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CONFIDENTIAL REPORT TO

THE PRESIDENT

ON SOME ASPECTS OF THE

CURRENT POLITICAL, ECONOMIC AND MILITARY SITUATION

IN CHINA

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March 15, 1941.

REPORT ON SOME ASPECTS OF THE CURRENT  
POLITICAL, ECONOMIC AND MILITARY SITUATION IN CHINA

I arrived in Chungking February 7 and departed February 27. In this interval I had about twenty-seven hours of serious discussion with Generalissimo Chiang Kai-shek, interviewed most of the cabinet members and leading generals in Chungking, interviewed a large number of other officials and members of the foreign colony at Chungking and Chengtu, and studied many memoranda submitted to me by the various ministries. I was assured by many that I was given access to material never before made available to a foreigner. I pursued my inquiries along three broad lines -- political, economic and military. In reading this report it should be kept in mind that in conducting my interviews and investigations I was not acting as an accredited representative of the American Government, but as a guest of the Chinese Government with the understanding that I would advise and consult on internal domestic matters with that government.

I - The Problem of Internal Unity and Morale. Your verbal message to Chiang Kai-shek on this general topic was remarkably well-timed and unquestionably contributed a good deal toward the lessening of the tension that prevailed just before I arrived. It also gave me my cue and I lost no opportunity to urge, in as tactful and inoffensive manner as I could, the importance of preserving a united front with the Communists against Japan, and the importance of making progress toward democracy and the establishment of civil liberties.

I took no position on the truth or falsity of the numerous charges and counter-charges made by the National Government and the Communists. What I

did stress, however, was that the Chinese Communists have received a very favorable and sympathetic press in the United States. I sought continuously to make the discussion turn on the question of tactics--on the desirability of alleviating real grievances and of depriving the Communists of the issues on which their support was based. In this connection I took the liberty of expounding at considerable length what I conceive to be your strategy of depriving your opponents of issues, and of your broad policy of removing grievances rather than attempting to suppress or ignore disaffection. I think this general line of argument made some impression on the Generalissimo, particularly as he himself has followed such tactics in dealing with disaffected groups other than the Communists and liberals. I am afraid, however, that my visit was too short to have left an enduring impression.

His hatred for the Communists is very deep and his distrust of them is complete. This hatred springs not from the usual antagonism between "property interests" and "the proletariat." It springs rather from the fact that the unification of China under his leadership has been a controlling passion with him for years and the Communists have been the only group that he has not been able to buy off, absorb, liquidate or suppress. Moreover, the Communists have been the only party which has been able to attract mass support. While the Generalissimo is a true Chinese patriot with a deep and profound love for his people he has little faith in the ability of the people to govern themselves. His attitude toward them is purely paternalistic. He remarked again and again that they were uneducated and easily influenced by rumors and that they had to be more fully trained and educated before they could be trusted with any political power. He distrusts the intellectuals, particularly the returned students with western ideas of free speech and

democracy. He deeply resents any criticism of the government, particularly if made in public.

I established sufficiently cordial relations with the Generalissimo as to feel able to tell him without offense various elements of disaffection which I had observed in China. This disaffection is particularly pronounced among the younger government workers, the university students and teachers, and in general in what we would call the liberal and progressive groups. They are definitely not Communists and are patriotic and loyal to the Generalissimo. However, they are disillusioned, discontented and discouraged. They do not feel that there is one liberal person among the ministers close to the Generalissimo. They do not feel that their own talents and patriotism are being availed of. Their economic status is rapidly worsening with the rise in prices. They feel that there is widespread spying going on and that it is dangerous to venture any criticisms of the government or government policies. I found that I got virtually nothing from an interview at which there were two Chinese present. I got very much more when I had one at a time, still more when I conducted the interview in my bedroom which was the most private room in the house, still more after a long interview, and that when they finally ventured on certain criticisms they would draw their chairs close to mine and their voices would fall almost to a whisper. I submitted that whether or not their fears were justified was not as important as that they thought that they were and that the intellectual atmosphere was definitely not healthy.

The censorship is so drastic that people have lost a good deal of faith in the press and the wildest kind of rumors readily gain credence. For example, there was a rumor circulating when I was there that I was strongly urging on the Generalissimo a policy of appeasing Japan. The Communist paper

in Chungking ran an editorial welcoming me, drawing certain things to my attention. I thought it was fairly innocuous but nevertheless it was severely censored. This censorship took the form not only of crossing out words and passages but of actually, in one instance, changing a word so that a sentence which originally ran "China needs a sound financial system" appeared in print as "China has a sound financial system." I was informed on good authority that there had been two to three hundred arrests of progressive elements in recent months but that all arrests had been suspended during my visit. The Minister of Education, Chin Li-fu, is particularly hated and distrusted by all the liberal elements.

The National Government-Communist relations.

