

TOP SECRET

DATE Feb. 16, 1955

COPY NO. 5

# **OPERATIONS COORDINATING BOARD**

## **Washington, D.C.**

PROGRESS REPORT ON NSC 146/2  
(FORMOSA AND NATIONALIST CHINA)

NSC REVIEWED 6/13/07 NO OBJECTION TO DECLASSIFICATION AND

### **REFERENCE:**

**OCB FILE NO.** 27

25X1

TOP SECRET



**WARNING**

*This document contains information affecting the national defense of the United States, within the meaning of the espionage laws, Title 18, Sections 793 and 794, U.S.C., the transmission or revelations of which in any manner to an unauthorized person is prohibited by law.*

TOP SECRET

OPERATIONS COORDINATING BOARD  
Washington 25, D. C.

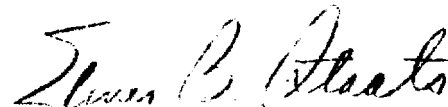
March 11, 1955

MEMORANDUM FOR THE OPERATIONS COORDINATING BOARD

SUBJECT: Progress Report on NSC 146/2 (Formosa and  
Nationalist China)

The attached second Operations Coordinating Board Progress Report on NSC 146/2, "United States Objectives and Courses of Action with Respect to Formosa and the Nationalist Government," dated February 16, 1955, was noted by the National Security Council on March 3, 1955, Action No. 1346.

The previous draft of this report, dated February 4, 1955, is obsolete and may be destroyed in accordance with the security regulations of your agency.



Elmer B. Staats  
Executive Officer

Attachment:

Executive Officer, OCB, Memo to  
NSC, on above subject, dated  
2/17/55, with attachment as listed.

OCB File No. 27

TOP SECRET

25X1



TOP SECRET

OPERATIONS COORDINATING BOARD  
Washington 25, D. C.

February 17, 1955

MEMORANDUM FOR: Mr. James S. Lay, Jr.  
Executive Secretary  
National Security Council

SUBJECT: Progress Report on NSC 146/2 (Formosa and Nationalist China)  
(Policy Approved by the President, November 6, 1953)

There is attached the second Progress Report by the Operations Coordinating Board on NSC 146/2, "United States Objectives and Courses of Action With Respect to Formosa and The Nationalist Government", covering the period June 22, 1954 through December 31, 1954. On February 16, 1954, the Operations Coordinating Board concurred in the Progress Report for transmittal to the National Security Council.

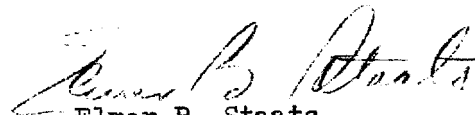
The Operations Coordinating Board wishes to bring the following developments since the cut-off date to the attention of the National Security Council:

1. NSC 146/2 has been superseded by NSC 5503, "U. S. Policy Toward Formosa and the Government of the Republic of China," which was approved by the President and assigned to OCB on January 15, 1955. (Par. 7 Summary)
2. The Mutual Defense Treaty has been referred to the Senate for advice and consent to ratification, which may be forthcoming during February. (Par. 1 Summary, par. 9 Annex A)
3. Additional demarches have been undertaken by our diplomatic representatives in Viet-Nam, Laos and Cambodia regarding diplomatic relations with the GRC, without concrete results to date. (Par. 3 Summary, par. 17 Annex A)
4. Pursuant to NSC Action No. 1312, January 21, 1955, the President sought and obtained by Joint Resolution signed January 29 authority from Congress for use of U.S. armed forces, if necessary in his judgment, to secure and protect

TOP SECRET

positions and areas closely related to the defense of Formosa and the Pescadores, and to assist the GRC to regroup and consolidate its forces. The U. S. has supported a cease-fire resolution in the UN Security Council which, if successful, would have the immediate effect of stabilizing the situation in the offshore islands and, if unsuccessful, might nevertheless be expected to improve the moral position of the U. S. and the GRC in defensive actions which might then become necessary.

5. Interagency agreement was reached on February 7, 1955 looking to the funding of \$48 million from Section 121 funds. This will cover defense support and common use programs in Formosa in connection with retiring ineffectives from the military forces and their replacement by new recruits. (Par. 12 Annex A)
6. In discussions with the GRC on the foreign exchange rate of the National Taiwan dollar, the U. S. is not at present pressing for changes in the rate. (Par. 26 Annex A)

  
Elmer B. Staats  
Executive Officer

Attachment:

Progress Report on NSC 146/2  
(Formosa and Nationalist China),  
dated February 16, 1955.



