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# Near East and South Asia Review



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27 February 1987

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## Articles

**US-Iraqi Relations: Argument for More Trouble Ahead** [redacted]

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[redacted]

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US-Iraqi relations may have been more severely damaged by Washington's Iran initiative than many observers currently believe. The revelations of the Iran initiative may well have convinced Iraqi leaders that their move toward the United States was a fundamental error, and they may now reassert their revolutionary ideology. [redacted]

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**Jordan: Perspectives on the Iran-Iraq War** [redacted]

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[redacted]

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Jordan's King Hussein is becoming increasingly concerned that recent developments in the Iran-Iraq war indicate Iran is gaining the upper hand. The King continues to be Iraq's most committed ally but has grown deeply apprehensive about the economic and security implications of an Iranian victory. [redacted]

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**Egypt: Anti-American Comment in the Press** [redacted]

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[redacted]

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Over the past three months the Egyptian press has become increasingly critical of the United States. The press campaign against the United States almost certainly can be seen as a warning sign of deepening disillusionment among Egyptian officials with US-Egyptian ties. [redacted]

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**Saudi Arabia-USSR: No Quick Fixes** [redacted]

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[redacted]

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Saudi Arabia appears to have relaxed its reluctance to expand ties to the Soviet Union, but recent speculation that Riyadh is considering significant upgrading of its relations following Saudi Petroleum Minister Nazir's visit to Moscow in mid-January is overstated. The chances for a dramatic breakthrough in the short term are minimal.

[redacted]

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**Israel: Budget Compromises Invite Economic Reversals**

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After nearly three months in operation, the Nablus branch of the Cairo-Amman Bank is losing money because of structural limitations imposed by Israel. The Jordanian Government can ill afford to lose the Nablus branch because its collapse would deprive Jordan of a solid institutional presence on the West Bank.

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**Syria-Turkey: Steering Clear of Controversy**

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Syria has sought to preserve its uneasy reconciliation with Turkey over the past year by making incremental concessions on longstanding bilateral disputes. As Syria regains its confidence, it is certain to increase support to Turkish subversives as its principal bargaining chip.

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**Syria: Preparing for the Next War With Israel**

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Within the last year Syria's worsening economic crisis, the revival of Palestinian strength in Lebanon, and intense maneuvering within the Alawite elite have put Syrian President Assad on the defensive, but these developments have not weakened his resolve to press the Arab struggle against Israel and ultimately to recover the Golan Heights.

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The Syrian-sponsored Palestine National Salvation Front continues to face a major uphill battle in its efforts to become accepted among Palestinians as a credible alternative to the PLO led by Yasir Arafat. Despite the Front's dependence on Syria, President Assad may be slowly losing his Palestinian card.

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**Lebanon: The National Fund—The Christian War Chest** [Redacted] 39

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[Redacted]

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Created to ensure the survivability of the Christian enclave, the National Fund is controlled by the Lebanese Forces, which receives two-thirds of the fund's money. With annual estimated revenues of \$23 million, the fund is further evidence of the Christian quest for autonomy in the absence of a political solution in Lebanon. [Redacted]

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**Algeria: Economic Slump Continues** [Redacted] 41

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[Redacted]

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Last year Algeria experienced its most serious financial crisis since independence, and the outlook for 1987 is little better. More protests against the regime can be expected as austerity intensifies, and more pressure on President Bendjedid to return Algeria to the socialist fold is also likely. [Redacted]

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**Foreign Investors** [Redacted]  
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Pakistan offers foreign investors words of welcome, legal protection, and a growing market—but a wide gap exists between promise and performance in reducing bureaucratic obstacles. The investment climate is likely to deteriorate as foreign payments strains mount and revival of political activity slows the pace of economic reforms. [Redacted]

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**India: Impact of Military Spending** [Redacted] 53

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[Redacted]

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India's long-term program to modernize its defense forces has not unduly strained its economy or hampered its development programs so far. Nonetheless, the large-scale purchases of weapons from foreign suppliers and the associated debt servicing costs are likely to strain India's fragile foreign payments position. [Redacted]

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[Redacted]

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**India: Succession Implications of Cabinet and Congress Party Changes** [Redacted] 57

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Prime Minister Rajiv Gandhi's shakeups of his Cabinet and the ruling Congress Party have resulted in a lack of second-echelon leaders with broad political support in either organization. P. V. Narasimha Rao, the senior Congress Party Cabinet Minister, heads the list of candidates in the event of a succession struggle. [Redacted]

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The Tamil insurgency has placed serious strains on Sri Lanka's democratic institutions. Despite controversial measures undertaken by the government to combat the insurgency, in the long run Sri Lanka's democratic fabric will probably remain largely intact. [Redacted]

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Sri Lanka's Tamil militants have turned to high-risk, high-profit international crime—particularly drug trafficking—to maintain their war chests. They are not only becoming more actively involved in drug trafficking but also are likely to continue their involvement regardless of the outcome of the autonomy struggle in Sri Lanka. [Redacted]

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*Some articles in the Near East and South Asia Review are preliminary views of a subject or speculative, but the contents normally will be coordinated as appropriate with other offices within CIA. Occasionally an article will represent the view of a single analyst; an item like this will be designated as a noncoordinated view.* [Redacted]

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**Near East and  
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**Articles****US-Iraqi Relations: Argument  
for More Trouble Ahead**<sup>1</sup>

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US-Iraqi relations may have been more severely damaged by Washington's Iran initiative than many observers currently believe. Iraq is a revolutionary society and is bound by revolutionary principles. In reestablishing diplomatic ties to the United States, Iraq compromised its revolutionary ideology. The revelations of the Iran initiative may well have convinced Iraqi leaders that their move toward the United States was a fundamental error, and they may now reassert their ideology more strongly than ever. In a development that may signal the beginning of such a trend, First Deputy Prime Minister Taha Yasin Ramadan—a longtime foe of the United States—has made the initiative the basis for several blistering attacks on Washington. In the coming months Ramadan could make further trouble for the United States and collect a following of individuals similarly hostile to US interests. The result could be a reversion by the Iraqis to previously held hardline positions, such as support for the more extreme Palestinian groups.

**Iraq as a Revolutionary Society**

Despite some evolution in its domestic and foreign policies, Iraq's revolutionary political culture remains alive. As a revolutionary society, many of Iraq's leaders regard the United States as an imperialist power with interests ultimately inimical to those of Iraq. As a result, the underlying aim of the United States—in the eyes of these members of Iraq's ruling Ba'th Party—is to reduce Iraq to the status of a subjugated nation, a colony.

Although Iraq deemphasized this ideological view when it agreed to reestablish relations with the United States in 1984, it is possible to argue that this move

was based solely on expediency. At the time, the US-orchestrated arms embargo seemed to Iraqi leaders one of the few possibly effective means of winding down the war.

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**An Intense Debate**

According to the US Embassy, the proposal to renew relations with the United States encountered intense resistance at the time and probably would have failed had it not been for Foreign Minister Tariq 'Aziz. 'Aziz, an extremely sophisticated diplomat, pushed for the resumption of ties and, according to the US Embassy, steered the proposal through Iraq's ruling body, the Revolutionary Command Council (RCC). According to the US Embassy, 'Aziz used his considerable debating skills to talk his less sophisticated RCC colleagues into going along with the proposal.

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Arguing against the proposal was Ramadan, not generally esteemed as a deep thinker and with no special knowledge of international affairs. Nonetheless, Ramadan—a cold, bristly individual, described by the US Embassy as the epitome of a tough Ba'thist—is respected for his political savvy. His instincts have enabled him to avoid pitfalls that have destroyed many of his Ba'thist colleagues.

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Ramadan, according to the US Embassy, was the last key figure in the regime to agree to reestablishing formal ties to the United States. Once he approved, however, like a good soldier he endorsed the policy and gave the appearance of supporting it wholeheartedly. He granted interviews to US visitors—something he had never done before—and spoke, apparently with conviction, about the need to

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<sup>1</sup> This article represents the views of the author and has not been fully coordinated with other NESAs analysts.

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develop strong bilateral ties. Ramadan, however, almost certainly retained some mistrust of the pro-US policy, and his support may well have been a tactical expedient. Once the revelation about the Iranian arms sales emerged, Ramadan appears to have cast aside whatever sympathy he had for Washington and began openly attacking the United States. [redacted]

#### **Ramadan Takes a Stand**

In his recent anti-US blasts, Ramadan adopts the revolutionary perspective of a hardline Ba'thist. He attacks the United States for being an imperialist power. He claims its aim is to carve up Iraq, promoting the creation of a Shia republic in Al Basrah and an independent Kurdish state in the north. The United States acts, according to Ramadan, to prevent Iraq from becoming a strong, independent state because this would foil Washington's scheme to establish hegemony over the Persian Gulf.

Washington's partner in this plot, says Ramadan, is Israel. [redacted]

Ramadan's line—essentially a conspiracy theory—conforms not only to Ba'thist ideology but also to the Iraqis' basic beliefs about the conduct of politics in the Middle East. It explains a number of embarrassing and potentially ruinous military defeats Iraq has suffered in the past year by blaming the United States. In Ramadan's interpretation of events, the setbacks at Al Faw and later near Al Basrah were caused by US duplicity in selling arms to Iran and passing false intelligence to Iraq, not by the ineptitude of Iraq's military machine. Ramadan's theory also gets Baghdad off the hook in another area. It explains why Saddam has been unable to end the war—the United States and its ally Israel are keeping it going by supporting Iraq's enemy. [redacted]

#### **Ramadan Attracts a Following**

There is evidence Ramadan's enunciation of a conspiracy theory has other supporters within the Iraqi regime. Information Minister Latif Jasim has begun parroting ideas originally voiced by Ramadan. Jasim's attacks, moreover, provide a clue to a more disturbing development. According to the US Embassy, Jasim is a sycophant who attempts to do nothing that would offend Iraq's President Saddam Husayn. If Jasim is spouting Ramadan's views, Saddam may approve of them as well. [redacted]

Further evidence that Ramadan's views may have the upper hand in Baghdad's leadership circles can be seen in an interview in early February between the US Ambassador in Baghdad and 'Aziz. Saddam's views on the initiative—as laid out by 'Aziz—appear to parallel those of Ramadan. 'Aziz told the Ambassador that Iraq believes the US arms sales to Iran are part of a conspiracy against Iraq aimed at perpetuating instability in the region. [redacted]

#### **Outlook and Implications for the United States**

If the above arguments about the extent of damage to US relations prove correct, Washington can expect more trouble from Iraq. It will take a while for Ramadan's ideas to trickle down into both the party and the bureaucracy, but trickle down they will. Iraq is a thoroughly regimented society, and approaches decided on by the top leadership are transmitted to all sectors of society in the manner of an imperial decree. As such they are supposed to be assimilated, upheld, and acted on without question. [redacted]

An indication of further trouble for the United States would be the reemergence throughout the Ba'th Party structure of ideological hardliners. These individuals—for example, Salah Mukhtar of the Ministry of Information—dropped out of sight following the reestablishment of relations with Washington. If Ramadan's criticisms of the United States reflect overall Iraqi policy, they almost certainly will reappear. They will call for fundamental changes in Iraq's foreign policy, such as increased support for the Soviet Union and the Palestinian resistance. [redacted]

Ultimately, anti-US talk could be supplemented by action. The ideological hardliners could come to dominate important government Ministries. They could, for example, take over the Iraqi Intelligence Service (IIS). This probably would be harmful to US interests in the region. A previous IIS director—hardliner Barzan al-Tikriti—was a principal supporter of Palestinian terrorist Abu Nidal. [redacted]

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## Jordan: Perspectives on the Iran-Iraq War

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Jordan's King Hussein is becoming increasingly concerned that recent developments in the Iran-Iraq war—especially Tehran's gains in the fighting at Al Basrah and its victory last year at Al Faw—indicate Iran is gaining the upper hand. The King continues to be Iraqi President Saddam Husayn's most committed and vocal Arab ally but has grown deeply apprehensive about the economic and security implications of an Iranian victory. [redacted]

increasing vulnerability to Iranian-sponsored fundamentalism and fears that Saudi Arabia and the smaller Gulf states could fall prey to Islamic radicals. [redacted]

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In a departure from its traditional practice of balancing regional rivals, Jordan has given unswerving support to Iraq throughout the six-year-old war. Amman has made no overtures to the fundamentalists in Tehran, refusing to recognize any legitimacy for the Iranian position in the war. King Hussein has strongly urged other Arab states to do likewise despite the major friction this has caused in relations between Jordan and Syria. [redacted]

### Economic Impact of the War

Jordan has benefited financially from its close relationship with Iraq during the war, giving further impetus to Amman's strong support for Saddam Husayn. Iraq has become Jordan's leading trade partner. About 25 percent of Jordan's exports go to Iraq, and Baghdad has become Jordan's leading source of oil. Some of the oil has been used to reduce Baghdad's \$500 million debt to Amman. This arrangement reduces Jordan's heavy dependence on Saudi oil, which must be paid for in cash. Amman is in arrears to the Saudis for past oil deliveries. [redacted]

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### Fear Breeds Staunch Support for Iraq

The King is worried that an Iranian victory would seriously undercut his efforts at forming a moderate Arab consensus to support Jordan's strategy on peace negotiations with Israel—a central tenet of Hussein's regional strategy. The King has worked particularly hard to moderate Iraqi policies and to speed Egypt's return to the Arab fold to form a moderate bloc aimed at defusing regional tensions and to facilitate a revival of the peace process. An Iranian victory would almost certainly force Hussein into a closer relationship with Syria to contain the new eastern threat and would thereby strengthen the hand of the Syrians and other radicals. [redacted]

Jordan's transport sector—including port handlers, truckers, and freight forwarders—also has greatly benefited from the war. The US Embassy estimates that nearly two-thirds of the cargo transiting the Jordanian port of Aqabah is destined for Iraq. The cargo, including both military equipment and large quantities of civilian goods, is shipped overland through Jordan to Baghdad. [redacted]

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Jordanians have a deep-seated fear that Iranian-sponsored fundamentalist fervor will undermine the established Jordanian social and political order. According to US Embassy reporting, Hussein is worried that an Iranian victory would "Arabize" the fundamentalist revolution and lend it credibility among the large Shia populations in moderate Arab states. He is particularly concerned over Egypt's

Despite these economic benefits, Jordan has more to gain from an acceptable end to the war than from its continuation. Jordan probably expects that its subsidies from the Gulf states would increase after the war, since Iraq's heavy demands on them would subside. Jordan also probably expects to play an important role in Iraq's reconstruction efforts after the war. Several Iraqi cities have been heavily damaged during the course of the war and will require years to restore and rebuild. Jordan would expect to provide large numbers of workers and receive construction contracts for Jordanian companies for the postwar rebuilding of Iraq. [redacted]

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On the other hand, an Iraqi defeat would be an economic disaster for Jordan. Amman would have little hope of collecting on Iraq's debt, and transit revenues gained from supplying Iraq's war effort would be lost, as would nearly one-fourth of Jordan's export market. Amman would once again be completely dependent for its crude oil on the Saudi pipeline. King Hussein probably fears that he could not develop, at least in the near term, a normal working relationship with a postwar fundamentalist regime in Iraq, given Jordan's unwavering support for Saddam during the war. [redacted]

**Military Support Limited . . .**

King Hussein has matched strong political and rhetorical support for Iraq with low-level military assistance. Jordan provides training—considered the best available in the Arab world—for Iraqi pilots and artillerymen. Jordanian interlocutors also have negotiated arms purchases for Iraq. For example, a Jordanian delegation recently went to China to negotiate an aircraft purchase for the Iraqis, [redacted]

Since Iraqi ports were closed during the initial phase of the war, Aqabah—Jordan's only port—has been used extensively to handle military equipment destined for Iraq. Because of the distance involved, most of the gear shipped through Jordan consists of support equipment such as trucks, light vehicles, and ammunition. [redacted]

that the materiel is checked out and in some cases possibly assembled at Jordan's maintenance facility at Az Zarqa. [redacted]

**. . . But Few Options Open for Amman**

Jordan has few other options for contributing militarily on Iraq's behalf. Jordan's Army—consisting of four divisions with fewer than 75,000 men—is insignificant compared to the forces Iraq has assembled. The bulk of Jordan's military equipment—except a small amount of Soviet air defense weaponry—is Western-built and could not be maintained by the largely Soviet-equipped Iraqis. Moreover, Jordan's military suffers from severe spare parts shortages, maintenance problems, and is equipped with increasingly obsolescent equipment. Its

ability to sustain extended combat operations on its own borders—much less hundreds of kilometers away in Iraq—is questionable. [redacted]

Jordan's Chief of Staff, Lt. Gen. Abu Taleb, last year denied rumors that Jordan was prepared to send troops to Iraq. [redacted]

[redacted] that such a move made little sense and that Jordan would not send forces. He noted that a Jordanian expeditionary force of as much as two or three brigades would in no way improve Iraq's ability to resist Iran but would significantly deplete Amman's forces and erode its ability to defend itself. [redacted]

Some alternatives—albeit distasteful to Amman—could have some short-term impact on Iraqi military capabilities, according to the US Embassy. If an Iraqi collapse seemed imminent, Jordan could provide one or two squadrons of Mirage F-1 fighter-bombers—the only aircraft common to the two countries' air forces. Jordanian pilots, maintenance crews, and support equipment would probably improve the performance of Iraq's Air Force but would make little difference in the outcome of the war. [redacted]

Jordan would be extremely hesitant to make such a commitment. Its two squadrons of F-1s are likely to remain the most modern aircraft in its inventory and, given Amman's dire financial position, may be for some years to come. King Hussein is keenly aware of the heavy losses Iraq's Air Force has suffered recently, and almost certainly will not risk losing a large number of his best planes—and more important some of his scarce pilots—in what would ultimately be only a show of support for Saddam. [redacted]

**Frustrated With Iraqi Performance**

Jordanian military leaders—often accompanied by King Hussein—frequently visit Baghdad to get updates on the fighting. In their discussions with Iraqi officials, the Jordanians consistently counsel Iraq to take a more aggressive posture in the war, [redacted] [redacted] They have long pressed the Iraqi Air Force to accelerate its attacks on Iranian economic targets and have urged the Iraqi Army to