I received the complete government story of the events leading up to the Fourth Group Army incident. I also, with the Generalissimo's knowledge and consent, interviewed Chou-en-lai and received, as I expected, a story with an entirely different slant. My own conclusions, for what they are worth, are as follows:

The Communists had expanded both in number and in areas unauthorized by the central government. Their introduction of progressive taxation on landlords, of local village democracy, their anti-Japanese propoganda, and their ardent advocacy of a rapid carrying out of Dr. Sun's Three Principles, have all proved popular with the peasants. The central government has become increasingly alarmed at the growing strength of the Communists. It has sought to meet this strength in various ways. One was by ceasing to give the Communists any military supplies. The second was by enforcing a military and economic blockade around the northern Communist areas. Finally, they adopted a legalistic attitude toward orders to the Communist armies, taking the position that these armies were no different from any

other Chinese armies and that any failure to carry out any orders immediately constituted mutiny and insubordination. It was claimed, though I am not able to confirm this, that the Chinese commander who precipitated the pitched battle that occurred exceeded his orders. Thereafter, a very tense situation prevailed for a time when the part of the Fourth Route Army that had crossed the Yangtze was surrounded by Japanese and Chinese Government troops. Chou-en-lai told me, however, that the Fourth Route Army had succeeded in making a junction with the Eighth Route Army so that that particular danger seems to have passed. Just before I left China, Pai-Chung-hsi, the Deputy Minister of War, told me quite frankly that the Communists had suspended all guerilla activities and that the government had fifty of their best divisions immobilized in watching the Communists. When I asked him if there was any hope of a reasonable settlement being arrived at which would permit both armies to devote their full attention to the Japanese he replied that he was "hoping against hope."

In other words, the situation remains serious and a very important segment of Chinese military strength is not being used to prosecute the war against the Japanese. Nevertheless I do not think that actual hostilities on a large scale will occur in the near future. Chiang Kai-shek asked me in a most earnest and confident tone to assure you that he had the situation well in hand, that he knew exactly how far he could go and that there would be no civil war. Judging from the attitude of Chou-en-lai, the Communists are equally desirous of avoiding a showdown at this time. Given this will on both sides, I think that while the central government will continue to apply pressure to restrict the areas in which Communists operate, and while the Communists will resist such pressure and while they will both talk as if a showdown

were imminent, actually it probably will be avoided. I think your verbal message that I conveyed, together with independent evidence of widespread concern in this country, the pressure that has been applied by the British Ambassador, Sir Archibald Clark-Kerr, and lastly, the importance of continued aid from Russia, will all combine to dissuade Chiang from precipitating actual conflict. When at one of our last meetings Chiang asked me pointblank what my impression was as to the prospects of maintaining internal unity I told him that there were many things that disturbed me and many things that I did not know, but that I was clinging fast to the assurances he had given me and the attitude evidenced by Chou-en-lai. He replied that it was a very confused and involved situation, but that I had put my finger on the one essential fact.

In connection with the growing disaffection of the liberal elements within the central government areas of free China, I argued as strongly as I dared for a policy of conciliation rather than suppression. One of the arguments I used for my proposal for drastic land taxation reform was that it would hearten the liberals and steal some of the thunder of the Communists, and this argument seemed to attract him. The central government has recently begun to introduce some mild reforms in the hsiens, or counties, which provide among other things for popularly-elected advisory councils. I praised this extravagantly and said that it was one of the most exciting things I had heard and that it should be widely known in America. Chiang was very pleased and sent three or four people to tell me about it. Actually it amounts to very little, but I thought that I could not give too much encouragement to even small steps in the direction of democracy. I ventured to suggest that the appointment as a minister of somebody who would be

regarded as a representative of the younger and more liberal groups would do much to reassure those groups and to reconcile them to such people as Ho-Yin-Chin and Chin Li-fu. At this point Madame Chiang interjected that we had in a walk that very afternoon been discussing the desirability of Madame Sun returning to Chungking. The Generalissimo then said that he would like to have her in Chungking where she would be a completely free agent, that he needed a good Minister of Health, and that he would like Madame Sun to accept that position and would I please bear that message to Madame Sun when I saw her in Hong Kong on my return. Madame Sun said she could not accept such a post when I saw her, and I did not urge it upon her, as I felt that she was not fitted for administrative work and would be stepping out of character. I may be doing him an injustice, but I cannot help having the suspicion that the Generalissimo knew she would not accept the post.

My general conclusion is that while internal conflict will be held to a minimum during the war there is a very dubious prospect of maintaining political stability in the post-war period. My own experience has led me to believe that an American liberal adviser, backed by his government and able to deliver or withhold dollars and technicians in the post-war period, and finally, temperamentally congenial to the Generalissimo and able to hold his confidence, might be able to exert enormous influence in instituting thorough-going political and economic reforms and so prevent the clash that now appears inevitable between the left and the right.

II - The Economic Problem. A good part of my time was spent on the economic problem. The remainder of this section is the brief discussion of my impressions and suggestions which I submitted to the Generalissimo at his request at the conclusion of my visit. I also submitted a statistical appendix to this report, on which the impressions and suggestions were largely based.

