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Memorandum for:

[Redacted]

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[Redacted]

attached are two items we think would be most appropriate for the Attorney General's briefing book.

[Redacted]

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**Office of European Analysis
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CENTRAL INTELLIGENCE AGENCY
WASHINGTON, D.C. 20505
Deputy Directorate of Intelligence

5 October 1982

MEMORANDUM

SPADOLINI II: FROM THE FRYING PAN INTO THE FIRE

Summary

Prime Minister Spadolini, the leader of the tiny Republican Party, may have successfully navigated a crisis in August only to find that his second government is weaker than its predecessor. The press has already begun to speculate that continuing political differences between the Christian Democrats and the Socialists--the two largest parties of the coalition--may force President Pertini to dissolve parliament and call national elections in the spring.

The Play-by-Play

The August crisis began with the defeat of a government bill on the petroleum tax that the leaders of all of the coalition parties had agreed to support; thirty Christian Democratic (DC) Deputies defected during a secret vote. Although the press, the Socialists, and the other coalition partners allege that the thirty responded to bribes from the petroleum lobby, some of the DC "snipers" may have wanted to embarrass Finance Minister Formica--a Socialist--to underscore their longstanding unhappiness with Christian Democrat/Socialist ties. Socialist leader Craxi then pulled his ministers out of the government, precipitating its collapse.

(EUR M10102)

This memorandum was prepared by [redacted] Office of European Analysis. [redacted] was requested by [redacted] Research was completed on 5 October 1982. Comments and questions are welcome and should be addressed to [redacted]

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The Socialists soon found, however, that they could not force President Pertini or the other coalition partners to replace Spadolini with Craxi or to send the country to the polls.

Social Democratic leader Pietro Longo openly accused the Socialists of violating the Socialist/Social Democrat consultation pact; he subsequently lined up with the Christian Democrats in favor of negotiations for a second Spadolini government and against early elections. The Social Democrats were joined by the small Liberal party and Spadolini's Republicans.

DC-PCI Discussions: Smoke or Fire?

The press and Embassy Rome have reported rumors that the Christian Democrats and the Communists, shortly after the crisis broke, began to discuss a four-party government -- Christian Democrat, Social Democrat, Republican, Liberal-- that the Communists would support from outside. This raised the prospect that the Socialists would be pushed to the margins of the political game. A decision by the DC and PCI to work together would have made Socialist support for the government superfluous and undermined Craxi's leverage with the other members of the coalition.

Press reports make it clear, however, that officials close to party Secretary DeMita queried a number of party members about their views on a deal. (DeMita

probably still believes that little progress can be made toward governing the country effectively without their cooperation.)

According to the press, DeMita's soundings were opposed by the Christian Democratic right.

While DeMita might have been able to survive the defection of either Piccoli or Fanfani, the loss of both men simultaneously would have made it all but impossible for him to maintain his grip on the party.

A Second-Best Solution

Spadolini's return to the premiership, therefore, is disappointing to Christian Democrats and Socialists alike. It signifies that political leaders in both parties have concluded

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that neither party is strong enough to assert its own will and that supporting Spadolini is the best alternative outcome. [redacted]

In our view, the current circumstances are similar to those which gave rise to Spadolini's first government. The Christian Democrats continue to play for time to revamp their program and revitalize their party. Despite their misgivings that a prolonged Spadolini premiership will cut into their power and patronage, we believe that they find a Republican-led government more palatable than either of the most likely alternatives -- a national election or a Socialist Prime Minister. [redacted]

Craxi still covets the premiership, but he needs an issue that will (not only) allow him to (trigger) a crisis -- and new elections -- but will also safeguard the Socialists from public criticism and a backlash at the polls. Craxi sees an early election as a means to transfer to the national level the strength that the Socialists have shown in a string of local and regional elections since 1979. This would strengthen his bargaining position vis-a-vis the DC, and possibly open the way for reforms -- such as restricting the use of the secret ballot during parliamentary voting and designating a prime minister for the length of the legislature -- which would strengthen the premiership. We believe Craxi hopes by these means to avoid some of the pitfalls that have snared his predecessors. [redacted]

