

## PROBLEMS ARISING IN THE IMPLEMENTATION OF THE SURPLUS PROPERTY AGREEMENT OF AUGUST 30, 1946 <sup>1</sup>

893.24/11-946 : Telegram

*The Acting Secretary of State to the Consul General at Shanghai*  
(Davis)

WASHINGTON, November 9, 1946—1 p. m.

2053. From Connolly,<sup>2</sup> OFLC,<sup>3</sup> for Davis,<sup>4</sup> FLC. Reur A-858,  
Oct 17.<sup>5</sup>

1. Concern felt here re implementation Para B Article III Agreement Aug 30<sup>6</sup> which is considered of paramount importance. It is feared delays in consummation of adequate arrangements or failure to select a firm of high competence and equipped to move with all expedition may result in much disorder and confusion. In our view it is highly important that early decision be made and that choice fall to best equipped outfit. Our further opinion that job should be viewed whole and brought under direction of one, not several firms, or in any case that one firm be put in supreme charge as strongly urged by McCabe.<sup>7</sup> We do not venture to suggest preference but suggest that you join with Monnett Davis<sup>8</sup> in considering appropriateness of proffering a suggestion based on your knowledge of overall situation.

2. Wang, Chairman of Chinese Supply Commission here at Washington, has proposed that the \$25,000,000 fund payable to China under Article III, paragraph C-1, be made available in part to discharge obligations to U. S. firms and citizens for supplies and services furnished by them for shipping under Chinese flags. Ostensible purpose of this is to augment available shipping to move property from islands to China, as well as to increase residue of fund which would finally be

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<sup>1</sup> For previous correspondence on this subject, see *Foreign Relations*, 1946, vol. x, pp. 1033 ff.

<sup>2</sup> Maj. Gen. Donald H. Connolly, Foreign Liquidation Commissioner.

<sup>3</sup> Office of the Foreign Liquidation Commissioner.

<sup>4</sup> Donald B. Davis, Field Commissioner, China and Eastern Area, OFLC.

<sup>5</sup> Not printed.

<sup>6</sup> Surplus Property Agreement signed at Shanghai, August 30, 1946; Department of State, *Report to Congress on Foreign Surplus Disposal*, October 1946, p. 40.

<sup>7</sup> Thomas B. McCabe, Foreign Liquidation Commissioner and Special Assistant to the Secretary of State, October 1945 to September 1946.

<sup>8</sup> Consul General at Shanghai.

payable to China in dollars. We are tentatively disposed to refuse this request on ground this would mean less provident use of resource and might easily dissipate substantial part of fund in less orderly loading and movements. Total amount was considered adequate only if U. S. flag vessels were employed and under efficient direction competent U. S. authorities. In short we feel that [this would] expedite rather than delay movement. Request your full views re this.

3. This office must determine at early date method and procedure for payments to China under said Art III, Para C-1. Your views requested best method safe-guarding this fund and providing necessary withdrawal restrictions. We are contemplating a proposal to deposit entire 30 million dollar fund in Federal Reserve Bank at New York City and making same subject to withdrawals only on certification of a competent board of three sitting at Shanghai representing Field Commissioner, OFLC, Consulate General and the Maritime Commission. It would be responsibility of this board to reach agreement with Chinese in advance of obligating fund as to character of expenditures to be honored under Article III, paragraph C-1 and 2, and to set up procedures at Shanghai for effective control and for validation of each specific withdrawal from the account. We will be glad for your full views re desirable protective procedure.

Sent to Shanghai at 2053; repeat to Manila as 641. [Connolly.]<sup>9</sup>  
ACHESON

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893.24/12-2346 : Telegram

*Major General Donald H. Connolly to Mr. John B. Stetson, Jr.*<sup>10</sup>

[WASHINGTON,] 23 December 1946.

88373. 1. Arrangements now being completed<sup>11</sup> for establishment by the US Treasury of two funds for 25 million dollars and 5 million dollars respectively to the credit of the Government of the Republic of China for the fulfillment of the purposes as provided in Article 3 of August 30 Agreement. 2. Consideration being given to the proposal for a revolving fund to be placed in the custody of Bosey<sup>12</sup> expendable by Bosey with withdrawals replaceable as the appro-

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<sup>9</sup> In telegram No. 2385, December 3, 5 p. m., the Consul General at Shanghai responded to the queries raised in paragraphs 2 and 3. He recommended that part of the shipping fund be made available for obligations other than charter of American flag vessels and approved the establishment of a Board of Three (893.24/12-346).

<sup>10</sup> Central Field Commissioner, Pacific and China, OFLC, at Manila.

<sup>11</sup> In telegram No. 89641, January 14, 1947, Maj. Gen. Connolly informed the OFLC Shanghai Office that agreement had been reached with the War and Treasury Departments on immediate establishment of the two funds.

<sup>12</sup> Board of Supplies, Executive Yuan, the Chinese agency charged with taking possession of and distributing surplus property.

priate required documentation is supplied by Bosey. 3. Meanwhile we suggest Bosey advance such funds as necessary to avail and expedite movement of surplus with the assurance hereby given that Bosey will be promptly reimbursed upon receipt of certifying documents. 4. It is suggested that the exact form of documentary requirements for payment or reimbursement await Kendall<sup>13</sup> and Stetson's arrival Shanghai early January as well as determination as to the constitution and function of a Board of Review at Shanghai as suggested paragraph 3 our cable of 9 November.<sup>14</sup> 5. Suggest you share the above with Bosey and advise soonest whether these arrangements and assurances remove all obstacles in way of expeditious procedure.