TOP SECRET

February 16, 1955

PROGRESS REPORT ON NSC 146/2

"UNITED STATES OBJECTIVES AND COURSES OF ACTION  
WITH RESPECT TO FORMOSA AND THE NATIONALIST GOVERNMENT"

(Policy Approved by the President November 6, 1953)

(Period of Report: June 22, 1954 - December 31, 1954)

A. SUMMARY OF MAJOR ACTIONS

1. Mutual Defense Treaty. On December 2, 1954, a Mutual Defense Treaty between the U.S. and the GRC was signed. With the signing of this Treaty, Formosa and the Pescadores were formally incorporated into the offshore island defensive position which now stretches unbroken from the Japanese island of Hokkaido south to include the Philippines. (Annex A, para 9, page 5)

2. Military Aid. As a result of Chinese Communist activity against the offshore islands of Formosa, the GRC was placed in first priority to receive MDAP materiel required for operations in defense of the Chinese Nationalist-held offshore islands. Diversions of equipment from Indochina as a result of the Geneva Agreement and increased shipments from the U.S. as a result of placing the GRC in priority one have significantly raised the military potential of the GRC armed forces. (Annex A, para 10, page 5). FOA is now working on a project aimed at improving the efficiency of the Chinese Nationalist military force by resettlement of at least 73,600 ineffectives and their replacement by young, newly trained men, mostly native Formosans. The GRC MDAP has been continued beyond FY 54 with an illustrative FY 55-56 materiel program totaling \$169.9 million. (Annex A, para 12, page 6).

3. Recognition by Other Governments of the GRC on Formosa. There has been no change in the number of governments recognizing the GRC. In the UN, gratifying majority support was attracted for the U.S. positions on three items relating to China: the condemnation of Communist China's sentencing of 11 UNC airmen; a Soviet-sponsored item accusing the U.S. of aggression against China; and a Soviet-sponsored item charging the GRC with piracy. High government officials of the UK, towards the end of the period under review, made public statements reflecting somewhat stronger support for our position on Chinese questions. At the end of this period, both the GRC and the U.S. were taking active steps aimed at promoting the formal recognition of the GRC by the three Associated States. Despite these encouraging signs that the GRC is holding its own, however, the enhancement of Communist China's power and prestige following the

25X1

TOP SECRET

Geneva Conference continued, underscoring the urgent need for further efforts to seek the understanding and support of our allies for our policies toward the GRC. (Annex A, para 17, page 8).

4. Overseas Chinese Students. A Chinese-American Committee, on which USIA and FOA have representation, has succeeded, with the use of FOA counterpart funds, in increasing the facilities of the universities and middle schools on Formosa to accommodate an additional 1,000 Overseas Chinese students. By September 1955, it is expected that this figure will reach 2,600. USIA books, magazines and radio programs for overseas Chinese depicted the unfavorable conditions in mainland universities. (Annex A, para 19, pages 9, 10).

5. Repatriation to Formosa of Chinese Nationalist Personnel from Burma. On October 23, 1954, forty-six Chinese stragglers remaining in Burma were airlifted to Taipei, completing the evacuation program. There are no others in the custody of either Burma or Thailand. The GRC has stated that it would not participate in the evacuation of any additional irregulars from Burma and this program can now be considered officially closed, although the Burmese Government is dissatisfied because some irregulars remain in Burma. (Annex A, para 22, page 11).

6. Improving Economic and Fiscal Procedures. An economic advisory group of American financial and business experts went to Formosa in August 1954, at the invitation of the Chinese Government, to study outstanding economic problems and to chart an "economic blueprint" for the future. The group submitted a report to the GRC in December generally confirming and underlining FOA policies and advice. It is expected that the report will result in improved fiscal and exchange practices. (Annex A, para 26, page 13).

#### B. OPERATIONAL CONSIDERATIONS BEARING ON POLICY

7. The NSC Planning Board has already prepared a new policy paper on Formosa and the Government of the Republic of China. This draft paper reflects the changes in the situation since the adoption of NSC 146/2 and also reflects Far East policy contained in NSC 5429/5 as it applies to Formosa and the GRC. When adopted by the Council and approved by the President, this paper will supersede NSC 146/2.

