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OFFICE OF REPORTS AND ESTIMATES, CIA
FAR EAST/PACIFIC BRANCH

INTELLIGENCE HIGHLIGHTS NO. 15
WEEK OF 17 AUGUST - 23 AUGUST 1948

SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

New moves to stimulate trade between Japan and the sterling area will play a significant role in Japanese economic recovery (page 8). The British are disturbed by the Japanese implementation of SCAP's "suggestions" regarding the rights of government employees (page 4).

The successful conduct of the US-Korean negotiations is being endangered; at the same time, however, a blow is being dealt to the North Korean "Unity" program (page 4).

Nationalist leaders in North China still do not appear ready for an open break with Nanking (page 6). However, the National Government is confronted by growing civil unrest throughout China (page 6). In an attempt to restore financial stability, the Government has introduced a new currency (page 6).

The widening rift in Indonesia between the Netherlands Government and the Republic is now expected to lead to the most serious crisis for the UN Good Offices Committee since the signing of the 17 January 1948 Renville Agreement (page 9).

The reaction in Indochina to the French Assembly action on the Franco-Vietnamese 5 June, agreement is increasingly hostile (page 9).

The insurrection in Burma is expected to create serious economic difficulties (page 10).

Planters and miners in Malaya estimate that four divisions will be required if law and order is restored (page 10).

NOTE: In succeeding sections of this Weekly, the following marginal notations are used:

- (1) Double asterisk (**) --placed at beginning and end of information based solely on "S/S distribution" series.
- (2) Single asterisk (*) --to flag item containing "S/S distribution" series.
- (3) "A", "B", or "C" --importance, in B/FE's opinion, of the item, with "A" representing the most important ones.

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SUMMARY (continued)

The surprise New Zealand currency appreciation move is receiving some protest in New Zealand and is being sharply criticized in Australia (page 11).

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SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERAL

New moves to stimulate trade between Japan and the sterling area

"B"

A further stimulus to trade between Japan and the sterling area may be expected from a decision by SCAP to place sale of Japanese cotton textiles to sterling area purchasers on a 100 percent sterling basis. Since cotton textiles are perhaps the chief item the sterling area wishes to import from Japan, their omission from the original over-all payments arrangements of 31 May 1948, which placed all other Japan-sterling area trade on a sterling basis had been felt to be a major hindrance to the development of that trade.

Discussions are also taking place on the possibility of a sterling loan by the UK to Japan. Inasmuch as the over-all payments arrangements provide that the surplus of sterling either way is convertible into dollars, a sterling loan would obviously enable Japan to import more from the sterling area than the sterling area would import from Japan, without Japan having to delve into its scarce dollars. Meanwhile, a trade plan is reported to have already been drafted, which will involve reciprocal trade between Japan and the sterling area worth about \$242,000,000 during the one year period that began 1 July 1948.

These latest developments in the facilitation of Japan-sterling area trade emphasize the recognition by the UK and other sterling area countries of Japan's important position in world trade and will play a significant role in Japanese economic recovery. Despite frequent manifestations of political hostility to Japan, they want Japan's cotton textiles, raw silk, dried fruits, machinery, bicycles, paper, pottery, glassware and drugs; in return they can offer Japan salt, iron ore, crude rubber, wool, tin, sago flour, coconut oil, and industrial chemicals.

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JAPAN

Japanese shipyards to be permitted to repair foreign vessels. Japanese shipyards will be allowed to undertake general repairs and conversion of foreign vessels, according to reports; hitherto, SCAP has restricted work on foreign vessels in Japanese shipyards to emergency repairs. "C"

This permission should result in full resumption of activity in Japanese shipyards, a large part of which has been idle since the surrender due to lack of raw materials. Japanese shipyard labor will thus be kept occupied and will not drift to other means of employment. As a result, Japan, a maritime nation, will not face a shortage of skilled shipyard labor when materials become available for such shipbuilding as Japan may be allowed under any post-war settlement.

