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INTELLIGENCE HIGHLIGHTS NO. 11  
WEEK OF 20 JULY - 26 JULY 1948

**SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS**

The US proposal for increased Sino-Japanese trade with particular reference to its relationship to the China Aid Program can be expected to elicit a vehement reaction in China (page 3).

Chinese Nationalist Government fear that all Korea will fall into the Soviet orbit and its consequent desire to keep the US in South Korea until an adequate native security force is established has motivated recent Chinese pressure on Kim Koo and Kim Kyu Sik to support the South Korean regime (page 4).

The Department of State holds that Siam-Japanese trade is not inimical to US-Siamese trade (page 4).

The shipment of arms and ammunition to Malaya has become a major issue in Australia and has resulted in unusually swift consideration by the Labor Government of means to circumvent bans imposed by left-wing labor unions (page 5).

A recent Soviet broadcast beamed to Japan implies that only 200,000 more Japanese remain to be repatriated as contrasted with US and Japanese estimates of 600,000, thus leaving 400,000 unaccounted-for (page 6).

Although SCAP's suggestion that the Japanese adopt legislation forbidding strikes by government workers may avert an impending labor crisis harmful to Japanese economic recovery, leaders of the affected unions are bitter over the implications of the suggested restriction of presently legal activities (page 6).

**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 Chinese National Government remains in a precarious situation (page 8), although during the past week there have been no significant new developments threatening its overthrow. The military outlook for Nanking is very gloomy (page 8). Financially the Government is believed to be hopelessly insolvent (page 8).

Burmese Prime Minister, Thakin Nu, may risk an attempt to capitalize on possible dissension within the Burmese Communist Party by offering to include an anti-insurrection Communist in a reshuffled cabinet (page 11).

Continuing disturbances in Malaya may reduce rubber exports in the near future (page 11).

The President of the French-sponsored central government in Indochina admits weaknesses of his government (page 11).

The extensions by the Philippine Government of the deadline for arms surrender are raising doubts as to the success of amnesty (page 11).

A recent Australian-Chinese agreement on Chinese businessmen in Australia may represent a modification of the "White Australia" policy (page 12).

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SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERAL

Increase in Sino-Japanese trade suggested by Department of State

"A"

The Department of State has advised US Embassy Nanking that arrangements for increased Sino-Japanese trade would be desirable. It believes that some of the requirements for reconstruction projects under the China Aid Program to be paid for from ECA funds, e.g. railroad construction or other machinery and spare parts, probably can be obtained at less cost and greater speed in Japan than in the US or other available sources. In addition, increased trade on open account might take the form of China exporting to Japan an increased volume of salt, sugar, fruits, Tung oil, egg products, minerals, and a portion of wheat bran from ECA wheat milled in China; for its part, Japan could ship timber, rayon yarn, textile equipment and miscellaneous goods.

The Department believes that the crux of Sino-Japanese trade is iron ore and coking coal. Japan can compensate for Kailan (coking) coal by supplying Shanghai with boiler coal and presumably mining timbers for Kailan. In addition, redevelopment of iron ore resources in Hainan could be explored. The Department recognizes the hostility of China to Japanese economic development and states that it should be stressed to the Chinese that iron ore and coking coal shipped to Japan would be a Chinese self-help measure, in that these commodities are required for the manufacture of specific steel products needed for approved reconstruction projects in China.

The expansion of Chinese exports of iron ore and coking coal to Japan would be of major aid to Japanese economic rehabilitation. Moreover, availability of coking coal and iron ore in China would lessen the Japanese necessity to procure these commodities from USSR-controlled areas, e.g. Sakhalin and would correspondingly reduce the probability of the Japanese economy becoming Soviet oriented. Nonetheless, the proposal for such increased trade, since it envisages expansion of Japanese heavy industry, can be expected to elicit a vehement reaction in China which would undoubtedly stir up further the already noticeable Chinese resentment against the China Aid Program.

Generally, expansion of Sino-Japanese trade would stimulate economic progress and stability in the Far East. Increase in economic stability would mean concomitant improvement in US security interests. Japanese and Chinese economic rehabilitation would decrease the possibility of economic unrest being exploited by Communist interests. In addition to being a stabilizing factor in the Far East economy such trade would lessen the drain on US aid funds.