#### C. EMERGING PROBLEMS AND FUTURE ACTIONS

8. Focusing of Chinese Communist Belligerency on Offshore Islands. The conclusion of the Sino-U.S. Mutual Defense Treaty has dashed whatever hopes the Chinese Communist leadership may have had of pressuring the U.S. out of its commitment to defend Formosa and confronts them with the difficult choice of backing down on their "liberation" of Formosa campaign or running serious risk of war with the U.S. It is most probable that the Communists, in this situation, will vigorously prosecute actions against the offshore islands. Such actions will

25X1

TOP SECRET

be designed to provide successes which can be presented to the public (at home and abroad) as victories, thus saving face for the regime and compensating somewhat for the regime's inability to deliver on its promises to "liberate" Formosa. Second, the Communists will hope, by waging a campaign of attrition, and by seizing the islands one by one, to damage the GRC's material and moral capacity to resist. They may hope eventually to set in motion on Formosa itself the processes of decay that accompanied the crumbling of Nationalist resistance in 1949. In the case of the Tachens, at least, isolated, hemmed in, and close to Communist bases, it is quite possible that in the absence of stepped-up logistic support from the U.S., which has just been requested by the GRC, Chiang will decide to cut his losses and reduce the Tachen garrison and its logistic support to a minimum. This would, in the eyes of GRC forces and administrative personnel on Formosa, come perilously close to repeating the pattern of the defeat on the mainland. A sizeable increment of free-world manpower, large quantities of U.S. equipment and an important segment of U.S. national prestige has been exposed to Communist attack in an area in which we, together with the Chinese Nationalists, are at a great military disadvantage. The U.S. is now in a position in which we may well lose military equipment as well as national prestige. The Chinese Communists, on the other hand, because of the military advantage they hold in the area of the offshore islands, are in an excellent position to improve their military position with respect to Formosa and gain in national prestige.

The contrast between the limited objectives of the U.S. and the larger objective sought by the GRC (i.e., return to the mainland by force) continues to constitute a long-range problem, especially in the light of our adoption of the policy set forth in NSC 5429/5 further restricting the offensive mission of the GRC. For the immediate future, however, the implication of restraint in this policy (which presumably would not involve actual physical restraint in any event) will cause little trouble; this problem is overshadowed by the immediate problem of preserving the security of the offshore islands.

9. Growth of Chinese Communist Prestige as a Threat to the Position of the GRC. The Geneva Conference signaled Communist China's emergence, after a period of relative quiescence, into the arena of international political affairs. This was followed by a marked effort to acquire prestige and international acceptance, which has been pursued with vigor, persistence, flexibility, and considerable success. The visits of the Attlee Mission, Nehru, and U Nu were taken by the Chinese Communists as occasions for demonstrating their willingness to coexist with nations of differing political systems; the visit of UN Secretary General Hammarskjold brought an increment of prestige, as did the continuing success of North Vietnam under Chinese Communist tutelage, and the negotiation of a series of agreements with the Soviet Union having the effect of making Communist China appear to be the independent equal of the USSR. The apparent willingness of Communist China to negotiate the issue of



TOP SECRET

dual nationality with Indonesia on a reasonable basis improved the standing of Communist China with various Asian Governments. At the end of the period under review, the invitation of Communist China to the Afro-Asian Conference scheduled for Bandung in April 1955, appeared to offer Communist China not only prestige, but also a new theater in which to pursue its objective of exploiting the desire for peace and the nationalistic sentiments of the former colonial areas in order to drive Western influence out of Asia and to isolate the U.S. The immediate effect of these developments, as regards the GRC, will be to undercut international support for that government, and to make more difficult the maintenance of its position in the UN, seriously complicating the tasks of the U.S. in this area. There is also likely to be increased pressure from our allies and from certain sectors of American public and official opinion for an attempt to reach a comprehensive settlement with Communist China. Inasmuch as the Chinese Communists have made it abundantly clear that they would reject any terms on which the U.S. could conceivably negotiate a satisfactory settlement, the ultimate resultant of these pressures could only be to further complicate the task of maintaining support for the GRC. Despite encouraging short-range prospects (see paragraph 3 above), the outlook for the remoter future remains unfavorable.