British criticize Japanese restriction of government employee rights. The British Embassy in Washington has passed to the State Department the UK criticism of the Japanese Government ordinance regarding the rights of public employees issued in response to the suggestions embodied in SCAP's letter of July 23. The UK believes that the Japanese Government went beyond these suggestions in denying industrial workers on government-operated railways and in the salt, camphor, and tobacco monopolies the right to strike and to bargain collectively. Criticism that Japanese government action conflicts with the spirit of FEC directives could be avoided, according to the UK, by SCAP insistence on Japanese compliance with his suggestion that such categories of workers might well be excepted from the regular civil service. Although the UK does not object to regular civil servants being deprived of the right to strike, it considers the right of petition to which they are presently limited inadequate and cites the smooth function of the UK system wherein civil servants possess the right to organize and bargain coupled with the right of appeal to some form of arbitration tribunal. "B"

In making these representations in Washington rather than Tokyo, the British avoid the embarrassment of appearing to side with the Soviets whose representative to the Allied Council for Japan, in demanding the recall of SCAP's letter, has accused SCAP of breaching FEC directives regarding labor.

KOREA

Successful and expedient conduct of US-Korean negotiations endangered. US-Korean negotiations leading to liquidation of US Military Government have been threatened by leaks of confidential information on the part of Korean negotiators to American newsmen and by the desire of Korean statesmen to exercise complete and independent control of their destinies while "B"

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KOREA (Cont.)

obtaining the maximum in American economic and military aid. At the same time, a major blow to the "unity" program of the North Korean People's Government has been the refusal of several well known South Korean liberals and leftists to return to Pyongyang to support or accept posts in the government to be established following the 25 August elections.

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CHINA

Nationalist northern leaders realize time is not ripe for open break "B"
with the Nanking government. The reasons for this realization appear to be:
1) All overtures of the northern leaders (i.e. Fu Tso-yi in north China, Wei Li-huang in Manchuria, and Wong Yao-wu in Shantung) to foreign governments and the US for the purchase of arms and equipment have proven fruitless. Sweden refuses to sell to the National Government in fear of Soviet retaliation. Belgium is willing to sell if the Generalissimo bestows his blessings on the negotiations. Chiang's sanction has not been received to date despite his previous promises of condonement. 2) These Nationalist leaders are confident of a Republican victory in the coming US elections with a resultant greatly expanded US military and economic aid program for China. 3) They also feel that so long as Chiang continues as the recognized head of the government all US aid will be funneled through Nanking. Consequently they appear to have decided to string along with Chiang for the present in hopes of obtaining a slice of the much needed aid melon for North China.

Civil unrest is increasing in Nationalist China. Workers at the "B"
Fushun coal mines in Manchuria have stopped work in protest over their economic difficulties; the refugee problem in Peiping may produce serious consequences; and large-scale arrests of alleged Communists, particularly students, are underway in all major cities as a result of a recent order of the Executive Yuan. In an effort to curb civil disorder the Executive Yuan issued an order aimed at eliminating from Nationalist areas the Communist subversive elements which the Government blames for instigating disturbances. Among the new restrictions is the authority to search residences without a warrant. Chiang Kai-shek appears to be resorting to even more dictatorial methods than those which already have drawn the loudest complaints from anti-Government factions. Such severe restrictions will only increase unrest and the situation will not be alleviated until the basic causes of dissatisfaction are removed.

General quiet prevailed on the Chinese Civil War front last week with "C"
no large scale actions underway. In North China the attempt of at least two Communist columns under Nieh Yung-chen to recross the Peiping-Suiyuan Railroad below Nankou to established Communist bases along the Hopoh-Shansi-Chahar border is being countered by the movement of elements of Fu Tso-yi's forces from Eastern Hopoh. These forces recently undertook to drive the Communists from the area north of the Kailan coal fields, and if Fu can keep the Communists from their bases certain observers feel that he will have succeeded in neutralizing their effectiveness. This would represent a signal victory for Fu. Elsewhere, the Communist encirclements of Taiyuan and Tsinan were loosened, but raids on isolated Changchun continued unabated.

The chances that China's new currency will prove successful in producing "A"

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relative financial stability for a reasonable length of time, depend largely on (a) the effectiveness with which the Government can initiate the accompanying economic reforms, and (b) the degree of public confidence in the venture. Assuming favorable conditions in both these respects, the initial period of "stability" following the issuance of the new currency would contain certain self-perpetuating aspects that could be capitalized by the Government. An increased flow of commodities on the market could initially be expected from: (1) the reversal of the preceding flight from currency to commodities and (2) the marketing of the fall harvest. If in this situation Government receipts could be increased to projected levels (i.e. 70 percent of expenditures) and ECA resources used toward financing the residual deficit, the inflationary impact of the government's fiscal operations would be drastically reduced and stability prolonged. At the same time, a more realistic exchange rate could be expected to increase official receipts from exports and inward remittances and thereby reduce China's deficit on international amount.