[File copy not signed]

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Nanking Embassy Files, Lot F79, 824 Surplus Property

*Minutes of Meeting at Residence of the Ambassador in China  
(Stuart), Nanking, January 13, 1947, 2:30 p. m.*

Persons Present: Dr. Stuart (for part of meeting)  
Mr. Butterworth<sup>15</sup>  
Mr. Adler<sup>16</sup>  
Mr. Turner<sup>17</sup>  
Col. Underwood<sup>18</sup>  
Mr. Stetson, FLC, Manila  
Mr. Kendall, FLC, Washington  
Maj. Gen. Brown,<sup>19</sup> FLC, Manila

Mr. Stetson stated that he had come to Nanking to discuss with Embassy officials the following three problems: (a) the so-called Nanking Agreement of 22 June 1946,<sup>20</sup> (b) the rate of exchange<sup>21</sup> to be used in financial transactions growing out of the over-all surplus property agreement of 30 August 1946, (c) the administration of the fund of \$35 million equivalent covering the acquisition of and

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<sup>13</sup> Charles B. Kendall, Deputy Director, Legal Division, OFLC.

<sup>14</sup> *Supra.*

<sup>15</sup> W. Walton Butterworth, Minister-Counselor of Embassy in China.

<sup>16</sup> Solomon Adler, Treasury Representative in China.

<sup>17</sup> William T. Turner, First Secretary of Embassy in China.

<sup>18</sup> George V. Underwood, Executive Officer, Embassy Liaison Office. This Office was successor to the staff maintained by General of the Army George C. Marshall, Special Representative of President Truman in China, December 1945-January 7, 1947.

<sup>19</sup> Philip E. Brown, Deputy Central Field Commissioner, Pacific and China, OFLC.

<sup>20</sup> See memorandum of agreements, June 22, 1946, *Foreign Relations*, 1946, vol. x, p. 1041.

<sup>21</sup> For correspondence on other problems involving the rate of exchange, see pp. 1030 ff., *passim*.

improvements to real estate and government expenses, the \$20 million fund covering cultural activities, and (d) the \$30 million fund covering shipping and engineering costs. FLC was most anxious to solve these problems immediately, but wished to coordinate the matter fully with the Embassy prior to contacting the Chinese.

Mr. Butterworth stated that when Chinese Customs authorities seized \$1 million worth of Socony Vacuum Oil Company imports, the Board of Supply defended this action on the ground that under the "Nanking Agreement" all proceeds of surplus property sales in the Pacific after 22 June 1946 to other than China accrued to the National Government. The Board of Supply had requested Socony to place \$300,000 in escrow with the Board before it consented to unfreeze these imports. A meeting was held with General Marshall, which also included Donald Davis and General Johnson<sup>22</sup> from FLC, Shanghai in order to clarify the situation, and it was agreed that although the "Nanking Agreement" had no legal validity, the Chinese would appear to have some moral grounds for making certain claims under the "Nanking Agreement". At the same time, Mr. Davis was told to try and settle the issue promptly on the basis that the United States accepted only the August 30 Agreement.

Mr. Stetson stated that Mr. Davis had written a letter to the Chinese Government<sup>23</sup> stating that the United States Government did not recognize the "Nanking Agreement" as a legal instrument, and that the only official document was the over-all surplus property agreement of 30 August. The National Government had neither replied to nor acknowledged receipt of Mr. Davis' letter. Privately, however, Mr. Stetson understood that the Chinese did not intend to alter their position.

Mr. Butterworth asked Mr. Kendall if the "Nanking Agreement" had been discussed during negotiations leading to the 30 August Agreement. Mr. Kendall replied that Mr. McCabe had brought it up quite specifically. Mr. McCabe had informed the Chinese that the so-called "Nanking Agreement", which was in fact nothing more than a tentative understanding to serve as a basis for a subsequent agreement, had been rejected as such a basis by the War and Navy Departments which had flatly stated that it would be impracticable for them because of inescapable budget and man-power restrictions. For this reason, Mr. McCabe added, it was decided to send out a mission with authority to negotiate a definitive agreement on a new basis. Mr. Kendall felt quite certain in his own mind that at the time the 30 August agreement

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<sup>22</sup> Brig. Gen. Bernhard A. Johnson, predecessor of Donald B. Davis as Field Commissioner, China and Eastern Area, OFLC.

<sup>23</sup> Dated October 29, 1946, *Foreign Relations*, 1946, vol. x, p. 1095.

was concluded, the Chinese clearly understood that the "Nanking Agreement" was null and void.

Mr. Adler stated that it was unfortunate for us that both Mr. Howard and Mr. Vogelback<sup>24</sup> had initialled the "Nanking Agreement". Moreover the instrument itself was headed "Nanking Agreement" when, in fact, because of its preliminary and tentative character, it should have been headed "Proposed Nanking Agreement".

Mr. Butterworth asked if General Johnson had not been told prior to 30 August to inform the Chinese that the Nanking Agreement was a dead issue. The consensus of opinion was that he had been so instructed, but that he had only done so orally.

Mr. Stetson referred to his understanding of General Marshall's connection with the matter. By way of clarification, it was stated that General Marshall's chief interest all along had been that a fair surplus property sale to China be concluded at the earliest moment. He had agreed with FLC that the 30 August agreement was the only legal and valid agreement. At the same time, he recognized that there was a possible moral claim on the Chinese side because of the awkward way in which the "Nanking Agreement" had been handled. However, his major interest was in a prompt and equitable settlement of the issue.

Mr. Kendall referred to the Socony Vacuum problem and stated that the principle involved applied to some \$6 million worth of sales to other parties during the 22 June-30 August period.

Mr. Butterworth asked again how clearly the Chinese negotiators of the 30 August agreement understood that the Nanking Agreement was null and void. Mr. Kendall replied that he was morally certain the Chinese negotiators fully understood the situation. This understanding was attested by the price difference in the final agreement and the exclusion of property in the Philippine Islands. However, he felt that by making some minor concessions, FLC could negotiate a settlement with the Chinese which would completely reconcile all issues arising out of the abortive "Nanking Agreement". He stated that, if agreeable to the Embassy, FLC would hold that the 30 August agreement was the only legal agreement, but that as a matter of being practical and realistic, FLC would then proceed to liquidate the legacy of the "Nanking Agreement" by making suitable minor concessions. Mr. Butterworth stated that such a course was completely agreeable with the Embassy. Mr. Stetson then stated that FLC would proceed on the basis outlined by Mr. Kendall.