[Craxi's lieutenants remain divided over timing. [redacted]

[redacted] one group led by Party Vice Secretary Claudio Martelli argues that the party can afford to bide its time. The other group, led by Formica, insists that the Socialists must move as quickly as possible. Formica claims, [redacted]

[redacted] that he and Minister of State Participations Demichelis were instrumental in persuading Craxi that the Socialists should leave the cabinet. [redacted] they argued that the Socialists would not only gain in elections, but would avoid the risk of sharing blame with the Spadolini government for the country's economic problems. [redacted]

Further DC-PCI Talks?

If DeMita believes that an arrangement can be reached with the Communists, he can be expected to work quietly in the months ahead to expand the dialogue and to build support within the DC for a new look at DC/PCI relations. (We believe that Communist leader Berlinguer still harbors hopes of an eventual return to his "historic compromise" strategy, albeit under a different name, and probably looks upon DeMita as a potential ally. Both obviously see Craxi as a principal adversary, and for similar reasons firmly oppose an early national election.) [redacted]

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After months of press speculation that the Berlinguer era has come to an end and that next February's party congress will see him eased out, Berlinguer suddenly seems to be making some progress in the struggle to coopt his most prominent critics within the party. Recent verbal attacks on Craxi and the Socialists by Giorgio Napolitano, long viewed as the most important "pro-Socialist" in the PCI leadership, may be a measure of Berlinguer's success. Napolitano's new tack suggests to us that party officials may put their earlier differences aside and that the PCI will be more cohesive in the months ahead than it has been for some time.

If press reports are accurate, the August crisis marks the first time in several years that the party has expressed a willingness to support--or at least not oppose--a new government in return for something less than cabinet posts. It also marks the first time since the birth of the new center-left governments anchored by the Socialists that other options have been explored. It could signal the beginning of a process that would lead the Communists back to center stage.

If Berlinguer becomes confident that his internal opponents are under control, we think discussions with the Christian Democrats in the coming months could be accompanied by a PCI return to the practice of the mid-1970s of articulating alternative economic programs and reform proposals designed to win broad support.

Implications for Craxi and the Socialists

Craxi's ambitions may have been derailed, but unless the Christian Democrats and the Communists can come to terms, the setback will be only temporary. [Although Craxi was forced to retreat, he was still able to extract several promises from Spadolini.]

Spadolini agreed that the new government would:

- [-- Give a high priority to institutional reform, with a special emphasis on increasing the powers of the prime minister.]
- [-- Formally recognize the Palestinian Liberation Organization.]

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(-- Continue price negotiations for natural gas from Algeria -- as favored by the Socialists -- as well as from the Soviet Union.)

[redacted] the Prime Minister agreed to urge the reorganized Banco Ambrosiano to sell its 40-percent share of the influential newspaper "Corriere della Sera" to a group of Craxi supporters.] [redacted]

Moreover, the Italian media is convinced that Craxi still believes that he and his party would benefit from early elections. Unless he is inhibited by fear of a rapprochement between the Christian Democrats and the Communists, he will almost certainly keep probing for a politically acceptable way to bring down Spadolini and send the country to the polls. [redacted]

Implications for Spadolini

[redacted] press reports suggest Spadolini hoped that his new cabinet would be smaller, free of personal rivalry, and more independent, but he too has been blocked. He tried to exercise his constitutional prerogative as Prime Minister to choose his Ministers without interference from the parties [redacted] he wanted to replace a [redacted] effort came to an abrupt end, however, when leaders of his coalition hinted to journalists that a deviation from normal practice would not be tolerated. [redacted]

