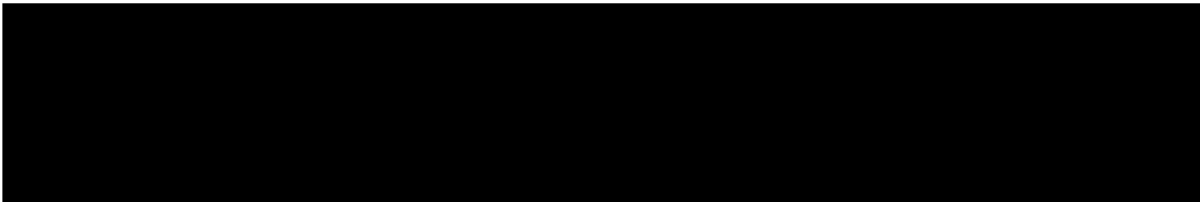


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INTELLIGENCE HIGHLIGHTS NO. 3
WEEK OF 25 MAY - 31 MAY 1948

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SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS



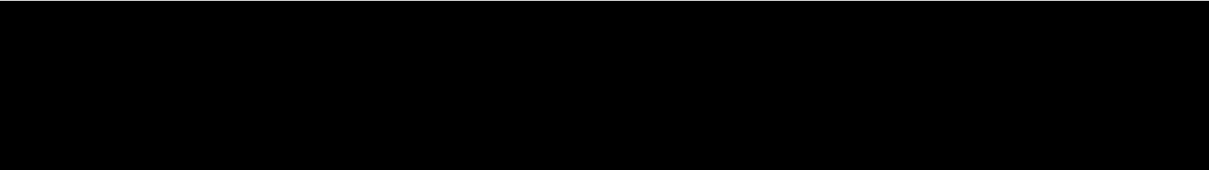
The significance of the shift in the high command of the Soviet Forces in North Korea remains uncertain since there is no indication as to whether this change is a routine change of station or a prelude to a shift in Soviet policy in Korea (page 3).

A new cabinet finally has been formed at Nanking with the most significant change being the return of General Ho Ying-chin to the post of Minister of Defense. However, political conditions in Nationalist China remain unstable, as indicated in student unrest, currently manifest in demonstrations critical of US policy toward Japan (page 5).

A Soviet economic offensive in Southeast Asia, to match their propaganda and political offensive in that area, appears to be developing in view of reported trade proposals made by the newly opened Soviet legation in Bangkok (page 2).

The announcement by the USSR of an agreement to establish relations between the Kremlin and the Republic of Indonesia has jeopardized further the achievement of a political settlement in Indonesia and may result in the Netherlands Government, at least temporarily, suspending negotiations. (page 7).

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

- (1) An asterisk (*) -- To indicate that all or part of an item is based solely upon information from State's "S/S distribution" series.
- (2) "A", "B", or "C" -- Importance, in B/FE's opinion, of the item, with "A" representing the most important ones.

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SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERAL

USSR attaching notable priority to trade with Southeast Asia

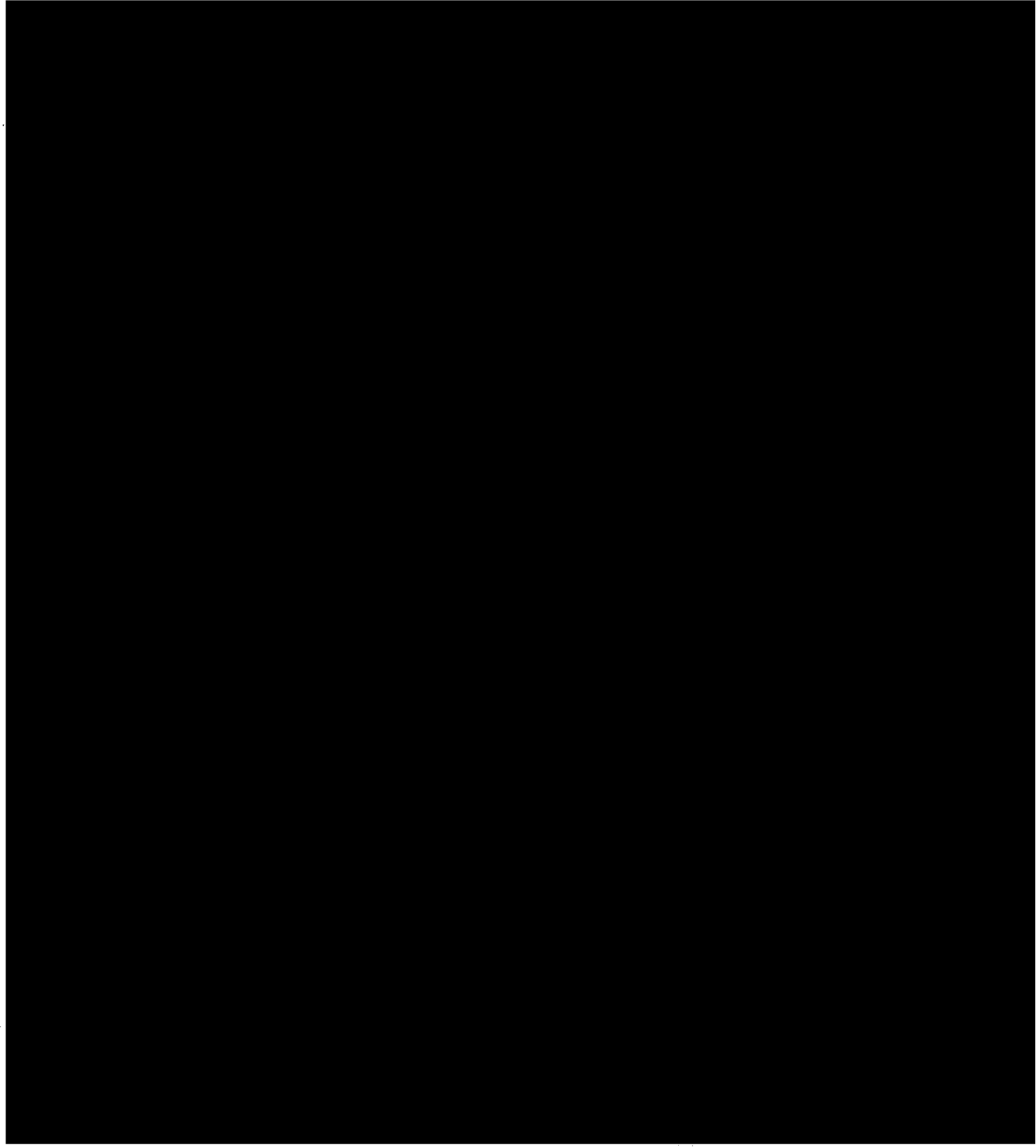
"A"

A Soviet economic offensive in Southeast Asia to match their propaganda and political offensive in that area has become increasingly apparent since the opening in March of a Soviet legation in Bangkok. A commercial organization, the "Exporthleb", attached to the Soviet mission has already made specific offers of industrial items (coal, coke, steel plates and bars, cement, and chemicals) in exchange for rice, rubber, teak, agricultural oils, etc. The trade proposals include quotations which in some cases underbid the US and UK and in others are on items which are not available from the US and UK. The Soviets have gone so far as to indicate that in a short time they will be able to offer piece goods in large quantities. While the character of these proposals would indicate that a determined economic offensive is just beginning a few commercial transactions have already been completed, including shipments of rubber from Malaya and a recently delivered cargo of cement to the Philippines. The Soviets apparently are quite aware that their propaganda and political offensives, if successful, must be accompanied by some tangible economic benefits, and are attaching a notable priority to Southeast Asia. This may be due in part to the Soviet desire to obstruct the proposed US program for the utilization of Japan's economic capacities.

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KOREA

Lt. Gen. Korotkov, Commanding General of Soviet Forces in North Korea, and his Chief of Staff, Maj. Gen. Shanin, have returned to the USSR and have been replaced by Lt. Gen. Merkulov and Col. Puznetzov. The significance of the move is still uncertain and there is no indication

"B"

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as to whether this change is a routine change of station or that it is a prelude to a shift in policy. Although it is possible that Gens. Korotov and Shanin are returning to Moscow to receive new instructions there are only evidences of routine Soviet troop movements and reductions in North Korea and no clear indication that the USSR is making preparations for immediate withdrawal. It is to be noted, also that for the first time in many months the Soviet command has displayed unusual courtesy in their personal dealings with US personnel in North Korea.