Mr. Butterworth gave background material on the rate of exchange

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<sup>24</sup> John K. Howard, Central Field Commissioner, Pacific and China, OFLC, and William E. Vogelback, his appointed successor at the time of the Nanking "Agreements".

problem. When the 30 August deal was made, the legal rate of exchange (CN \$3,350 to US \$1) and the open market rate for U. S. currency were about the same. However, as time went on, a spread developed between the legal and the open market rates. Accordingly, the Embassy applied to Dr. T. V. Soong<sup>25</sup> for an adjustment in the matter. Dr. Soong finally agreed in principle that [in] the final audit of the surplus property financial transactions, China would adjust the values from the \$3,350 rate to a more reasonable one. Mr. Butterworth emphasized that Dr. Soong was in a difficult position in this matter, as acceding to our request meant the settlement of transactions between the Chinese Government and a foreign government at a rate other than the official rate, which would make him vulnerable to internal criticism. At the last discussion Dr. Soong stated that further action should be taken with the Governor of the Central Bank of China<sup>26</sup> and Embassy was proceeding accordingly.

Mr. Adler referred to his discussions with Mr. Pei, the Governor of the Central Bank. Mr. Adler had pointed out to Mr. Pei that the rate of exchange problem not only cut across the surplus property agreement, but also the American Army and Navy need for CN<sup>27</sup> to meet current operating expenses. He had made a frank statement of the American position. He had mentioned that the United States was much more economy-minded than it had been during the war, that the Army and Navy could not get deficiency appropriations now as they could then, and that they therefore urgently needed an arrangement which would enable them to meet their CN expenditures from their available appropriations. Moreover, he had indicated that an unfavorable settlement might well have undesirable repercussions in the present delicate overall situation. Mr. Pei had stated he would discuss the matter with Dr. Soong and would report finally to Mr. Adler in a few days.

Mr. Stetson asked if we were legally bound to observe the official rate of \$3,350 to \$1 in the absence of any specific understanding to the contrary. Mr. Butterworth replied affirmatively. He stated that the Embassy believed that Mr. Adler should meet periodically with the Governor of the Central Bank of China and agree on the rate of exchange to be used for short intervals for transactions arising from the implementation of Article 6 b 2 of the August 30 Agreement and for Army and Navy expenditures. Mr. Stetson asked what formula should be used in arriving at the agreed rate. Mr. Butterworth replied that no fixed rate could be used and that the best

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<sup>25</sup> President of the Chinese Executive Yuan.

<sup>26</sup> Pei Tsuyee.

<sup>27</sup> Chinese national currency.

method was simply to review prevailing open market rates every two weeks. He stated that the Embassy would coordinate its efforts fully with FLC. Mr. Adler would go back to Shanghai with the FLC party for this purpose.

Mr. Stetson then asked if all funds related to the surplus property deal would be covered by the agreed conversion rate which Mr. Adler would obtain semi-monthly. Mr. Butterworth replied that the example used for basis of discussion had been acquisition of real property and that question, for example, of the cultural relationship program had not yet arisen. However, he believed there would be established in China a Sino-American Institute which would spend the equivalent of \$1 million a year.

Mr. Butterworth then raised the question of the degree of Embassy interest in the fund to be established to meet shipping and engineering costs in accordance with the surplus property agreement. Mr. Adler stated that the Embassy had a strong policy interest. The Embassy did not wish FLC to make this fund available to the Chinese before satisfactory settlement had been obtained on the "Nanking Agreement", the rate of exchange, and the handling of other funds under the surplus property program.

Mr. Stetson stated that shipping funds could only be used for United States flag shipping, but that the Chinese might ask to use part of the funds to meet United States dollar obligations arising out of the use of Chinese shipping. The FLC had no objection to this proposal. Mr. Butterworth stated that the Embassy agreed with FLC.

Mr. Stetson stated that the FLC did not propose to make available to the Chinese any part of the shipping and engineering fund until documented bills had been received. The reason for taking this position was to keep the Chinese from dissipating funds before the property had been moved to China. Mr. Butterworth expressed Embassy's agreement with Mr. Stetson's view.

Mr. Butterworth then repeated a point which he had made several times during the meeting: namely, that maximum effort should be exerted to complete arrangements at the earliest possible moment for the acquisition of real estate, the defraying of government expenses, and the establishment of the cultural relations program. These all represented tangible assets to the United States. It was imperative that these matters be formalized before the surplus property had been consumed in China. Otherwise, the United States would wind up with a book credit which it would be very difficult to realize.



893.24 FLC/2-2847

*Mr. John B. Stetson, Jr., to the Ambassador in China (Stuart)* <sup>28</sup>

MANILA, 27 January 1947.

MY DEAR MR. AMBASSADOR: As requested by you I am setting down the views I expressed to you during my visit.

The fundamental objective of the overall bulk sale contract was to transfer surplus goods to the Chinese of which they had need, the possession of which would help in their economic restoration, and to relieve the U. S. Army and Navy of the responsibility of guarding the surpluses scattered as they are in the Pacific.

The contract was signed August 30, 1946. Six months have passed and the accomplishment so far by the Chinese has been disappointing. The enclosed memorandum <sup>29</sup> from my office summarizes the accomplishment to date. What disturbs me are certain tendencies which seem to be apparent in the work of Bosey.

I do not wish to complain about it because I recognize two great difficulties on their side. First the fact that Bosey was set up without a separate appropriation from the government but is obliged to finance its operations from its sales. Second the vastness of the undertaking, a formidable task no matter what government were to undertake it.