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GENERAL (continued)

Chinese Nationalist Government fears that all Korea will fall into the Soviet "A" orbit

Chinese Nationalist Government fears that all Korea will fall into the Soviet orbit and its consequent desire to keep the US in South Korea until an adequate native security force is established has motivated recent Chinese pressure on Kim Koo and Kim Kyu Sik to support the South Korean regime. This pressure was undoubtedly a contributing factor in the recent statement by the two politicians which denounced the establishment of a separate regime in North Korea as a step toward civil war. The Chinese Consul General in Seoul is reported to have delivered a message from Chiang Kai-shek to both Kims, and to Rhee Syngman, which took the two Kims to task for attempting to deal with the Communists controlling North Korea and threatened to disavow all three leaders if they did not join forces in attempting to make the new South Korean Government a success. Although Rhee claims that he is agreeable to including the two Kims in his government, he has said that their recent rather weak and piously-worded statement does not constitute a sufficient disavowal of their previous North Korean venture. Despite China's generally weak international position, it can continue to exert considerable influence on South Korean politics due to Chiang's long standing association with present-day Korean political leaders through the exiled Korean Provisional Government in Chungking; and China's present strategic position on the UN Temporary Commission on Korea.

Siam-Japanese trade held not inimical to US-Siamese trade

"A"

The Department of State, in reply to a warning by the US Ambassador to Siam of possible conflicts inherent in the proposed revival of Siam-Japanese trade by SCAP, has stated that the development of Siam-Japanese trade is not necessarily inimical to US trade interests in Siam because: (1) to conserve scarce dollars, Japan is being encouraged to increase purchases from non-dollar areas; (2) revival of Japan's international trade is imperative in order to rehabilitate Japan's economy which is being maintained by the US at a high annual cost; (3) it is not anticipated that the development of Siam-Japanese trade will interfere with US strategic stock-piling of rubber and tin; and (4) if Siam can secure goods more advantageously in Japan, the resultant savings should enable Siam to purchase goods most economically obtained in the US and other countries, thus stimulating a greater volume of trade movement.

The Department's position is represented as entirely in accord with the US objective of fostering the general development of international trade on a multilateral basis and permitting equal access by all countries to markets as well as in line with the US supported ITO Charter and the General Agreement on Trade and Tariffs.

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GENERAL (continued)

Shipment of arms and ammunition to Malaya becomes major issue in Australia

"B"

The shipment of arms and ammunition to Malaya has become a major issue in Australia and has resulted in unusually swift consideration by the Labor Government of means to circumvent bans imposed by left-wing labor unions. Informal requests from Malaya apparently have already been made in view of the Government's announcement that it will use Air Force planes and naval vessels to transport any arms it may decide to ship, thus circumventing union bans.

The SYDNEY MORNING HERALD has reported its view that the present disorders were planned at a March 1948 meeting of the Indian Communist Party, held in Calcutta and attended by Australian Communists. According to this report, events in Burma and the outbreak of widespread stoppages in the Australian coal fields were timed to coincide with the Malayan uprising.

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the violence in Malaya is being directed through the maritime unions, mentioning the possibility that Ernest Thornton, Communist Secretary of the Australian Federated Iron Workers and Eliot V. Elliott, Communist Secretary of the Australian Seamen's Union are key figures in the chain of direction. The Seamen's union has already proclaimed its intent to impose a ban on shipments of arms to Malaya, a development which has been given prominence by the Moscow radio.

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The present situation in Malaya, coupled with the hostility encountered by McMahon Ball's recent goodwill mission, could result in a reorientation of Australia's attitude toward the nationalist movements in Southeast Asia. Australia's instantaneous reaction of support for the UK has already been compared with her opposition to the Dutch in Indonesia. However, it should be noted that in the case of Malaya Australian interests own about one quarter of the Malayan tin mines and that Singapore is still considered by the Australians as vital to Australia's security.

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JAPAN

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Industrial production index continues upward curve. Preliminary figures for April 1948 show that the Japanese industrial production index has reached its highest point since the beginning of the Occupation: 49.7 (the base period 1930-34 = 100). This compares with an index of 49.3 in March 1948 and is a 23.6 percent improvement over the April 1947 index of 39.9.