Spadolini was also unable to include any of the other changes he sought -- such as merging the ministries of budget, finance, and industry into a "super ministry" headed by an independent technician and appointing a special minister without portfolio for institutional reform -- to make his new government stronger. Despite the renewed commitment to institutional reform -- indicated by the attention it received in the Prime Minister's speech to Parliament outlining his government's program -- the process will be long and tedious and we believe this government will barely be able to make a start. Moreover, the personality clashes and disagreements that haunted Spadolini's first government have not only been carried over to his second but most likely have been exacerbated by the crisis. [redacted]

Spadolini's tenure is fragile; since he remains a compromise candidate agreed to by the two largest parties of the coalition only because neither has the strength to force its preferred solution on the other. The Mafia assassination of the prefect of Palermo, General Dalla Chiesa, and the arrest of Lucio Gelli, the

(Preliminary agreement with Algeria initialed on 27 September.)

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alleged mastermind of the clandestine P2 Masonic Lodge, have already threatened to submerge his government in recrimination and back-biting. [redacted]

In the immediate aftermath of Dalla Chiesa's murder Christian Democrats at the local and national level were accused of purposely delaying enactment of laws providing special powers to strengthen the fight against the Mafia. [redacted]

[redacted] Similarly, the P2 Masonic Lodge scandal touched Italian politicians of nearly all political stripes and actually precipitated the fall of the Forlani government in June 1981. We believe that if new revelations link leaders of the governing coalition or members of the Cabinet to any of the numerous crimes that Gelli is accused of, or if charges of DC ties to the Mafia are proven, Spadolini would almost certainly be hardpressed to keep his government afloat. These issues pose the most immediate threats to his government's survival, but others -- economic policy in particular -- will almost certainly surface in the weeks ahead.

[redacted]

Implications for Economic Policy

The second Spadolini government has set the containment of the budget deficit as its top economic priority, but there is little reason to believe that Spadolini II will succeed where Spadolini I failed. The fiscal policy prescriptions of the DC and PSI remain incompatible. The Socialists support supply-side economics and view a combination of selective tax cuts and a stepped-up fight against widespread tax evasion as the best hope for curing Italian inflation. The Christian Democrats favor a more direct attack on inflation via tax hikes and spending cuts. [redacted]

On non-budget economic issues, we believe Spadolini faces an uphill battle to forge a consensus among coalition members. Big fights on several key issues -- foreign natural gas purchases, for example -- are inevitable because the symbolic and financial rewards -- in the form of "commissions" from interested domestic and foreign groups -- for the parties that "win" are so great. The parties are also split on labor issues, particularly wage indexation questions. Spadolini hopes to avoid confrontation on these issues as much as possible, but friction within the coalition on these points will add to the factors pushing the country toward new elections. [redacted]

Outlook

The traditional period of good feelings that follows the

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formation of a new government is likely to be especially shortlived this time. Even as the announcement that the coalition partners had reached agreement on a new government was being made, the press had begun to speculate that national elections will be held simultaneously with local elections that are scheduled for sometime between April and June. We anticipate that it will be only a matter of weeks before tension within the coalition has once again reached a boiling point. The Socialists, in particular, will yet again be searching actively for a way to force the country to the polls.

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Italy: A Traumatic Transition in the Labor Scene



As Italy's economic troubles have mounted in recent years, the work force—once considered unmanageable—has become increasingly pragmatic and work oriented. Industrial managers at the local level have begun reasserting themselves and winning union concessions on measures to raise productivity. Hoping for similar success at the national level, the private-sector employers' association, Confindustria, now is pushing for changes in the generous national wage indexation system. The industrialists hope their assertiveness will help end the wage cost spiral that has plagued Italian firms since 1969. The issue has become politically charged, and the prospects for modification are uncertain.