However, it would seem better from stand point of both governments if we could discern on the part of the Chinese a tendency to create a sales plan at wholesale rather than retail. We would prefer to see the Chinese taking delivery of the surplus outside China more rapidly, as they have taken over the surpluses within China, and to sell them at more reasonable prices more rapidly. The Chinese say they wish to prevent speculation and reduce prices but from what we hear Bosey sells at retail for the highest obtainable internal price. To do this they seem to be more interested in creaming off saleable items which lend themselves to this handling.

From our point of view we fear that we shall still be guarding goods throughout the twenty-two months the contract runs. That at the end of the period we shall be held to account for loss by theft and by deterioration.

I take this opportunity to thank you for the generous hospitality shown us in your agreeable house.

Sincerely yours,

JOHN B. STETSON, JR.

<sup>28</sup> Copy transmitted to the Department by the Ambassador in his despatch No. 533, February 28; received March 7.

<sup>29</sup> Not printed.



893.24/3-1147

*Memorandum by Mr. John B. Stetson, Jr., to Major General Donald H. Connolly*

SHANGHAI, 11 March 1947.

1. Upon my departure from Washington I was instructed to dispose of the problems involved in the dispute emanating from the so-called "Nanking Agreements". As you are aware I was empowered to make reasonable concessions in the terms of the Agreement of 30 August 1946, and by exchange of correspondence I have since been clothed with more precise authority in this direction.

2. On 16 January a meeting was held with General P. Kiang<sup>30</sup> at which there were present in addition to myself, Major General Philip E. Brown, Mr. Donald B. Davis, Mr. Charles H. Kendall and Capt. S. N. Ferris Luboshez,<sup>31</sup> USNR. The known position of the United States in this matter was carefully explained to General Kiang but he emphatically insisted on maintaining China's stand with which you are already familiar. General Kiang said that he had no authority to make any concession and that Dr. T. V. Soong, the then Prime Minister, would have to be consulted.

3. A meeting was arranged and held with Dr. Soong on 20 January at which there were present in addition to myself, Mr. Monnett Davis, General Brown, Mr. Davis and Mr. Kendall. Dr. Soong stated that he understood our situation. However, he felt most strongly that it would be impossible for China to abandon the position already taken by the Chinese Government without creating serious embarrassment to that Government. He requested time to reconsider the matter in all its aspects.

4. In due course General Kiang came in and said that he had been instructed by Dr. Soong to settle the Nanking Agreements dispute with FLC on the best terms available to China. As a result of that, and subsequent conferences, and in view of the necessity of saving face for General Kiang, it was decided not to request a categorical abandonment of the Chinese position, but to eliminate the meat of their claim. With this object a proposed letter was discussed with General Kiang and other Chinese representatives in which no mention was made of the Nanking Agreements but in which the Chinese claim for payment for surplus property sold prior to 30 August was to be abandoned. General Kiang balked at this and requested specific information with respect to all property sold and identification of all contracts

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<sup>30</sup> Director of Bosey.

<sup>31</sup> General Counsel, Pacific and China, OFLC.

involving the property in question. I agreed to meet his request only to the extent of furnishing him with the total amount of the property sold between 21 June and 30 August, with a statement of the broad categories of such property.

5. On March 1 Dr. Soong resigned and General Kiang was called to Nanking to confer with the Generalissimo.<sup>32</sup> Upon his return he came in and said that he was to retain his office and report directly to the Generalissimo.

6. On 6 March a meeting was held at which there were present in addition to myself, General Brown, Mr. Davis, Capt. Luboshez, General Kiang and Mr. Wong.<sup>33</sup>

7. A letter dated 6 March 1946 [1947] was handed to General Kiang copy of which is inclosed.<sup>34</sup> In reply, General Kiang presented a letter substantially in the form desired with the exception that he had substituted for the word "disclaims" the words "will disclaim", interest in the property. A discussion of this point disclosed that the Chinese representatives had made the change for the purpose of postponing final settlement in order to permit them to check FLC sales figures between 21 June and 30 August. It was pointed out to them that this was unsatisfactory since the object of the negotiations was to settle the Nanking dispute with finality.

8. Ultimately General Kiang agreed, and signed a letter dated March 6, 1947 a copy of which is enclosed,<sup>35</sup> substantially in the form desired by me, of which you were informed in SFLC dispatch No. 1026 of 7 March 1947.<sup>36</sup>

9. In view of the circumstances I believe that the settlement arrived at achieves in substance the object desired. It will be recalled that the Nanking Agreements, correspondence and negotiations relating thereto, provide at least an argument for the position taken by China. Under the settlement arrived at the interests of the United States are protected without undue embarrassment to General Kiang and the Chinese Government. Furthermore, no concessions were made in the terms of the Agreement of 30 August 1946.

JOHN B. STETSON, JR.

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<sup>32</sup> Generalissimo Chiang Kai-shek, President of the National Government of the Republic of China.

<sup>33</sup> Of the Board of Supplies of the Executive Yuan.

<sup>34</sup> Not printed; Mr. Stetson's letter indicated that not more than \$5,260,964 worth of surplus property of specified broad categories had been sold in the Guam area between June 21 and August 30, 1946.

<sup>35</sup> Not printed; General Kiang's letter asserted Bosey's disclaimer of any right, title or interest in the property, as set forth in Mr. Stetson's letter of March 6, not to exceed \$5,260,964 in value.

<sup>36</sup> Not found in Department files.

893.24/3-1247

*Memorandum by Major General Donald H. Connolly to the Under Secretary of State for Economic Affairs (Clayton)*

[WASHINGTON,] 12 March 1947.