"C"

USSR's Japanese repatriation figures. A 20 July Soviet broadcast to Japan takes great pains to deny recent reports regarding Japanese POWs in the USSR. The broadcast included the statement: "It is sufficient to point out that the Soviet people have never even thought of using the 200,000 Japanese to fulfill the post-war Five Year Plan." This statement certainly implies that only 200,000 Japanese remain to be repatriated which is a vastly different figure from the approximately 600,000 which US and Japanese officials claim are still in USSR-dominated areas. The difference of 400,000 between the figures is hard to reconcile. Should the Soviet broadcast have disregarded Japanese still in Sakhalin and the Kuriles the difference would still be over 200,000. It is possible that the USSR may have been advising Japan as to the maximum number of nationals she may expect to have returned. The "difference" may be accounted for by a combination of the following: (a) deaths in POW camps; (b) need for a laboring force; (c) hostages for Japan's future "good behavior", (d) denying Japan trained field and general rank officers; (e) holdout troops in Manchuria who were never sent to Siberia.

"B"

SCAP suggests legal ban on strikes by Japanese government workers. General MacArthur has suggested in a letter to Premier Ashida that Japan's National Public Service Law be revised to penalize government employees who resort to strikes and other dispute tactics which tend to impair the efficiency of government operations. The timing of this step indicates an intention to avert by early action the re-occurrence of labor troubles between the government and the employees of state-run instrumentalities (railways, communications, and certain commodity monopolies) where threats of a general strike have twice before necessitated SCAP intervention.

"A"

In response, the Japanese Government has: (1) cancelled its acceptance of the mediation efforts of the Central Labor Relations Board and (2) begun drafting a revised law preparatory to calling a special session of the Diet to consider its passage.

Pressure to bring government employees' wages more nearly into line with those of private industry has only recently made possible the consolidation of the government employees' struggle with government. The disunity evident at the time of the March communications workers crisis when the government railway workers union (GRWU) under moderate leadership accepted the government 2920 yen wages standard, ended in June when leftists gained control of the GRWU and swung it into line with the other government workers' demands for a 5200 yen wage base. The government on July 16 accepted mediation of these wage demands but it insisted that the demands are beyond the ability of the government to meet within the recently passed budget

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JAPAN (Cont.)

which had been balanced at SCAP's insistence in terms of a 3791 yen wage base. Chiefs of the affected unions are bitter over the implications of SCAP's letter and charge that the government, in reversing its acceptance of mediation, is ignoring labor's present legal rights.

KOREA

Representations by Washington to Moscow have failed to bring about any settlement of the South Korean electric power question. As anticipated, the Kremlin, in its reply to the US note of June 26, has reiterated its position that all nationalized industries in North Korea, including electric power stations, are under the direction of the Peoples Committee of North Korea and that further negotiations concerning electric power should therefore be conducted directly with that committee. This course of action is politically impossible for the US since direct negotiations with the Peoples Committee of North Korea would amount to de facto US recognition of the Soviet puppet government in North Korea.

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CHINA

The precarious position of the Chinese National Government remains unimproved. The low state of morale is attested by recurring rumors that high Nationalist officials have engaged in peace discussions with the Communists. There are increasing indications that the National Government, no longer confident that it can improve the situation in Manchuria and North China, is giving serious consideration to a removal to South China. However such a withdrawal probably would precipitate military and political disintegration throughout Nationalist China. For the moment none of the principal Nationalist leaders appears ready to participate in a move to force Chiang's overthrow. This reluctance is partly based on the fact that Chiang's Government is the recipient of US aid, in which they hope to benefit, and partly on their fear of piecemeal destruction in the event that the National Government breaks up. In addition, they realize that despite Chiang's great loss of prestige he still holds in Chinese politics a unique position of leadership which none of them can match. Some of them remain hopeful that he can be persuaded to delegate authority to competent and forceful administrators who will give the Government new vigor.

"B"

The military outlook of the National Government remains gloom. Pessimism in high Nationalist circles compounded with the unrelieved low morale of both the populace and the troops militates against effective employment of available resources. Current widespread Communist military activity throughout North and Central China is seriously threatening the government at Nanking. Despite the fact that the Communist forces in Manchuria, their best, have been uncommitted for over three months, the Nationalists have lost an estimated eighteen divisions in the same period. In North China the Communists will probably continue to harrass Fu Tso-yi at widely separated points, forcing him to shuttle his first-line troops from place to place thus vitiating his strength, until additional, powerful Communist forces can be brought to bear upon Fu's area from the north and the south. Fu will then be forced to retire once again into Suiyuan leaving Peiping and Tientsin to the Communists or to attempt some sort of an accommodation with the Communists. In Central China, the long-term Communist move to isolate the large body of Nationalist troops deployed along the Lunghai railway by stopping all overland communications with base areas to the south is moving to fruition. The Communists now threaten to isolate the large Nationalist military center at Kweichow as the Chingsien-Kaifeng area and Sian have previously been isolated. If successful (and indications are that they will be), the Communists should then be in a position to carry the war southward into the Yangtze Valley in force.