10. Increased Pressure on Government Budget from Military Expenditures. If the accelerated operational activity in the offshore island area continues, military expenditures will almost certainly rise above levels previously estimated for the current fiscal year and ways and means of financing these additional expenditures will be required.

11. Difficulty in the Development of Foreign Trade. Export earnings in 1954 are expected to total only \$101 million as compared with \$126 million in 1953. This situation has largely resulted from the world surplus of sugar and rice.

12. Possible Revision of U.S. Military Posture. The question of whether the U.S. military posture in the Far East should be reviewed, in the light of the conclusion of the Mutual Defense Treaty, may arise after ratification of the Treaty.

#### D. EXTENT OF AGENCY INTERESTS

13. During the period of this report only departments and agencies represented on the OCB have been involved in the implementation of the security policies set forth in NSC 146/2.

25X1

TOP SECRET

ANNEX A

DETAILED DEVELOPMENT OF MAJOR ACTIONS

Para. 9: "Effectively incorporate Formosa and the Pescadores within U.S. Far East defense positions by taking all necessary measures to prevent hostile forces from gaining control thereof, even at grave risk of general war, and by making it clear that the United States will so react to any attack."

The First Progress Report stated that the State Department had considered the negotiation of a bilateral security pact with the GRC but had decided not to proceed with it at that time, primarily because a defensive pact might have the effect of tying the hands of the GRC. However, since submission of that report, which covered the period through June 21, 1954, the Department has altered its thinking and on December 2, 1954 a Mutual Defense Treaty between the U.S. and the GRC was signed. Under the terms of this Treaty, the United States recognizes that an armed attack against Taiwan and/or the Pescadores would be dangerous to its own peace and safety "and declares that it would act to meet the common danger in accordance with its constitutional processes." With the signing of this Treaty, Formosa was formally incorporated into the offshore island defensive position which now stretches unbroken from the Japanese island of Hokkaido south to include the Philippines.

Para. 10: "Without committing U.S. forces, unless Formosa or the Pescadores are attacked, encourage and assist the Chinese National Government to defend the Nationalist-held offshore islands against communist attack and to raid Chinese Communist territory and commerce."

On September 3, 1954 the Chinese Nationalist-held islands in the Kinmen group were subjected to heavy artillery fire from Chinese Communist artillery positions in the vicinity of Amoy. U.S. and Chinese Nationalist reaction to this attack was prompt. A task group of the U.S. Seventh Fleet was moved into position to conduct air patrols over the Formosa Strait and the Chinese Nationalist Air Force attacked Chinese Communist gun positions which had fired on Kinmen. CINCPAC and Chief MAAG Formosa conducted inspections of the Chinese National defensive positions on the offshore islands, and advised the Chinese regarding troop dispositions and defensive plans.

Chinese Communist military action against the offshore islands of Formosa has continued sporadically throughout the period of this report. As a result, the GRC was placed in first priority to receive materiel required for operations against the Chinese Communists. Diversions of equipment from Indochina as a result of the Geneva Agreement and increased shipments from the U.S. as a result of placing the GRC in priority one have significantly raised the military potential of the GRC armed forces. These deliveries have included ammunition,

25X1

vehicles, communications equipment, and maintenance equipment for the Army and anti-aircraft ordnance and fire control equipment for the Air Force AAA units.

25X1

- Para. 12: a. Continue military assistance beyond Fiscal Year 1954 to assure the completion of present programs designed to develop an army of approximately 350,000 capable of limited offensive operations; a small navy capable of conducting limited coastal patrol, anti-shipping, and commando operations; and an air force designed to provide limited air defense, troop support and interdiction capabilities. \* \* \*
- b. "Keep U.S. military assistance to Formosa under continuous review in the light of the development of Japanese forces and possible political settlements in Korea and Indochina."

The GRC MDAP has been continued beyond FY 54 with an illustrative FY 55-56 materiel program totaling \$169.9 million. In addition to this program, FOA is working on a project aimed at the maintenance of an efficient Chinese Nationalist military force by resettlement of at least 73,600 ineffectives and their replacement by young, newly trained men, mostly Formosan natives. Some of the funds needed for these purposes are now being sought through a Presidential Determination from Section 121 (PL 665) to assist the Chinese in carrying out this project. At the same time, added funds through the Common Use (Direct Forces Support) program are being sought to equip and train new troops drawn from an expanded reserve training program in order to bring JCS-approved units up to full strength.