Reference the attached radio <sup>37</sup> sent by the War Department to its Pacific commands, Royall <sup>38</sup> is urging a speeding up of turnover activity in the Pacific. It has been lagging badly chiefly with respect to the surplus sold to China and largely due to China's vacillation and awkwardness in getting at the job. We share this impatience and are applying all possible pressures to expedite the turnover. Our contract with China provides for a system of notification of availability of surplus and an allowance of sixty days in which China agrees to take over the property with the understanding that the Army or the Navy may withdraw their custodial care after sixty days.

We have felt that from the State Department's point of view some consideration was due China in terms of not loading them with notices of availability beyond what is humanly possible to accomplish. As a matter of fact McCabe and Petersen <sup>39</sup> when negotiating the deal at Shanghai last August gave oral assurances to China that we would not pass the property to China faster than she could reasonably absorb it. However, the danger is present that our accommodations will be taken unfair advantage of and the movement delayed by the recalcitrance of China.

In his cable Royall is asking Army commands in the Pacific to move with all possible dispatch in the matter of placing notices of availability in our, FLC's, hands, and is asking us in turn to require our offices to immediately pass these notices of availability to the recipient governments, China and the Philippines, with the understanding that the sixty-day rule will be strictly enforced. We think it a wholesome thing and perhaps one which can be applied with good moral effect to pursue this course. Moreover, if we do not accede to this request by the War Department, we are putting ourselves into a position of possibly causing a delay with resultant expense to the War Department. If this proves to be the case, we shall be asked to support a request to Congress for additional funds for the War Department which will be embarrassing. However, I am reserving with Royall the option of bringing this issue up for further review if it later develops that our exactions on China are unfair and attended with any serious hazard to good relations.<sup>40</sup>

<sup>37</sup> Telegram No. 93821, March 11, not printed.

<sup>38</sup> Kenneth C. Royall, Under Secretary of War.

<sup>39</sup> Howard C. Petersen, Assistant Secretary of War.

<sup>40</sup> In a memorandum of March 21 to Major General Connolly, the Assistant Secretary of State for Economic Affairs (Thorp) indicated his full concurrence in the policy line being followed by Connolly.

893.24/6-3047

*Memorandum by the Chief of the Division of Chinese Affairs (Ringwalt) to the Director of the Office of Far Eastern Affairs (Vincent)*

[WASHINGTON,] June 30, 1947.

Subject: Status of Turnover of Surplus to the Chinese under Surplus Sale Agreement

The following is the text of a statement on the above subject dictated to me over the telephone by Mr. Murphy <sup>41</sup> of OFLC:

"The surplus sale with the Chinese Government was signed on August 30, 1946. In its early stages the turnover of surplus to the Chinese proceeded rather slowly. This was due in a large measure to shipping supply plans of the owning agencies, screening requirements of the owning agencies and more or less normal operational and procedural delays to be expected when a program of this nature is being set up. However, it should be noted that during this period the Chinese would have been unable to handle any appreciable quantities of surplus because they had failed to make timely arrangements to carry out their part of the operation. They were slow in making the necessary preliminary inspection trips and especially dilatory in setting up their organization and chartering ships for taking possession of surplus stocks made available to them.

"Recently the owning agencies and OFLC have resolved most of the procedural and operational obstacles and the Chinese have been notified that large quantities of surplus are available to them. They are unable to handle expeditiously the quantities which are ready and waiting for them to take possession. It is expected that from now on ample surplus will be consistently available to the Chinese. However, unless the Chinese expand and augment their facilities it appears that they will not have the ability to receive and ship surplus in an orderly manner as fast as we can produce it."

Mr. Murphy informed me that OFLC was having a very difficult time in evaluating reports from the field as those from Colonel Stetsen on the one hand and General Kiang on the other hand were almost completely contradictory. Judging from the tenor of recent messages, however, OFLC is becoming convinced that the Chinese authorities are taking advantage of every possible opportunity to procrastinate and complain, probably with a view to developing a case for the reopening of the Surplus Sale Agreement on the basis of Article 5 thereof, which states in part: ". . . it is understood that if a material disparity is found to exist between the property sold to China hereunder and the consideration given therefor by China hereunder, the two Governments will consult together to fix an appropriate adjustment in the price paid."

It is generally believed by OFLC that no effort whatsoever will be

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<sup>41</sup> Francis T. Murphy, Area Director, Pacific and China, OFLC.

made by the Chinese to move surplus stocks from at least six of the smaller Pacific islands involved.<sup>42</sup>

A[RTHUR] R. R[INGWALT]

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893.24/7-1547

*Mr. John B. Stetson, Jr., to Major General Donald H. Connolly*

MANILA, 1 July 1947.

MY DEAR GEN. CONNOLLY:—My last visit to China has left a gloomy impression on me.

The great speculative problem at present is whether or not the Chinese will complete the overall contract, and if they fail is it with design or because of natural ineptitude.

At first the bulk sale seemed to be received with enthusiasm. It looked as if the Chinese would acquire for little cash outlay consideration a very valuable block of goods which not only would help the country by supplying needed articles, but would also offer a chance by sales abroad to acquire foreign exchange. This latter idea was encouraged by the U. S. negotiators who pointed out that goods on Guam could be sold in U. S. and even some types of goods located elsewhere in the U. S. or in other hard money countries. Last January Bosey saw large and satisfactory prospects. Although Bosey had no funds of its own, by some quick sales it could finance itself providing money for renovation of certain heavy equipment at a period when such equipment had a worldwide demand at high prices. Several changes in the picture have occurred since January which completely changes it. The change of Government in China<sup>43</sup> changed the function of Bosey and brought it from a semi-independent body to a body dominated by several ministries, creating a political atmosphere instead of the freedom of a dictatorship. Bosey was required to offer all goods received first to the government ministries before selling to private parties and it was required to turn over all proceeds of sales to the Minister of Finance<sup>44</sup> and get its funds for operations from the Executive Yuan. The organization for taking over surplus lagged and is only now taking shape to adequately per-

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<sup>42</sup> Marginal comment by James K. Penfield, Deputy Director of the Office of Far Eastern Affairs: "The Chinese side of this story, as related to me by General Ting on Guam, is equally unhappy—on the smaller islands question, for instance, he said that there is 25,000 tons on Majuro where there is no port and no equipment for handling it—they estimated that it would cost 2 or 3 times what the stuff is worth just to remove it from the island." Maj. Gen. Ting Tien-yung was Commanding Officer, Bosey, Guam.