"A"

Insolvency of the National Government. In an effort to arrive at a settlement of the substantial Chinese indebtedness to the Export-Import Bank the latter has requested the Central Bank to furnish a complete and accurate financial statement listing all the Government's foreign exchange assets.

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Such a statement is expected to reach Washington this week. It is believed that the Chinese will not attempt to misrepresent their position by submitting padded figures as the US is in a position to verify various holding accounts; also China looks to the US as the only country that might help meet the crisis. This statement will undoubtedly reveal that the National Government is hopelessly insolvent. Not only is their foreign exchange exhausted, but there are literally stacks of unpaid foreign bills for which the Government banks are responsible, and unable to meet.

As the revelation of the Government's financial weakness reaches the Chinese public, as it surely will sooner or later, repercussions on foreign exchange notes and domestic prices are likely to have most serious consequences.

Shanghai newspaper subscriptions to AP and Reuters have been ordered stopped by the Shanghai Newspaper Guild as the result of a long smouldering rate dispute. The US-owned "Evening Post" and the British-owned "North China Daily News" immediately published notices that they would defy the Guild and pay the higher rates demanded by the news agencies. About a year ago, the agencies converted their rates to Chinese currency at open market rate and at the Guild's insistence adopted rates based on COL index. As a result of the phenomenal decline in Chinese currency and the index link the agencies are now receiving a mere US\$10 monthly for large papers and as low as \$3 for small papers, instead of the original charge of \$200 and from \$50/100 respectively. Since the Guild controls newsprint allocations to all papers Chinese publishers feel they are not in a position to defy it. There is a possibility of the low rates being enforced by the Guild in an effort to drive foreign agencies out of China.

"C"

The production and supply of strategic materials from China for US stockpiling purposes should be a specific undertaking of the Chinese Government under the China Aid Act, according to State Department instructions to the Nanking Embassy. The Department had desired to incorporate such an undertaking in an amendment to the Bilateral Agreement, but in view of strong Chinese Foreign Office objections to this course, has now instructed the Embassy to obtain it in the form of an exchange of notes, and if this is not possible, the US interpretation of the agreement on this point should be presented to the Chinese Government in the form of an aide-memoire for purposes of the record. This interpretation includes "the promotion of the increased production of such materials within China, and the removal of any hinderances to the transfer of such materials to the USA."

"C"

A prelude to Government suppression of anti-US criticism on Japan policies is indicated by a double attack from the KMT organ CHUNG YANG JIH PAO on the TA KUNG PAO's editor who is accused of being a "fellow traveler, communist mouthpiece, and anti-US." The TA KUNG PAO has been a leader in anti-US building up Japan movement.

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An early repatriation of dependents of Soviet diplomatic personnel in Nanking and Shanghai is seen in a reliable report of greatly increased buying of clothes and other personal items by these persons. "C"

The National Budget. Reports from Nanking announce that the Legislative Yuan has approved a CN \$900 trillion budget for the last six months of 1948. Although the budget for the first half of this year was set at CN \$96 trillion, the Government spent CN \$240 trillion. This deficit was met primarily by printing press money. The new budget, which is based on June prices, will also end up unbalanced unless the Government can curb the inflation and reduce military costs which now amount to 80% of all expenditures. Although the Government hopes to meet the new budget by increasing taxes and customs revenue and disposing of Government-owned property, these measures are expected to prove grossly insufficient as in previous efforts.