An analysis of the current combat effectiveness of the GRC military forces is as follows:

ARMY: Based on the existing state of training, equipment on hand programmed and the status of personnel it is estimated that by 15 April 1955 the infantry divisions will be 81% trained, Corps troops 61% and Army troops 45%. By no later than April 1956, all Army units will have reached an equipment level and state of training adequate for conducting truly sustained defensive combat operations. Until the reorganization training of the newly organized units is completed, giving Army, GRC those logistical elements required to conduct combat operations, Army GRC, can conduct an effective, well organized defensive operation for an estimated five to fifteen days. The Nationalist ground forces are not capable of defending Formosa against present Chinese Communist attack capabilities without outside logistical, air and naval support. At present, the offensive capability of the Army is limited except for small scale patrols and raids and the conduct of counter attacks in the execution of defense.

NAVY: There are certain limiting factors, which are receiving constant attention, adversely affecting the efficiency of the Navy as

25X1

TOP SECRET

a combat force. These are: (1) the caliber and motivation of senior commanders; (2) command relationships; (3) lack of adequate communications; (4) lack of air support and logistic support; (5) inadequate maintenance ability. Nonetheless, the Navy has improved steadily and is probably superior to its most likely opponent, the Chinese Communist Navy.

AIR FORCE: The combat effectiveness of the Chinese Air Force is presently limited. Due to lack of proper radar equipment, lack of pilot ability to fly under poor weather conditions, and outdated fighter aircraft, the defensive capability is limited. Offensively, the potential is much greater provided no MIG reaction is encountered. One fighter-bomber group is presently equipped with F-84G aircraft and is considered operationally combat ready. However, until the remaining 3 fighter-bomber groups are so equipped, sustained day operations would not be feasible without U.S. Air Force assistance and U.S. logistical support.

Para. 13: "Continue coordinated military planning with the Chinese National Government designed to achieve maximum cooperation from the Nationalists in furtherance of over-all U.S. military strategy in the Far East, subject to the commitment taken by the Chinese National Government that its forces will not engage in offensive operations considered by the United States to be inimical to the best interest of the United States."

Close coordination in military planning between the Ministry of National Defense of the GRC and the U.S. Chief MAAG Formosa under the supervision of CINCPAC continued. Throughout the operations involving the Chinese-held offshore islands which began in early September 1954, the Chinese Nationalists have cooperated fully with U.S. authorities and have honored their previous commitment not to engage in operations inimical to U.S. interests.

Para. 14: "Encourage and assist the Chinese National Government, through such means as offshore procurement and technical advice, to construct and maintain on Formosa selected arsenals and other military support industries."

No offshore procurement contracts have been authorized in FY 1955. However, defense production in Formosa has continued to benefit from FOA assistance in the form of dollar and counterpart financing plus technical assistance. Smokeless powder and shell loading plants have been completed and are in production. Work is continuing on a double base powder plant with technical assistance from Dupont. Defense production projects being financed by FOA in FY 55 include: small arms cartridge plant, shell loading plant, double base powder plant, shell forging plant, artillery shell case and fuse manufacturing, mortar and gun tube manufacturing. FY 1955 defense production projects are being financed at US\$1.3 million and the counterpart equivalent of \$3.8 million.

25X1

TOP SECRET

TOP SECRET

Para. 15: "Maintain the right to develop facilities on Formosa for use by U.S. forces and agencies in the event of need."

The right of the United States "to dispose such U.S. land, air, and sea forces in and about Taiwan and the Pescadores as may be required for their defense, as determined by mutual agreement" is granted in Article VII of the Mutual Defense Treaty between the U.S. and the GRC. Meanwhile, facilities for use of U.S. aircraft are being developed under informal agreements.

Draft agreements have been submitted by the Embassy in Taipei to the Ministry of Foreign Affairs of the GRC relating to the establishment of a USAF communications station on Formosa.

Para. 16: "Strive to make clear to the Chinese National Government that its future depends primarily upon its own political and economic efforts and upon its ability to command the respect and support of the Chinese people. Meanwhile, continue efforts to show our continuing friendship for the Chinese National Government and the Chinese people, while avoiding any implication of U.S. obligation to underwrite the Government or to guarantee its return to power on the mainland."

