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

INTELLIGENCE HIGHLIGHTS NO. 8  
WEEK OF 29 JUNE - 5 JULY 1948

SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

The USSR continues its efforts to foster Japan-Sakhalin trade (page 2).

While the Chinese Communist Party appears to be in no imminent danger of a "Yugoslav-type" castigation by Moscow, Chinese Communist leaders must realize that such action is possible at any time (page 2).

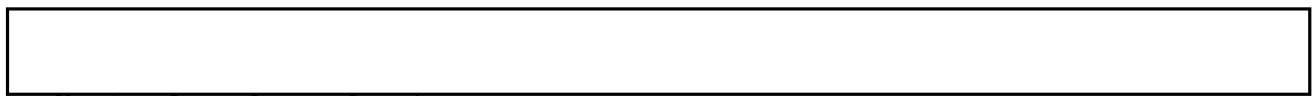
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A road net, suitable for high speed traffic and military use, is being built in North Korea by Soviet engineers (page 3).

China's recent financial crisis has subsided but has served to re-emphasize the very precarious state of the Nationalist economic structure (page 4). Military activity remains on a minor scale (page 4). The chief event of the week was the signing of the Bilateral Agreement concerning US Aid to China (page 4).

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Increasing signs of Indonesian unity may force GOC consideration of US-Australian proposals as only basis for peaceful solution (page 6).



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## SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERALUSSR continues efforts to build Japan-Sakhalin trade

The US Political Adviser in Tokyo has advised the Department of State "A" that the difficulties which Japan is incurring in its attempts to secure iron ore from other Far Eastern countries may result in its increased dependence upon the USSR. He states that the USSR trade representative has indicated that it may be possible for Japan to secure iron ore from Sakhalin deposits whereas varying types of obstacles are being offered by Japan's "normal" sources, i.e. the Philippines, Hainan and the Yangtze Valley (China), Malaya, India, and Indochina. The Political Adviser stresses that the "normal" sources fail to realize that iron ore sales to Japan would result in mutually beneficial trade leading to rehabilitation not only of Japan but of themselves and the Far East in general (Supplies of iron ore from other areas, e.g. Canada, are obtainable, but at higher costs).

The favorable consideration by the USSR trade representative to the possibility of Japan securing vitally needed iron ore from Sakhalin is another indication of Soviet efforts to build up trade between Japan and Sakhalin. As yet, however, it is impossible to conclude whether primarily the USSR is seeking to build up such a trade because: (1) Japan can furnish items (e.g. railroad rolling stock) apparently of essential concern to Sakhalin in the building up of its economy or (2) the USSR is seeking to make Japan economically dependent upon it as a means of subsequent political penetration.