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conduct massive counterattacks using its superior armored forces. Jordan has often warned that Saddam's defensive tactics over the past several years are doomed to fail, given the Iranians' religious fervor and vastly superior manpower resources. [redacted]

Iraq's consistently optimistic view of the war has made the King increasingly distrustful of Baghdad's information. According to the US Embassy, Jordanian assessments often differ fundamentally from what the King is told in Baghdad. For example, a high-level Jordanian official visited Baghdad last year just before Iran's offensive at Al Faw and was told by Saddam that the Iranians were in a desperate situation. The Jordanian warned the Iraqis that their defensive strategy could have dire consequences, but to no avail. Jordanian military leaders have told US officials that none of the Iraqi generals have a realistic grasp of their situation. [redacted]

#### **Prospects for the War—Viewed With Dread in Amman**

Jordan has given up expecting an Iraqi victory, according to the US Embassy. Jordanian military leaders see only two possible outcomes to the war—a clear-cut Iranian victory or a stalemate forcing the Iranians to the negotiating table. The Jordanians fervently hope for the latter outcome, but many believe that every limited Iranian battlefield gain, such as Al Faw and Al Basrah, makes Tehran closer to becoming the eventual victor. [redacted]

Despite his view that Iraqi fortunes are waning, King Hussein evidently perceives no acceptable alternative to continuing his open support for Saddam. The King believes that a leadership change in Iraq, which the Iranians have long demanded as a requisite to ending the fighting, might in itself hand victory to the Iranians. He recently told US Embassy officers that Saddam's departure probably would cause the Iraqis to collapse and thus is not a viable option for ending the war. [redacted]

#### **Implications for the United States**

Revelations of US dealings with Iran late last year shocked and outraged the Jordanian leadership and deepened its apprehension that Iraq eventually will

lose the war. Chief of Staff Abu Taleb, like other Jordanian military leaders, had long pressed for direct US support to Iraq. [redacted]

King Hussein felt particularly betrayed by the United States, believing the US action undermined years of effort to isolate Iran. Hussein had believed that Washington supported his Iraqi policy and now views the United States as actively undermining a major Jordanian foreign policy initiative. [redacted]

Since the US-Iran revelations, Jordanian leaders have increased their support for international efforts to restrict arms sales to Iran. Given its disillusionment with US policy, Amman increasingly believes that intervention by both the Soviet Union and the United States may be the only way to avoid an Iranian victory and its dire implications for Jordan's future. [redacted]

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## Egypt: Anti-American Comment in the Press

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Over the past three months the Egyptian press has become increasingly critical of the United States. Articles in both the government-owned "national" press and the independent opposition press have focused criticism on US arms sales to Iran, the US role in the Middle East peace process, and US policy on Foreign Military Sales (FMS) debt relief. Opposition newspapers have carried particularly strident attacks on US policies and officials.

The Egyptian press is freer to print such attacks on US—and by implication—Egyptian policies than at any time in its recent history. Under President Mubarak's regime of safety valve democracy, Egypt's newspapers probably are the freest in the Arab world.

Nevertheless, the Egyptian press remains under at least limited forms of control, including self-censorship and "guidance" from senior government officials, and the press campaign against the United States almost certainly can be seen as a warning sign of deepening disillusionment among Egyptian officials with US-Egyptian ties. In our view, Mubarak tolerates the criticism of the United States and probably has encouraged some of it to defuse Egyptian frustrations, to build credibility with other Arab states, and to improve his nonaligned image.

### Targets of Egyptian Criticism

Criticism of the United States in the Egyptian press has steadily increased in the years since the 1978 Camp David accords, but in recent months several events have come together to prompt harsher attacks on US policy:

- The exposure of US arms sales to Iran intensified anti-US comment in the Egyptian press. The mass dailies sensationalized "Irangate," speculating that it was a "massive plot" to impose "US-Israeli domination" over the region.

- US credibility as a broker for Arab-Israeli negotiations subsequently was called into question. *Al-Jumhuriya* published an editorial on 19 January commenting that, "Following revelation of the dubious US role in fanning the flames of the Iran-Iraq war, it has become a national necessity to discount 'the American alternative.'"
- US-Egyptian differences over FMS debt relief surfaced strong indications of resentment over US policies and the alleged US tilt toward Israel. On 13 January *al-Akhbar* published a frontpage interview with Prime Minister 'Atif Sidqi given by the newspaper's retired editor, Mussa Sabri. Opening the interview, Sabri asked the Prime Minister a few questions about the meeting on debt relief scheduled with US representatives for that day. Sidqi's answers were brief, but the paper carried Sabri's own criticism of the United States, including his closing comment that, "I still understand the US policy toward us is based on the American philosophy of 'do not let them die, do not let them live.'"

The opposition press carries even more inflammatory attacks on the United States, calling for Egypt to sever its relations with Washington, break the treaty with Israel, and return to the Arab fold:

- In a characteristically vituperative attack, on 27 January *al-Shaab*, the newspaper of the opposition Socialist Labor Party, commented in an article entitled "The Lying Ambassador" that the US Ambassador to Cairo had misrepresented the true character of US policy in the Middle East on several issues. The truth, according to *al-Shaab*, was that

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the United States would increase aid to Israel at a time when further aid to Egypt was being refused, that an attempt was being made to weaken Egypt economically, and that Egypt was being forced to abandon the idea of an international conference on peace in the region.

### **The Egyptian Press Under Mubarak**

Mubarak's concept of "safety valve" democracy has allowed substantially greater freedom of the press in Egypt. On taking office, Mubarak resumed the policy of political liberalization undertaken in the early years of the Sadat regime. Mubarak extended greater autonomy to groups in and outside of government, attempting to circumvent the political instability and the resulting violence that ultimately destroyed his predecessor. With specific regard to the media, Mubarak has adhered to the Egyptian Constitution of 1971 and to the Press Law of 1980 that grant freedom of the press.

Under Mubarak, government confiscation of newspapers and purging journalists of the opposition press have ceased. By and large the government disregards the inflammatory rhetoric of the opposition press, claiming that it has limited popular appeal.

Nevertheless, government controls over the press have not been lifted entirely. The Shura Council owns the national press and must approve any new publications. The government-controlled High Press Council makes major press appointments. The censorship department in the Ministry of Culture screens material for treasonable substance or "morally deviant" items. Although guidance is less stringent than under Sadat and less frequently imposed, chief editors meet regularly with Mubarak, presidential adviser Osama al-Baz, or Minister of Information Safwat al-Sharif. In addition, journalists have learned to impose self-censorship.

### **Orchestrated Attacks on US Policy?**

In the weeks before the Islamic Conference Organization's summit meeting in Kuwait in late January, Mubarak delivered some unusually critical remarks on the United States in the course of interviews with Arab journalists. He bemoaned Washington's "loss of credibility" as a result of the

Iran affair, and charged that Washington is too preoccupied with its own problems to focus on steps toward resolving the Arab-Israeli conflict. Mubarak also reproached the United States for not meeting his expectations on relief from debts incurred from US military sales.

The President's attacks on the United States, like the press campaign over the previous several months, falls well short of an unrestrained campaign against the United States and US relations with Egypt. US Embassy officers in Cairo reported that there was no evidence of a government effort to orchestrate press attacks on the United States. Mubarak, moreover, almost certainly was seeking primarily to underscore his independence from Washington and his solidarity with Arab causes before his meeting with other Arab leaders in Kuwait.

Nevertheless, the anti-American comment appearing in the Egyptian press is at least tacitly approved by the government, and—as Mubarak's interviews before the Islamic summit meeting indicate—the frustration and resentment the comment reflects are felt at the most senior levels of the regime. We do not believe Mubarak wishes to instigate a crisis in US-Egyptian ties or to cool relations, but the anti-American comment appearing in the press appears to be a warning of deepening Egyptian disillusionment with Washington.



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**Saudi Arabia-USSR:  
No Quick Fixes** [redacted]

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Saudi Arabia appears to have relaxed its reluctance to expand ties to the Soviet Union, but recent speculation that Riyadh is considering significant upgrading of its relations following Saudi Petroleum Minister Nazir's visit to Moscow in mid-January is overstated. Although Saudi-Soviet relations have improved marginally over the past few years, the chances for a dramatic breakthrough in the short term are minimal. Riyadh continues to insist that the Soviet occupation of Afghanistan and poor Soviet treatment of Muslims in the USSR are impediments to expanded ties. The Saudis are also worried about Soviet inroads in the Yemens and the Horn of Africa and what they judge is lukewarm Soviet support for the Arabs in the Arab-Israeli confrontation. [redacted]

Moscow's efforts to extract maximum propaganda value from the visit and portray it as a major breakthrough in Saudi-Soviet relations, which have atrophied since 1938, have been a source of consternation to the Saudi Government. Senior Saudi Foreign Ministry officials insist to US officials that Nazir's trip was solely to seek cooperation in stabilizing world oil prices. They are embarrassed by Moscow's exploitation of the visit through the media to convey the impression that substantive discussions were held covering a wide range of nonoil matters, including sensitive political issues. Moreover, Riyadh refused a request before Nazir's visit for greater contact between Soviet and Saudi academics specifically to avoid giving the impression that the trip indicated an improvement in bilateral relations, according to the US Embassy in Riyadh. [redacted]

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Nazir's visit, however, will undoubtedly be used by Moscow as a steppingstone to better relations, and Saudi-Soviet contacts are likely to increase. In addition, a number of factors are gradually pushing Riyadh closer to Moscow, including overlapping oil interests, concern over Iranian aggression, and a desire to appear nonaligned by putting distance between itself and the United States. [redacted]

**Unresolved Obstacles**

Although Moscow strongly wants to improve ties to Riyadh, a number of major impediments—Afghanistan, treatment of Soviet Muslims, and ideological differences—are likely to prevent quick improvement in relations. In our view, these obstacles, combined with the usual Saudi caution on major foreign policy decisions, will limit Riyadh's receptiveness to recent Soviet overtures. [redacted]

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**Saudi Petroleum Minister's Visit**

The US Embassy reports that, following a special session of Persian Gulf oil ministers in early January to review the impact of OPEC's December accord, the group proposed that Saudi Arabia and Kuwait intensify contacts with non-OPEC oil producers to help stabilize world oil markets. On 19 January Petroleum Minister Nazir arrived in Moscow for an unprecedented four-day visit—the first ever by a Saudi Petroleum Minister. A Soviet spokesman described the visit as "an unusual event" in Saudi-Soviet relations. According to press reports, Nazir held talks with senior Soviet officials, including Foreign Minister Shevardnadze and Premier Ryzhkov. The discussions focused on the international oil market, the Arab-Israeli conflict, the Iran-Iraq war, Afghanistan, and bilateral issues, according to the US Embassy in Moscow. [redacted]

Riyadh continues to insist that the Soviet occupation of Afghanistan, in large part, prevents expanded ties. Late last month King Fahd called the intervention "a historic and strategic error" and demanded the withdrawal of Soviet forces from Afghanistan. Shevardnadze tried hard to persuade Nazir—apparently with some success—of Moscow's and Kabul's desire to achieve national reconciliation among the Afghan people, according to US Embassy reports. [redacted] Soviet officials asked

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a visiting PLO delegation in early January whether the Saudis would accept a Soviet offer to reestablish diplomatic relations if Moscow removed its troops from Afghanistan. Fahd, however, remains insistent that the USSR demonstrate its sincerity before he gives any serious consideration to the reestablishment of diplomatic relations, [redacted]  
[redacted]

Moscow's treatment of its Muslim minority and Riyadh's reluctance to reestablish diplomatic ties to a nation that officially espouses atheism also hamper an improvement in relations, according to Embassy reporting. During the past several years only a handful of Soviet Muslims have made the annual pilgrimage to Mecca, and Saudi religious leaders remain vehemently opposed to increased contacts with the USSR. Fahd would be unlikely to provoke these conservative elements, upon whom he depends for support, without having clear gains to show for it. Crown Prince Abdallah, although known for his criticism of US policies, is even more dependent on religious and tribal constituencies and is unlikely to move quickly to improve Saudi-Soviet ties should he become king anytime soon. [redacted]

### Prospects

Although Nazir's trip has marginally improved Riyadh's poor relations with Moscow, we believe further improvement will be gradual, at the Saudis' pace, and carefully weighed against US-Saudi relations. Following the visit, Soviet Foreign Ministry officials said there was little chance that the Saudis and Soviets would formalize relations soon, according to the US Embassy in Moscow. The Soviet Ambassador to Jordan publicly said last month that an exchange of ambassadors between Saudi Arabia and the USSR was unlikely at this time. [redacted]

Moscow's attempts to expand ties to Riyadh will continue to be hindered by the Saudis' deep aversion to a regime they believe is atheistic, aggressive, and expansionist. They are sensitive to the Soviet presence in the Yemens, and they fear that the risks of subversion would increase dramatically if the Soviets had a diplomatic mission in Riyadh. Moreover, Saudi leaders are likely to hesitate as long as they judge that they will be giving more than they get in return for

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### *Saudi-Soviet Ties at a Glance*

*Political* Moscow established relations with the Saudi kingdom in 1926 but recalled its Ambassador in 1938. Both sides, however, maintain informal and discreet contacts.

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*Economic* Saudi imports from the USSR in 1985 were \$451 million, or less than 2 percent of total imports. Saudi exports to the USSR in 1985 were only \$18 million.

*Cultural* There are an estimated 45 million Muslims in the USSR, who account for over 15 percent of the total Soviet population.

*Military* There have been no Soviet military sales to Saudi Arabia.

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reestablishing relations. Any rapprochement with Moscow would be costly because of conservative domestic opposition and increased strains in US-Saudi relations. It also would provide a boost for Moscow in its efforts to increase Soviet influence in the region. [redacted]

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The Saudi security relationship with the United States remains strong, but significantly enhanced Saudi-Soviet ties would provide Riyadh with an alternative to the conspicuous US presence and limit radical Arab criticism of the regime for being too pro-Western. As long as Riyadh continues to view the United States as the ultimate guarantor of its security, the Saudis would be unlikely to make a precipitate move toward the Soviets. Nevertheless, the

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Saudis probably will increase informal contacts with the USSR, and relations are likely to improve gradually over the next several years. Riyadh's support for Baghdad in its war with Iran has accelerated this trend and demonstrated a commonality of interest rarely seen in Saudi-Soviet relations.

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## Israel: Budget Compromises Invite Economic Reversals [ ]

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Prime Minister Shamir's beleaguered economic reform package is under relentless assault from powerful interest groups in business, labor, and the government that are demanding spending increases and other concessions that favor their constituents. Shamir's response so far has been to avoid the political fallout of a budget crisis by providing the additional funds. His policy of fiscal appeasement, however, is heading Israel toward renewed inflation that may well reverse the earlier gains of the National Unity government and damage his ability to manage the economy. [ ]

Prime Minister Shamir announced last December a sweeping economic reform program designed to achieve growth while maintaining Israel's fragile price stability. The plan called for a 4-percent increase in real GNP, a reduction in the foreign payments deficit, and a lowering of inflation to roughly half of last year's 19.7 percent rate. [ ]

### A Promising Start

To reach these targets, the government proposed a package of reforms that included:

- Restructuring the tax code by broadening the tax base and eliminating many tax exemptions and deductions.
- Opening the capital market to investments from the private sector.
- Selling government-owned enterprises to the public to help improve productivity and efficiency. [ ]

Reducing government expenditures—and the budget deficit—are the keys to the success of the reform plan. To these ends, Prime Minister Shamir proposed spending reductions totaling almost \$300 million for the fiscal year beginning this April, including cuts in the defense budget of about \$110 million. The plan mandated reductions in social programs as well. Subsidies were to be slashed by \$65 million, and the budgets for the Ministries of Health and Education each were to be cut by \$18 million. The government contended that no funds were available for new

settlements in the occupied territories. The reforms put additional demands on labor by prohibiting negotiated wage increases and postponing about half the 5.4-percent cost-of-living allowance until April 1988. [ ]

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### Obstacles

Opposition to the reforms was immediate and almost universal. Objections poured in from powerful interest groups, including the Ministry of Defense and the Histadrut trade union federation, that demanded annulment of the budget cuts. Other affected Ministries including Health and Education took up the chorus. [ ]

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The government did not even win partisan support as Likud members joined the Labor Party in criticizing various aspects of the plan. The proposals drew fire from the Knesset Finance Committee, the body that must agree to the budget submission before the entire Knesset can enact it into law. [ ]

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To win the Cabinet's backing last month—the first stop in the tortuous budget approval process—Shamir had to accept a watered-down version of the economic package. Yielding to pressure from Defense Minister Yitzhak Rabin and Foreign Minister Shimon Peres, Shamir withdrew the planned cuts in defense spending. Industrial interests, championed by Minister of Industry and Commerce Ariel Sharon, extracted a 10-percent shekel devaluation aimed at making exports more competitive. Despite some cosmetic fixes, the Cabinet effectively killed the tax reform measure and made no progress on revamping the capital market, according to the US Embassy in Tel Aviv. These compromises made serious inroads in the government's ability to attain its economic goals. [ ]

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Other measures endorsed by the Cabinet set the stage for renewed opposition to the reforms. Doctors, nurses, and teachers represented by the Health and Education Ministries escalated their objections to cuts in their budgets by threatening to go on strike. The Cabinet did not help matters when it agreed to defer a portion of the workers' cost-of-living adjustment until April 1988 to offset the inflationary impact on import prices of the shekel devaluation. The decision to maintain the subsidy reductions continued to be a major point of contention with Histadrut, whose endorsement was needed before the reforms could move on for legislative approval in the Knesset. [redacted]

To convince Histadrut to support the reform package, Finance Minister Moshe Nissim was forced to make substantial concessions that further undermined the government's capability to implement an austerity budget. In exchange for Histadrut's approval, the government agreed to bail out Histadrut's health care development fund by providing allocations in the form of an increased budget and a concessionary loan totaling about \$57 million. Histadrut also forced the government to preserve most subsidies and to retain many tax benefits that favor low income groups, according to the Embassy. [redacted]