<sup>43</sup> See pp. 47 ff., *passim*.

<sup>44</sup> O. K. Yui.

form its functions. But with the lag in setting up the machinery for handling, the sales picture changed. Heavy machinery was not in such demand as in January. Bosey's very unbusiness like methods killed the enthusiasm of potential American buyers and the actual recovery of Bosey in terms of hard money is negligible. I know of one sale for dollars to Americans amounting to about \$500,000 which looks firm but which is not quite consummated.

Today Bosey has to present its acquisition to its Board made up of representatives of five ministries, and each ministry has its priority. The question of inter-departmental needs and inter-departmental payments has slackened the pace of possible monetary recovery. At Djukon docks<sup>45</sup> there has been lying a fine group of heavy machinery for at least three months. It was supposed that this group had been sold to an American concern who promised payment in dollars against shipping documents. Now I learn from Gen. P. Kiang that it has been earmarked with much more of the same type of machinery for the Ministry of War. Kiang dolefully remarked that not only was he losing the sale but was required to rehabilitate the machinery for the army at Bosey's expense and he had no funds for the purpose. It is the story of Admiral Mar<sup>46</sup> over again. Mar was required to repair vessels for the Chinese navy and there is no money forthcoming, which seriously cripples his operations. Unless one knows this part of the world it is difficult to understand the long delays which occur in China in settling these inter-departmental difficulties.

Hence the original enthusiasm for the Bulk sale is waning. One should recall that Mr. John Blandford, Financial Advisor to the Generalissimo was always of the opinion that the Bulk sale would be of little or no benefit to China. He held this opinion probably for realistic reasons. The Chinese are not clever in organization and he could foresee their inability to acquire, move, repair and turn into money such a mass of goods. Delays would cost money, their lack of adequate facilities and planning, and the general inertia would make the margin of tangible profits from the deal a very small one for a great amount of effort, or might actually result in a loss.

Bosey started out as a dictatorship under Gen. Kiang who has no knowledge of merchandising. Since his role has been diminished he has lost whatever enthusiasm he ever had. For the last month he has openly stated to me that China would make very little from the Bulk sale. Last week he asked me what my reaction would be if he re-

<sup>45</sup> In Shanghai.

<sup>46</sup> Rear Admiral Pellian T. Mar of the Chinese Navy; for correspondence regarding the rehabilitation of Chinese dockyards and shipyards, in which Admiral Mar played a key role, see *Foreign Relations*, 1946, vol. x, pp. 1069 ff.



requested the cancellation of the Bulk sale contract. I treated his remark as a jest and made no comment but I fear that is his mood at present. This matter came up in connection with our cancellation of contract 1270.<sup>47</sup> He claimed that if the U. S. could unilaterally cancel a contract after it was signed and money was paid, why could China not do the same thing.

In the meantime we move along in the old ruts toward the completion of the deliveries under the contract. We press Bosey to move more goods, we push Bosey to get on the Finschaffen deal, we urge movement of small ships from Manila and advise that Bosey is now owner and had better look after its property, but matters move at just the rate Bosey wants.

Commodore Erl Gould's<sup>48</sup> visit elicited many promises but nothing has changed. The change in policy by liberalizing the use of the shipping fund was hailed by Bosey but it will not cause freight to move any faster. The only gainers are American contracting firms who now see their refunds coming through. The activities of the contractors are still hampered and controlled by Bosey as before, and Bosey's authorization to them to act must still be obtained and this authorization still takes as long as before.

All of the above, which could be much expanded with examples and cases, brings one back to the original question. Do the Chinese want this contract to proceed or not. Do they want to raise a big claim under the disparity clause and make the failure of the plan a political issue between the two governments. Are they doing their best and is the mess wholly due to incompetence. A good case could be made out for either theory.

The failure of a satisfactory fulfillment of the contract is pregnant with repercussions at home and in China. The American Embassy is much worried. They see failure to realize any gold values from the deal.

Put this dim picture before the dimmer one of Chinese crises and there is little cheering to be found. Chiang Kai-shek's government is losing favor and his armies are being beaten by the Communists. There is a proposal that Southern China secede. The CN dollar went down during my stay there from 36,000 to 50,000 to the U. S. dollar. It looks as if disorder of a widespread nature would soon occur.

Sincerely yours,

JOHN B. STETSON, JR.

<sup>47</sup> For a summary account, see telegram No. 1596, December 31, 8 p. m., to the Ambassador in China, p. 939.

<sup>48</sup> Of OFLC.



893.24 FLC/6-1747: Telegram

*The Secretary of State to the Ambassador in China (Stuart)*

WASHINGTON, July 22, 1947—6 p. m.

903. [In] View [of] failure Chinese authorities correct erroneous statements<sup>49</sup> by Dr. George Yeh<sup>50</sup> June 4 press conference (Shanghai's 1475, June 17 to Nanking; repeated Dept 1465,<sup>51</sup> and FLC Manila as 66) Dept releasing today following press statement which will be included Far East Wireless Bulletin and Voice of America:

"The China and Eastern Asia Office of the Foreign Liquidation Commissioner has announced that contrary to previous reports, as of May 31, 1947, about U. S. \$170,000,000 procurement cost of movable surplus United States Property had been made available to China. These turnovers were made under the terms of the Bulk Sale Agreement of August 30, 1946. The current figure represents the first part of the \$500,000,000 of property (procurement cost) provided for by the Agreement. Previous to the signing of the Agreement the United States Government had turned over to China a total of approximately \$324,000,000 of property at cost in addition to the \$500,000,000 of movable goods.