Implications for Chinese Communists of Cominform Resolution on Yugoslavia

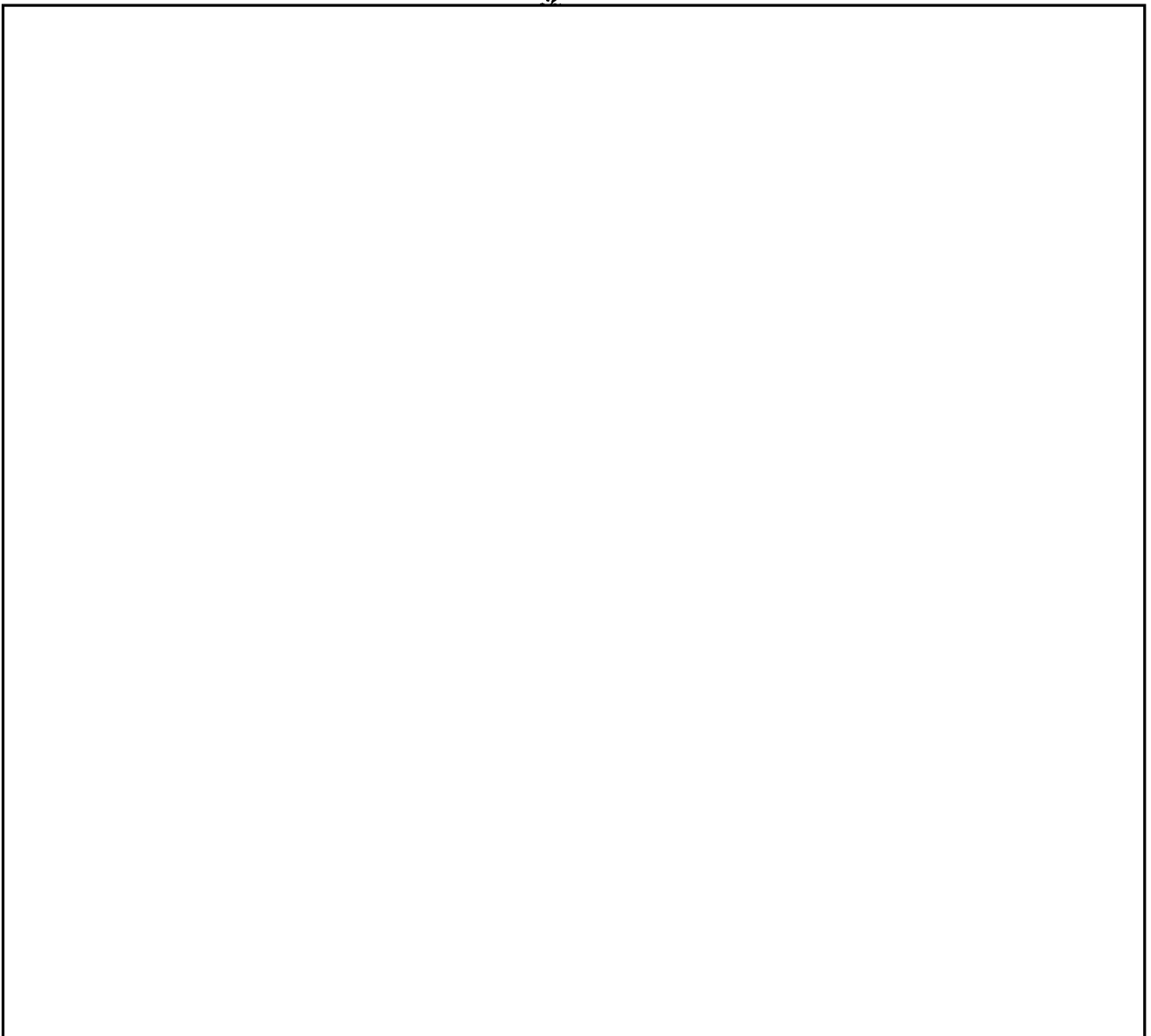
Chinese Communist leaders must be impressed by the recent Cominform "B" resolution on Yugoslavia because of the parallels in the agrarian background of the Communist parties in both countries and the applicability of certain criticisms in the resolution to the Chinese Party's policies. The Chinese Communist leader Mao Tse-tung has stated that the Chinese Communist Party represents the "joint rule of several revolutionary classes" as opposed to the Soviet concept of rule by the proletariat. Thus the resolution's condemnation of the Yugoslav Popular Front, with its inclusion of varied class elements and political groups would also condemn the Chinese emphasis on the unity of the Communist Party with the proletariat, peasantry, intelligentsia and petite bourgeoisie in a "mighty, independent, political power".

The Chinese Communist Party appears to be in no imminent danger of similar castigation by Moscow, as such is not necessary nor desirable in the Kremlin's present plans, but Chinese Communist leaders must realize that the Yugoslav-type action toward them is possible at any time. The resolution also offers an object lesson to those Chinese elements desirous of collaborating with the Communists in a possible new government that any arrangement with Communists seems to lead inevitably to Communist domination and control.

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KOREA

Soviet machinery and engineers are being employed in a program of road construction and improvement in North Korea, south of Pyongyang and near the 38th parallel, on a scale much larger than usually carried out each spring and fall. This out-of-season activity is significant since the pattern of construction for the routes, which in most cases now come to an abrupt end at the parallel, is such that the roads will be suitable for high speed traffic and rapid movement of military personnel and equipment to the 38th parallel.

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CHINA

The Bilateral Agreement between the US and China was signed at Nanking 3 July covering \$275,000,000 for economic aid to that country. The agreement comprises 12 articles, a short annex detailing safeguards on aid administration and an Exchange of Notes between the two governments granting Most Favored Nation treatment on a reciprocal basis for trade to territories under occupation by the US, including Japan and South Korea. Apparently the device of an Exchange of Notes - an executive act - was evoked for the Most Favored Nation provision in deference to the Chinese Government's fears that its inclusion in the regular agreement would subject it to adverse criticism in the Legislative Yuan and to popular resentment. The principal provisions of the agreement are that China will initiate and maintain more stable currency conditions; make practical efforts to improve commercial relations with other countries; administer import/export controls in uniform equitable manner; promote agricultural and industrial development on sound basis; facilitate transfer to the US for stockpiling or other purposes materials originating in China which are required by US; will agree to cooperative study projects to be financed by US; and to keep the people of China fully informed of progress in implementing undertakings under the agreement.