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CHINA

Chinese student opposition to US policy in Japan has been gaining momentum in recent weeks, centering in Shanghai and spreading to Peiping. A mass demonstration scheduled in the former city for 30 May was temporarily postponed, but Shanghai municipal authorities are alerted for any demonstrations which might erupt into violence. The Chinese students, who have actively expressed their opposition to certain National Government policies through riots and demonstrations in recent months, now appear to be focussing their traditional anti-foreign sentiment toward the US Japan policy. The growing student anti-American feeling gains added significance from the fact that most criticism of US policy in Japan until now has come primarily from the press, while the National Government has outwardly and officially supported this US policy. Though it is generally recognized that the current anti-American move is in reality being exploited by Communist and other dissident elements and aimed at discrediting and embarrassing the Government, there is danger that this movement might mark a portentous step in the development of an attitude of suspicion and antagonism towards American policies. "A"

The Communists opened their long-expected Manchurian offensive last week when they launched an attack upon Changchun, isolated Nationalist garrison in central Manchuria. The attack, largely diversionary, was undertaken at the same time that additional Communist units were moving westward to the Chinchou area, where the main attacks are still expected. Communist successes were reported in neighboring Jehol Province where they occupied Lunghua and Pingchuan, north and east, respectively, of the beleaguered provincial capitol Chengteh. In Shantung, Communist units under Chen Yi are recrossing the Yellow River and have already cut the Tsinan-Pukou railroad at Taian, while Lui Po-cheng's forces are apparently driving eastward across the Peiping-Hankow railroad toward a rendezvous with Chen in northeast Honan. "B"

A new Chinese cabinet has finally been formed by Premier Wong Wen-hao with the approval of Chiang Kai-shek. The complexion of the cabinet remains appreciably the same with the only significant changes the appointments of General Ho Ying-chin as Minister of National Defense and Wang Yun-wu as Minister of Finance. General Ho, another of the Generalissimo's old reliables, served as Minister of War 1930-1944, and Chief of Staff 1937-1946. However, he is not generally considered an especially competent military man by foreign observers, although he is believed to wield a powerful influence within the Nationalist Army. He replaces Pai Chung-hsi, who supported Li Tsung-jen for Vice-President against the Generalissimo's opposition. Wang Yun-wu's appointment is noteworthy since, as deputy premier under Chang Chun, he advocated the relaxing of foreign trade and exchange controls, a policy rejected by Premier Chang. "B"

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The Soviet Embassy in Nanking issued a statement on 29 May, denying "C" current rumors that Roschin, new Soviet Ambassador to China, would undertake mediation in the Chinese civil conflict.

New Import/Export Exchange System. O. I. Yui, newly appointed Governor "C" of the Central Bank, announced on 31 May the abolition of Circular 131 which required importers to deposit a margin of 50% of the value of the cargo with the Central Bank when applying for an import license. Importers registered strenuous objection to this regulation. (Re FE/P Weekly 18-24 May)

At the same time Yui announced the adoption of an exchange link system, effective immediately, under which exporters selling exchange to appointed banks will receive exchange surrender certificates equal to the exchange sold. In turn importers are required to buy from exporters or brokers exchange surrender certificates equal to the amount of the import license. Yui said rice, wheat, flour, cotton and fertilizer imports will be excluded from the new system. The link system is not new to China, however, its application at this time indicates the seriousness of the shortage of the government's foreign exchange holdings. The volume of general imports, which are chronically in excess of exports, will drop accordingly if dependent upon foreign exchange derived mainly from exports.

Foreign Trade. Chinese Customs statistics reveal that both March imports "C" (US \$32.3 million) and exports (US \$17.3 million) were larger than those reported for January and February, with an unfavorable balance also greater. The import excess for the first quarter of 1948 stands at about US \$20 million. Petroleum products, valued at US \$5.7 million continued in March as principal China import, followed by machinery and tools. Piece goods (US \$2.8 million) led exports, followed by hides and skins.

Floods. The Yangtze river is approaching the danger level; some roads "C" and farm lands in the Nanking area are under water and Hankow is threatened. Other areas reported flooded include Hengyang and Kweilin in south central China, and Yintak and Kukong in northern Kwangtung.