The US-GRC Mutual Defense Treaty underscored the fact that our commitment in Taiwan and the Pescadores is purely defensive while reaffirming the traditional friendship between the U.S. and the GRC. Extensive speculation in Formosa concerning U.S. intentions of preventing military action against the mainland, while to some extent exaggerated or unfounded, has further dispelled GRC illusions that the U.S. would underwrite a reconquest of China. U.S. representatives on Formosa have continued to make clear that United States assistance can strengthen the military and economic potential of the GRC but can provide no substitute for popular support. The GRC has been left under no illusion as to its responsibility for developing and maintaining this requisite element of national strength.

Para. 17: "Continue to recognize and encourage other governments to recognize the Chinese National Government on Formosa as the Government of China and to support its right to represent China in the UN and other international bodies."

During the period covered by this report the diplomatic position of the Chinese Nationalist Government has continued to be maintained with difficulty. With the enhancement of Communist China's power and prestige as a result of the Geneva Conference there developed an increased need for obtaining understanding and support of our policies toward the GRC on the part of our allies.

The short-range prospects for success in this endeavor improved slightly towards the end of the period under review. Not only did

25X1

TOP SECRET

we continue to hold our own with an unchanged majority of UN member states still recognizing the GRC, but also some heartening support for our position in Chinese questions was manifested in public statements by high British officials. This occurred partly as a result of the UN's condemnation of Communist China's action in sentencing eleven UNC airmen. The net effect of UN consideration of this question and of two Soviet-sponsored items, the one accusing the U.S. of aggression against China and the other charging the GRC with piracy, was on balance favorable to the U.S. position. In regard to the strengthening of Chinese diplomatic representation abroad, our desire to secure the replacement of the Charge d'Affaires in Bangkok by a more effective representative has not been satisfied; but active steps are now being taken by the U.S. and by the GRC to develop diplomatic relations, or at a minimum, regularized consular relations, between the GRC and the three Associated States. In the case of South Vietnam, at least, conditions are believed to be favorable for such a development.

Nevertheless, in the long-range view, the considerations outlined in paragraph 9 of Section C, Emerging Problems and Future Actions, made it apparent that only an intensification of present efforts in this field can enable the U.S. to continue to hold its own.

Para. 18: "Continue to encourage the Chinese National Government to take all possible steps to attract growing support and allegiance from the people of mainland China and Formosa."

The FOA program continues to place emphasis on improving opportunities for Taiwanese under the "Industrial Loan Program" financed by FOA with US\$1.5 million in FY 1955, and financed with counterpart funds equivalent to US\$3.0 million under the "Small Industry Fund" in FY 1955. This latter fund is being administered in cooperation with local banks, mostly Taiwanese, which are contributing 20% of the US\$3.0 million local currency equivalent in the "Small Loan Program." As of November 27, actual withdrawals totalled 78% of the Small Loan Program funds. The local currency program has moved more rapidly than originally expected and has benefited Taiwanese borrowers who have received 75 out of a total of 106 loans.

USIS Taipei has consistently but without effect advised GRC propagandists that the principal difficulties with the GRC propagandists are: (1) Its extremely bombastic tone which often ignores the necessity for some credibility, and (2) the unrealistic exchange rate which hinders the overseas commercial distribution of publications from Formosa. (See also paragraph 21)

Para. 19: "To the extent feasible, encourage the Chinese National Government to establish closer contact with the Chinese communities outside mainland China and Formosa and to take steps to win their sympathy and their support to the extent consistent with their obligations and primary

25X1

TOP SECRET

allegiance to their local governments. Encourage the leaders of these communities to reciprocate by extending such sympathy and support to the Chinese National Government as a symbol of Chinese political resistance to communism and as a link in the defense against Communist expansion in Asia."

Implementation of this course of action has been mainly by means of our USIA program in which increased emphasis has been placed on the aim of dissuading Overseas Chinese students from going to the mainland for study. This program has been carried out through the medium of Chinese magazines and books, such as "WORLD TODAY" and "FOUR SEAS" published in Hong Kong and Taipei and distributed throughout Southeast Asia. VOA radio programs contrast the cruelty and oppression of the Chinese Communist regime with the progress being made by Free China. These programs are broadcast to the mainland and overseas Chinese from short wave and medium wave facilities in the Philippines and Okinawa.

