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**FAR EAST****1. Comment on Communist China's 1955 budget:**

[Redacted]

Almost one fourth of the record \$12 billion Chinese Communist national budget for 1955 will be spent on defense, according to an announcement from Peiping on 6 July. Total budgeted expenditures are 21 percent higher than the amount spent in 1954, while the rise in military spending is set at 24 percent.

Moreover, the military budget of approximately \$3 billion is probably understated by 10 percent or more because it does not cover investments for military purposes made by industrial ministries.

The large increase in defense expenditures in 1955 is explained by Peiping as being necessary because "the imperialists are still encircling China and she has to protect her independence and national constitution, liberate Formosa, and safeguard her territorial integrity."

Emphasis on military spending may have cut into funds for industrialization, which comprise about 22 percent of the budget. A rise of only 11 percent in industrial investment is planned this year over 1954, but heavy industry is to receive a greater share.

The military spending figure is about 10 percent of China's gross national product of more than \$30 billion, and economic investments constitute another 20 percent. The peasantry will continue to bear the main burden of these large military modernization and industrial programs. Although the budget report stated that direct farm taxes would drop to 12 percent of total revenues in 1955, the regime can expect increased revenues from the stepped up program of forced purchases of agricultural products at low prices.

[Redacted]

**SOUTHEAST ASIA****2. Comment on Pathet Lao attack in northern Laos:**

The recent clash between Pathet Lao and Laotian government forces at Muong Peun, southwest of Sam Neua village, appears to have subsided, with no essential change in the military situation. This latest action in the series of clashes instigated by the Communists since the 1954 cease-fire follows a several months' build-up of military strength by both sides in the vicinity of Muong Peun.

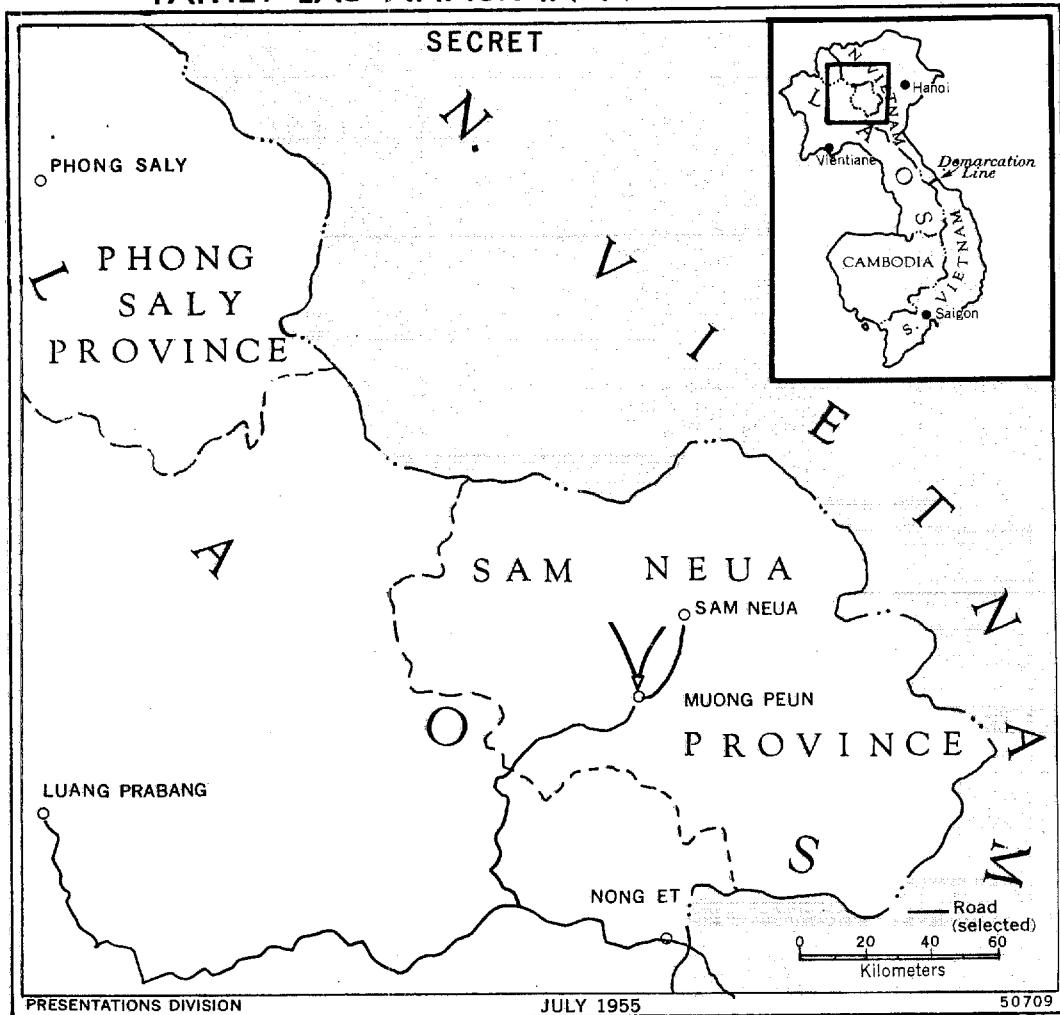
The Pathet Lao forces began their attack on 3 July and succeeded in capturing strategic hill positions encircling the Muong Peun garrison. Subsequent reports stated, however, that royal government forces recaptured these positions.