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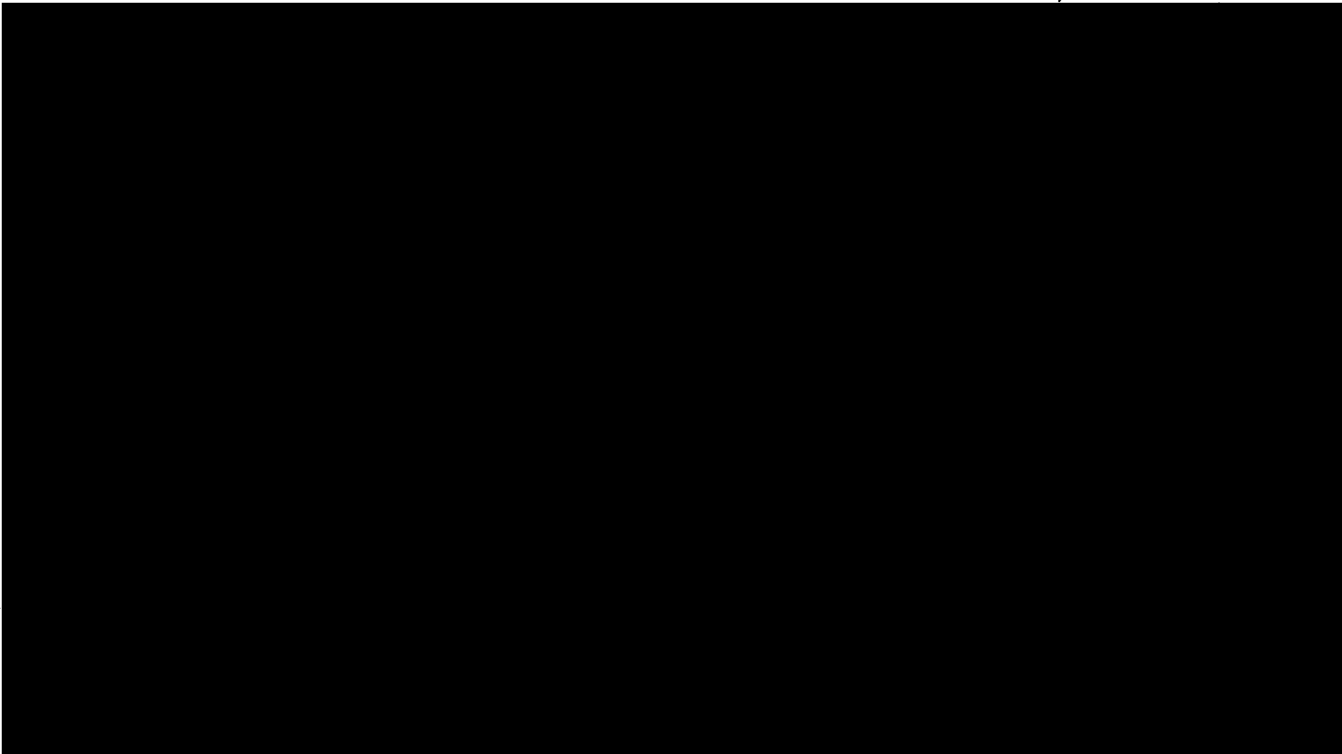
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INDONESIA

Announcement of USSR-Republic of Indonesian relations jeopardizes GOC negotiations. The Soviet announcement that representatives of the Indonesian Republic and the USSR agreed at Prague on 22 May to establish consular relations has jeopardized further the possibility of reaching a political settlement in Indonesia. Discussion of Republican relations with the USSR comes at a particularly awkward time since the question of the Republic's foreign relations is a major point upon which little or no progress has been made. It would appear that the Republic through characteristic lack of coordination and the lack of communications with its representatives overseas now faces the dilemma of whether to affront western nations by accepting Soviet recognition or to alienate its own public opinion by disavowing recognition at a time when it believes that the Dutch are preparing to dispose of the Republic by force. For the Netherlands it represents an opportunity to suspend negotiations on the grounds that Republic-USSR relations are contrary to the Renville agreement. The UN Good Offices Committee and particularly the US delegation is now faced with its most serious crisis in view of the probable failure, under circumstances easily exploited by the USSR, to achieve a political agreement.

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SECTION III. DIGEST OF IMPORTANT STUDIES AND ESTIMATES

No contributions.

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