Movable property on which notices of availability have been sent to China include many types of equipment, including trucks, road and construction equipment, clothing, food and medical supplies, but specifically excluding aircraft, combat matériel, ships and other maritime equipment. The property is located in China itself and on 17 islands of the Pacific including Guam and Okinawa.

At the end of May, the Board of Supplies of the Executive Yuan had taken possession of \$59,700,000 procurement cost of movable property. The rate of acceptance by China necessarily lags behind notification by the Office of the Foreign Liquidation Commissioner due to transportation problems and arrangements.

The procedures have been set up and large amounts of movable property have already been transferred to China. The transfer rate is now accelerated and under these procedures it is to be expected that the transfer operation will be completed within the 22 months allowed by the basic contract."

Sent Nanking as 903, repeated Shanghai as 1204 and FLC Manila as 830.

MARSHALL

<sup>49</sup> These statements, reported in telegram No. 1217, June 5, from the Embassy in China, indicated that China had received only \$20,000,000 worth of goods, principally in the form of non-military trucks (893.24 FLC/6-547).

<sup>50</sup> Chinese Vice Minister for Foreign Affairs.

<sup>51</sup> Not printed.

893.24 FLC/7-3147 : Telegram

*The Consul General at Shanghai (Davis) to the Secretary of State*

SHANGHAI, July 31, 1947.

[Received July 31—8:20 a. m.]

1862. Official Central News Agency distributed following story 26th:

"Shanghai—In connection with the Associated Press cable from Washington under the date of July 22 and published in the local papers yesterday regarding American surplus property turned over to China, the Board of Supplies of Executive Yuan of the Chinese Government has issued the following statement:

As the figures contained in the Washington cablegram are apt to give to the general public a wrong impression about the actual quantity of surplus property received by China up to date, it is desirable to make clear that of the total estimated worth (original procurement cost) of U. S. \$500,000,000 of movable property which the United States Government intended to turn over to the Chinese Government under the over-all agreement of August 30, 1946, only material and equipment costing U. S. \$170,000,000 have been declared surplus, but this will not be all acquired by China as the declarations are subject to checkings and withdrawals. As far as the U. S. \$500,000,000 bulk sale of movable goods is concerned, China actually received about U. S. \$71,000,000 up to June 30, 1947.

The U. S. \$324,000,000 of property referred to under item 1 in the announcement is not a part of the U. S. \$500,000,000 bulk sale. This figure obviously represents the cost of fixed installations (U. S. \$84,000,000,000), covered by the same over-all contract of August 30, 1946, and the few deals such as the Calcutta stockpile,<sup>52</sup> small ships,<sup>53</sup> miscellaneous sales, etc., which were closed prior to the signing of the over-all agreement and cannot be regarded as coming under the U. S. \$500,000,000 movable property bulk sales.

The statement that the United States in the 9 months has turned over to China or 'made available' to her American surplus property originally costing U. S. \$500,000,000 is misleading. Under the over-all agreement signed on August 30, 1946, the United States Government has yet to make available to China U. S. \$330,000,000 worth of surplus property."

DAVIS

893.24 FLC/9-2647

*The Consul General at Shanghai (Davis) to the Secretary of State*

No. 1715

SHANGHAI, September 26, 1947.

[Received October 7.]

SIR: I have the honor to refer to the over-all agreement of August 30, 1946, covering the sale of certain surplus war property, and to

<sup>52</sup> For correspondence on this subject, see *Foreign Relations*, 1946, vol. x, pp. 1060 ff.

<sup>53</sup> For correspondence on this subject, see *ibid.*, pp. 785 ff., *passim*.

transmit for the information of the Department and the Embassy, a memorandum prepared in the Commercial Section of the Consulate General, with attachments,<sup>54</sup> which describes the current status of the surplus property program insofar as sales to foreign buyers for foreign currencies are concerned. Not unless this memorandum were coupled with a formal request from the Chinese for foreign exchange assistance from the United States Government could there be a much more impressive illustration of the financial paradox that exists in China today—on the one hand, an all-out governmental effort to conserve foreign exchange at the expense of essential imports vital to sustained or increased production, and on the other, failure to exploit even half-heartedly a pool of assets readily convertible into foreign exchange with very little material loss to China.

This failure of the Chinese to capitalize upon what was originally an important potential source of foreign exchange income to them, before deterioration and competing post-war production in the United States could dissipate these values to a large extent, is most logically attributed to the administration of the surplus property program in China through the Board of Supplies, and the policies and procedures developed by its Director, General P. Kiang. It is fair to state, however, that not a little of the responsibility for the present impasse can be attributed to higher officials of the Chinese Government, who have failed to clarify satisfactorily either the basic policies or objectives of the surplus property program since the retirement of Premier T. V. Soong last winter.

Dr. Soong's demise was followed by a period of almost three months' duration of uncertainty for the Board of Supplies, during which time General Kiang tried repeatedly to either resign or establish a firm definition of his status. Finally a plan was evolved whereby other government agencies became priority claimants on surplus property instead of being made responsible for justifying their requirements through normal channels. This development was tantamount to withdrawal of the operating autonomy which General Kiang had insisted upon previously, and had obtained. He has carried on under the new system reluctantly and only because the Government could not, or would not, replace him.

The above-described tendency towards frustration which has become increasingly apparent within the Board of Supplies, and which has certainly tended to modify the zest with which the organization approached its problems, has been accompanied by other developments which contribute towards impairing operating efficiency. General Kiang's failure to delegate authority and responsibility, and his reluctance, bordering on refusal, to accept advice or assistance from foreign technicians and specialists have combined to stunt his organ-

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<sup>54</sup> None printed.

ization's growth personnel-wise. Nor is the General any exception to the almost universal rule among Chinese Government officials that it is no longer wise to make bold decisions in view of the political persecution that may result. Rather, his tendency is to refer all substantive matters to the highest levels where political necessity demands inviolability.