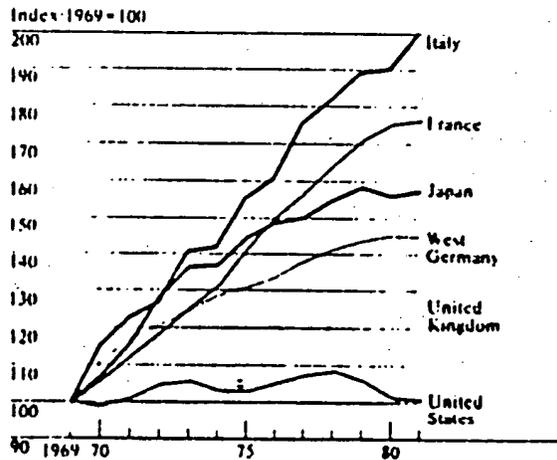
The Legacy of the Hot Autumn

The labor difficulties of the 1970s can be traced in large measure to the so-called hot autumn of 1969. At that time the triennial national contract negotiations were marked by an unusual level of strike activity and violence. Workers in many plants set up "factory committees" that pressed the three national confederations—CISL (associated with the Christian Democrats), CGIL (associated with the Communist Party), and UIL (associated with the small lay parties)—to put aside their rivalries and bargain more aggressively. Ties with parent political parties were deemphasized, and in 1972 the three unions formed an umbrella organization, the United Federation (UF), to act as a common bargaining agent for the 50 percent of the work force that is unionized.



The unified, depoliticized union movement wielded immense power in the early 1970s. Labor's biggest coup was parliamentary passage of a so-called

Major Industrial Countries: Real Wage Growth



Workers' Statute, which circumscribed management control to such an extent that trying to fire an employee came to be viewed as both expensive and futile. Union clout translated into generous pay hikes. During the 1970s, real wage increases averaged 7 percent each year. The wage bill climbed from 57 percent of Italian GDP in 1969 to 70 percent in 1981, squeezing profits and lessening export competitiveness. To prevent Italian exports from being priced out of the market, Rome let the lira depreciate sharply.



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Unit Labor Costs and Productivity in Manufacturing, 1971-80

Average Annual Percent Increase

	Output per Man-Hour	Unit Labor Costs in National Currencies	Unit Labor Costs in US Dollars
United States	0.3	0.6	0.6
Japan	7.3	6.3	11.3
West Germany	0.5	0.6	13.4
France	4.9	9.5	12.5
United Kingdom	0.2	14.9	14.6
Italy	4.8	14.4	11.0
Canada	0.3	0.8	0.7

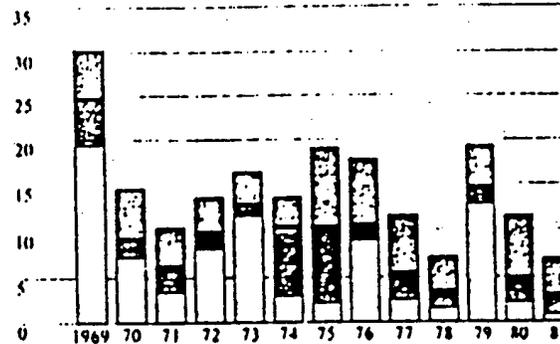


Italy: Man Hours Lost to Strikes, by Cause

Million Man Hours

Legend

- Other reasons
- Layoffs
- Salaries
- Contract Renewals

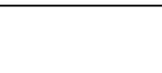


Labor's Grip Begins To Weaken

The bases of labor gains—strong unions, a militant work force, and acquiescent employer groups—began to crumble in the late 1970s as rapid inflation and a series of foreign exchange crises gave economic austerity a certain respectability. Since then the United Federation leadership has been reduced to infighting, and union membership has steadily declined. The leaders of the big unions and confederations often have seemed to be out of touch with the rank and file. The Communist-dominated CGIL has had the worst record in this respect, maintaining a combative attitude toward employers, even as its membership has become more moderate

Signs of a reemerging work ethic have become commonplace since October 1980, when 40,000 Fiat workers staged a "back-to-work" march to protest a 5-week-old strike:

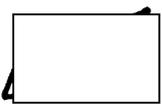
- Only 69 million man-hours were lost to strikes in 1981, the least since 1958. Absenteeism also has plummeted.



