Manchuria in return for future Chinese assistance in the conquest of North Korea.

Regardless of the practicality of these reported aims, it is certain that the future Rhee-Kim coalition will have a decided penchant for political adventures. Hence any overt US connection with, or commitments to, such a regime will be fraught with considerable hazard.

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CHINAMilitary

A full-scale Communist effort at Mukden is not expected to develop before late March or early April when the food shortage in the city will be at its worst. The Communists, still disposed in a broad arc south and southwest of Mukden, are now continuing their efforts to keep the city isolated and disrupt its economy. The Communists are further aided by the evident dissension and staff confusion in Chen Cheng's Manchurian headquarters. The feud between General Chen and the Whampoa Clique broke into the open again when an entire division, presumably Chen's, was wiped out as two Whampoa-commanded divisions were slow to reinforce. Nationalist sources admit losses totalling 25,000 for the past three weeks.

At a conference in Mukden--noteworthy for the presence of the two ex-Manchurian leaders, Hsiung Shih-hui and Tu Li-ming--the Generalissimo was said to have scolded Chen Cheng for his inefficient leadership. He also insisted that Changchun and Kirin be defended and that the Peiping (Peiping-Mukden) railroad be opened.

In Hopeh, the government claimed several victories in the Paoting area, while the Communists crossed the Machang Canal south of Tientsin and threatened the Tangku area. Fighting continues in both sectors. Shansi governor, Yen Hsi-shan, was reported on the move for the first time in months as his units advanced toward Linfen, which is surrounded by the Communists. At the week's end Nationalist units were still trying to open the Pinghan railroad between Chenghsien and Hankow. Communist units south of the Lunghai railroad remained comparatively quiet.

Internal Political

Some results of the election of National Assembly members have been announced by the National Government, with returns thus far indicating that the expected landslide for the Kuomintang has materialized. However, the claim by the National Government that 150 million votes were cast may be discounted. The actual number cast is difficult to estimate, but probably totals less than one-third of the government's figures. While the election might have had some effect in stimulating the political awareness among some Chinese groups, it is apparent that the arbitrary method of selection of candidates, wide-spread corruption and election irregularities, and the use of intimidation and family and local claims to personal allegiance, all testify to the election of Kuomintang-dominated National Assembly which is far from representative of public opinion in China.

Chinese newspapers in Hong Kong published lively comments on the formation of the "democratic revolutionary group". Papers controlled by the Kuomintang charged that the group was Communist inspired and directed, while the opposition professed to see in the group a revolt of liberals against the tyranny of right-wing elements. The Hong Kong press also gave considerable space to news about the opening of the Democratic League's third plenary session, but this development was ignored on the mainland, except for attention given it by a Soviet-owned Shanghai daily. The official

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Kuomintang Chung Yang Jih Pao finally commented on the Christmas statement of Mao Tse-tung, leader of the Chinese Communist Party, which had been up to that time ignored in news and editorials. The account, however, was boiled down to two paragraphs and only two proposals (the suggestion of a "Comintern" for the Far East and the proposed correction of "erroneous" Chinese Communist thinking) were given mention, after considerable distortion. This inadequate summary was labelled the new "traitor line."

External Political

A Soviet source in China has revealed that a new mass repatriation of Soviet citizens will take place in the spring of 1948 and will be followed by similar official offers of repatriation to Poles, Czechs, Yugoslavs, Rumanians and citizens of other Soviet satellite states. However, Tass is to remain at full strength, according to this report, and the activities of Torgpredstvo will be increased by the unofficial participation of representatives of the satellite states. It has been learned from another Soviet source that a Torgpredstvo office recently has been set up in Canton, marking a major penetration of South China by the Soviet trade organization. According to the same source Torgpredstvo's representatives are no longer permitted to operate in Hong Kong.