There is a growing similarity between the surplus property disposal program as a whole and the UNRRA <sup>55</sup> program in its near-precipice stages of a year or eighteen months ago. The main effort on the part of the U. S. agencies actively concerned with operations, and on the part of the Board of Supplies, as the accompanying memorandum points out, is to move the property to China without adequate regard to the problems which are second in importance only from the standpoint of time—namely, inventorying, reconditioning, and disposal to qualified distributors or end users. There is now no doubt but that a reasonably satisfactory solution of these difficulties for either Government can only occur after a wholesale shake-up in the Board of Supplies administration, and in its relations with other agencies and departments of the Chinese Government.

Independently of, or as a step towards this objective, remonstrances can be made with the Chinese to develop more realistic sales policies in surplus property disposal, at least to apply to foreign buyers. This can be readily justified by reference to the stringency of the present foreign exchange position. It hardly seems advisable, however, for the United States Government to press at this late stage for attempts to rebuild only part of a foundation on which a dangerously rickety edifice now stands.

Respectfully yours,

MONNETT B. DAVIS

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893.24 FLC/12-147

*The Consul at Shanghai (Pilcher) to the Secretary of State.*

No. 1904

SHANGHAI, December 1, 1947.

[Received December 10.]

The American Consul at Shanghai has the honor to refer to Airgram A-858 of November 26, 1947,<sup>56</sup> and to previous communications dealing with the disposal of surplus property located on certain Pacific islands, title to which was transferred to China under the Bulk Sale Agreement of August 1946.

The Consulate General has reported periodically that little progress was being made by the Board of Supplies of the Executive Yuan in

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<sup>55</sup> United Nations Relief and Rehabilitation Administration.

<sup>56</sup> Not printed.

concluding sales of surplus property for foreign exchange. Eventually the Central Bank interested itself in the whole proceeding and, as reported in the Airgram under reference, concluded a contract with Bosey on November 25, 1947, wherein it undertook responsibility for the sale of the bulk of the surplus property declared available and not yet removed to the China mainland. It is felt the injection of the Central Bank into the picture of surprop sales may conceivably have been a roundabout, face-saving method of taking the matter out of Bosey's hands and placing it in those of a foreign organization better equipped technically, and with a knowledge of world markets, to conduct an effective sales program.

A translation copy of the agreement entitled "Contract between the Central Bank of China and the Board of Supplies for the Purchase of Surplus Property on the Pacific Islands" is appended as Enclosure No. 1.<sup>57</sup> It will be noted (Article 1) that the original "nine-island" program has been expanded to include all such property, wherever situated with the exception of Okinawa, and it is reported that, should further declarations of availability be made by the U. S. military, they will also fall within the scope of the subject agreement. Purchase price (Article 2) to be "paid" by the Central Bank to Bosey is stipulated as 31% of original U. S. procurement cost. In commenting on this phase of the agreement, General P. Kiang, Chief of Bosey, states that his policy throughout has been to sell for not less than 50% of U. S. procurement cost, terming the latter figure as reasonable and necessary to secure an adequate return to China, in view of the heavy expenses incurred administratively and otherwise. General Kiang reports that the 31% figure represents a compromise reached between the Central Bank and the Ministry of Finance, and he estimates that the difference between it and the previous Bosey selling average of 50% will reach US\$15 million in actual value when extended over the amount of surprop still to be sold.

E. A. Bayne, adviser to the Central Bank, has consistently advocated the appointment of a qualified [foreign]<sup>58</sup> sales agency to handle the Bank's sales program on a commission basis, thus reducing to a minimum the administrative burden of the Bank in respect to such sales. Certain qualified companies were suggested and considered, and on November 27th a "Memorandum of Agreement" was signed between the Central Bank of China and the Vinnell Corporation of California. Copy of the Agreement appears herewith as Enclosure No. 2, in which it will be noted the Vinnell Corporation is nominated as exclusive selling agent for the Central Bank of all sur-

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<sup>57</sup> Enclosures not printed.

<sup>58</sup> Brackets appear in the original.

plus property within the scope of the Central Bank's agreement with Bosey. The agreement is to remain in force for an initial period of ninety days from date of signature, with the option of extension provided certain conditions of performance are met.

As previously reported, General Kiang has repeatedly referred to preemptive procurement by the military and other Chinese government agencies as the principal reason why foreign sales could not be realized to any appreciable extent. It now appears, in light of the inauguration of the Central Bank's foreign sales program, that such procurement will come to an end, or at best be accorded only secondary consideration. Asked to comment on this phase, General Kiang's rejoinder was that much of the surplus property obtained by the government agencies in the past was found to be in bad condition and hence of little immediate value, for which reason less opposition has now been voiced by such agencies to the foreign sales program than would otherwise be expected. It is at least conjecturable, 1) that procurement for government account may have already overreached itself quantitatively, and 2) that many of the items so acquired cannot be put to immediate practical use.

It appears the way is now cleared for Mr. Bayne to proceed to the Islands for the purpose of negotiating sales (in conjunction with the Vinnell Corporation) for the account of the Central Bank. He will in all probability be accompanied by Mr. Li Fa-tuan as Chinese counterpart and direct representative of the Central Bank, deputed to conclude sales agreements on its behalf.

It may be reasonably anticipated that sales for foreign exchange will receive additional impetus in the hands of the Central Bank's representatives, and the Department and the Embassy will be kept informed of the progress that is made.<sup>59</sup>

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<sup>59</sup> In despatch No. 1971, December 22, the Consul at Shanghai (Pilcher) reported that Mr. Bayne had proceeded to various Pacific islands accompanied by a Central Bank representative and Major Ivy and that they were laying "the groundwork for bulk sales of surplus property to certain American interests". (893.24 FLC/12-2247)