- In January 1982, the United Federation and some autonomous unions agreed to ban transportation strikes during peak travel periods and limit them at other times.
- A recent survey by Italy's leading financial daily reveals a pragmatic, work-oriented labor force. While placing most of the onus for the ill health of Italian industry on government economic policies, 44 percent of the workers interviewed felt their tendency to work too little and strike too much was also at fault

The advent of a generation of Italian managers willing to challenge unions and terrorists also has altered the union-business power equation. Fiat, Italy's largest private employer, has led industry's move to restore shop-floor discipline. In 1979 the

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company, a favorite Red Brigades target, dismissed 61 employees suspected of terrorist activities. As the auto market softened, the firm put 24,000 employees on a state-subsidized layoff program for three years. Fiat's productivity increased 20 percent between October 1980 and January 1982. Several other major Italian companies, playing on layoff fears, have extracted concessions from labor that have led to healthy productivity gains []

Wage Indexation: A Key Industry Grievance

Wage increases have greatly outpaced productivity gains in recent years. In its quest to control unit labor costs, industry has focused on Italy's entrenched wage indexation system, the *scala mobile*. Indexation now accounts for over 60 percent of annual wage increases, strictly limiting the flexibility of union and management contract negotiators. The IMF, OECD, EC, and Bank of Italy all have criticized the *scala mobile* on economic grounds, citing four key defects:

- The existing *scala mobile* diminishes the government's ability to implement deflationary policies because indirect taxes are included in the "basket" of goods and services used to determine quarterly cost-of-living increases.
- Because this basket includes items that are traditionally imported, the effectiveness of currency depreciation in shifting domestic resources to import substitutes and exports is greatly reduced.
- When the indexation mechanism was modified in 1975, a "unitary point" was adopted. A one-point increase in the *scala mobile* index boosts each worker's paycheck by the same amount in lire, narrowing the gap between highest and lowest paid workers. While this result satisfies social equity considerations, it weakens a worker's incentive to improve his skills.
- Indexation also distorts the impact of any change in relative prices []

In the spring of 1981, Confindustria began to hint it might not renew the 1975 wage indexation accord. Prime Minister Spadolini, upon assuming office that June, persuaded Confindustria to put off a decision on the *scala mobile* in return for a promise to hold discussions among labor, industry, and government leaders on a so-called social pact. Rome hoped these talks would yield a consensus on how to keep the increase in labor costs below 16 percent—the government's inflation target for 1982. However, it was clear almost from the start that the labor leaders—aware of the growing pragmatism on the shop floor but intent upon defending at least the principle of earlier labor gains—were unwilling to make meaningful concessions on wages or productivity. []

The employers postponed the scheduled triennial contract negotiations out of dissatisfaction over the lack of progress in the social pact discussions.¹ In hope of inducing the unions to be more forthcoming, the cabinet approved a \$1.6 billion income tax cut and dangled the possibility of further tax cuts upon conclusion of a social pact on wages. To buy industry good will, the government earmarked \$1.1 billion for medium-term, low-interest loans and value-added tax concessions for industry. This handout, coming on the heels of a costly new severance pay law, was not enough to placate industrialists. On 1 June of this year Confindustria announced its intention not to renew the 1975 agreement. []

A Mixed Reaction

Confindustria realized that the decision was a gamble. Reactions have underscored the unpredictability of the situation. The labor rank and file immediately greeted the announcement with scattered protest strikes. Since then there have been

¹ Contracts covering 6 million workers in the private sector and 3 million in the public sector—about half the work force—expired during late 1981 and early 1982. []

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impact on Italian industry during the past few years. Improved work habits and union concessions have improved the bottom line for many firms. Similar gains will be possible once again after bitterness over Confindustria's unilateral revocation of the 1975 accord dies down. [redacted]

Italian industry will, however, continue to suffer from a variety of handicaps unrelated to labor relations. Frenetic political maneuvering led the government to slight several key economic problems in the past, and this pattern is likely to continue. If energy and government spending problems are allowed to fester, an above-average inflation rate will persist, weakening even the most constructive efforts of labor and industry to boost Italy's industrial competitiveness. [redacted]

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