The economic situation, in my view, has reached a dangerous state and, if no drastic remedial measures are adopted, will probably become critical this year. After making full allowance for the effects of the economic blockade and transportation difficulties, China is confronted with a condition in which the volume of money (notes and current deposits) available to buy goods has increased rapidly while the supply of goods for sale is not increasing. The only possible consequence is a rise in price. On the basis of figures furnished me by the Ministry of Finance, another large expansion of money is in prospect for this year, amounting to nearly a doubling of the money in circulation in Free China. This can only lead to further inflation. The anticipated revenue this year from taxation is negligible and there is little hope in these circumstances of selling more than a negligible amount of bonds to the public. Taxation of land and income from land is left entirely to the provinces. Much of the land escapes any taxation and the part that is taxed pays only nominal rates.

The social and political effects of continued inflation are more serious than the purely economic effects. Important sections of the population are finding the buying power of their incomes reduced while

other sections are making windfall profits. This is bound to be damaging to national morale and will be exploited by opponents of the Government. Moreover, a continued policy of drift and the continued absence of any serious effort to correct the situation cannot fail to create a bad impression abroad of China's financial instability and will thus militate against other than purely military aid.

Suggestions:

1. Land Tax. The first, and in my view, absolutely indispensable step to be taken is the reform in the character and administration of the land tax by the Central Government. China, particularly Free China, is an agricultural country. The basic source of wealth is in land, and the bulk of income is from land. Unless the Central Government can draw its revenues from the real wealth and income in the country, it can never hope to cover more than a negligible portion of its war and post-war expenditures through taxation. The resulting borrowing will cause further inflation and rapidly increasing debt charges.

This reform is not only desirable on budgetary grounds, but it would also serve to emphasize to the people that this Government was determined to proceed along the lines of social justice and equality laid down by Dr. Sun. It would cut the ground out from under the Communists and they should be forced to applaud it. The tax would fall largely on the well-to-do landowners who are now profiting by the inflation. In Szechuan,

a small proportion of the landowners own the bulk of the land and receive the bulk of the rice. Much can be made of the fact that the Government is not only prepared to conscript men in the war against Japan, but also wealth. The opportunity to use the patriotic and emergency appeal should make the tax easier to introduce now than in the post-war period. It can also be intimated that such a step is a prerequisite to obtaining foreign credits in the post-war reconstruction of China.

Needless to say, this proposed far-reaching reform requires an honest, patriotic and efficient administration possessing the full support and confidence of the Generalissimo.

Assuming proper administration, the tax can be made very productive of yield. Professor Buck estimates that the land available for taxation in Free China amounts to two hundred million acres, which, at an average of four dollars per acre, is now yielding provinces and districts about six hundred million dollars. At twenty dollars an acre, the yield would amount to four billion dollars. It should, therefore, be possible for the Central Government to secure in the first year twenty-six hundred million dollars or, after rebate to the provinces and districts, two billion dollars net.

This figure, in conjunction with the estimate of non-borrowing receipts for 1941 of \$1,220,000,000, would amount to \$3,220,000,000 out of total estimated expenditures of nine billion dollars, and total domestic expenditures of seven billion dollars. Moreover,

I am convinced that more vigorous administration would result in a substantial increase in the yield of existing Government taxes.

2. Sale of Bonds to the Public. The assurance of greatly increased tax receipts, by increasing confidence in the financial soundness of the Government, would facilitate the public sale of bonds. Given this favorable psychological background, a great popular campaign could be launched. Quotas could be assigned each district, town and village; the aid of all college students and prominent citizens and returned and wounded soldiers could be invoked to speak at mass meetings and canvass individual people; suitable badges could be given every person subscribing; and the patriotic appeal stressed throughout. Failure of well-to-do people to buy their proper share of bonds would be regarded as unpatriotic. The appeal could be extended to Shanghai and Hong Kong. A goal of \$1.5 billion could be set for the year with, say, three or four popular drives.

3. Aid from Stabilization Funds. As foreign exchange is sold to meet an adverse balance of payments, the Stabilization Funds convert their U. S. dollars into fapi. The fapi, whether in the form of notes or deposit, is thus withdrawn from circulation. Consequently, a corresponding amount can be borrowed from the banks by the Government without entailing a net increase in the volume of money in circulation. In other words, the inflationary effect of borrowing from the banks can be offset to the extent that stabilization fund dollars are converted into fapi.

4. Increasing the Supply of Goods. Various suggestions have been made for increasing the production of agricultural goods. Among those that appear to merit consideration are:

- a. Suspend recruiting at planting and harvesting time and, when practicable, grant furloughs to men near their homes.
- b. Release a number of men now engaged in building operations.
- c. Reduce rents so that farmers can afford to hire more help.
- d. Guarantee a minimum buying price for rice.
- e. Organize smuggling under Government auspices. Thoroughgoing and vigorous organization of smuggling could result in a significant addition to the supply of certain types of essential goods.
- f. Prepare for recapture of Ichang and Canton at the earliest practicable time.