The achievement of a Chinese-American committee in Taipei, on which USIA and FOA have representation, is readily apparent. This committee, with the use of FOA counterpart funds, has succeeded in increasing the facilities of the universities and middle schools on Formosa to accommodate an additional 1,000 Overseas Chinese students. By September 1955, it is expected that this figure will reach 2,000.

By joint action this working group and the OCB working group on NSC 5405, Southeast Asia, have reviewed and submitted to the Executive Officer of the OCB a study containing suggested courses of action aimed at preventing or counteracting the ill-effects of the migration of overseas Chinese students to Communist China.

Para. 20: "While continuing to manifest U.S. confidence in and support of the Chinese National Government, permit U.S. officials as appropriate to maintain discreet contact with anti-Communist Chinese groups outside Formosa which continue to reject cooperation with the Chinese National Government, and without making commitments of U.S. support, encourage such groups actively to oppose communism."

This paragraph will be separately reported to the Board.

Para. 21: "Seek to enhance the Chinese National Government's political appeal and to increase its administrative efficiency."

Influence continues to be exerted at the diplomatic level by U.S. representatives in Formosa, particularly in regard to achieving increased administrative efficiency. In addition, USIA on Formosa assists the MAAG and FOA in giving local publicity to the U. S. aid programs and publicizes the political, military and economic

25X1

TOP SECRET

accomplishments of the GRC in order to build up greater confidence in Free China among the residents of Formosa and the Overseas Chinese.

Para. 22: "Continue to press through diplomatic channels for the repatriation to Formosa of Chinese Nationalist personnel from Burma. If transportation is not available consider U.S. logistic support to repatriate such Chinese Nationalist personnel to Formosa."

As previously reported, an extension to September 1, 1954 of Phase III of the evacuation of KMT irregulars from Burma was approved by the OCB on June 16, 1954. In order to take care of stragglers this was further extended by a September 17 decision of the Board Assistants. On October 23, forty-six Chinese stragglers remaining in Burma were airlifted to Taipei, completing the evacuation program. There are no others in the custody of either Burma or Thailand. The GRC has stated that they would not participate in the evacuation of any additional irregulars from Burma and this program can now be considered officially closed.

Para. 23: "Continue to provide limited economic aid to Formosa in such a manner and of such a scope as to promote U.S. objectives in the area; but plan gradual reduction and eventual termination of such assistance, bearing in mind, however, that some economic aid will probably be required so long as the present military programs are continued."

FOA is financing a regular program during FY 1955 -- \$90.0 million of economic aid (i.e., Defense Support and Technical Cooperation), and "common-use item" aid (i.e., Direct Forces Support). A program of \$102.0 million has been requested in FY 1956. Of these programs, capital development funds total \$20.9 million and \$21.4 million respectively in FY 1955 and in the planned FY 1956 program. These amounts plus obligations beginning in FY 1951 bring the grand total of capital development funding to \$121.0 million. The effect of the investment program plus imported raw materials has thus far been to increase production nearly 50% above the pre-war Japanese peak of 1940. According to the Chinese Government's four year plan, a total of \$155 million of capital development funding will be required during the period 1953 through 1956, to enable Formosa to reach viability. FOA capital investment financing for the period FY 1953 through FY 1956 is \$91.2 million. This \$91.2 million, plus private investment of \$11.4 million, totals \$102.6 million, leaving a shortfall of \$52.4 million as against the \$155 million target for investment.

Even if the full investment requirement is met, some uncertainty remains as to Formosa's attainment of economic viability. The uncertainty is caused by such factors as: (a) Formosa's foreign exchange position which will improve or deteriorate depending largely upon

25X1



TOP SECRET

markets for sugar and rice; the current prospects for markets are unfavorable; (b) the probability that with a rise in production, much of the increased national product is likely, in the absence of strong Chinese government policy determination, to contribute to higher consumption standards rather than to increased viability. Consumption standards for both the military and civil population have shown some tendency to rise from the austere levels prevailing from VJ day to 1952.

Para. 24: "Continue to assist the Chinese to plan the most productive use of their resources on the island and to make them available to the free world."