It appears clear, therefore, that the Government's ability to restrict its budgetary deficit to manageable proportions represents the crucial determinant to the success of the new program. In assessing the Government's prospects, however, some pessimism is warranted both because the new program presupposes an improvement in real revenues of two to three times the existing level, and because of the Government's conspicuous ineffectiveness in implementing similar reforms during the past two years.

In any event, however, issuance of the new currency at this time represents a major gamble. Its success will have to be effected despite the burden of civil war requirements and despite widespread scepticism in Chinese financial circles as evidenced in the Shanghai press regarding the Government's ability to meet these requirements without resort to inflation, its failure would eliminate for all practicable purposes a last ditch measure previously available for prolonging the National Government's survival.

Former Premier Chang Chun is visiting Japan, allegedly in a private capacity but undoubtedly to make a complete survey of the Japanese situation, especially as it relates to China. A graduate of Tokyo Military Academy, Gen. Chang, who has many important Japanese friends, may attempt to promote a Sino-Japanese policy of friendly co-existence and a common front against Communism. Gen. MacArthur has welcomed him. The State Department has instructed the Acting US Political Adviser in Tokyo to accord special consideration and every facility to Gen. Chang and his party so that he may become thoroughly informed of our efforts in Japan in view of the influence his opinions will have upon the Chinese attitude toward our occupation policy in that country. "C"

Alleged mistreatment of Chinese by US Immigration Service is being played up by Soviet personnel in Shanghai, who are attempting to start a "C"

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whispering campaign on the subject among normally proud Chinese. (This was the issue which precipitated a large-scale boycott of US goods in China early in the century, and the Soviets may have it in mind in their present attempts).

The use by US ships of Chinese inland waterways and ports, which has been strongly opposed by Chinese shipping and other interests, is the subject of new instructions by the State Dept. to the US Embassy at Nanking. The Department feels that the fact most maritime nations are more liberal than is China on the use of such waterways for (among other reasons) motives of economic self-interest, should be helpful to the Embassy in discussing the question with the Chinese Government and in counteracting press attacks. "C"

<u>The Shanghai Market:</u>	<u>US \$ Exchange (Selling Rate)</u>		<u>Wholesale Price of Rice</u> <u>per 172 lb picul</u>
	<u>Official "open"</u>	<u>Blackmarket</u>	
This week (17 Aug 48)	CN \$480,000	CN \$11,700,000	CN \$65,000,000
Week ago (12 Aug 48)	480,000	10,500,000	49,500,000
Month ago (17 Jul 48)	480,000	5,800,000	30,000,000
Year ago (17 Aug 47)	12,000	41,000	410,000

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INDONESIA

Serious UN GOC crisis expected--The widening rift between the Netherlands Government and the Republic is now expected to lead to the most serious crisis for the UN Good Offices Committee (GOC) since the signing of the 17 January 1948 Renville Agreement. The Netherlands Government on 22 August submitted to the Bandoeng Conference (a meeting of delegates from non-republican areas) a draft plan for the proposed administration of Indonesia until the United States of Indonesia (USI) is formed. The US Delegation of the UN GOC (US GOC) expressed concern to Dutch officials in Batavia when it learned of the method of procedure the Netherlands Government intended to pursue inasmuch as they had made no provision for informing the Republic. Under the Renville Agreement, the Republic is to have a place in the provisional federal government and later in the USI. Under these circumstances US GOC feels that the Republic, after a shocked reaction, may protest to the UN Security Council that the Dutch have violated the Agreement by failing to consult the Republic regarding future administration in Indonesia. "A"

In any event it can be expected that moderate Republican leaders will have greater difficulty in retaining the support of steadily growing leftist groups. Some of the more extreme groups in the Republic have already advocated further negotiations with the Dutch only on the basis of full Republican sovereignty.

INDOCHINA

Reaction to French assembly action on Franco-Vietnamese Agreement hostile. "B"
The French Assembly on 19 August voted 347-183 to postpone indefinitely the debate on the Indochinese question, which the French Government now maintains is indirect approval of the 5 June Franco-Vietnamese Agreement. Premier Marie, in his statement to the Assembly on the Government's policy, paid tribute to the work of French High Commissioner Bollaert and transferred the responsibility for changing the status of Cochinchina (still a French colony) from approval by the French Assembly to a referendum by the population of that state. Marie concluded by expressing the hope that the creation of a permanent government "may be rendered possible as soon as circumstances shall permit."