5. Emergency Forced Rice Loan. If it does not prove possible to carry out a thorough-going reform in taxation, the possibility of having recourse to a forced rice loan might be seriously explored. This, however, should be regarded as an emergency measure to be resorted to once only. It could take the form of borrowing a certain proportion of the rice crop from the landlords and peasant proprietors with a promise to repay the

same amount or slightly larger amount of rice, or the equivalent value thereof, in, say, three or five years' time. Such a loan would serve the double purpose of alleviating the Government's financial position and of ensuring an equitable distribution of the available rice.

III - The Exchange Problem. My discussions of the Chinese exchange problem dealt chiefly with the wisdom of continuing to support fapi in the Shanghai exchange market. The disadvantages of this policy are well-known. Of the many offsetting advantages which are made in favor of this policy, the only one which seems to me to carry weight is the necessity of avoiding a huge flow of national currency from the occupied areas into Free China. Such a movement would serve to bid up prices and to intensify inflationary tendencies greatly. So long as the occupied areas and the International Settlement remain willing to absorb fapi, Free China can pay for its essential smuggled imports in national currency instead of in foreign exchange. If the British and American Governments can be persuaded to block private Chinese balances abroad, the chief disadvantage of supporting the black market, namely the opportunity it affords for private capital export, will be removed. The taxation and internal financing measures set forth above should, if adopted, make the task of supporting the external value of fapi considerably less difficult, should lead to increased use of fapi in the occupied areas as a safe place for savings, and should increase the usefulness of the stabilization credits which are being extended to China.

Suggestions:

1. For the reason indicated above, supporting operations at Shanghai should not be discontinued for the present.
2. However, because of the military vulnerability of the Shanghai International Settlement, an open market in exchange should be gradually developed at Chungking through the introduction of supporting operations here. These operations should be undertaken on a limited scale at first and enlarged gradually thereafter. With the development of an open market in exchange at Chungking, exporters should no longer be required to sell their exchange at the commercial rate, and the so-called commercial market should be discontinued.
3. As suggested elsewhere, smuggling traffic should be systematically organized under Government auspices to enlarge the flow of essential commodities from the occupied areas and from abroad.
4. If exchange supporting operations at Shanghai have to be discontinued, the Government should be prepared to impose, if necessary, drastic restrictions on deposit withdrawals from Chinese banks at Shanghai in order to avoid excessive pressure on these banks and to limit the flow of money to Free China.
5. Urge the United States and British Governments to freeze private Chinese balances. Such action would greatly restrict the possibility of further export of Chinese capital. It

would permit the foreign exchange resulting from current exports and from remittances of overseas Chinese to be applied exclusively to purchasing needed imports and meeting other expenditures abroad. Finally, such action would pave the way for eventual action by the Chinese Government to compel its nationals to surrender their previously exported capital for fapi.

IV - The Banking Problem. China, unlike other major countries, has no central bank of issue. The problem of securing unified banking operations and policies is therefore difficult of attainment. The Government pays a high rate of interest to the banks on the money it borrows, and the figures of debt charges are growing rapidly.

Suggestions:

1. Buy out privately-owned shares in the Central Bank.
2. Confine all future increases of note issues to the Central Bank. The growth of other banks would then be restricted to the growth in their deposits, and their purchase of Government bonds would be limited by the growth in deposits.
3. Convert profits of the Central Bank into the Treasury.
4. Regulate extension of private loans of the banks.
5. Appoint Government examiners of banks.
6. Compel filing of statement of profits and loss and tax profits.

V - Road Transportation. Time did not permit a survey of the whole field of transportation. Attention was directed mainly to the most crucial route, the Burma Road. There appears to be unanimous opinion

to the effect that the capacity of the road, now around 2,500 tons a month, could be doubled and even trebled by unified and efficient control and the more effective utilization of existing equipment.

Suggestions:

1. Create a Burma Road Commission of three members under the Chairmanship of the Director of Military Transport. The Minister of Communications and Mr. J. E. Baker would be the other two members.
2. The Ministry of Communications would represent the needs of all non-military uses of the road.
3. Mr. Baker would be given the post of Executive Director of the Road. Mr. Francis Pan and Mr. Tan might be loaned from the Ministry of Communications to act, for the time being, as Mr. Baker's assistant directors.
4. The Commission would collaborate with the appropriate Burma commissioner authority.

VI - The Yunan-Burma Railroad. I understand that the Burma Government has decided to extend the railroad from Lashio to the border, and that the extension by the Chinese Government of the road to Kunming is being actually considered. I have not had an opportunity to go into the matter, and I shall confine myself to one or two observations. The foreign loan required would amount to U. S. \$20,000,000. It would take about two years to build the road. It is questionable whether materials from the United States will be available. I suggest study by qualified experts of the feasibility

of putting in a light Diesel engine cog or rack railroad which would be much cheaper and quicker to build. It could then be laid alongside the Burma Road and could, I am informed, carry 30,000 tons a month.