The Knesset broke a two-week deadlock on the budget debate by giving preliminary approval to a Likud-Labor compromise on 18 February—but at the expense of a further battering of the reform package. In exchange for Labor's support, the Finance Ministry agreed to reschedule bank loans of \$158 million owed by the United Kibbutz Movement. The concession translates into a contribution of about \$20 million to the financially troubled kibbutzim. Labor in return will not stand in the way of demands from Herut, Likud's major component, for financial assistance for a few new settlements in the West Bank and Gaza, according to the US Embassy. Nissim is reviewing the Herut proposal, which calls for an immediate payment of \$29 million followed by another \$83 million at a later date. Shamir probably did not want to give the settler activists, especially Deputy Prime Minister David Levi who is challenging Shamir for party leadership, any ammunition to use against him at the Herut convention scheduled for the end of March. [redacted]

To ensure the approval of Avraham Shapira, chairman of the Knesset Finance Committee and leader of a major religious party, the government agreed to his demands for financial support for religious educational institutions (yeshivas). Shapira had warned that he would refuse to bring the budget to a vote unless he was assured of nearly \$20 million for the yeshivas. [redacted]

#### Prospects and Implications

The budget almost certainly will undergo additional attacks that will help defeat Shamir's original recommendations for fiscal restraint. Before final approval, the budget must go through two more Knesset debates, each of which offers fresh opportunities for more political wheeling and dealing. Health and education advocates will press to overturn cuts in their budgets. Herut will lobby for a financial bailout of several debt-plagued moshavim—agricultural cooperatives. Meanwhile, both Labor and Likud Finance Committee members are raising new objections to each other's proposals that led to the compromise. Signaling problems ahead, the Embassy reports one Likud ally of David Levi has demanded an investigation of kibbutz financial practices. Both sides of the coalition are determined to be in the strongest possible position should the government call for new elections before those scheduled for November 1988. [redacted]

Histadrut will fight proposals that threaten wages or social welfare programs. Israel Kessar, Histadrut secretary general, has announced he will demand compensation in the wage negotiations scheduled for this April if the government fails to control inflation. The Embassy reports that Histadrut's Trade Union Division already has decided to ask the government and private employers for an early start of wage talks because of recent price and interest rate increases. If prices continue to rise, Histadrut has served notice it will seek the restoration of at least the 2.7-percent deferred cost-of-living adjustment in defiance of the government's wage guidelines. It also will resist elimination of benefits for low income groups and insist instead that revenues be raised by taxing upper income brackets, capital gains, and property. [redacted]

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The government stands little chance of substantially increasing budget revenues, given the strong opposition to tax increases. Moreover, the revenue picture will be hurt by the expiration of several temporary taxes that added \$170 million to the coffers last year and planned reductions of some \$500 million in customs duties and employer contributions to the National Insurance Institute. Discretionary budget reserves of about \$370 million will not be enough even to cover revenue losses. Moreover, Israel cannot count on supplemental US assistance that last year amounted to \$750 million. [redacted]

Shamir's failure to exercise strong leadership during the budget process will contribute to the government's inability to rein in budget spending. His pattern during the recent debates has been to avoid controversy and to delegate nearly all the economic decision making to Peres and Nissim. Shamir's predilection for crisis avoidance will leave a vacuum that competing interest groups will fill with demands for additional changes, further eroding the austerity budget. [redacted]

A decline in public confidence in Shamir's ability to manage the economy will not make it easier for him to tighten the purse strings. Recent Israeli public opinion polls demonstrate a significant drop in support for his tenure. Without a perceived sense of emergency, the populace is less willing to accept stringent measures than they were during the stabilization program of 1985. A consensus believes that, with the window of opportunity for reform closed, the government will have to settle for a revised package that results in the continuation of the current system at best or, at worst, leads to spiraling inflation. [redacted]

Shamir as a result faces the prospect of a large budget deficit that could lead to runaway inflation, an outcome that would blot out the gains made over the past year when prices rose only 19.7 percent compared with 180 percent in 1985. The deficit could increase at least \$470 million—and as much as \$1 billion, according to one Israeli estimate—if, as seems likely, the government caves in to all the requests for increased expenditures. Even without the spending increases, the originally proposed budget deficit was already an inflationary \$850 million, about twice that

of 1986. Covering this revenue shortfall either by credit expansion or money creation will help push up the price level. By January the inflation rate was already running at an annual rate of 28 percent and probably will exceed this as budget discipline continues to break down. [redacted]

The impact of other government decisions on prices will make it even more difficult for Shamir to contend with growing inflationary pressures. The currency devaluation—aimed at stemming the growth in imports—will help boost the general price level because imports of goods and services still account for about 60 percent of Israeli GNP. To counter the effects of the devaluation—and the surge in consumer borrowing and spending—the Bank of Israel has temporarily raised the prime rate to 31 percent per annum. Although designed to curb consumer demand, the Bank's decision builds in some inflationary expectations that could actually worsen the situation if the monetary authorities are forced to leave the increase in place for an extended period, as now seems likely. At the same time, the Ministry of Industry and Commerce approved price hikes ranging from 4 to 10 percent on a large number of goods probably to compensate the business sector for the Bank's move. The Embassy reports the price increases will add 0.3 percent to the consumer price index. [redacted]

The decisions to raise interest rates and prices will not enhance Shamir's popularity and may well trigger a new round of wage and price increases. Histadrut officials assert the Bank's move runs counter to the government's stated intention of lowering the interest rate. Business leaders have denounced the monetary policy, contending it threatens economic stability and damages their competitiveness, according to the US Embassy. We believe higher interest rates will create an uncertain investment climate that may well retard growth and compound the government's problems in implementing even minimal capital market reform. [redacted]

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## Israel-Jordan-West Bank: New Bank Hits Snag

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After nearly three months of operation, the Nablus branch of the Cairo-Amman Bank is losing money because of structural limitations imposed by Israel, according to the US Consulate General in Jerusalem. The branch's financial troubles may jeopardize the bank's expansion plans in the West Bank. The Jordanian Government can ill afford to lose the Nablus branch because its collapse would deprive Jordan of a solid institutional presence from which to channel development funds efficiently into the West Bank. The Israeli Government would also suffer from a closing because this would undercut Israel's quiet cooperation with Jordan to weaken PLO influence among West Bank Palestinians.

The Nablus branch of the Cairo-Amman Bank originally was scheduled to open in early October last year. The opening was delayed, however, because of the branch's inability to secure an international bank guarantee as stipulated in its founding agreement with the Bank of Israel. Logistic problems in installing computer facilities further delayed the opening until early November. The opening of the branch on 3 November was marked by little fanfare, as both Jordanian and Israeli officials chose a low-key approach so as not to unduly politicize the venture.

The branch, however, has not fared well. To date, only 1,700 accounts have been opened, as it has failed to draw in large numbers of Palestinians to open accounts. Reporting from the US Consulate General in Jerusalem makes clear that most West Bank Palestinians continue either to hoard personal reserves at home or work through unofficial moneychangers to invest their money in banks in Jordan. The branch is also apparently losing money as a result of structural limitations imposed by the Israeli Government.

### Structural Limitations

Restrictions on foreign exchange transactions have cut down on the branch's ability to engage in international operations, according to the US Consulate General. Presently, foreign exchange levels

are restricted to 5 percent of the branch's holdings. Bank officials argue the low level severely hurts the branch's profitability.

Israel also requires that all letters of credit be issued through the Discount Bank in Tel Aviv. The US Consulate General reports that bank officials fear this restriction makes the Nablus branch of the Cairo Amman Bank virtually a branch of the Israeli Discount Bank. Although less onerous, several Central Bank of Jordan regulations also complicate the branch's ability to issue letters of credit.

Israel's refusal to allow East Jerusalem Arabs to open dinar accounts further compounds the branch's problems. Because Israel does not recognize the Jordanian dinar as legal tender in Jerusalem, East Jerusalem Arabs can hold only shekel accounts—a politically unacceptable option for most. Many Palestinians were surprised that the Jordanian Government and the Cairo-Amman Bank agreed to the exclusion because of the implicit risk of recognizing Israel's annexation of East Jerusalem. As a result, the bank's credibility has been hurt, as many Palestinians, especially businessmen, have chosen for political reasons not to use the branch.

Limits on the branch's loan portfolio have limited the scope of its operations. Bank officials argue that Israel's refusal to count as branch assets either the \$3 million the Cairo-Amman Bank has on deposit as a guarantee against bank failure with the Union Banque de Suisse in Switzerland or the Nablus branch's deposits at the bank's Amman headquarters unduly restricts loan potential. The Cairo-Amman Bank's current agreement with Israel allows for a 10:1 gearing ratio, meaning the branch can lend only up to 10 times its assets, a somewhat low ratio. By

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**Impact of Cairo-Amman Bank's Difficulties on Other Potential West Bank Financial Institutions**

*After the opening of the Cairo-Amman Bank's Nablus branch in early November, several other banks—Arab Bank Limited, Arab Land Bank, and Grindlay's Bank—expressed interest in either opening branches that were in operation before the 1967 war or in opening entirely new branches. The Cairo-Amman Bank's difficulties, however, have forced reconsideration of these plans.*

**Arab Bank Limited.** *According to the US Embassy in Amman, the Arab Bank Limited—owned primarily by Jordanian interests and with assets of slightly over \$12 billion—has submitted a request to the Bank of Israel to open a branch in Nablus. Arab Bank officials, however, have made clear they will not pursue the application until the Israelis liberalize their initial agreement with the Cairo-Amman Bank. In particular, the Arab Bank will not accept restrictions on letter of credit operations, which bank officials believe would effectively limit the branch to financing trade through Israeli ports. By financing trade through Israeli ports, the Arab Bank probably would find itself in trouble with the Arab Boycott Office, a development the bank could ill afford, given its large volume of business in Arab countries. In our judgment, the Arab Bank is willing to remain on the sidelines to see whether the Bank of Israel will allow the Cairo-Amman Bank to broaden its operations.*

**Arab Land Bank.** *The Egyptian-owned Arab Land Bank has been negotiating with the Israeli Government indirectly through the Egyptian Ministry of Foreign Affairs to reopen its former branches in Gaza and Bethlehem, according to the US Embassy in Amman. According to Arab Land Bank officials, Israeli approval has been obtained for the reopening of the Gaza branch, with the reopening of the Bethlehem branch a possibility. Nevertheless, the Arab Land Bank is holding out for approval to reopen both offices simultaneously.*

*Arab Land Bank officials point out that collateral for loans could become a highly sensitive political issue. The first difficulty is that collateral for most West Bank commercial loans would be West Bank real estate. If the Arab Land Bank were forced to foreclose on any of these loans, its only option would be to auction off the real estate to recover the loan value. Since a public auction would leave open the possibility of an Israeli purchase of West Bank real estate, this would be politically unacceptable.*

*Another difficulty is that few West Bank importers would be willing to pay both Jordanian and Israeli import duties required to import goods through Jordan to the West Bank. To avoid the double duty payments, the Arab Land Bank would have to issue most West Bank letters of credit for importing goods through Israeli ports. This would risk putting the bank at odds with the Arab Boycott Office, which would be politically unacceptable.*

**Grindlay's Bank.** *According to the US Consulate General in Jerusalem, the British-owned Grindlay's Bank—the British subsidiary of the Australia and New Zealand Banking Group—is interested in eventually reopening the West Bank branches of the Ottoman Bank that Grindlay's bought in 1969. It probably will not do so, however, until it can be assured that an Israeli Government license would not generate Arab boycott problems or otherwise harm the credibility of Grindlay's broader operations in the Middle East. Like the Arab Bank Limited and the Arab Land Bank, Grindlay's will probably wait to observe the performance of the Cairo-Amman Bank branch before seeking to open its own offices.*



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including the additional assets in Switzerland and at the bank's Amman headquarters and by changing the gearing ratio, bank officials argue their loan potential will increase—spurring growth and profitability.

#### **Making the Nablus Branch Viable**

The survival of the Cairo-Amman Bank branch in Nablus is in the unquestioned interest of Palestinians on the West Bank and, if successful, would allow Jordan to strengthen its economic and political ties to the territory. If key structural limitations remain unsolved, however, West Bank PLO supporters may step up their attacks on the branch opening as a purely political venture by Jordan not aimed at improving the economic status of Palestinians. The PLO supporters probably would argue that, by signing the bank agreement, Jordan played into Israel's hands by implicitly recognizing its annexation of East Jerusalem.

For the Nablus branch to become a credible institution, the Bank of Israel will probably have to ease its current restrictions by:

- Allowing the branch to count as assets either the \$3 million held in the Union Banque de Suisse or deposits held at the bank's Amman headquarters. The Bank of Israel is more likely to recognize the Swiss deposits than those in Amman, given the political obstacles to a formal agreement with the Central Bank of Jordan.
- Increasing the current 10:1 gearing ratio.
- Loosening restrictions on foreign exchange transactions to allow greater coordination with the Cairo-Amman Bank's headquarters in Amman.

The Bank of Israel presently is considering a plan that would permit uninvested dinar deposits—stemming from insufficiently low loan activity—to be returned to Jordan for investment purposes. Such a move would help the Nablus branch's profitability, but it also would serve Tel Aviv's interests since the Bank of Israel would require compensating, convertible currency deposits matching the deposits diverted to Amman.

#### **Outlook**

Israel and Jordan share a common interest in assuring that the Cairo-Amman Bank branch in Nablus does not close its doors. With a closure, both would suffer a severe setback in their quiet cooperation to weaken PLO influence among West Bank Palestinians. A closure also would undermine Jordan's ambitious development plan for the occupied territories by deepening Palestinian skepticism about Amman's ability to fulfill its promises.

A compromise stressing flexibility would allow both sides to save face while ensuring the continued operation of the Nablus branch. The bank could normalize its financial activities in the occupied territories by providing credit and other services needed to conduct business. A long-term benefit would be the positive psychological impact of expanded bank operations, which might convince Palestinians to deposit as much as \$250 million, which US Consulate General sources suspect lies unused in "mattress" savings. In turn, this boost in deposits probably would eventually stimulate additional branch openings by the Cairo-Amman Bank, the Arab Bank Limited, the Arab Land Bank, and perhaps further down the road, Grindlay's Bank.



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### Syria-Turkey: Steering Clear of Controversy [redacted]

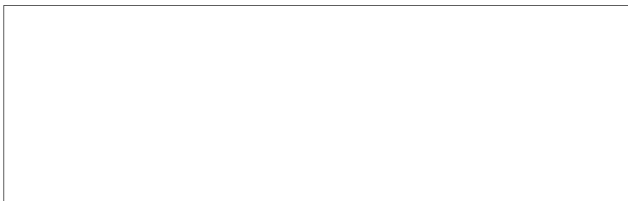
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Syria has sought to preserve its uneasy reconciliation with Turkey over the past year by making incremental concessions on longstanding bilateral disputes. Although Syria has become increasingly concerned over the potential economic impact of Turkey's control over Euphrates River headwaters, Damascus has demonstrated good faith in restraining operations by anti-Turkish subversive groups without a reciprocal water-sharing agreement. Ankara probably believes that its control over the Euphrates offers an effective deterrent to Syrian-sponsored terrorism. For this reason, Ankara has resisted Western pleas to press Syria harder on the terrorism issue and has minimized revelations of Syrian involvement in recent terrorist incidents and plots in Turkey. As Syria regains its confidence, it is certain to increase support to Turkish subversives as its principal bargaining chip. [redacted]

- Syria and Turkey's respective superpower alliances create a formidable obstacle to long-term normalization of relations, and Syria's attempts to establish closer ties to Turkey's estranged neighbors, Greece and Bulgaria, have imposed additional strains.

Syria and Turkey have often moderated their disputes in the past because of pressing national security threats on other frontiers. Diplomatic contacts were stepped up in 1985 to head off potentially explosive tensions. The reduction of public rhetoric since then belies the intransigence of both sides on fundamental issues. [redacted]

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#### Persistent Tension

Tensions between Syria and Turkey, rooted in historical antagonisms, continue to be fed by current frictions:

- So long as Turkey proceeds with plans to expand its hydrological projects along the Euphrates River, the Syrians will fear that such plans will substantially reduce the volume and quality of Euphrates water flowing south into Syria and will jeopardize its own ambitious hydrological schemes.
- The Turks are convinced that Syria is supporting anti-Turkish terrorists—primarily Kurds and Armenians, but also Turkish Communists—with training, equipment, and help in infiltrating into Turkey. Ankara believes that Syrian camps used for training Palestinians—with Soviet support—are also used to train anti-Turkish operatives.
- Syria does not acknowledge Turkish sovereignty over the province of Hatay, which the French colonial rulers of Syria ceded to Turkey, and Syrian maps show it as part of Syria. The Turks regard Syrian irredentism as a potential threat to Turkey's territorial integrity.

[redacted]. Moreover, Turkish security officials met with their Syrian counterparts to seek cooperation in eliminating cross-border activity by Turkish dissident groups based in Syria. Although no accord was signed, Syrian officials pledged not to support subversion against Turkey. [redacted]

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#### Temporary Backslide

Severe water and power shortages in northern Syria last summer caused Damascus to step up its complaints through diplomatic channels that Turkey had virtually shut off Euphrates water, according to the US Embassy in Ankara. These shortages were probably a result of Syria's chronic technical difficulties with its own irrigation and hydroelectric projects in the northwest, however, and Damascus stopped short of blaming Turkey publicly for politically unpopular rationing of water and electricity. [redacted]

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Damascus's preliminary and discreet unilateral concessions to Turkey beginning last year were probably an attempt to counter Syria's growing political and economic isolation following revelations of its involvement in international terrorism as well as intended to secure more water. Although the concessions to date have been largely cosmetic and revocable, they have probably pleased Turkey. Ankara has resisted joining US and West European efforts to extract greater concessions, such as requiring Syria to sever relations with international terrorist groups, particularly Abu Nidal, and is pursuing an independent course, which it believes to be more effective. Syria's concessions include:

- The removal of all Kurdish and Armenian insurgents from camps near the Syrian-Turkish border, according to the Turkish press, and sending them to the Al Biqa (Bekaa) Valley in Lebanon. The Syrians also extradited to Turkey several Kurdish Worker's Party (PKK) members last year who escaped from prison in Turkey and fled to Syria, according to the US Embassy in Damascus. The

[Redacted]

- The restriction of political activity by the PKK and the Armenian Secret Army for the Liberation of Armenia (ASALA), although they continue to maintain offices in Damascus, according to press reports. Syrian authorities have also begun to scrutinize the activities of ASALA leader Hagop Hagopian [Redacted].