FOA has continued to encourage the Chinese to take maximum advantage of export opportunities and hence to increase foreign exchange availabilities. These efforts, while succeeding in individual cases, (pineapples, bananas, salt) have in the overall been unsuccessful since export earnings in 1954 are expected to total only \$101.0 million as compared with \$126.0 million in 1953. This situation has largely resulted from the world surplus of sugar and rice. Formosa, ostensibly benefiting from an all-time high in rice production has, in fact, suffered because of its inability to market over 300,000 tons of rice (value US\$52.5 million at \$175 per MT), due in part to the growing competition of U.S. exportable grain surpluses and to the inability of the Chinese and Japanese to reach mutually agreeable terms of sale.

FOA has encouraged the Chinese to invite private capital, notably through the American Overseas Petroleum Corporation (CALTEX affiliate), in the development of Formosa's crude petroleum resources. Negotiations are in progress between AOP executives and the Chinese Government in Taipei.

FOA has continued its support of coal development through technical assistance (Department of Interior, J. G. White Engineering Corporation) and through counterpart and dollar financing. Supplies of bituminous coal from Formosa are available for export, but unfortunately U.S. Government policies to promote the export of U.S. coal have proved a major deterrent to Formosa's export sales in the Far East, notably to Korea.

Para. 25: "Continue to emphasize and to implement examination and consultation with the Chinese concerning proper fiscal procedures and to curb tendencies toward excessive demands by the Chinese National military establishment on the economy of Formosa."

In cooperation with the MAAG, screening of the Chinese military budget has continued with markedly improved procedures. Defense expenditures approved by the FOA and MAAG have risen, however, in FY 1955 as compared with FY 1954. The increase is considered reasonable

25X1

TOP SECRET

in view of the intensification of hostilities on the offshore islands beginning in September 1954. Despite some increases in expenditures, military spending has not been allowed to reach such proportions as to injure price stability. In fact, the wholesale price index has dropped from 115 at the beginning of 1954, to 108 in November 1954 (based on the average of 1952 as 100).

Para. 26: "Continue to exert the influence of the U.S. Government to modify programs which run counter to prudent advice on economic and fiscal procedures offered to the Chinese by U.S. representatives."

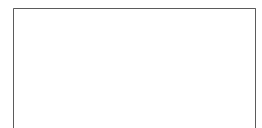
In general, the GRC has responded satisfactorily to U.S. advice in economic and fiscal procedures. U.S. influence is currently being brought to bear to achieve improvements in (a) the electric power rate structure and thereby remove subsidies, and (b) the foreign exchange rate.

An economic advisory group of American financial and business experts went to Formosa in August at the invitation of the Chinese Government to study outstanding economic problems and to chart an "economic blueprint" for the future. The group submitted a report to the GRC in December generally confirming and underlining FOA policies and advice. It is known that the Chinese are considering certain EAG recommendations seriously, and it may be anticipated that the report will result in some improvement in fiscal and exchange practices.

Para. 27: "Assist the Chinese National Government to develop a well-balanced foreign trade which will meet the needs of the Formosan economy after the termination of U.S. economic assistance."

As reported under paragraph 24 of this report, the export earnings in 1954 are expected to total only \$101 million as compared with \$126 million in 1953. This situation has largely resulted from the world surplus of sugar and rice. While ostensibly benefitting from an all-time high in rice production Formosa has, in fact, suffered because of its inability to market over 300,000 tons of rice (value \$52.5 million at \$175 per MT), due in part to the growing competition of U.S. exportable grain surpluses and to the inability of the Chinese and Japanese to reach mutually agreeable terms of sale. Supplies of bituminous coal are available for export, but unfortunately U.S. Government policies to promote the export of U.S. coal have proved a major deterrent to Formosa's export sales in the Far East, notably to Korea.

25X1



Para. 28: "Encourage the Chinese National Government to adopt policies which will stimulate the investment of Chinese and other private capital and skills for the development of the Formosan economy."

As a result of FOA encouragement, the Chinese Legislative Yuan approved on July 7, 1954 a foreign investment law, which liberalizes treatment of foreign investors and allows foreign ownership of corporations and mineral rights. As of December 1954, investment since 1951 has been approved totaling \$3.5 million from Overseas Chinese, \$11.4 million from the U.S. and Japan. Investments totaling \$11.2 million are under negotiation largely initiated during 1954. (Source: Taiwan Economic Fact Book, Supplement #8, December 17, 1954).

Para. 29: "Develop Formosa as an effective base for psychological operations against the mainland, along lines which support U.S. policy objectives, and in collaboration with the Chinese National Government when appropriate."

This will be separately reported to the Board.