VII - Air Freight Transport. In rugged regions in northern Canada and Central America air transports have been used for heavy freight with conspicuous success. China appears to offer the same possibility. With regard to the danger of Japanese reprisals, it might be pointed out that the planes can fly by night and be afforded some protection on the ground by the new pursuit ships.

In view of the possibility that the Burma Railroad might be bombed or subject to blockade, it would appear desirable to bend every effort to build up an adequate reserve stock of aviation gasoline and other most urgently needed articles. For this reason, the transport of things like refining equipment that cannot be put in operation for two years should be vigorously restricted for the time being.

VIII - Economic Mission. I have given considerable thought to this matter. Provided certain conditions are met, I should think that such a mission would be of benefit to China. These conditions are, however, of extreme importance. The first is that under no circumstances should the appointment of a mission be used as an excuse to postpone obviously needed action. The second is that extreme care should be used in the selection of personnel. At the British Ambassador's invitation, I have discussed the matter with him and he is perfectly agreeable to a joint British and American Mission under the chairmanship of an American. The problem of securing first-class

men (and only first-class men should be appointed) is difficult now that Britain is at war and America is engaged in a mighty defense effort. Possibly some outstanding men may be available in America during the long summer vacation.

Suggestion:

I suggest that a final decision be delayed until after I have had a chance to see if first-class men are available in America and England. If good men are not available for a mission, and if good men can be found to act as political and economic advisors, it might well prove the wiser course to postpone the appointment of an economic mission to a period immediately following the conclusion of actual combat.

IX - Post-War Economic Problems. I have had little time to study these, but I cannot fail to be impressed by the enormous need for materials and skills. In this connection I might venture a few tentative observations of a general nature.

a. Trade in the post-war world will probably be subject to much greater control than in the past. Therefore, the problem of servicing foreign debts cannot be left as readily to the free play of international trade. Trade may be carried on more in terms of barter arrangements. Hence, in securing foreign credit, particular care should be given to the expansion of foreign trade industries and arrangements for repayment.

b. In general, it would be desirable to secure foreign government credits rather than private credits. In the past private loans have too often led to graft, bribery, and excessive

meddling in internal affairs.

c. I should hope that China will avoid the dangers associated with private exploitation of her natural power resources.

d. The three most essential needs for post-war reconstruction are (1) political and financial stability, (2) avoidance of borrowing abroad beyond the capacity to repay, (3) an honest and efficient public service.

e. I most earnestly hope that all the gains of technical progress in industry and agriculture will not be used up solely in supporting more people at a subsistence level of living. I feel that one of China's greatest needs is more widely diffused knowledge of birth control.

This concludes the very hastily-written report I submitted. Most of the material was covered at some length in discussion. The report and the statistical appendix were requested largely as aids to memory. The Generalissimo professed himself to be very pleased with my diagnosis and suggestions. He immediately put into effect my suggestion for the reorganization of the Burma Road, although the suggestion of appointing Baker as Director General came from the Chinese. I understand that he has also since my departure appointed a commission to undertake the transition of land taxes from the provinces and districts to the central government. The foreign financial measures which he favors are discussed at the conclusion of this report. I am not sure that this report conveys a proper impression of the completely chaotic condition of the Budget. There is no semblance of budgetary control

and no significant effort has been made to date to finance expenses other than by borrowing from banks. Large lump-sum payments are made to the military, and the Ministry of Finance had no idea how they are spent. I was informed that some of the material I requested had never before been collected and presented in the form I wanted it. I did not meet one person whom I considered competent in the whole Ministry of Finance. Fortunately, I had previously known the head of the Farmers Bank, Y. C. Koo, who is an able economist with fiscal experience, and through securing his services, I was able to obtain what I think was a fair approximation of the budget picture. I have, therefore, little hope that the Ministry of Finance as now constituted can carry out any far-reaching budgetary reforms.

X - The Military Situation.

1. The Army Strength and Equipment. From some points of view China's military strength is greater today than at the outbreak of the war. In comparison with 176 regular divisions at the outbreak of war China today has an army of 308 regular divisions, comprising 3.8 million men. A substantial portion of these men have had combat experience and are relatively well trained. In addition are some 500,000 recruits, 600,000 guerillas and over 500,000 transport and other auxiliary troops. The regular army is well equipped with rifles, machine guns and ammunition. There are not, however, nearly enough rifles for the recruits and guerillas. The gravest defects of the regular army are in field pieces (it has about 650 mountain guns, of which only 100 are modern type), anti-tank and anti-aircraft guns, and aircraft.