- Cooperation in a de facto security arrangement to secure their common border, according to a Turkish Foreign Ministry official. According to an Embassy report, governors from the neighboring provinces of Al Hasakah in Syria and Sanliurfa in Turkey met earlier this year in Turkey to discuss border security. At the meeting the Syrian governor admitted that Kurdish militants were at large in Syria, and both governors agreed to end haphazard firing between border guards which has resulted in casualties among civilians and border guards.

- Return of the Syrian Ambassador to Turkey last year. The Syrians did not have an Ambassador in Ankara for three years, and the Turks may have been miffed when the Ambassador did not arrive as anticipated during Kasm's trip in March 1986.

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**Turkey Tries the Soft Sell**

Turkish officials appear encouraged by the Syrian moves and probably hope to parlay Syria's heightened desire for amicable relations into more substantive concessions on security matters. In recent talks with US Government officials in Washington, Turkish Prime Minister Ozal said his government would not press Syria to withdraw support for terrorist organizations, and that Turkey must maintain good relations with Syria to moderate its policies.

[Redacted]

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Moreover, the Turkish Government has avoided damaging rhetoric against Syria despite incriminating public disclosures of official Syrian participation in terrorist plots in Turkey:

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- The confessions of Jordanian Embassy interpreter Adnan Ameri, who was arrested last October in connection with the assassination of Jordanian Embassy First Secretary Zaid Sati in July 1985, directly implicated Syrian Embassy Second Secretary Darwish Baladi as a principal accessory. Baladi has since been indicted in absentia and charged with murder along with seven other codefendants.

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- Ameri's confession, which was leaked to the Turkish press, also implicated Syrian intelligence services in a widespread conspiracy with the Abu Nidal organization to attack economic and military targets throughout Turkey.

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- Turkish police uncovered an alleged Syrian plot last January intended to implicate Turkey in terrorism against Syria. Explosives were discovered in the apartment of Muhammad Azkour, an employee of the Syrian Embassy's military attache's office. Turkish authorities claim that Azkour and two accomplices intended to fabricate tacit support of Turkish authorities for fictitious Muslim Brotherhood insurgents based in Turkey, according to the US Embassy in Ankara. [redacted]

Turkish Prime Minister Ozal may visit Syria this year, according to the US Embassy in Ankara, and would probably do so if the previously negotiated security agreement was completed. The Syrian Government has formed a delegation to go to Ankara this year to offer more trade, including development of Syrian gasfields for the Turkish market, according to the US Embassy in Damascus, but any economic talks are likely to be dominated by the contentious Euphrates water issue. [redacted]

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President Ozal and his government apparently have tried to minimize possible damage from these incidents to bilateral relations and have resisted attempts by factions in his regime to escalate tensions with Syria:

Both governments have cooled their rhetoric in the interest of maintaining at least the appearance of reconciliation, but the absence of real progress in negotiations probably will soon subvert this process. Turkey's Euphrates development plans proceed unabated to the alarm of the Syrians. [redacted]

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- [redacted]

[redacted]

When Ozal returned, he called for an end to press leaks and cautioned the press "not to become the tool of those who are trying to spoil Turkish-Syrian relations," according to the US Embassy in Ankara.

As Syria's confidence grows and it emerges from its isolation, Damascus will probably escalate its support for Turkish dissidents as its principal bargaining chip. [redacted]

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- In spite of the investigations into Ameri's allegations, a Turkish Foreign Ministry official told the US Embassy in Ankara that "Turkish-Syrian relations are of such a special nature that they would probably not be broken whatever the Syrian involvement in the Abu Nidal case."

**Long-Term Prospects**

Syria would probably restrain Turkish dissidents only in exchange for concessions on Euphrates water use, but it will keep a tight rein on the activities of these groups to avoid cross-border retaliation by the Turks. Damascus is not likely to abandon Turkish dissident groups because it wants to keep its options open.

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- [redacted] the Turkish Foreign Ministry alerted the Syrian Embassy to withdraw suspects in the Ameri case before they had to be expelled. Azkour was probably afforded the same prior notice. Turkey probably feared that expulsions would force a reciprocal action by Syria against Turkish diplomats in Damascus and damage diplomatic contacts. [redacted]

Turkey is likely to continue the planning and construction of its Euphrates water projects while relying on heightened border security measures to offset the transit of anti-Turkish insurgents across the southern border. Ankara, however, may be willing to coordinate future plans with Damascus if Syria pledges to withdraw its support for Kurdish and Armenian groups. [redacted]

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**Near-Term Prospects**

Syrian-Turkish diplomatic contacts are likely to remain active in the near term, but any warming in relations will be more formal than substantial.

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Despite their differences, both Ankara and Damascus clearly prefer handling their differences through diplomatic channels. Pressing national security interests elsewhere in the region will probably discourage both sides from militarizing their common border as a means of extracting political or economic concessions. Still, the differences dividing them are great and unlikely to be overcome anytime soon.



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**Syria: Preparing for the Next War With Israel** [redacted]

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Within the last year Syria's worsening economic crisis, the revival of Palestinian strength in Lebanon, and intense maneuvering within the Alawite elite have bedeviled Syrian President Assad. These problems have put him on the defensive and stretched out his campaign to attain "strategic parity" with Israel, but they have not weakened his resolve to press the Arab struggle against Israel and ultimately to recover the Golan Heights. Assad believes the pursuit of these goals is essential for Syria to exercise Pan-Arab leadership and to ensure that his minority Alawite regime continues in power. [redacted]

**Strategy**

During an interview with the Kuwaiti newspaper *al-Qabas* last month, President Assad said that Syria has not reached nor abandoned its goal of strategic parity and reiterated that parity is "not a tank for a tank or a gun for a gun . . . but a comprehensive balance covering various aspects of life." In March 1986, Assad indicated that parity included political, social, cultural, and economic, as well as military aspects and cautioned that neglecting any of these elements created weakness. [redacted]

Probably because of his training in the USSR, Assad's formulation is akin to, if not identical with, the Soviets' "correlation of forces" concept, which also includes morale and leadership. As they use it in formulating plans and policies, the Soviets pay as much attention to an adversary's intangible strengths as they do to his tangible strengths. Assad's estimate of strategic parity is therefore flexible and depends partly on his assessment of Tel Aviv's resolve and its support by the Israeli populace. [redacted]

**Military Forces and Operations**

Egypt's conclusion of the Camp David accords with Israel in 1978 led Assad to embark on a major expansion and modernization of his armed forces—particularly the Army—which has been consistently supported by the USSR. The Israeli invasion of

Lebanon in 1982 caused Assad to redouble his efforts and led Damascus to review its approach to war, reorganize its command structure, and develop new capabilities, especially in the area of electronic warfare. As a result of these trends, Syria has markedly increased its inventory of artillery, armored vehicles, combat aircraft, and air defense missiles. Syria has basically obtained numerical parity with Israel, but Tel Aviv still enjoys qualitative superiority in key areas, including tanks and fighter-bombers. [redacted]

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**Doctrine and Tactics.** Syrian military doctrine and tactics closely follow Soviet concepts, which emphasize concentration of forces, continuity of military action, and, if possible, achievement of surprise. According to current Soviet doctrine, the successful conduct of offensive operations does not require vast total superiority, but it requires the achievement of local superiority—at least 3:1—along key axes of advance. [redacted]

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[redacted] By emphasizing continuity of action, the Soviets seek to avoid giving an opponent the opportunity to recover and counterattack. [redacted]

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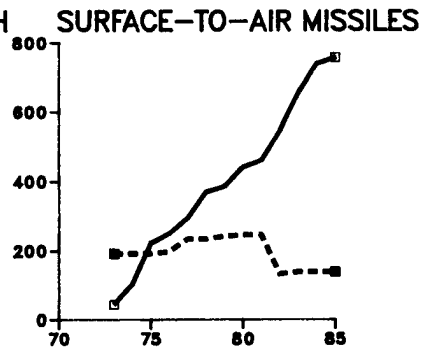
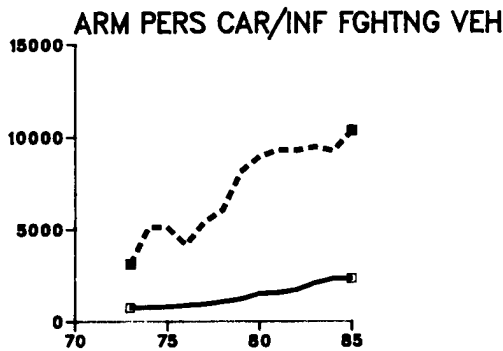
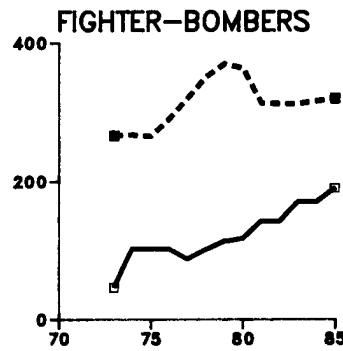
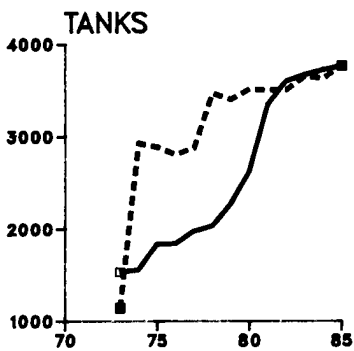
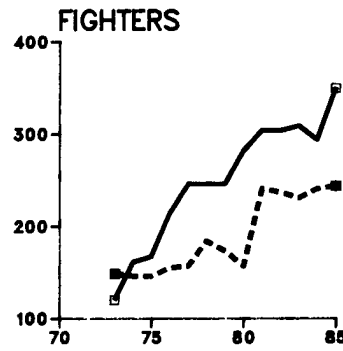
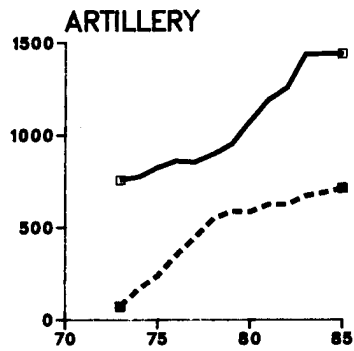
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Like their Soviet mentors, the Syrians consider air, air defense, and naval forces as adjuncts to the ground forces. In planning and conducting operations, the Syrians emphasize simple tactics taught using repetitive drills, and combined arms operations—involving a mix of artillery, infantry, and tanks—are conducted exclusively by general officers. Large numbers of men and equipment are required for offensive operations, and the Syrians believe that they must be closely monitored by senior commanders,

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## ISRAELI AND SYRIAN MILITARY EQUIPMENT TRENDS



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leaving few important decisions to general officers closer to the battle and none to the field and company grade officers fighting it. [redacted]

additional training. [redacted]  
[redacted]

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Upon initial inspection, Soviet doctrine and tactics would appear to be ideally suited to the Syrian military. Like most Soviets, the Syrians are generally poorly educated and not well prepared by their society to handle sophisticated technology, and the Soviet emphasis on simple tactics and training are positive factors. Similarly, the Arab penchant for the leader exercising or appearing to exercise overall control meshes well with the Soviet philosophy of centralized command and control. In both societies, proper initiative is defined as promptly and correctly carrying out orders, not exercising independent judgment. [redacted]

**Organization and Equipment.** Upon Moscow's urging, Damascus has formed intermediate headquarters to reduce the burden of command and improve military operations. [redacted]

[redacted]

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In important respects, the Soviet system is not well suited to Syria and its needs. Although the Soviets have provided the Syrians with a large amount of equipment since the late 1970s, they have been unwilling to supply, nor have the Syrians been able to field, the large, well-equipped forces the Syrians need to implement their doctrine successfully. Restricting combined arms operations to general officers coupled with centralized command and control has placed the Syrians at a serious disadvantage in fighting the innovative Israelis. Moreover, the Soviets have been slow and haphazard in helping the Syrians adjust to changes in Israeli force structure and operations. [redacted]

**Ground Forces.** Since the start of the partial Israeli withdrawal from Lebanon in early 1985, Damascus has embarked on new programs to increase the size, improve the disposition, and upgrade the equipment of its Army. Syria began by reorganizing the Defense Companies—a hodgepodge of regular and special forces units dedicated to protecting Assad's regime—into a regular armored division, the 569th, and the 14th Airborne Division. Later that year, Damascus started to bring the airborne division up to strength and began to expand the Republican Guards Brigade into an armored division. In 1986, Syria established a third corps to control these units and [redacted]

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Even when the Soviets offer doctrinal and tactical advice, the Syrians do not always accept it or apply it well. [redacted]

[redacted] The defeat derived more from deficiencies in Syrian leadership and training than from the obsolescence of Soviet-supplied weaponry. Although US assessments would differ on their appraisal of the efficacy of Soviet doctrine, they agree with the Soviet estimate of the main causes of the Syrian disaster. Since then, Damascus has accepted some of Moscow's suggestions for reorganizing its force structure, but the Syrians seem to be slow in making changes. Syria appears to have rejected most Soviet offers of

began to form the 17th Armored Division near the Turkish border and the 18th Armored Division west of Hims. [redacted]

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A key Syrian goal remains maintaining hegemony and, if possible, extending Syria's control over Lebanon. Terrain and transportation problems throughout southern Lebanon make the country

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better suited to a northbound than southbound thrust. [redacted] Assad wants to prevent a repetition of the June 1982 campaign when Israeli armored columns pushed up the Al Biqa (Bekaa) Valley, threatening Damascus and potentially the Alawite heartland in northern Syria. [redacted]

[redacted] the Syrians have prepared field fortifications and developed plans to move forces into the southern part of the valley to accomplish this goal. The continued presence of Israeli forces in Tel Aviv's unilaterally declared security zone and that of its surrogate, the Army of South Lebanon, in and near the zone would facilitate another Israeli thrust up the valley. [redacted]

Within the past year, the Syrians apparently have begun to prepare to realign and buttress their forces opposite the Golan Heights. [redacted]

[redacted]

[redacted] Later in the year, [redacted]

[redacted]

[redacted] and terrain studies suggested that the 569th and the 11th Armored Divisions probably would form a second echelon for the Golan front. Considering that the 11th Armored Division is located near Hims, the Syrians may be planning to move it closer to the Heights—probably after they have essentially completed forming the 18th Armored Division. [redacted]

During the same period, Damascus continued to receive and lobby for new ground forces equipment. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted] 25X1  
[redacted] Assad wants to ensure that his praetorian guard is the best equipped unit in Syria, and he will undoubtedly keep pressing to outfit the division with T-80s. [redacted] 25X1

*Other Forces.* The Israeli air force's success in suppressing and confusing Syria's air and air defense forces in 1982 has led Damascus to begin a major expansion and modernization program. [redacted] 25X1  
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[redacted] 25X1  
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Syria's lopsided defeat at the hands of the Israelis over Lebanon also spurred President Assad to press the Soviets for more and better weapons. Since then, Syria has acquired some of the Soviets' best equipment, including two squadrons of the latest version of the MIG-23 and a squadron of the newest model MIG-25 interceptors, and is on the verge of receiving the MIG-29, a highly maneuverable fighter. [redacted] 25X1  
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[redacted] which extends its air defense coverage over the eastern Mediterranean and most of Jordan and Israel. [redacted] 25X1  
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The modernization of the small Syrian Navy is lagging badly, but the acquisition of three R-class submarines in the last two years marks the beginning of an undersea warfare capability. Although the boats are obsolescent, acoustics in the eastern Mediterranean are such that the Israelis will have difficulty detecting them. Along with the submarines, [redacted] 25X1  
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[redacted] to extend the defense of its territory farther seaward. [redacted] 25X1  
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*Economic Constraints.* Although Assad has made substantial progress in building up his armed forces, the buildup has been a major factor in causing Syria's current economic malaise. Like Moscow, Damascus is secretive about defense spending, publishing only an aggregate figure called "national security expenditures." As a share of the gross domestic product, this figure has fluctuated between 14 and 17 percent since 1980 and probably only includes funds used for domestic spending. Imports of weapons and spare parts from the USSR and Eastern Europe depend heavily on credit. Imports from Western countries rely exclusively on hard currency grants from Arab donors, which have been declining since 1982. [redacted]

[redacted]

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The partial Israeli withdrawal from Lebanon in 1985 enabled Syria to substantially reduce its military presence there and reemphasize improving the combat capabilities of its armed forces. That December,

[redacted]

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Damascus tested its ability to repel an Israeli attack from the Heights in the largest [redacted]

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field training exercise ever held in Syria. The joint forces exercise included elements of four divisions and aircraft from a number of fighter, fighter-bomber, and helicopter units and featured elements of the 3rd Armored Division—long considered Syria's best—counterattacking the invaders. [redacted]

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Within the last year, Damascus has begun to reduce its military spending, primarily by saving on operations and manpower costs. [redacted]

[redacted] the Syrians have begun to release all conscripts and reserve officers at the end of their duty tours instead of extending their service to bolster military readiness. [redacted]

[redacted] have lowered the mandatory retirement age for officers for all grades, which will foster the removal of older, more expensive personnel. [redacted]

[redacted] The Syrians may have canceled the exercise for economic reasons, as the [redacted] says that they concluded the training year early. [redacted]

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Despite the Syrians' efforts, they still have shortcomings in all branches of service. In the ground forces, for example, they are deficient in such key areas as tank gunnery, which tends to offset gains in combat efficiency arising from the acquisition of new models, and in combined arms operations. Although the Syrians could begin correcting most of these problems fairly easily, it will be much harder to improve combined arms operations. [redacted]

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*Leadership and Training.* Within the last few years, the Syrians have worked to improve the performance of their armed forces, particularly the Army. [redacted]

[redacted] Moreover, it may be impossible to instill professionalism in these officers, who tend to be Alawites selected primarily because of their loyalty to President Assad. [redacted]

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*Problems With Personnel.* Alawites constitute less than 12 percent of Syria's population, but they head almost all of its intelligence services and, with one exception, command all Syrian ground forces divisions and elite units such as the Republican Guards. Although Sunnis make up more than 80 percent of the population, only a few are included among Assad's close advisers and none directly controls troops. Many of these officers and officials are longtime acquaintances and some are even close relatives by blood or marriage, but President Assad guards against any one of them becoming too powerful—primarily by playing one against the other.