The eviction by the Hong Kong authorities of a number of Chinese squatters from the area formerly known as the "Kowloon Walled City" (justified by the British on health and safety grounds) which resulted in protests to the British Embassy from the Nanking Foreign Office early in December and January, has become the excuse for rioting in Canton on 16 January, and demonstrations in Shanghai on the 18th. The rioters in Canton, composed of students, labor unioners and hoodlums, invaded and burned the British Consulate and a number of British commercial houses. Four non-official Britons were slightly injured.

Governor T. V. Soong of Kwangtung informed Minister-Counsellor Clark that he and the Governor of Hong Kong had agreed to "let sleeping dogs lie" with reference to the Kowloon evictions. He blamed the Communists for the outrage but expressed abject apologies to the British Consul General, assumed responsibility for the protection of British lives and property, offered to pay compensation for damage, and promised severe punishment of the offenders.

The British Ambassador protested the outrage, eliciting a statement of regret from the Chinese Government and an order to local authorities to protect the British.

In Shanghai mobs of students and others demonstrated before the American and British Consulates shouting charges of "imperialism", but were prevented from entering the premises by strong police guards.

These incidents at Canton and Shanghai have all the hallmarks of inspired outbreaks. Legalistically speaking, the Chinese Government may be correct in claiming jurisdiction in the former "Kowloon Walled City" in

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conformity with a provision in the Sino-British Convention of 1898. However, the Hong Kong authorities subsequently denied this "right" because of the resistance of Chinese armed forces to the British occupation (in 1899?) of the New Territories leased under that Convention; and as the Chinese Government appears to have tacitly acquiesced in that denial during the intervening period, the British may be putting forward a claim of prescriptive right in that area. Generally speaking, the Chinese are basically xenophobic and therefore receptive to charges of "foreign imperialism". This is true, especially, of student groups and other nationalist organizations. So it would seem that this outbreak has been promoted by the skilful transformation of their indignation against the delinquencies of the Nationalist Government into resentment of "British Imperialism". Doubtless anti-Americanism could be engendered by the same play on prejudice and with the same facility. Therefore, the real motives for the agitation against the British action in Kowloon and its unpleasant denouements must be sought in (a) the desire to distract the popular discontent from the foibles and maladministration of the Nationalist Government and to avoid a demonstration against that government; (b) the desire of political foes (including the communists) to embarrass Chiang Kai Shek and his immediate entourage, especially T. V. Soong, the Governor of Kwangtung; (c) the dissatisfaction and jealousy of outside elements over the smuggling traffic from Hong Kong with its large profits.

The disturbances at Shanghai, including the demonstration before the American Consulate, serve to support the belief that communists have seized on the occasion to disconcert the Nationalist Government. However, American officials at Canton disagree with the assertion that communists had instigated the disturbances there, for the following reasons: (1) students had given warning that "will of the people was going to be expressed in a determined manner" and advising that British officials should be evacuated to Hong Kong; (2) absence of precautions by Chinese authorities, and delay in arrival of substantial police and troop reinforcements; (3) American property and flag carefully respected, with exception of residence of American Assistant Military Attache, which caught fire from adjacent British buildings; (4) British in Hong Kong have been playing along with communists; (5) British Consulate prime objective, unlike Communist type of action; (6) agitators were from government organizations and Canton municipality deemed to be sufficiently Kuomintang dominated to thwart any large communist demonstration.

Economic

Currency. The Government raised the official US dollar exchange rate from CN \$90,000, which was established on 30 December 1947, to CN \$115,000 on 12 January 1948. The Shanghai US \$ blackmarket rate opened this week at CN \$152,000, then fluctuated widely reaching a new high of CN \$210,000 before leveling off at CN \$180,000 on 17 January 1948 following reported arrests of 200 blackmarket dealers.

The government now requires all banks and insurance companies to submit detailed daily reports on all trade loans.

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Prices. Commodity prices continue to rise in spite of police controls and the government's tight money policy. After rice hit an all-time high of CN \$1,580,000 per picul, Mayor Lu of Shanghai placed a ceiling of CN \$1,500,000 per picul on this essential item. Rice dropped on 16 January 1948 to CN \$1,400,000 following the arrival of large shipments at Shanghai. Higher prices are expected before the Chinese New Year (10 February) settlement period is over.