The particular arsenal I inspected was excellent, being mostly equipped with modern automatic German machinery with German-trained Chinese technicians. The arsenals are, however, hampered by a shortage of raw material and are operating at less than half capacity. Consequently, it is felt that the reserve stock of small arms ammunition, rifles and machine guns is inadequate for a vigorous offensive. A program has been prepared which calls, if possible, for the expenditure, mainly in the United States, of \$77 million for raw materials, gasoline, etc., and \$130 million for armaments. If this material can be obtained, and if air superiority can be wrested from the Japanese, the Chinese are confident that they can assume the offensive with excellent chances of success. At present, they feel that any large-scale offensive would have to be undertaken under conditions involving too heavy loss of effectives.

2. Aircraft. The Chinese have recently received from Russia 50 new bombers and 50 pursuit ships. They have on order about 200 more but are not sure that they will get them. The new pursuit ship, the "I32", was said by the Minister of War to be 50 kilometers an hour faster than the old E-15's and E-16's, had considerably greater firing power and also was able to climb 5,000 meters in ten minutes. I inspected one of the new Russian bombers, which unusual privilege, I am afraid, meant little to me. According to the General in charge, it can fly 320 miles an hour, has a 7-hour range, and can carry a bomb load of  $1\frac{1}{2}$  tons. The Chinese were pleased with the accuracy of the bomb sight. I observed that it had two water-cooled improved Hispano-Suiza engines, a three-man crew, a

machine gunner in the nose and one in the rear (in front of the rudder) who operates one machine gun from a manually-driven turret at the top and one gun that can be pushed down through the opening of the compartment and can shoot below. The Chinese pilot said the bomber was remarkably sensitive to the controls.

There were only five Russians at the Club in Chengtu where they and we stayed. However, 300 Russians were expected shortly.

The Chinese are making great efforts to build a number of airfields that can carry the weight of our flying fortresses. I inspected one at Chengtu which was being built by 75,000 peasants with no power-driven machinery of any kind. The man in charge was a Chinese civil engineer trained at the University of Illinois. It was a marvelous job of organization and, so far as I could judge, completely adequate from the point of view of foundation and drainage. I was assured that a number of such fields were being built near the coast.

I questioned the Generalissimo and the various generals I met closely on the specific need for airplanes. It developed that the most pressing need is for pursuit ships and a few very long-range bombers. While medium-range bombers would be useful, they are not so essential as the others. Pursuit ships are essential to protect troop concentrations in an offensive and to machine gun opposing troops.

The Generalissimo is very anxious to secure a few flying fortresses. He is under the impression, via T. V. Soong via Secretary Morgenthau, that you promised some in March or April. If you did not, this matter should be cleared up.

I inspected an aviation basic training school, where an air show was staged for my benefit by the more advanced commissioned pilots. There was formation flying, landing and taking off without stopping and a dog fight. The cadets were a fine-looking group. I saw no evidence of any slackness and I was told that they were vigorously selected and trained. One defect I noticed is that they receive no training in motor mechanics.

My opinion on these technical matters is entitled to little respect. Therefore I would strongly urge that a high-ranking naval aviation officer be dispatched on an inspection trip to check (a) on the extent to which the Chinese air force has corrected its deficiencies, (b) on the adequacy of facilities in China as a possible base of operations, (c) to check on the qualities and tactics of the Japanese air force, (d) and to convey to the Chinese the impression that we regard them as important potential allies. Such a visit would, I am sure, be welcomed enthusiastically and be of great tangible and intangible benefit. A young air attache at the Embassy cannot hope to achieve the same results there and here.

3. Strategy. I received the very strong impression that the Chinese will not assume the offensive until they have more pursuit ships, more artillery and more small arms ammunition. On the other hand, they have little fear of any further offensive action by the Japanese. The Indo-China -- Chinese border is now very strongly defended and the General Staff is confident that the Japanese cannot penetrate there. It is believed that apart from the release of

troops from Manchuria, Japan cannot put many more effectives in the field. I was cited many instances of the decline in the morale of the Japanese troops, -- how at first they would commit suicide rather than be taken prisoners, and would recover and bury their dead, while now they would even desert and leave their dead unburied. The sight of the officers living riotously and enriching themselves through "squeeze" is likewise not helpful to the morale of the common soldier.

By all accounts the morale of the Chinese soldier is good. Certainly, in the Military Academy I visited, I could not hope to see a harder-working nor more serious-minded group of men.

XI - Foreign Policy and Peace. The generalissimo expressed the hope that relations between America and the U. S. S. R. would become closer. He gave it as his view that the Russians could not be influenced or swayed by diplomacy; but that if they wanted a thing badly enough in their own interest they usually found a way of getting it. He felt that the Russians were preparing for an inevitable clash with Germany and needed American science and technology. Hence Russia would make efforts to secure closer relations with America.

On China's relations with Russia I received some interesting sidelights from Chiang and from Sun Fo. Chiang said that Dr. Sun and Lenin had worked out an agreement whereby the communists would confine their appeal to Dr. Sun's Three Principles in China.

Since that time, and particularly since 1935, the Russian attitude toward the National Government has been scrupulously correct. The Soviet Government made it clear that it regarded the Fourth Route Army Incident as a purely internal affair. However, he made a sharp distinction between the Soviet Government and the Third International which latter, he claims, determines Chinese Communist policy. He said that the Soviet Government had given a great deal of aid solely for the purpose of fighting Japan but had not given one cent for any non-military purpose.