[Redacted]

Public disclosure of Syria's involvement in supporting terrorism in 1986 has apparently stimulated infighting within Assad's inner circle and also may have led the President to make changes in the military hierarchy.

[Redacted]

[Redacted] has replaced several division commanders and may be planning to reassign Maj. Gen. Shafiq Fayyad, commander of the 3rd Armored Division, to head a corps command.

*Sustainability.* Since the late 1970s, Damascus has labored to improve its ability to sustain combat.

[Redacted] the Syrians have significantly expanded their ammunition and petroleum storage facilities and have amassed large

numbers of trucks, heavy lift transporters, and tank recovery vehicles to support ground forces operations. Although Damascus has reasonably good capabilities to repair or overhaul these vehicles and has constructed a tank rebuilding facility near Hims, its capabilities to support air and air defense operations are not as good. Syria lacks adequate numbers of skilled technicians to perform more than routine peacetime maintenance on its modern air and air defense missile systems. The Syrians overhaul MIG-21s in country, but they must send MIG-23s and MIG-25s back to the USSR for major repairs.

[Redacted]

During the past year, Syria has encountered difficulties in supporting military operations—primarily because of its worsening economy.

[Redacted] Iran's repeated failures to deliver crude oil last summer led to a temporary shortage of diesel fuel and caused a reduction in ground forces training. The US Embassy in Damascus says that the lack of hard currency led Syria to draw down its medical and pharmaceutical supplies to dangerously low levels last year, indicating it is not prepared to cope with casualties.

[Redacted] Moscow did not ship any tank parts last year, and Syria has begun to cannibalize and mothball part of its tank force.

**Outlook**

Events of the past year have put Syria on the defensive, but they have apparently not weakened Assad's resolve to press for strategic parity with Israel. Buffeted by problems within the ruling elite, Assad has begun to reassert control, moving carefully to avoid a complete break with any of his key, but headstrong, lieutenants. Although reforms might improve Syria's economy, which is shackled by Ba'thist socialism and riddled with corruption, sustained recovery probably will depend more on higher international oil prices, which would mean higher export revenues, larger remittances by expatriate Syrian workers, and possibly increased grants from oil-rich states. In the meantime, Syria will remain more dependent than ever on Soviet

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support. and [redacted]

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[redacted] Assad [redacted]

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[redacted] probably will lobby hard for the acquisition of new weapon systems. Given the large investment the Soviets have already made in Syria's military, they probably will agree to selectively modernize it but will not agree to provide the number and types of weapons Damascus is seeking.

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[redacted]

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Assad's frank comments on strategic parity show he is aware of the critical need to improve the human dimension of the armed forces. If Syria avoids sending large numbers of regular troops into Lebanon, which would further strain its operating budget as well as draw attention from the task of force building, Assad probably can continue working on training and leadership. Last year the [redacted]

[redacted] had allowed the

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personnel strength of even the units in the Golan Corps to decline to 60 percent of authorized strength, which, according to Soviet doctrine, would be sufficient for defensive operations but would virtually preclude offensive operations. Although the plan to deactivate one of four maneuver brigades in most Syrian divisions was made to cut costs, bringing the remaining brigades up to 85 percent of their authorized strength will over time boost operational readiness and facilitate better training. When going to a war footing Damascus might initially be slightly less dependent on its mobilization system but would probably rely more on senior commanders to reassign brigades. In this regard, the development of corps commands and their staffs, headed by such trusted officers as Shafiq Fayyad, becomes somewhat more important. [redacted]

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### Palestinians-Syria Problems in the Salvation Front

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The Syrian-sponsored Palestine National Salvation Front continues to face a major uphill battle in its efforts to become accepted among Palestinians as a credible alternative to the PLO led by Yasir Arafat. The Salvation Front's problems stem largely from its reputation as a Syrian surrogate. Syria now is faced with increasingly bitter divisions within its Palestinian client organization over the camps war in Lebanon and PLO reconciliation efforts that could eventually tear the Front apart. Despite the Front's dependence on Syria for logistic and material support, President Assad may be slowly losing his Palestinian card.

The Front was formed in March 1985 primarily to remove Arafat as PLO chairman and to revive the PLO commitment to armed struggle against Israel. All Front members are committed to the elimination of conservative Arab regimes. Only the PFLP has a developed political ideology that advocates Marxism/Leninism. The Salvation Front is made up of the following:

|  | Leader                        | Membership  |
|--|-------------------------------|-------------|
| Popular Front for the Liberation of Palestine (PFLP) | George Habbash                | 1,500-2,000 |
| PFLP-General Command                                 | Ahmad Jibril                  | 800-1,000   |
| Fatah dissidents                                     | Said Musa Murgagha (Abu Musa) | 1,000-1,500 |
| Sa'iqā   | Isam Qadi                     | 500-1,000   |
| Popular Struggle Front (PSF)                         | Samir Ghawshah                | 200-300     |
| Front for the Liberation of Palestine (FLP)          | Abd al-Fattah Ghanim          | 150         |

#### Splits Over the Camps War

We believe the latest round of fighting in the camps war in Lebanon between the Palestinians and the Syrian-backed Amal militia has seriously eroded the credibility of most Salvation Front groups and has limited Syria's ability to sabotage the PFLP's efforts

to reconcile with the Arafat-led PLO. [redacted] Salvation Front acquiescence to Amal attempts to drive Arafat's Fatah loyalists out of Lebanon is widely regarded by Palestinians in Lebanon and in the Israeli-occupied West Bank as part of Syria's strategy to undermine Arafat and to transform the PLO into a Syrian puppet [redacted]

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US Embassy sources in Damascus say this has led to a serious internal dispute over the Front's goals and strategies. According to the sources, the PFLP—the second-largest Palestinian group and the only member of the Front with a substantial popular following—has taken a decidedly anti-Syrian line. It has split with the pro-Syrian groups, including the Fatah dissidents, the PFLP-GC, and Sa'iqā. During the latest round of fighting in South Lebanon, the PFLP refused to accept Syrian-sponsored cease-fire agreements. Unlike other Front groups, the PFLP negotiated on its own, refusing to turn over territory to Syrian-backed Lebanese militias. [redacted]

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In addition, the PFLP helped orchestrate a demonstration at a major refugee camp in Damascus in hopes of exploiting local Palestinian frustration over Syria's support for Amal in the camps war,

[redacted] the mood among Palestinians in Damascus has become so defiant that an armed clash with Syrian security forces may be inevitable if the fighting in Lebanon continues. [redacted]

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In reaction to the PFLP's confrontational approach, the Syrian Government has increased harassment of Palestinian groups and leaders in Damascus,

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[redacted] Moreover, many PFLP officials are hesitant to leave Syria for fear they may not be allowed to return. [redacted] even Syria's relations with groups that generally toe the Syrian line, such as the PSF, are becoming strained over its Lebanon policy. [redacted]

#### Efforts at Reconciliation With Arafat

In the face of increasing isolation from Syria and pro-Syrian members of the Salvation Front, PFLP leader George Habbash has made greater efforts to achieve a formal reconciliation with Arafat. During the past year he and other PFLP figures have held a number of meetings with representatives of Fatah—the largest organization in the Arafat-led PLO. Although [redacted] Habbash is pursuing reunification over the objection of most groups within the Salvation Front—and even some leaders in his own organization—Habbash has not budged from longstanding demands that Arafat formally abrogate his accord with Jordan's King Hussein, agree to a collective PLO leadership, and sever contacts with Egypt. We believe Habbash's efforts are designed to assert his independence from Assad rather than to move decisively toward reconciliation with Arafat. [redacted]

Nevertheless, Arafat's senior deputy Khalil al-Wazir told US Embassy sources in Amman recently that he was optimistic about the chances for PLO reconciliation. Wazir claims that the Democratic Front for the Liberation of Palestine (DFLP)—the second-largest Damascus-based Palestinian group although not a Salvation Front member—and the PFLP have gradually moved closer to Fatah. Wazir hopes these changes will lead to a meeting of the Palestine National Council—the PLO's quasi-parliament—in 1987 with representatives of the DFLP and PFLP in attendance. Another Embassy source said that a recent meeting of the General Union of Palestinian Writers and Journalists in Algeria brought together representatives of most of the PLO's former constituent groups, except the Fatah dissidents and Sa'iq'a, in an impressive display of unity. Although no substantive agreements toward reconciliation were made, the participation of most major groups—despite harsh Syrian media criticism and official efforts to stop Damascus-based

Palestinian representatives from attending—indicates that Syrian control over these groups may be slipping. [redacted]

#### Prospects

According to the US Embassy in Damascus, the camps wars have demonstrated that Salvation Front leaders blindly loyal to Damascus cannot deliver Palestinians to participate in the fighting in South Lebanon or Beirut. The willingness of most Salvation Front groups to negotiate early cease-fires without concessions from Amal's military commanders has weakened Front support among Palestinians in Lebanon and on the West Bank and has led to further fractionalization of the Salvation Front. To put distance between themselves and Syrian policy, some groups are looking to third parties for support. Abu Musa's Fatah dissidents, for example, have begun to rely increasingly on Libyan financial and military support to keep the group from falling apart. [redacted]

Habbash undoubtedly realizes that he would risk losing the Popular Front's bases in Syria and in the Syrian-controlled Al Biqa (Bekaa) Valley of Lebanon if he seriously attempted a formal reconciliation with Arafat. As the leader of the largest and most powerful of the Salvation Front groups, he has long chafed under Syrian domination and is looking for opportunities to weaken Assad's control of the Salvation Front, particularly now that Syria's attention is distracted in Lebanon. Despite the Front's reliance on Syria for logistic support, increasingly bitter divisions within the Front's ranks almost certainly will reduce Assad's ability to manipulate the Palestinian movement. [redacted]

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## Lebanon: The National Fund — The Christian War Chest [redacted]

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Created to ensure the survivability of the Christian enclave, the National Fund is controlled by the Lebanese Forces, the principal Christian militia, which receives two-thirds of the fund's money. To promote acceptance of the Lebanese Forces among the population, the remainder of the fund's revenues supplement governmental services and finance civilian projects and services for the Christians. The fund draws on nongovernmental taxes from ports, gasoline, and restaurants as well as on illicit activities such as the narcotics trade. With annual estimated revenues of \$23 million, the fund is further evidence of the Christian quest for autonomy in the absence of a political solution in Lebanon.<sup>1</sup> [redacted]

### Origins

When Christian Lebanese groups formed the Lebanese Front in 1976, the new organization's leaders agreed that a financial arm would be necessary. Their intention was to sustain a protracted defense of the Christian enclave through independent financing. In a loose fashion, the Front began to levy taxes unofficially on a variety of sources including ports, gasoline, and restaurants and to channel these to the National Fund. Few checks were made on disbursements and allocations by the Christian leadership. [redacted]

### Structure

Until last year, the National Fund remained rather loosely controlled and organized. This changed following Samir Ja'Ja's ouster of Lebanese Forces Commander Elie Hobayqa on 15 January 1986 because Hobayqa had embezzled from the fund, according to the fund's Director of Public Relations, Charbel el-Khoury. El-Khoury says that Hobayqa and his cohorts had left the fund nearly bankrupt. Ja'Ja has since restructured the fund to prevent a repetition of the Hobayqa experience. Ja'Ja seeks to present an image of the Lebanese Forces as incorruptible and well disciplined. [redacted]

<sup>1</sup> All amounts are converted at the rate of \$1 = 87 Lebanese pounds. [redacted]

El-Khoury says that the National Fund has emerged as a full-fledged, well-structured financial organization over the past year. At the top of the fund's organizational structure is the Lebanese Front command council. Reporting to the council are executive, legal, investment, and social welfare departments, along with 16 suboffices. The fund has over 1,000 employees. Half are college graduates, says el-Khoury. [redacted]

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### Sources of Revenue

According to el-Khoury, the National Fund's revenues for 1986 can be broken down as follows: 45 percent (\$10.3 million) from taxes on ports (Beirut and Juniyah); 20 percent (\$4.6 million) from recreational taxes (Casino du Liban, ferryboats, cinemas); 12 percent (\$2.7 million) from restaurant taxes; 10 percent (\$2.3 million) from gasoline taxes; 10 percent (\$2.3 million) from real estate taxes; and 3 percent (\$700,000) from grants. [redacted]

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In 1986, according to el-Khoury, the fund had about \$22.8 million in receipts. Partly because of shortfalls due to Hobayqa's embezzlement, the fund ran a deficit during most of 1986. Figures consistently quoted by different Christian leaders put the deficit at \$340,000 monthly during most of 1986, but only \$80,000 to \$90,000 monthly for the latter part of the year. Lebanese Front official Roger Deeb told a US Embassy officer in January 1987 that the fund is projected to take in \$34.2 million in 1987. [redacted]

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According to the Embassy, more sensitive sources of funds including sales of wheat and gasoline on the black market may have helped reduce the National Fund's deficit. [redacted] in January 1987 [redacted] the Lebanese Front is selling large quantities of flour to Syria, along with an undetermined amount of gasoline and bottled gas.

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**Fund Expenditures**

[redacted] fund spending was divided as follows in 1986 and is expected to remain proportionately the same in 1987:

| Beneficiary              | Percent of Total | Million US \$ |
|--------------------------|------------------|---------------|
| Lebanese Forces          | 65               | 15            |
| Intelligence             | 10               | 2.3           |
| Political parties        | 10               | 2.3           |
| Security                 | 10               | 2.3           |
| Information <sup>a</sup> | 5                | 1.15          |

<sup>a</sup> Lebanese Broadcasting Company, El Massira magazine, FM radio station.

[redacted]

bail them out. Regarding housing, the fund has already built about 150 apartment units near Jubayl and plans to build 800 more by 1988. [redacted]

**Outlook**

Christian leaders have succeeded in establishing a mechanism by which their militia activities are self-financed. In theory, the necessity for a fund would cease to exist if an acceptable political settlement were to be reached in Lebanon. Christian leaders say the fund, having served its function, would be dissolved at that time, but this is unlikely to happen. The National Fund is an accepted institution and is further evidence of Christian efforts to build a self-sufficient ministate. [redacted]

[redacted]

The proposal was originally made to Ja'Ja by George Antun, fund chairman, and intended as a fundraising measure. [redacted]

[redacted]

**Other Fund Activities**

Aside from funding Lebanese Forces activities, the fund is used to help the civilian Christian population by engaging in a wide range of activities. This probably includes sponsoring neighborhood repair projects during breaks in the fighting to quell Christian dissatisfaction over the resulting damage. Another social service is an office that aids the Government of Lebanon's Internal Security Forces in solving crimes. The fund's investigation team helped find culprits in 10 of 13 recent robberies. In social welfare, the fund helps families pay for medical care. For example, the government's National Social Fund is supposed to cover 85 percent of the costs of open-heart surgery; the National Fund picks up the remaining 15 percent. On the labor and industrial side, the fund's Investment Department helps unemployed Christians find jobs. It recently purchased a plastics factory on the verge of closure to ensure that workers would not be laid off. When apple exporters in the Christian enclave could not find buyers, the fund bought several tons of the fruit to

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## Algeria: Economic Slump Continues

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Last year Algeria experienced its most serious financial crisis since independence, and the outlook for 1987 is little better. The worldwide drop in energy prices cost Algiers some \$6 billion in hydrocarbon earnings in 1986—a devastating development for a country dependent on energy exports for its economic well-being. Unlike many other oil and gas producing countries, however, Algeria reacted quickly by launching an economic adjustment program. Although the government succeeded in softening the economic blow, the political cost was dear. Rioting against austerity measures erupted in several cities last November. Moreover, President Bendjedid's drive for political and economic reform lost momentum as socialist ideologues within the government blamed him and his Western-leaning policies for the disturbances and for the economic crisis. With little prospect for a dramatic improvement in the world oil market this year, Algeria's economic difficulties are likely to continue unabated. More protests against the regime can be expected as austerity intensifies. More pressure on Bendjedid to return to the socialist fold is also likely.

### 1986 in Review

The once-booming Algerian economy suffered greatly last year as energy prices plummeted. Algeria depends on hydrocarbons for 98 percent of its export receipts, about 50 percent of its government revenues, and nearly 25 percent of its GDP:

- With export receipts half the 1985 level, Algiers racked up its largest current account deficit since the mid-1970s.
- The country's debt service ratio may well have topped 60 percent as external debt rose to more than \$21 billion.
- Economic growth probably was barely 1 percent—Algeria's lowest rate of growth in nearly two decades.

### Government Actions

To the Bendjedid government's credit, it did not sit idle as the crisis unfolded. Algiers almost immediately announced a variety of measures to salvage the

country's deteriorating financial position. The budget, for example, was drastically cut. Embassy reporting indicates overall government operating expenses were reduced 11 percent and development expenditures 26 percent, which slashed imports by about \$3 billion. According to the US Embassy, Algeria cut another \$600-700 million off its services bill by restricting foreign access to work and residence permits and eliminating technical services contracts. Algiers also suspended the costly government-subsidized C.O.D. postal system, halved foreign exchange allocations for tourist travel, and reduced annual allowances for pilgrimages to Mecca.

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The Bendjedid government also used less traditional means to save scarce foreign exchange. Embassy reporting indicates some ministries offset a fixed percentage of their annual planned hard currency imports through countertrade, a highly unusual practice for Algeria. Some state companies sought payment for the foreign exchange portions of their contracts entirely in barter. In addition, Embassy reporting indicates Algiers deferred foreign exchange outlays by delaying payment of commercial invoices and by encouraging foreign companies to provide long-term financing for Algerian purchases. One US firm in Oran reported three outstanding invoices for its merchandise last fall, one 18 months old. Furthermore, Bendjedid attempted to reduce agricultural and light industrial imports by encouraging increased private-sector participation in the economy.