The Pathet Lao is estimated to have 3,000 troops in the Muong Peun area, approximately one half of its total force. Laotian army forces there totaled 1,800 at the start of hostilities but have since been reinforced by the air dropping of several hundred fresh troops.

The Communist attack may have been an attempt to take this important post by surprise, as the first stage of a campaign to force the complete withdrawal of royal forces from the disputed provinces of Sam Neua and Phong Saly. The similarity to previous actions suggests, however, that this attack was another effort on the part of the Communists to influence the course of recently resumed negotiations between Pathet Lao and government officials.

During the course of these negotiations, which began last January, the Pathet Lao has frequently staged shows of strength, apparently in an attempt to pressure the Laotian government into an acceptance of its exorbitant demands. The immediate consequence in this case, however, has been the suspension of these talks by the government.

## PATHET LAO ATTACK IN NORTHERN LAOS



Muong Peun remains a potentially explosive situation, and hostilities there could spread throughout both Phong Saly and Sam Neua provinces. Neither side at present appears capable of gaining complete military control over the northern provinces. The Pathet Lao, however, aided by both materiel and personnel support from the Viet Minh in contravention of the Geneva agreement, is gradually increasing its military capabilities.

**3. Outcome of Indonesian elections predicted:**

[redacted] [redacted] the  
**Masjumi and two smaller Moslem par-**  
**ties can be expected to win at least 50**  
**percent of the seats in parliament in the forthcoming national**  
**elections. The National Party, which heads the present govern-**  
**ment coalition, on the other hand, is not likely to obtain more**  
**than 15 percent of the seats.**

[redacted]  
**Socialist Party would strive to win a tenth of the parliamentary**  
**seats. In areas where there was no chance of electing its own**  
**representatives, it would support the Masjumi so as to prevent**  
**gains by the Communist Party.**

**Comment:** Since Indonesia has never held national elections and conditions are unsettled, any prediction regarding the outcome of the elections--scheduled for late September--should be treated with considerable reserve. On the basis of available information, however, it appears that the parties now in opposition will win the elections, if genuinely free, but by a smaller margin than indicated in the above report.

There is some reason to expect the Indonesian Communist Party to obtain more votes than the National Party, which it is presently supporting, and thus become the second strongest party in parliament.

### NEAR EAST - AFRICA

**4. Early fall of Iranian cabinet seen possible:**

[redacted]  
 Iranian prime minister Ala told the American chargé on 7 July that attacks on his government were coming from all sides and that the regime, if not in retreat, was definitely on the defensive. Even cabinet members and progovernment Majlis deputies are actively speculating on its chances of survival.

The embassy comments that the resignation of the government in the near future is quite possible, either as a result of the prime minister's and the cabinet's discouragement or the Shah's belief that the cabinet is not carrying out his directives.

A no-confidence vote by the Majlis is, however, unlikely, and most of the deputies will continue to support Ala as long as the Shah desires it.

Comment: The Shah is heavily committed to the success of the present government and probably will try to maintain it as long as possible.

Any new government would--like the Ala cabinet--be likely to suffer from the attempts of the Shah to participate in day-to-day government operations.

#### WESTERN EUROPE

##### 5. CSC president seeks US co-operation during atomic pool talks:

[Redacted] President René Mayer of the Coal-Steel Community's High Authority told American observers to the CSC on 7 June that he was gratified by Washington's sympathetic attitude toward the negotiations scheduled to begin in Brussels on 9 July for a European atomic pool. He hoped, however, that the United States would not sign any new bilateral atomic energy agreements with any of the six CSC countries while these talks were in progress.

French opposition to further European integration will be overcome, Mayer said, provided France's contribution to an atomic energy pool is matched by an equivalent contribution in raw materials by other prospective members. This would involve, however, a revision of the American-Belgian accord on uranium supplies.

Comment: Mayer's anxiety regarding possible bilateral agreements apparently results from the American invitation to a number of countries on 10 June for negotiations about agreements on peaceful uses of atomic energy.

The Brussels conference of experts was set up at the 1-3 June meeting of the foreign ministers of the six CSC countries, which showed great interest in the pooled development of atomic energy to keep Western Europe industrially abreast of the United States and the Soviet Union. A sharp dispute arose between France and Belgium, however, over their respective contributions to the proposed atomic energy pool.

Belgian foreign minister Spaak, the "pro-European" chairman of the Brussels talks on atomic energy, wants to use the Belgian Congo's resources in uranium as a lever to induce Paris to take a decisive step toward further supranational integration. There appears to be broader French political support for a common European effort in the atomic field than in any other. (Concurred in by OSI)