Reaction in Saigon to the French assembly's action is increasingly hostile. An influential member of the French High Commissariat has stated that the present situation prevents any real implementation of the agreement as regards Cochinchina, thus making it impossible to turn over the administration of courts and justice to the Central Vietnam Government. President Xuan has cabled Paris asking for clarification of the status contemplated for Cochinchina and its relationship to his central government. In addition, an influential Vietnamese editor, who publishes in the French-

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INDOCHINA continued

controlled area, characterizes Marie's statement as "a triumph of diplomatic slipperiness," and warns that the delay will make the final solution no easier and has already deterred many nationalists from supporting the Xuan regime.

BURMA

Insurrection expected to create serious economic difficulties. Although "B" the Burmese Government appears to have recovered somewhat from the initial shock of its latest insurrection, the situation remains serious. New army and police battalions are being hastily organized, and the Burmese Government has approached the US and UK for large quantities of military supplies. There are indications also that the Government is depending upon the various ethnic minority groups, particularly the warlike Kachins, to supply much of the necessary manpower. Although the Government's position continues uncertain and a sustained and determined effort is necessary, any military successes now might start a trend towards the ultimate pacification of the country. Furthermore, the rigorous monsoon weather is likely to have taken a greater toll of rebel weapons than those of the Government forces. If, by the end of September when the monsoons are over, the Government has adequately reorganized its military forces, it may be able to seize the initiative from the rebels. The Government, however, is threatened by serious economic difficulties which may prove even more dangerous than the insurrection. While loyal forces hold most towns, the rebels control large areas of the hinterland and straddle the main lines of communications. The insurrection has probably already reduced rice and teak production, and will prevent the export of other stocks on hand. Since these commodities, especially rice, are the mainstays of the Burmese economy, the ability of the Government to prevent inflation, assume the burden of an expensive military campaign, and import sufficient consumer goods for any length of time is highly questionable unless it secures substantial outside military and financial assistance.

MALAYA

Four divisions held necessary by planters and miners. The Communist-led "B" insurrection in Malaya appears now to be restricting the work of tappers, interfering with the vital replanting on rubber trees, and causing growing apprehension among planters, miners and laborers. The planters and miners are reported to have estimated that the services of four divisions will be required to undertake both offensive and defensive operations which they believe necessary if law and order is to be restored.

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MALAYA continued

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NEW ZEALAND - AUSTRALIA

New Zealand pound appreciation appears to be an anti-inflationary measure. "C"
It now appears that the primary objectives of the surprise New Zealand currency appreciation program are: (1) to strengthen the internal stabilization program which has been greatly weakened in the past 18 months, and (2) to preserve the New Zealand sterling balance which is expected to fall later in the year. A strong protest has been raised against the government's move by the opposition Nationalist Party representing the Farmers Union and the Federation of Manufacturers. The Government proposes to placate the farmers with relatively small increases in their guaranteed price. US Legation sources feel that the New Zealand Government estimates of the reduced cost of living will tend to be offset by an increase in import prices, and an accentuation of New Zealand unfavorable trade balance. However, the Government appears to have taken a bold step in its effort to create a more equitable distribution of the national income without indulging in further inflationary practices in the domestic economy.

Australians critical of the New Zealand pound appreciation. The sudden decision by the New Zealand Government to raise the New Zealand pound to parity with sterling is being sharply criticized in Australian business and financial circles who, in spite of Prime Minister Chiefly's statement that his Government has no such intention at this time, are predicting that their Government will be compelled to follow the New Zealand move. Chiefly stated that in his opinion the New Zealand action would not affect a recent trade agreement between the two countries but it would increase the cost of New Zealand goods to the Australian public. A national manufacturers organization in condemning the New Zealand action termed it a direct violation of the International Trade Agreement which New Zealand ratified on June 29, 1948. The agreement provides that all variations in exchange should be made in consultation with participating countries.

Considerable pressure will undoubtedly be brought to bear on the Government to place the official Australian exchange rate on a par with that of Britain, South Africa and New Zealand. However, Australia unlike New Zealand is a member of the International Monetary Fund which must first concur in such a decision.

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