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Algiers attempted to boost export earnings to help ease its financial difficulties. Bendjedid traveled extensively last year, particularly in Latin America, drumming up new markets for Algerian goods—with some success. Embassy reporting shows Algiers amended its hydrocarbons investment law last fall to encourage foreign investment in that all-important

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industry by offering several new and attractive incentives including repatriation of profits and reimbursement of investment costs. Additionally, US Embassy reporting indicates Algeria took its first steps last year toward attracting investment in other industries by altering its joint venture law. Finally, Embassy sources report Algiers fought to prop up the price of oil and gas, taking a tough line within OPEC and fighting hard to maintain its gas prices in negotiations with its European customers. [redacted]

### The Results

All of these measures helped Algeria reduce the negative impact of lost hydrocarbon revenues. Algeria whittled its projected current account deficit of \$7 billion down to about \$3.5 billion. We believe most of the shortfall was covered through drawing down reserves and borrowing abroad:

- Algiers drew reserves down about \$2 billion, probably leaving a balance for the year of roughly \$1 billion.
- Algeria also won \$1.1 billion in new commercial loans, despite bankers' reluctance to increase their exposure in oil-dependent economies. Algiers, however, had to accept much more stringent terms to win the new monies.

[redacted] he country financed the balance of the deficit by allowing about \$400 million in debts to go unpaid—an unusual circumstance for Algiers, which usually repays its debts promptly. [redacted]

The benefits reaped by the Bendjedid government did not come without costs. As austerity took hold, real incomes plummeted, inflation ran about 14 percent—double the 1985 level—and shortages of food and other consumer goods became commonplace. Budget cuts sliced into social services such as education and housing, and cuts in the development program increased already burdensome unemployment pressures. We believe unemployment—Algeria's most serious social problem—hit a record 25 percent in many areas. Indeed, unemployment and underemployment together may have exceeded 30 percent nationwide. Open sources report joblessness

contributed to growing delinquency and crime among youths—65 percent of the populace is under 25, and the population is growing at a rate of more than 3 percent annually. [redacted]

### Political Fallout

For most of the year, the popular response to austerity measures was muted. Embassy reporting indicates the government mounted an impressive campaign to mobilize popular support for its adjustment program. Through media blitzes and regional meetings and conferences, the government urged the people to reduce imports and eliminate resource waste. Algiers's theme was "self-reliance" in fighting the "economic war that will be almost as difficult to win as the war for independence." By November, however, Embassy reporting indicates the protest against austerity was too great to be quieted by a public relations ploy. Economically inspired riots by students rocked Constantine, the third-largest city in Algeria, and minor disturbances occurred in several other cities including Algiers. [redacted]

Public disturbances mirrored heightened infighting within the regime over economic policy. The President had been trying for several years to turn the cumbersome and inefficient Soviet-style economy into a more Western-oriented system that relied heavily on private enterprise—with some success. He had also tried to improve political relations with the West, in part to open up new markets for Algerian goods. His leftist detractors, however, continually fought the changes, hoping to preserve the country's socialist heritage. Until last year, Bendjedid's plan seemed to be working, and his opponents had little leverage with which to push him back on track. The economy's poor performance last year and the protests against austerity, however, provided the leftists with ammunition to use against him. Indeed, we believe Bendjedid was forced to step back from some of his more progressive political goals to preserve his economic program. For example, Algerian foreign policy activities last year included rapprochement with Libya, closer ties to radical Palestinians, and renewed activity within the "Steadfastness Front," which consists of radical members of the Arab League—Libya, South Yemen, and Syria. [redacted]

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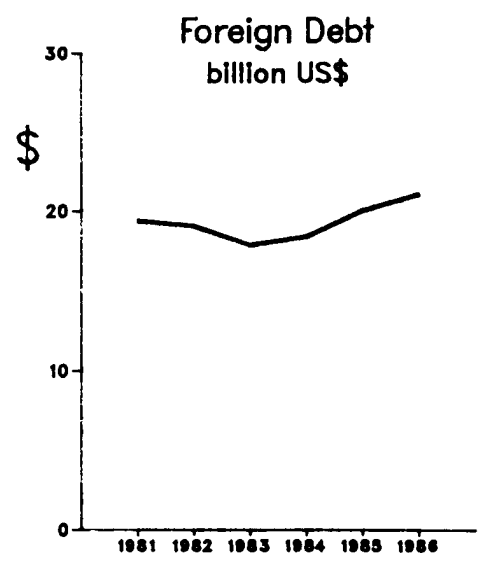
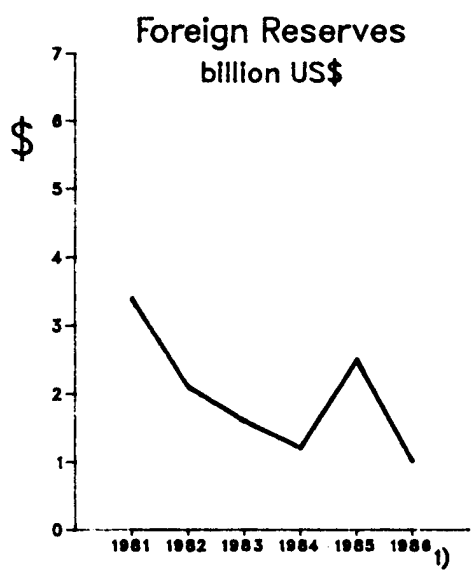
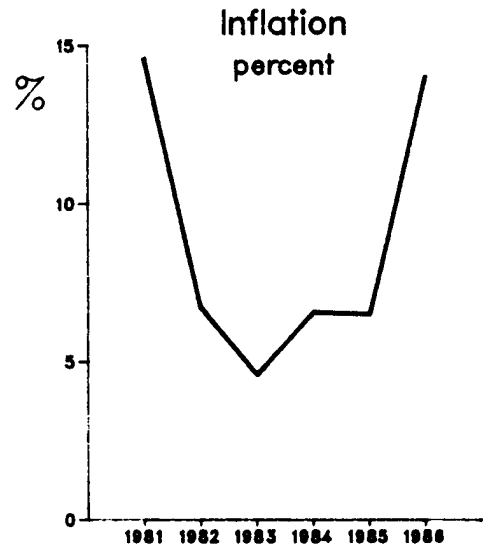
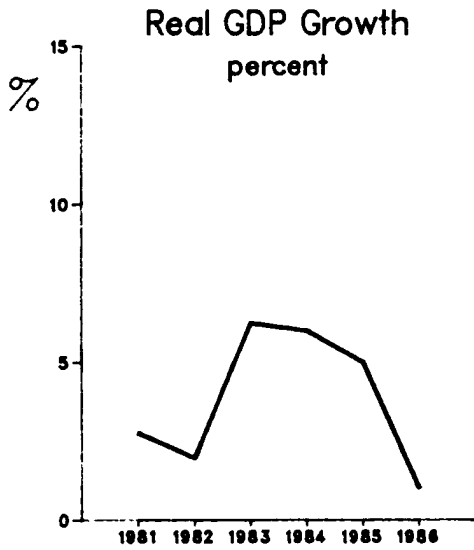
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### Algeria: Economic Indicators, 1981-86



1) Estimate



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Strains also developed between Bendjedid and the Army over economic policy because he included the military in his austerity program. Of particular concern to officers were the cuts ordered—albeit small—in the military procurement budget. We believe many worried that these reductions would give Morocco an advantage over Algeria in their 10-year struggle for control of Western Sahara. Embassy reporting indicates other unpopular measures included eliminating the pay incentive for mandatory service in the south and curtailing automatic medical coverage for dependents at military medical facilities. According to the US Embassy, the military lost many privileges including guaranteed supplies of food—especially meat—as well as clothing, shoes, and blankets.

#### The Year Ahead

Algeria's economic outlook for 1987 is bleak at best. Without sustained improvement in hydrocarbon prices, Algiers is likely to top last year's current account deficit—recording a shortfall of nearly \$4 billion. Algeria's losses could be even greater if petroleum prices fall sharply again or Algiers strays from its austerity program. Even if the OPEC accord holds together and achieves the \$18 per barrel annual average it is seeking and current spending policies are maintained, Algiers will still record more than a \$2.5 billion deficit.

A deficit of even \$2.5 billion will be difficult to finance. We believe the most politically acceptable solution to covering such a shortfall—depending entirely on drawing down reserves and borrowing abroad to make ends meet—is not feasible. Algiers has only about \$1 billion in reserves. With a \$500 million monthly import bill, the Bendjedid government cannot afford to draw this sum down much further. Algeria borrowed over \$1 billion last year to cover the 1986 deficit, probably pushing its debt service ratio to over 60 percent. As a result, the government is not likely to find many bankers who are willing to risk loaning more funds to Algiers even under generous repayment terms. Moreover, Algiers no longer has the solid international credit rating that helped it win the needed loans in 1986.

#### Algeria: Current Account Analysis

Billion US \$

|                         | 1985 | 1986 <sup>a</sup> | 1987 <sup>b</sup> | 1987 <sup>c</sup> |
|-------------------------|------|-------------------|-------------------|-------------------|
| Trade balance           | 3.6  | 0.2               | -0.2              | 1.2               |
| Exports                 | 12.6 | 6.2               | 5.8               | 7.2               |
| Crude oil and products  | 6.7  | 2.9               | 2.7               | 3.4               |
| Condensates             | 3.0  | 1.2               | 1.1               | 1.4               |
| Natural gas             | 2.6  | 1.6               | 1.5               | 1.9               |
| Other                   | 0.3  | 0.5               | 0.5               | 0.5               |
| Imports                 | -9.0 | -6.0              | -6.0              | -6.0              |
| Food                    | 1.7  | 1.3               | 1.3               | 1.3               |
| Consumer goods          | 0.5  | 0.3               | 0.3               | 0.3               |
| Industrial goods        | 6.8  | 4.4               | 4.4               | 4.4               |
| Net services            | -4.7 | -3.7              | -3.7              | -3.7              |
| Grants                  | -0.1 | -0.05             | -0.05             | -0.05             |
| Current account balance | -1.2 | -3.55             | -3.95             | -2.55             |

<sup>a</sup> Assume crude oil and product exports of 521,000 b/d, condensate exports of 240,000 b/d, and natural gas exports of 20.1 bcm annually. Assume prices of \$15 per barrel for crude oil, \$13.42 per barrel for condensates, and \$2.25 per mBTU for natural gas. All figures are estimated.

<sup>b</sup> Assume same export levels as above, but prices of \$14 per barrel for crude oil, \$12.53 per barrel for condensates, and \$2.10 per mBTU for natural gas. All figures are projected.

<sup>c</sup> Assume same export levels, but prices of \$18 per barrel for crude oil, \$16.10 per barrel for condensates, and \$2.70 per mBTU for natural gas. All figures are projected.

As last year, Algiers will risk some political backlash to cover its payments needs. Our analysis indicates the government will again have to drastically cut spending in order to supplement limited reserve drawdowns and new borrowing to make ends meet. We believe Algeria will try to eliminate at least \$1-2 billion of the projected deficit through increased austerity. Algiers, for example, has already passed an austere budget for this year that calls for only a 6-percent increase in operating revenues and no growth in investment spending, according to Embassy reporting. Indeed, according to a US official recently in Algiers, the government will authorize no investment spending if revenues are too low. The

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**The Private Sector in Algeria**

*Chadli Bendjedid sees private investment as essential to building a highly diversified economy that will outlast the country's oil and gas reserves. Under his tutelage, the country's economic development strategy has begun shifting away from socialist economic policies and toward a more Western-style system. Agriculture, tourism, retail trade, and the production of consumer goods have been singled out as areas in which the private sector is to be encouraged to participate. Algiers will have to radically change its game plan for encouraging private-sector participation, however, if it really intends to reap significant benefits from such a development.* [redacted]

*Algiers's efforts so far to develop a true private sector have been limited. Declining oil and gas revenues have severely curtailed government efforts to prepare the way for such initiatives. More important, entrepreneurship has not blossomed because many private citizens appear uninterested in such ventures. We believe this lukewarm response is largely the fault of the government, which has failed to create an appropriate environment for such efforts to thrive. Nor has the government provided a means for private citizens to open their own businesses. Would-be entrepreneurs, used to nearly two decades of extensive state control, are hesitant to do much without concrete guidance from the government.* [redacted]

*Private activity in agriculture provides interesting insights into why local investors hesitate to become involved. Embassy sources indicate the Algerian bureaucracy has been slow to turn to private entrepreneurs after years of dealing primarily with collective farms. The average private farmer, for example, has been forced to accept government feed deliveries—with no control over timing or quality—because he is prohibited from importing his own needs. Furthermore, according to the Embassy, even if a farmer is resourceful enough to arrange a contract to supplement state supplies, the government routinely denies him the requisite foreign exchange. The average farmer also has trouble procuring drugs and veterinary services—government veterinarians receive no additional pay for serving private farms. State control over the marketing of domestically produced farm products also limits individual farm production. Prices paid by the state for farm goods are often far below cost and certainly below market prices. The government's inability to provide needed tractors and equipment to new farmers under its land redistribution program also limits output.* [redacted]

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government will also probably try to reduce its sizable services bill. Algiers may push for a debt rescheduling to reduce payments pressures. Bendjedid, however, is unlikely to approach the IMF for help. [redacted]

Bendjedid will probably continue to encourage creative solutions to ease the foreign exchange crunch. He will probably push ahead on his program of drumming up new customers for Algerian products and encouraging foreign investment in all types of industry—especially hydrocarbons. The President is also likely to order government ministries to continue to conduct as many transactions as possible in

countertrade. Furthermore, he will probably redouble efforts to increase private-sector participation in the economy to strengthen domestic agricultural production and develop import substitution industries. [redacted]

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25X1**Political Considerations**

Bendjedid will have to be extremely careful in implementing new austerity measures to avoid additional popular backlash. Algiers has not hesitated in the past to use its large and efficient security forces

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to put down disturbances. We believe the government would not hesitate to use force to suppress problems in the future. The security forces, however, may not be as willing to contain protests because they, too have been reeling under the effects of austerity. [redacted]

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In our judgment, Bendjedid is not in any immediate danger of losing his position even if protests become more numerous and widespread. To date no opposition has coalesced, and we do not expect that will change. Nevertheless, pressures from his socialist colleagues and the military will undoubtedly increase if protests spread and it appears that the President cannot turn the economy around. Bendjedid could be forced to rescind some of his austerity program—particularly as it affects the military—to preserve his presidency. He may also have to abandon his desire to bolster private-sector participation in the economy to placate some of his more vocal socialist critics. [redacted]

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**Pakistan: Warm Words,  
Few Deeds, Welcome  
Foreign Investors** [redacted]

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Pakistan offers foreign investors words of welcome, legal protection, and a growing domestic market—but a wide gap exists between promise and performance in reducing bureaucratic obstacles. In addition to cumbersome government regulations, shortages of skilled labor, energy, good roads, and telephone links inhibit foreign interest. Equity contributions from foreign companies have fluctuated widely but contribute only a small share of Pakistan's total investment. The investment climate is likely to deteriorate during the next two or three years as foreign payments strains mount and revival of political activity under a civilian government slows the pace of economic policy reforms. We expect that direct investment will continue to come primarily from companies that expect to sell equipment and services to Pakistan or that are already active there.

[redacted]

**Official Welcome**

The civilian government of Prime Minister Junejo has continued the rhetoric of welcome for foreign investment evident during the 1977-85 martial law regime of President Zia. Junejo met repeatedly with foreign business groups during 1986 to promote interest in joint projects and, according to press reports, has reaffirmed his interest to domestic audiences as well. He usually highlighted Pakistan's guarantees for repatriation of capital and profits. President Zia—still the key decisionmaker, although now less concerned with economic policy details—remains supportive.

Islamabad is especially interested in foreign support for high-technology, capital-intensive, and export industries. According to senior officials, Pakistan is becoming increasingly disenchanted with mere assembly of imported components.

Ministry of Industries officials tailor the kinds of joint venture opportunities they say they are seeking to match the expertise of businessmen in various countries. The list for the United States emphasizes

food processing, agricultural and textile machinery, deep sea fishing, electronic components, and paper manufacturing.

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**Investment Incentives**

Rapid economic growth and modest policy reforms that have reduced detailed government controls have attracted some interest by foreign investors. Good agricultural weather, combined with massive receipts of worker remittances and foreign aid, contributed to 7 percent average annual GDP growth during the past five years. Meanwhile, Islamabad has relaxed import and industrial licensing barriers, albeit slightly, and lowered the corporate income tax rate. According to Embassy and press reports, it has also begun to move away from price and profit controls that previously obliged a few producers to subsidize less efficient competitors. Policy emphasis on the private sector—and government budget stringency—have even led Islamabad to open electric power generation to private investors. More comprehensive proposals for deregulation are being considered.

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Pakistan's laws and explicit regulations rarely discriminate against foreign business. A 1976 ordinance, which is still in effect, mandates equal application of income tax and foreign trade controls for private industrial investment and guarantees repatriation of profits and capital. Policy guidelines distributed by Pakistan Embassy officials note a preference for minority foreign equity holdings in new investments but permit approval of wholly owned subsidiaries on a case-by-case basis. Companies with foreign equity, however, must obtain government permission for all new investments and share issues, unlike wholly domestic companies that can take advantage of simplified approval procedures for small ventures.

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**Financial Incentives**

*Islamabad offers substantial concessions to attract new investment in selected regions and industries:*


- Location. *A five-year tax holiday and total exemption from duty on imported plant and machinery for industries in specified remote areas; 50- to 75-percent import duty concessions and smaller import tax credits for units in industrial estates or outside major cities.*
- Selected industries, any location. *Income tax holiday and import duty exemption for some metal manufacturing, garments, minerals exploration, and agrobusiness.*
- Export industries. *Rebate of import duty and sales tax; 55-percent income tax credit on export profits; concessional financing; income tax holiday for units in Export Processing Zone.*


*Additional concessions for foreign investors who accept earnings in rupees have been of interest primarily to Pakistanis who work in the United States, Europe, or Dubai.*



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**Limited Foreign Response**

Pakistan's policies and official interest have not brought a significant flow of direct investment. Private foreign equity has contributed less than 1 percent of Pakistan's total annual investment, though, in a few years, about 7 percent of manufacturing investment. Still, more than 500 business organizations in Pakistan have some form of foreign participation, according to survey data available through 1984. Foreign equity holdings include minority shares in public-sector businesses, such as automobile assembly, and majority holdings in a few key sectors, such as natural gas. The United Kingdom and the United States have been leading suppliers of equity capital. 