<u>The Shanghai Market</u>	<u>US \$ Exchange (Selling Rate)</u>		<u>Wholesale Price of Rice "C"</u> <u>per 172 lb picul</u>
	<u>Official "open"</u>	<u>Blackmarket</u>	
This week (23 Jul 48)	CN \$480,000	CN \$7,300,000	CN \$ 35,500,000
Week ago (16 Jul 48)	480,000	5,800,000	30,000,000
Month ago (23 Jun 48)	480,000	2,550,000	14,500,000
Year ago (23 Jul 47)	12,000	41,000	350,000

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BURMA

Government may offer cabinet post to anti-insurrection Communist. "B"  
There are indications that Prime Minister Thakin Nu's Leftist Unity Plan and offer of amnesty may have created some dissension within the ranks of the insurrectionary Burma Communist Party (BCP). Goshal, possibly second to Than Tun in the Burmese Communist hierarchy, is reported to be willing to accept the Government's offer, while Than Tun favors fighting to the bitter end. Although the insurgents would be weakened by any defections within the BCP, the insurrectionary-minded faction with the aid of dacoits would still be capable of carrying on prolonged guerrilla warfare, and thus continue to keep Burma in a state of turmoil. Nevertheless, it appears that Thakin Nu, who has agreed to remain as Prime Minister at least until the Parliament convenes on 15 August, may risk an attempt to capitalize on any dissension within the BCP by offering to include an anti-insurrection Communist in a reshuffled cabinet.

MALAYA

Continuing disturbances may reduce rubber exports. "B"  
There may be a reduction in Malayan rubber exports in the near future as a result of the continuing disturbances. Despite stringent precautionary measures British officials fear that the violence may soon spread to Singapore and further threaten the Malayan economy. The undiminished seriousness of the situation is indicated by: (1) the transfer to Malaya of troops from Hong Kong and the UK; (2) the outlawing of the Malayan Communist Party and several of its affiliated organizations; (3) the registration of all Malaysians; and (4) the promises of the Labor Government to undertake all necessary measures to restore law and order.

FRENCH INDOCHINA

General Xuan admits weaknesses in his government. "B"  
General Nguyen-van-Xuan, president of the French-sponsored provisional central government of Vietnam, apparently is aware of distinct weaknesses in his regime. He is reported to have stated, during a recent press conference, that his government cannot function properly because: (1) the 5 June Franco-Vietnamese Agreement has not yet been ratified by the French Government; (2) sufficient funds to organize the necessary government services are lacking; and (3) the resistance cannot be crushed by military means, inasmuch as the friendship of the Vietnamese would be lost even though the French might regain military control. President Xuan argued, however, for continued confidence in both former Annamite emperor Bao Dai and French High Commissioner Bollaert in their efforts to satisfy Vietnamese aspirations and at the same time to maintain French rights and interests in Indochina.

PHILIPPINES

Extensions of deadline for arms surrender raise doubts as to success of amnesty. "B"  
President Quirino's action extending to 31 July the period of grace during which Hukbalahap and PKM (National Peasants' Union) members may

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PHILIPPINES (continued)

present their arms raises serious doubts as to the ultimate success of amnesty. Quirino acted after the Huks failed to appear for scheduled mass presentations of arms at some 36 registration stations located throughout central and southern Luzon.

Luis Taruc (Huk leader and Congressman from Pampanga Province), appears optimistic concerning eventual presentations of arms and attributes the current delay to inadequate communication, poor transportation due to the rainy season, and too much emphasis on "surrender" of weapons. (The announced procedure calls for legal licensing of firearms which have been registered.) On the other hand, Philippine law enforcement and intelligence agencies are much less sanguine. These circles doubt the Huks' good faith and believe that the dissidents—hoping for assistance from the USSR during anticipated hostilities with the US—are using the period of grace to reorganize for further armed violence.

There may be those among the Huk Communist leadership who will refuse to accept any terms from the Government. However, available evidence suggests that the hesitancy of the rank-and-file Huk membership to present their arms and accept amnesty is more likely due to Government inaction on measures to correct agrarian abuses and the Huks' fear of retaliation by private landowner armies—known as "civilian guards"—and by the Constabulary. Unless some means is devised for overcoming this basic distrust, the Government will be forced to extend the period of grace beyond the present 31 July deadline.

AUSTRALIA

Australian-Chinese agreement may represent modification of "White Australia" policy. A recent Australian-Chinese agreement which appears to be a modification of the "White Australia" policy provides that Chinese businessmen may remain in Australia for 7 years on condition that they bring a starting capital of 500 pounds with them. If they wish to employ a Chinese assistant required capital is 1000 to 2000 pounds. The assistant's period of residence is limited to five years but the agreement provides that this may be extended for another five upon application to the Australian authorities.

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