Chinese dissatisfaction with Sino-Soviet relations is indicated in a resolution, introduced by over 100 members of the Legislative Yuan, requiring the Government to list violations of the 1945 Sino-Soviet Treaty. The Yuan members charged the Foreign Affairs Ministry with "remaining as quiet as a cicada in cold weather" on this matter.

Military activity in China was scattered and comparatively minor last week. In Central China Communist forces, following the successful completion of a well-planned raid on Kaifeng have been evading an armed brush with pursuing, superior Nationalist units, who claimed to have encircled the Communists south of Kaifeng. The Communists are now massing south of Chenghsien and according to press dispatches have already begun to probe the defenses of that city. Meanwhile Communist attacks on Tzuyang, Shantung continued and small scale fighting was noted along the eastern sector of the Lunghai Railroad near Lienyun. North China Communists continued to harrass the Peiping-Mukden Rail line, with the latest attacks directed at the Shanhaikuan-Chinhsien sector. Late reports indicate that peripheral attacks have been launched against Chinhsien.

China's Financial Crisis. Tension has partially relaxed in Shanghai, the financial nerve center of the nation, from the near panic conditions of the previous week when Chinese National currency depreciated 100% in a matter of a few days precipitating the greatest price rise yet seen. Probably anticipating further financial decline, the local garrison com-

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mander has repeated his fear that continued economic disintegration would lead to disturbance of peace and order for which he is responsible and has followed up his public warning of 26 June with a convening of heads of local security forces to draft plans to wipe out blackmarket operations. Civilian leaders were conspicuously absent from the meeting. The resulting plan provides no new economic weapons, but appears to be merely a re-statement of currently ineffective orders. This action on the part of the Shanghai Garrison Commander substantiates a report that Chiang Kai-shek is directing the campaign over local civilian heads in an effort to save Shanghai, China's "show window", even to the extent of considering martial law. The growing severity of the financial decline emphasizes anew the extremely precarious position of the Nationalist economic structure, but there is no evidence as yet of a complete collapse.

Currency Prices. The Shanghai general cost of living index for workers increased 110.7% over May, reaching 710,000 (1936 = 1). This is the greatest monthly increase yet recorded. The increase for May over April was only 28.6%. The percentage increase for June, however, was still less than half that of the price of rice (basic commodity) which increased 252% during the month. The Blackmarket US dollar exchange rate increased 272% in the same period.

The Shanghai Market:	<u>US \$ Exchange (Selling Rate)</u>		<u>Wholesale Price of Rice per 172 lb picul</u>
	<u>Official "open"</u>	<u>Blackmarket</u>	
This week (30 Jun 48)	CN \$480,000	CN \$3,975,000	CN \$18,000,000
Week ago (25 Jun 48)	480,000	3,600,000	15,500,000
Month ago (2 June 48)	480,000	1,130,000	7,200,000
Year ago (2 Jun 47)	12,000	45,000	480,000

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INDONESIA

Increasing Indonesian unity may force GOC consideration of US-Australian proposals. Dutch attempts to precipitate a serious cleavage between Republican and non-Republican Indonesians appear not to have been successful as the majority of the delegates to the Dutch-convened Federal Conference at Bandoeng composed of representatives of non-Republican states are reported to have reacted favorably to the recent US-Australian plan for a future federal government in Indonesia. It is probable that the delegates' favorable reception to the joint US-Australian paper has resulted from the fact that representatives of the more important states, including East Indonesia and Pascoenda (in West Java), have been working on a plan of their own which is not incompatible with the US-Australian working paper and which calls for cooperation with the Republic in the formation of an interim government. If this movement for mutual cooperation among various Indonesian factions continues to gain support, the Dutch position in Indonesia will grow proportionately weaker since the Dutch have consistently publicized the difficulties in Indonesia as being a conflict between non-Republican and Republican elements. As a result it is quite likely that the UN Good Offices Committee, whose negotiations in Indonesia are now practically suspended pending the arrival of new US and Dutch delegations, will be forced by these signs of increasing Indonesian unity to consider seriously the US-Australian proposals as the only basis for a peaceful solution.

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