A surge in direct investment receipts—to \$140 million during 1985, compared with \$60 million the year before—is reported in official foreign payments estimates but, in our judgment, probably does not signal a lasting shift. Most new manufacturing projects, as described in recent Pakistani press reports, still call for only a small equity contribution, with most foreign exchange costs met by loans from Pakistani Government financial institutions or by supplier credits. The 1985 increase was concentrated in the third quarter and may reflect either acceleration of previously approved investment to take advantage of tax concessions or a move from loans to equity as part of the Islamization of the economy. Portfolio investment also increased sharply during 1985 and early 1986, probably less in corporate stock than in high-interest government bonds offered to ease a foreign exchange shortage. 

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**Bureaucratic Obstacles**

We believe cumbersome approval procedures are a major deterrent to potential foreign investors who must negotiate with multiple central and provincial government agencies. Bureaucratic delays of many months even plague projects that appear to meet all Pakistani Government criteria for approval, according to US Embassy reports. Separate permission is required to bring in funds, import equipment, issue shares, employ foreign technicians, and obtain scarce water and power connections. Proposals to assemble capital goods or consumer durables from imported components must include detailed plans to gradually increase domestic content. A Cabinet official must approve all projects that cost more than \$17 million or have a substantial import content. Approval, once granted, is limited to production of specified quantities of specified products at a particular location. 

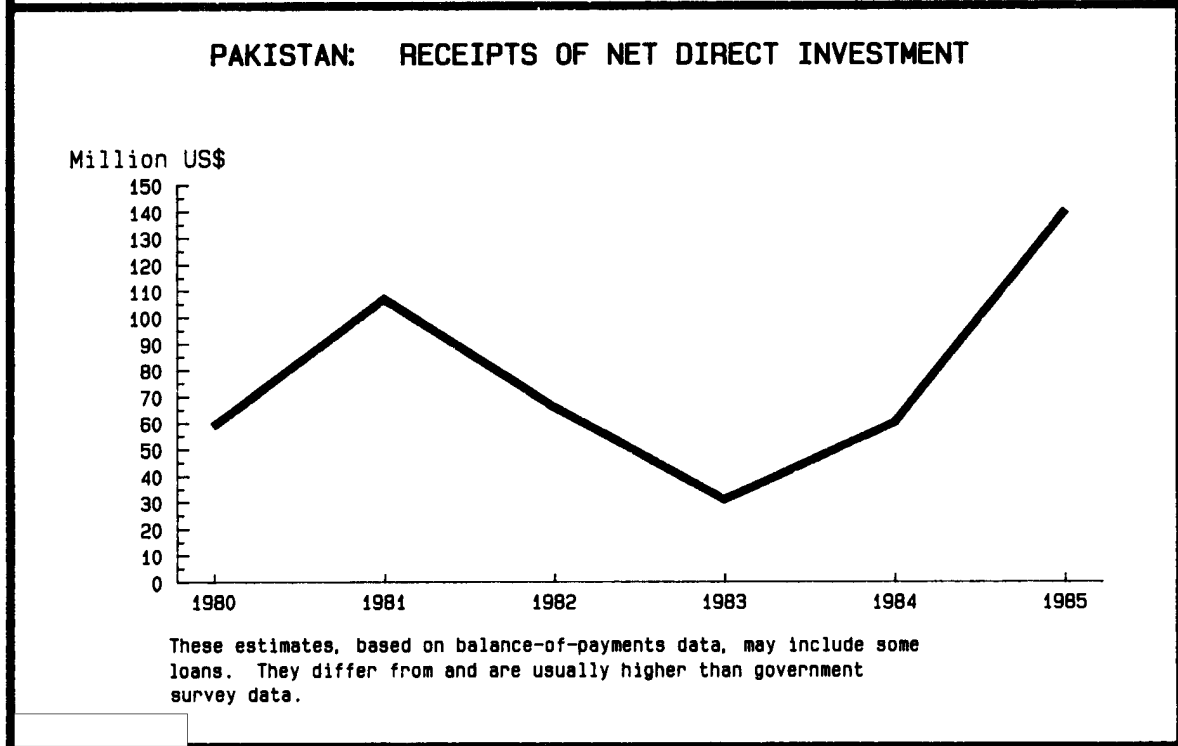
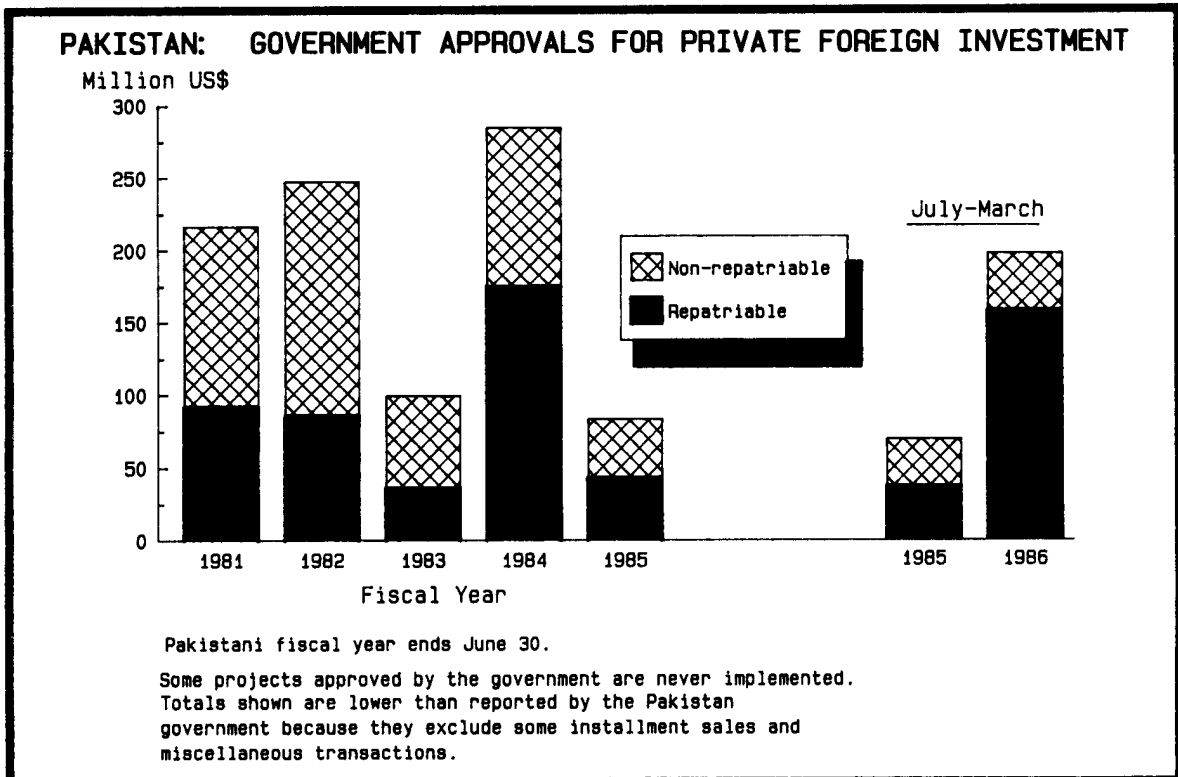
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Royalty and fee agreements must also be submitted for detailed government review if they deviate from standard terms. Automatic approval is granted only for annual payments of a maximum 5 percent of factory value and is limited to five years. Royalties and fees are usually denied for manufacture of consumer goods for the Pakistani market. Comparison

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of published regulations indicates that these terms are less favorable than in some other developing countries. [redacted]

The bureaucratic stranglehold continues even after an investment has been approved. Comprehensive, extremely detailed credit controls limit the working capital available from Pakistani banks, according to US Embassy analysis. Borrowing from abroad requires government approval, which is granted readily only for long-term loans with interest limited to 1.5 percentage points above LIBOR.<sup>1</sup> Labor regulations limit dismissal of superfluous or inefficient employees. Price and profit ceilings, now imposed on a few products, such as petroleum and pharmaceuticals, could be extended by administrative fiat to as many as 66 items covered by legislation regulating essential commodities. [redacted]

Although foreign investors face only minor legal discrimination, Pakistani regulations give middle-level bureaucrats considerable discretion, and US Embassy officials believe that foreign investment proposals are subject to more detailed scrutiny than domestic ventures. Some US companies have complained that they must pay taxes and comply with controls that their local competitors can evade. They are also at a disadvantage compared with other foreign investors because US laws forbid kickbacks and bribes that could smooth the way in Pakistan. Pakistani authorities have been sometimes reluctant to authorize exemptions for foreign investors to standard royalty ceilings—on pharmaceuticals, for example—arguing that transfer pricing between parent companies and subsidiaries in Pakistan affords adequate profits. In addition, a few explicit regulations, such as an excise tax on foreign brand soft drinks, disadvantage companies with strong foreign connections. [redacted]

#### **Economic and Political Disincentives**

Bureaucrats are not the only impediment to foreign investment. Lack of skilled labor limits industrial productivity and quality control, according to US Embassy reports, because training is inadequate and many qualified workers have taken jobs in the Middle

East. The road network cannot cope with increasing traffic, and telephone links frequently break down. Electricity and natural gas shortages, partly a reflection of inappropriate pricing policies, handicap industrial users. Islamabad will have to subsidize production from its inefficient, Soviet-supplied steel mill to attract downstream industries. These constraints usually swamp any benefits from government financial incentives. [redacted]

Return to civilian government has probably delayed implementation of many economic reforms. Prime Minister Junejo still supports “deregulation” but, in the view of US Embassy officials, prefers to avoid contentious decisions. As political activity increases, Junejo will probably become increasingly reluctant to lower administered prices for key commodities, expose existing businesses to competition, or approve investments that could be portrayed as a sellout to foreign interests. [redacted]

Junejo’s caution is evident in the recent handling of Shell’s efforts to expand in Pakistan by acquiring Burma Oil assets. The transaction, prompted by Burma’s worldwide move out of oil and gas exploration, would have given Shell a dominant interest in Pakistan’s major gasfields as well as substantial holdings in petroleum refining and marketing. According to press reports, Junejo sought to mollify critics by holding Shell’s equity below 50 percent—even though it would cost Islamabad \$10-20 million to buy Shell shares. Delay in obtaining Pakistani approval has jeopardized not only the change in ownership but also \$200 million in proposed investments by Shell. [redacted]

Prospects for internal political stability trouble some foreign bankers and potential investors. Domestic businessmen, whose cooperation is essential for most projects, are more sanguine, according to US Embassy reports, but they too are reluctant to make long-term commitments. Mounting ethnic conflict—such as severe riots in Karachi, where many industries and the major port are located—increases the risk that plant operations will be disrupted. In addition, some

<sup>1</sup> London interbank offer rate. [redacted]

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country risk analysts downgrade Pakistan because of the proximity of the insurgency in Afghanistan and a history of repeated wars with India. [redacted]

- The investment is in sectors of primary interest to the Pakistani Government.

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The most severe risk for foreign investors, however, is probably Pakistan's vulnerability to a sharp and sudden deterioration in its foreign payments position. Exports are concentrated in a few commodities, such as cotton and textiles, that are subject to wide international price fluctuations or market barriers. Remittances are likely to decline as workers return from the Middle East. Commercial bank deposits and private funds, now attracted by high interest rates, could be withdrawn rapidly. Policy adjustments, such as intensified import barriers or currency devaluation, that might be used to cope with increased strains would jeopardize profits from import-intensive investments. [redacted]

Some major projects in oil and gas exploration, electricity generation, telecommunications, and pesticides meet these criteria. Press reports of preliminary investment proposals suggest that Japanese and European companies are more likely to enhance their marketing efforts with a small equity contribution than are US businesses. [redacted]

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**Prospects**

We expect a modest flow of direct investment will continue from foreign companies that hope to sell goods and services to Pakistan. For some foreign suppliers, joint ventures may become necessary to preserve their share of the Pakistani market, lest competitors obtain tariff and licensing protection for import-substitution ventures. Other companies will probably offer equity to stimulate interest by potential Pakistani partners or government officials in projects that will use foreign equipment. Foreign ownership can make a project more attractive because it presages long-term technological support and helps bring in supplementary funds from international bankers or the Pakistani stock market. We believe equity offers from foreign equipment suppliers are most likely when:

Modest new investment in company shares is also likely from Pakistanis resident abroad who have no interest in management. Islamabad has stalled but not yet abandoned plans to sell a \$126 million package of minority shares in public-sector corporations to domestic and nonresident Pakistani investors. Tax concessions for share purchases may attract some accumulated savings from professional and skilled workers returning from overseas employment. In addition, Pakistan's shift to interest-free Islamic banking, even though not mandatory for foreign transactions, may lead a few domestic companies to seek some form of equity, such as a specified share of profits, rather than interest-bearing loans from their suppliers. [redacted]

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- A proposed project will be partly owned by a Pakistani public-sector corporation or will be financed and monitored by aid donors. This reduces the risk of adverse shifts in government price controls, import licensing, or subsidies.
- The foreign investor has experience coping with difficult bureaucracies or has a local partner with excellent political connections.

At best, foreign investment is likely to make only a marginal contribution to the financial resources Pakistan needs for its development over the next several years. In our judgment, risks of economic deterioration and adverse policy shifts are too great to attract substantial capital from those investors who are primarily interested in repatriating profits. Simplified, less restrictive bureaucratic procedures for approving investments—which US officials have urged Islamabad to adopt—could probably stimulate additional foreign interest in licensing some types of technology but would not be sufficient to turn around the overall climate for equity investment. [redacted]

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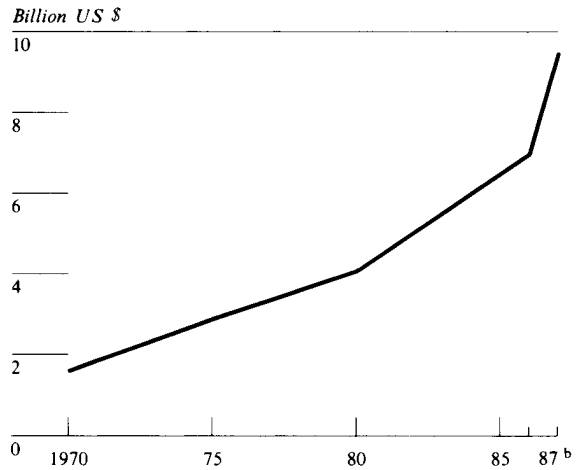
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**India: Impact of Military Spending**

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India's long-term program to modernize its defense forces has not, in our judgment, unduly strained its economy or hampered its development programs so far. The defense buildup has enabled India to maintain a clear edge over Pakistan in terms of military manpower and quality of equipment. Nonetheless, the large-scale purchases of weapons from foreign suppliers and the associated debt servicing costs, combined with oil imports and other debts, are likely to strain India's fragile foreign payments position in the next few years. India probably will try to cope with growing defense costs by turning more to cheaper Soviet weaponry and increasing the use of domestically produced arms. Only selective technology and component systems will be purchased from the West. Within the next several years, military imports will probably become an increasingly sensitive political issue as pressure on India's foreign currency reserves increases and competition for funds between military and civilian programs becomes more acute.

**India: Defense Expenditures, 1970-87<sup>a</sup>**



<sup>a</sup> Fiscal period beginning 1 April of the stated year.  
<sup>b</sup> Projected.

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**Defense Expenditures**

New Delhi's growing defense expenditures have been prompted largely by perceived external threats from longtime enemies, such as Pakistan and China. Other factors include a greater superpower presence in the region since the late 1970s and New Delhi's desire for a greater military role in the Indian Ocean. More recently, internal security threats from continuing communal violence have prompted New Delhi to improve its paramilitary and police forces.

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3.4 percent—keeping pace with India's yearly average GNP growth rate. Between FY 1970 and FY 1986, defense expenditures averaged about 4 percent of GNP and have ranged from 12 to 19 percent of central government budget expenditures, according to government documents.

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India has steadily expanded its military spending over the past 15 years to strengthen and modernize its defense forces. We estimate annual defense expenditures have more than quadrupled in nominal terms since FY 1970, reaching an estimated \$7 billion in FY 1986.<sup>1</sup> Since FY 1970 defense expenditures have risen in real terms at an average annual rate of

The recently proposed FY 1987 budget calls for a 36-percent increase in defense spending and reflects India's desire to continue its modernization program. Under the new budget, military spending will be about 4.3 percent of GNP and account for over 21

<sup>1</sup> The Indian fiscal year begins on 1 April of the calendar year.

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**Value of Military Deliveries, 1980-86**

*Million US \$*

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percent of government budgetary expenditures. The proposed budget is being debated in Parliament with a final decision expected in early March. We believe that defense allocations will not be significantly reduced. The increase over FY 1986 is due in part to the rising debt servicing cost of weapons imports.