Budget. The National Government approved an interim budget covering operations for the first six months of 1948. Expenditures are fixed at CN \$96 trillion with revenue at CN \$58 trillion. No disclosure was made as to how the government proposes to meet the deficit of CN \$38 trillion; it is apparent, however, that strong reliance is placed on US aid. The announced 40% of expenditures for military purposes is considered unrealistic in the light of the approximate 75% spent in 1947. The new budget provides a pay rise for government workers, but cuts departmental staff forces by 25%, a reduction long ordered but never carried out.

Industry. The National Government in taking over the cotton industry has ordered the registration of all raw cotton in Shanghai. It is reported that 80% of the stock is being hidden and that the farmers are holding back more, all of which reflects the Chinese businessman's lack of confidence in the government.

Reparations. The Chinese Government reports that the first shipment of Japanese reparations, including 17 munitions plants, and 8,200 machines, has left Yokosuka, Japan, for Shanghai.

Smuggling. Provisions of the Hong Kong-China anti-smuggling agreement have been announced as follows: (1) Hong Kong is to restrict loading of vessels going to China to certain designated centers so Chinese Customs will have the liberty to check and inspect cargoes; (2) Chinese Maritime Customs are to establish Hong Kong centers to maintain a customs staff to collect or assess Chinese customs duties in advance; (3) Hong Kong harbor master is to refuse clearance to any Chinese port save those agreed upon; (4) Chinese customs are to be permitted to enter certain areas in Hong Kong waters for patrol examinations; and (5) Hong Kong is to restrict the export of goods to China across the northern land frontier at designated points.

Transportation - Shipping. The Ministry of Communications has approved an increase of 70% in fare and transportation rates effective 15 January 1948.

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BURMA

The strength of Burmese Communist groups is one of the major problems facing the newly-independent Government of Burma since, in some parts of central Burma, these groups have become strong enough to challenge governmental authority and administration. Some light has been shed on the depths of understanding of Communism and the willingness to support it on the part of the Burmese, eighty per cent of whom are agrarian. Recently a Burmese Communist when questioned on the principles of Karl Marx answered that they were: (1) no rent; (2) no taxes, and (3) a big price for rice.

PHILIPPINES

Constabulary begins new drive. Nineteen companies of the Philippine Constabulary, directed by Brig. Gen. Castaneda, launched a new offensive on 12 January aimed at the capture of Luis Taruc, leader of the dissident agrarian Hukbalahap. This new drive, labeled "Operation Mystery," calls for fifteen to thirty days of field operations. Launching of the new offensive followed closely Taruc's recent refusal to surrender thus apparently ending current attempts of administration leaders to solve the law and order problem by negotiation.

Surplus ammunition purchased from US. President Roxas has accepted US terms in connection with a purchase of approximately 92,000 long tons of surplus US ground and aviation ammunition through the Office of the Foreign Liquidation Commissioner. Terms of the contract, which was signed in Washington on 19 January, are not yet available but earlier US action approving the transfer specified that the Philippine Government agree (1) to demilitarize the ammunition; (2) that none of the ammunition will ever be delivered to any other government in a non-demilitarized state. The Philippine Government, subject to the terms in a formal contract, intended to salvage the powder for industrial uses in the Philippines and planned to sell the metal scrap to private US firms.

Application of \$88 million Export-Import Bank loan authorized. President Roxas has authorized Ambassador Elizalde to apply for a 30 year loan of \$88 million for a power development program which was proposed in a survey made recently by Westinghouse Electric Company. This loan is the first in a series to be sought for a long range Philippine industrialization program.

NEW ZEALAND

The Soviets have recently purchased between 20,000 and 25,000 bales of wool from New Zealand. Before World War II the USSR did not appear in trade statistics.

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