Sun Fo, who acts as special envoy to Russia, stated that in the early part of 1937 the Russian Ambassador proposed a non-aggression pact, to be followed later by a mutual assistance pact. The Chinese Government did not take advantage of this offer. After the invasion by the Japanese Sun Fo was sent to Moscow to revive the mutual assistance pact idea. Stalin told him that the whole situation had now changed, that the whole point of a mutual assistance pact was to prevent aggression, and now that aggression had occurred, the conclusion of such a pact would be tantamount to a Russian declaration of war on Japan, and this Russia was not prepared to do. However, he was prepared to conclude a non-aggression pact, and to make a loan. Stalin then told him to take the matter up with the League of Nations, and if the leading powers in the League of Nations were prepared to employ economic sanctions, Russia would

apply military sanctions. In June 1938 Russia extended a credit of \$50 million which was increased in September by another \$50 million. This one hundred million dollars was used largely for the purpose of purchasing about a thousand airplanes, employing aviation personnel, and acquiring some field pieces and machine guns. Of the last credit of one hundred and fifty million dollars extended in September 1939 a substantial sum is still unexpended.

On the relations of the Soviet Government with the Chinese Communists, Stalin said that he regarded the National Government's dispute with the Chinese Communists as a purely internal affair. He had urged the Chinese Communists in 1935 and 1936 to attempt to make a united front with the National Government and to prepare against Japan. He did not think that China was ready or would be for a long time for the Russian type of Communism. He assured Sun Fo that Russia had no territorial ambitions in China, and that just as soon as the National Government was in a position to assert adequate authority in outer Mongolia the Russians would give up their tutelage. Somewhere along in 1935 the Russians supported the local Chinese leader in Sikiang in the form of two divisions dressed in Chinese uniforms in a conflict with a Moslem leader who was prepared to be a Japanese puppet. This was the only occasion of Russian dealings with anybody except the National Government. It was Sun Fo's conviction that the Third International is now quite inactive.

Chiang is a vigorous supporter of the view that the Japanese invariably take advantage of any signs of weakness and back down when met in a determined manner. He was positive that there would be no danger of a Japanese southward move if America had an adequate base in the Far East. He was enthusiastic over the proposed fortification of Guam and, naturally, laid great stress on the deterrent effects of bombing of Japan from China. All of the people I talked to who had been trained in Japan or who claimed to know the Japanese thought that, being so methodical, they would consolidate their positions in Indo-China and Thailand, construct air and supply bases before moving on Singapore, and would move on Singapore before venturing to take the Dutch East Indies.

With reference to peace or appeasement, I personally heard nothing. Hollington Tong, Vice Minister of Information, who acted as interpreter and with whom I became intimate, told me that there were people in the Government "who were weary of the war" but that none of them ever dared speak to the Generalissimo along these lines. The Generalissimo himself assured me that he would not make a separate peace with Japan no matter how attractive the offer. The only peace in which he would participate would be one arranged by America, Britain, Soviet Russia, China and Japan, under the chairmanship of an American. The main objective of the peace should be peace for one hundred years. He was prepared to be generous and not vindictive to achieve this end. Parenthetically, I might remark that engraved on the ceremonial dagger he presents to each general is a motto that runs something like this. "It is a disgrace to a

military man so long as any Chinese soil is under foreign domination."

I think that Chiang can be held in line with a little care and attention from America. His attitude toward America is compounded partly of sentiment and partly of self-interest. He admires America, and particularly you, tremendously, and to be treated as an equal or ally would mean a great deal to him. Shortly before I arrived he complained to Clark-Kerr that Britain never treated China as an ally, not even according her the treatment accorded Turkey. He is most anxious that China be regarded as a "democracy", taking part in the common world struggle of democracies. From the point of view of self-interest he is relying almost entirely on American help in the great work of post-war reconstruction. He reverted to this topic again and again. He bears much more resentment toward the British.

I think it most important, in addition to giving material aid, to go out of your way to say nice things about China and to speak of her in the same terms now used toward England. Also, as something to be kept in mind, the surrender of our interest in the Shanghai International Settlement in the post-war settlement would enormously enhance our goodwill in China. Chiang resents deeply the Treaty Ports.

One further topic may be mentioned under this general heading. Chiang is afraid that the Japanese may invoke their belligerency rights in order to extend the blockade to ships carrying cargo destined for China. In such circumstances he hopes that you will not recognize such rights and that you will be prepared to embargo Japan and provide convoys for ships to China. This matter is outside my province but it occurs to me that a judicious "leak" to the effect

that America was considering possible reprisals should Japan invoke her belligerency rights might have a wholesome restraining effect. This possibility also suggests the desirability of rushing materials to Rangoon and India.

XII - Suggestions and Recommendations.

The following suggestions and recommendations are based on the assumption that it is to America's interests (a) that China should continue an intensified campaign against Japan, (b) that America should participate in any peace, (c) that political and economic stability in China be maintained, (d) that goodwill toward America be built up in China and (e) that we participate in China's reconstruction after the war.

1. Financial Measures.

a. The freezing of Chinese balances in the United States. The Generalissimo has very strong feelings on this matter and, after urging the necessity of the action verbally on me several times, gave me a strongly written appeal to you. I earnestly hope that you can comply with his wishes in this matter.

b. The conclusion of export and stabilization loans. These have been hanging fire for a long time. The Generalissimo hopes that they can quickly be concluded. He would prefer a single board under the Chairmanship of K. P. Chen, to administer the various stabilization funds. I think,

however, that he could be shown the desirability of separate Sino-British and Sino-American Boards since it appears that the handling of the funds will be for quite distinct purposes. He hopes that the \$5 million a month limitation on the availability of the American funds will be waived. I think also that we would gain by making this gesture of full trust and confidence in him.

2. Military Aid.

I was given a complete list of the artillery, ammunition and ordnance raw material needs of the Chinese Army, amounting to \$207 million. In addition, the Chinese would like as many pursuit ships and long-range bombers as we can spare. It was stressed continually that all these items were necessary in order to assume the offensive. I think that, in releasing materiel and pilots, you could arrive at a more definite understanding that an offensive will actually be undertaken. A first-class military diversion in China should have a decidedly deterrent effect on any contemplated Japanese move southward.

In addition to the more purely military supplies, the Chinese want and need help in transportation material. The Generalissimo asked me to convey to you his desire for help in (a) financing a railroad from Kunming to the Burmese border to connect with the Burma Railroad which the British have agreed to extend from Lashio to the border and (b) securing about 35 new or old transport planes that could be used for air freight, together with civilian pilots to fly such planes.

Military aid to China has hitherto been on rather a sporadic and ad hoc basis. I venture to suggest the desirability of making certain organizational changes that would ensure that Chinese needs be considered along with and weighed against the needs of Britain, Greece, and our own defense. This might be done by extending the terms of reference of your new Cabinet Committee and by attaching me to it in some capacity to ensure that Chinese needs for materiel, priorities, etc., are given proper consideration.

Finally, I would repeat the suggestion made earlier that one or two high-ranking naval aviation and perhaps army staff officers be dispatched on a flying inspection and consultation trip to China. In addition to the information secured, which I think would be valuable, such a visit would have excellent psychological repercussions in China and, I believe, in Japan.

3. General.

a. Political and Economic Adviser.

The Generalissimo is most anxious to secure an American political adviser and an economic adviser recommended by you.

b. Economic Mission.

He is also anxious to secure a joint Anglo-American economic mission under the chairmanship of an American. I should like to discuss both these requests with you verbally.

c. Necessary Administrative Changes in China.

During my visit I became convinced that the budgetary reforms necessary to check a very serious inflation and to ensure some measure of financial stability during and after the war cannot and will not be carried through by the present Minister of Finance. A change for the better here is absolutely essential. Unless this is done economic advisers or economic missions will be able to accomplish little. This, again, is a matter I should like to discuss more fully with you verbally.

d. Post-War Problem.

As I mentioned earlier, Chiang is relying very heavily on American assistance in the post-war reconstruction of China. He hopes that arrangements can be worked out whereby we will be able to dispose of much of our older and "surplus" machinery to China, together with supplying skilled technicians. He conceives that the Economic Mission he proposed would concern itself largely with post-war problems.

He said that in the post-war development of China the State would assume a predominant role, that he was opposed to the private exploitation of natural power resources, that he wished to avoid great inequality in incomes and wealth, and that he was determined to carry out land reforms so that those who tilled the soil would own it.

e. Publicity and Our Relations with China.

One of the most effective ways of encouraging China and deterring Japan would be to go out of our way in giving evidences of friendship, close collaboration and admiration for China. This can be done both overtly and through "inspired" stories coming out of Washington. Since China is really a dictatorship, the character of Chiang Kai-shek himself is a prime desideratum in our foreign policy. I am convinced that his sentimental attachment and admiration for America and for you in particular could be greatly increased through care on our part to accord the same treatment to China as to Britain, and by more personal evidence of friendship from you. As I told you, he reads every word of your speeches and considers you the greatest man in the world. The extreme consideration I received in China was solely attributable to my official relationship to you.

The great influence America now has in China can be exerted not only to further our own interests in a narrow sense, but also, if we have sufficient wisdom and goodwill, to guide China in her development as a great power in the post-war period. China is at a crossroads. It can develop as a military dictatorship or as a truly democratic state. If we use our influence wisely we may be able to tip the scales in the latter direction and, through the inauguration

of political, social and economic reforms and the enhancement of the efficiency and honesty of the bureaucracy, contribute toward the well-being of hundreds of millions of people, and indirectly to our own future well-being.

*Laurel*