[redacted]

New Delhi's reported defense budgets understate actual defense spending. They do not include loans and grants to India's large defense industries and research institutes, maintenance expenses for the country's large paramilitary forces, or military pensions. [redacted] aggregate defense outlays could be as much as 20 percent higher than official defense spending estimates. [redacted]

**Where the Money Is Spent**

[redacted] capital expenditures account for over half of India's defense spending, and we estimate that purchases of foreign military equipment account for about 20 percent of capital expenditure allocations. Arms deliveries from foreign

suppliers have totaled more than \$9.6 billion since FY 1980 compared with \$2.4 billion from FY 1970 to FY 1979. [redacted]

Before 1984, about 75 percent of India's purchases—not deliveries—were from the USSR and Eastern Europe. Over the last two years, about 45 percent—\$1.7 billion—of India's weapons purchases were contracted from the West. Unlike the Soviet Union, Western suppliers require repayment in hard currency. Additional weapons purchases from the West will increase the burden on India's foreign reserves. [redacted]

Each of the Indian military services has been able to expand and upgrade its weapons inventories, thanks to steadily increasing defense expenditures. The Army recorded a 33-percent increase in the number of tanks since 1980, including the acquisition of 450 T72 tanks from the USSR and 600 indigenously produced Vijayanta tanks. The Air Force has acquired some 400 new fighter aircraft, including advanced Mirage

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2000 and MIG-29 interceptors. The Navy, meanwhile, has received 12 new major warships<sup>2</sup> and enhanced its air arm with additional Harrier aircraft, antisubmarine helicopters, and maritime reconnaissance aircraft. [redacted]

Slightly less than 10 percent of the defense budget is spent on enhancing and diversifying India's defense industries—its second-largest manufacturing sector. India's domestic arms industry consists of 36 ordnance factories and nine public-sector research and development firms that together produced nearly \$2.5 billion worth of goods last year and provided employment for more than 290,000 people. During the past three decades New Delhi has undertaken several costly programs in which India assembles or produces under license sophisticated foreign-designed arms, such as the Vijayanta tank and the Jaguar fighter-bomber aircraft, with a view toward using the production experience to assist in developing India's indigenously designed and produced tank and light attack aircraft. [redacted]

Although India has a substantial industrial capacity to support its defense factories, it is deficient in many areas of high technology. As a result, India still depends heavily on imported defense industry components and designs and will remain so at least for the next 10 years and probably much longer. [redacted]

Operational expenditures—principally pay and allowances, transportation, land, and storage—amount to about 40 percent of the military budget. Pay and allowances for India's 1-million-man Army account for the largest share of operational expenditures. Most operational expenditures are made within India and do not require hard currency. [redacted]

#### Shifting Priorities

Indian defense budgets over the last decade have reflected a shift in priorities away from the Army toward the Air Force and Navy. Although the Army has consistently received the bulk of defense funds, its share has declined from 63 percent in FY 1974 to an estimated 53 percent in FY 1986. At the same time,

<sup>2</sup> Since 1980 India has received one aircraft carrier, four destroyers, four frigates, and three submarines. [redacted]

the Air Force's allocations have increased from 19 percent to about 22 percent, and the Navy's share has increased from 5 percent to 13 percent.<sup>3</sup> [redacted]

More recently, budget priorities within each of the services appear to be moving away from the early 1980s emphasis on purchasing new weapon systems to improving support and acquiring advanced technology. Slightly less than half of the Army's FY 1986 budget—about \$2 billion—will be used to modernize ordnance factories, build munitions inventories, and further defense research and development. A significant portion of the Navy's funds will be used to expand port facilities, increase naval and armament stores, and acquire spare parts. The Air Force spends its allocations differently. Although its budgetary allocations will go mainly toward the purchase of stores, special projects, such as producing India's first instrument landing system and installing modern air defense radar, and research and development, a significant portion of its resources will be used to purchase new weapon systems. [redacted]

#### Is India's Defense Spending a Burden?

The growth in defense spending and the military buildup over the last decade have encountered little popular opposition in India because of the widely shared concern about Pakistan and China. Political observers note that debates in Parliament on defense spending are usually free of rancor. The US Embassy reports that the opposition parties often prod the government to increase defense outlays. Although India has one of Asia's freest presses, journalists seldom criticize defense spending or its impact on economic development. [redacted]

Academics analyzing the impact of military spending on economic growth in India are split over whether defense spending has been a burden on the economy. Most studies suggest that higher defense expenditures have stimulated the economy by using funds that would otherwise be idle. India would have had

<sup>3</sup> We cannot determine the allocation by service of 12 percent of the budget. [redacted]

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difficulty administratively and technically using these funds in the civilian sector to establish new industries and employment opportunities. Other analyses have argued, however, that higher defense spending has siphoned resources from development, and the long-run effect has been to lower potential GNP growth by as much as 1 percentage point annually. According to some Indian studies, spinoffs to the civilian sector from defense research and production have been minimal because of secrecy and lack of communication between public and private firms.

Defense spending has not noticeably crowded out expenditures for development programs during the 1980s. Over the last six years government spending on development activities—agriculture, industry, public health, and education—grew 24 percentage points faster than defense allocations. Spending on these items amounted to about \$8.5 billion—over 20 percent of the 1986 budget—compared with \$7 billion for defense spending.

The overall impact of spending for imports of military equipment has been tempered by the easy terms offered by the Soviet Union, India's main arms supplier. Beginning in the 1970s, New Delhi won increasingly generous concessionary financing, payable in rupees or through barter arrangements, for its military purchases. Whereas in the early 1960s 40-percent downpayments and 10-percent interest rates for 10-year loans were common in Indo-Soviet military agreements, by the late 1970s the Soviets were making available 15-to-20-year loans at 2.5- to 3-percent interest rates with no downpayment on most items.

**Outlook**

Because of the threats New Delhi sees posed by Pakistan and China, it will continue to allocate significant financial resources to defense. Large US security assistance programs for Pakistan have compelled New Delhi to acquire additional sophisticated arms. The protracted border dispute with China and the growing US-China military relationship also motivate New Delhi to seek advanced weapons and technology.

The savings from lower oil prices will help New Delhi cope with its debt to Moscow and the West for military purchases at least temporarily. The drop in the average price of imported oil from \$28 per barrel in 1985 to \$15 per barrel in 1986 saved New Delhi approximately \$2 billion last year.

A combination of payments due for military weapons purchases, growing oil imports, and large commercial and IMF loan payments that will begin to come due in 1988 will strain New Delhi's fragile foreign payments position in the coming years. As a result, we believe India will continue to rely on the Soviet Union—because of the concessional terms Moscow offers—for most of its arms while selectively purchasing US and Western technology and defense equipment.

We judge that New Delhi's program to import modern weaponry will become an increasingly contentious political issue as pressures on India's foreign currency reserves increase. As larger shares of India's financial resources are devoted to military and civilian loan repayment obligations, competition for government financial resources will increase. Progress on India's development plans will also require a larger share of scarce domestic resources if, as seems very likely, New Delhi's access to concessional aid diminishes over the coming years.

**Implications for the United States**

India's continued emphasis on acquiring sophisticated weaponry and support gear provides US and other Western arms exporters with opportunities for new sales and loosening Soviet influence, even given the financial constraints we foresee. We believe New Delhi will selectively buy Western radars, communications and logistic support equipment, and component parts for its indigenously made weapons that are superior to Soviet goods. Bilateral talks have identified India's light combat aircraft program as one area for possible major military cooperation. At the same time, foreign payments problems make it unlikely that India will look to the West for large orders of expensive items unless highly concessionary financing is offered.

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## India: Succession Implications of Cabinet and Congress Party Changes

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Prime Minister Rajiv Gandhi's shakeups of his Cabinet and the ruling Congress Party—which he heads—have resulted in a lack of second-echelon leaders with broad political support in either organization. Should Gandhi die suddenly, the remaining weak party and Cabinet leadership suggests a successor will come from a pool of senior compromise candidates with strong party credentials but without the power of a consensus leader like Gandhi. P. V. Narisimha Rao, the senior Congress Party Cabinet Minister, has emerged from the shakeups with the requisite party ties and Cabinet experience to head the list of candidates in the event of a succession struggle.

### **Gandhi's Cabinet Reorganizations**

Gandhi's removal of independently powerful politicians from Cabinet posts suggests that he may fear political threats to his hold on the prime ministership. We do not believe, however, that Gandhi faces a significant challenge to his leadership. His personal popularity is greater than that of the Congress Party itself, according to the US Embassy in New Delhi. We believe that he retains much of the support that won him the biggest margin of victory in Indian electoral history. No Congress Party or regional politician comes close to matching his national appeal.

Gandhi has shuffled his Cabinet six times in his 27 months as Prime Minister primarily, in our view, to select ministers who effectively and unobtrusively implement his policy line. He also has been careful to remove cabinet ministers suspected of harboring leadership aspirations and to include representatives from key minorities and constituencies.

Gandhi came to power promising to move India into the 21st century and improve government effectiveness. Many of his Cabinet appointments have been designed, in our judgment, to promote people who he believes can loyally and efficiently follow his policy lead. P. Chidambaram, for example, quickly

moved up in the Home Affairs Ministry after proving his merit mediating between Sri Lanka and Tamil guerrillas. Gandhi has chosen V. P. Singh, regarded as his best Cabinet administrator, for several key senior posts, including Finance Minister and now Defense Minister. At the same time, Gandhi occasionally ousts key officials who overstep their responsibilities. Foreign Secretary A. P. Venkateswaran, for example, lost his post in part because he prematurely suggested during a visit to Pakistan that Gandhi would visit Islamabad in 1987.

At the same time, we believe Gandhi has used the shuffles to demonstrate to Cabinet members that their political ambitions must remain subservient to loyalty to his policies. In our view, Gandhi's insistence on loyalty—coupled with his charisma—has precluded the major politicians in his Cabinet from grabbing either the public limelight or enough party support to establish themselves as clear succession contenders. Arun Nehru, Gandhi's distant cousin and onetime strong succession candidate, lost his Cabinet post ostensibly because he was recuperating from a heart attack, but Indian observers widely regard Nehru's fall as Gandhi's response to his well-publicized designs on the prime ministership.

Finally, Gandhi has shown that he sometimes follows the Indian political tradition of using Cabinet appointments for political expediency. He often gives minorities Cabinet positions to reward regional, religious, and caste groups loyal to the party. Several Cabinet members—Muslim Transport Minister Mohsina Kidwai and Sikh Agriculture Minister G. S. Dhillon, for example—clearly were selected because they come from key ethnic groups or from states underrepresented in the Cabinet. Rajiv has also chosen several members in response to pressure and criticism from the Congress Party old guard who claimed that his penchant for youth had led to a lack of experience in the Cabinet.



### Stagnation in the Congress Party Organization

Gandhi also tried to shake up the ruling Congress Party—much as he did with the Cabinet—to promote officials who would revitalize the party without using their positions to gain personal support. But, like Gandhi's Cabinet, the Congress Party hierarchy offers few leadership options beyond Gandhi. The Congress Party remains a largely stagnant organization administered from the top down. Gandhi was left holding the party reins after his efforts failed last year to sponsor internal Congress Party elections. The seniormost party administrators—those who would have played a role in party and succession decision making—have either been co-opted into the Cabinet, lost their posts for disagreeing with Gandhi's party leadership, or resigned to give Gandhi a free hand in reorganizing the party.

Rajiv's premium on loyalty to his agenda has resulted in the dismissal of several Congress Party politicians who were prominent under his mother and the ouster of well-known party members—many of whom were Cabinet members—who suffered from widespread reports of their overblown political ambitions. Pranab Mukherjee, the number-two man under Indira, is a prime example. In April 1986, Gandhi expelled him from the Congress Party for six years after he strongly criticized Gandhi's management of the party. Mukherjee and several other fading Indira loyalists formed a splinter party last fall, emphasizing their ties to Indira in an effort to appeal to Rajiv's detractors.

Despite Gandhi's promises of and efforts at grassroots Congress Party reform, the continued delay of internal party elections has atrophied the party at its lower levels and probably will prevent the emergence of local leaders with strong constituent support, according to press and Embassy sources. Early in his administration, Gandhi pledged to sponsor local party elections (none have been held since 1972) to revitalize the party. But, after former Congress Party Vice President Arjun Singh failed last year to clear the party rolls of bogus members in Uttar Pradesh state—India's most populous state and the cornerstone of Congress Party support—Gandhi has shown little enthusiasm for the project. Although such elections would infuse the party with new blood, some of the old guard resisted change because it could severely

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### Succession Procedures

*The Indian Constitution calls for the President to fill a vacancy in the Prime Minister's office by appointing the senior Cabinet member representing the majority party or coalition in Parliament. The President can delegate the responsibility for choosing a candidate to the majority party's parliamentary committee, which would then be subject to intense lobbying from the succession contenders. In practice, however, Congress Party politics have usually dictated the selection of the Prime Minister, and the President plays only a ceremonial role. With national opposition to the Congress Party fragmented and the party holding a large majority in Parliament, Congress Party members are the only credible succession candidates.*

*At the time of Indira Gandhi's assassination in 1984, the succession question did not arise because Rajiv was widely accepted as her heir. He was sworn in within hours after the assassination. His mother's appointment in 1966, however, offers parallels to the current succession picture. Indira was chosen by Congress Party bosses—called the Syndicate—after the sudden death of Prime Minister Lal Bahadur Shastri largely because she was regarded as a noncontroversial compromise candidate who could be manipulated by senior party members. Unlike Rao, she had the powerful Gandhi name, and the Syndicate chose her in part because they calculated that her parentage (her father, Jawaharlal Nehru, was India's first Prime Minister) would pull in votes.*



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disrupt the entrenched party hierarchy. Gandhi may calculate that, with crucial state elections slated for 1987, he can ill afford to destabilize what party organization remains by shifting its focus to internal reform.

### How the Changes Affect the Succession Question

In our judgment, Gandhi's management of his Cabinet and the Congress Party has resulted in a dearth of popular second-echelon political leaders who

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could effectively succeed the Prime Minister. Longtime politician P. V. Narisimha Rao, Minister of Health and Human Resources and the senior Congress Party Minister, is the leading candidate to move up to the prime ministership but he lacks a political following. Rao's experience and seniority are his most powerful qualifications. No politician with comparable experience has survived the first two years of Rajiv's administration. At the same time, the Nehru family offers no credible dynastic candidates. Gandhi's son is only 16, and Gandhi's third cousin Arun Nehru has been politically inactive since his heart attack last year.

We expect Congress Party officials would weigh seniority heavily in their choice of a prime ministerial candidate. Rao ranks second only to Gandhi in the Cabinet and chairs its meetings in Gandhi's absence. He has been a Cabinet Minister since 1980, holding key portfolios—Home Affairs, Defense, Foreign Affairs, and now Health and Human Resources—and gaining experience under both Rajiv and Indira Gandhi. According to the Embassy, Delhi politicians respect Rao for his experience and intellect. We believe Rao's conservative, consensus style also makes him acceptable to senior Cabinet leaders.

We believe Rao would be an especially attractive candidate in the event of Rajiv's sudden death, when the President and Congress officials would want to calm a panicky public by appointing a successor with minimum delay. In our view, Rao, like Rajiv, would appeal to Indian leaders seeking to avoid time-consuming and divisive controversy by making the conservative choice for Prime Minister. Indian leaders might also calculate—much as they did with Indira—that, by selecting an inoffensive compromise candidate such as Rao, they could manipulate him to further their own views and policies.

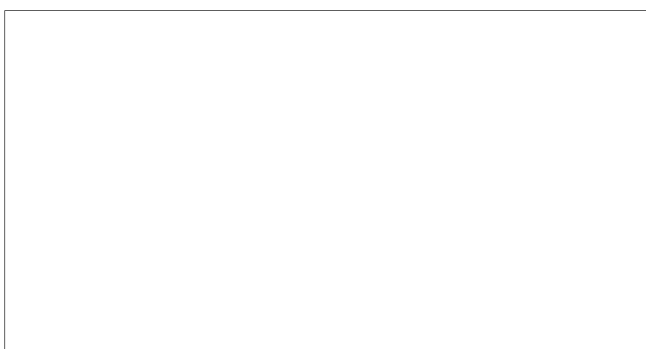
Defense Minister V. P. Singh would probably lead any group challenging Rao for the prime ministership. Indian observers regard him as one of Gandhi's most efficient and honest Cabinet ministers, and his several Cabinet posts have given him broad experience. Like

Rao, his limited political following would probably appeal to Congress Party officials seeking to avoid a strong, independent Prime Minister.

#### **Rao's Drawbacks: South Indian Heritage and Lackluster Record**

Although Rao is the clearest succession candidate, several weaknesses keep him from outdistancing the pack of potential successors. Rao's South Indian Brahmin heritage and his weak record in Cabinet- and state-level posts are his most damaging drawbacks:

- Congress Party powerbrokers would prefer to look to India's northern Hindi heartland—the base of Congress Party support—for a Prime Minister, but they lack candidates.



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#### **Implications of a Rao Succession**

Without Gandhi's public appeal and massive voter mandate, no succeeding Prime Minister would have as much freedom to fashion foreign policy—especially India's relations with the superpowers and with Pakistan—as does Rajiv. We believe Rao would be less able than Gandhi to cultivate warmer Indo-US relations. His unsure political footing and his consensus decisionmaking style would make him more vulnerable to pressure from opposition parties, disaffected Congress Party members, and the conservative senior party members who would play a role in his appointment. Like any compromise candidate, Rao's lack of strong support would weaken him in his dealings with the party. He would probably set policy cautiously because he would be susceptible to party dissidents waiting to use his perceived weaknesses to wrest power from him.

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Rao has traditional Indian views on key international and regional issues. He appeared frustrated, both as Foreign Minister and later Defense Minister, with US policies on technology transfer and Pakistan, and he strongly defended India's record against technology diversion. On the other hand, as Home Affairs Minister he supported Indo-US cooperation on antiterrorism and antinarcotics trafficking efforts.

**Afghanistan.** Echoing Indian policy, Rao has espoused a compromise political solution to end the Soviet occupation. He claims that the Nonaligned Movement has adopted the substance of India's position, adding that India would have little leverage with the Soviets if it had not taken such a "constructive" position and instead "joined the chorus" condemning the invasion.

**The Soviet Union.** [redacted]

[redacted] In 1982 he characterized Indo-Soviet relations as having a mutually beneficial character over a period of decades. He has privately opposed foreign bases—specifically including both the United States and the USSR—in the Indian Ocean, according to Western diplomats. During his tenure as Defense Minister, Rao was involved in the eventually successful negotiations for MIG-29s.

**Pakistan.** We believe Rao, like most Indian politicians, is suspicious of Pakistani intentions in South Asia. In meetings with US officials over the past five years, Rao has repeatedly voiced concern about Pakistan's military purchases. He has argued that the lack of democracy in Pakistan could increase pressure on the Pakistani regime and force military "adventurism" against India.

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## Sri Lanka: Democracy Feeling the Pinch

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The Tamil insurgency has placed serious strains on Sri Lanka's democratic institutions. Before the insurgency Sri Lanka had a strong record of upholding democratic principles. Many measures undertaken by President Jayewardene over the past several years to combat the Tamil insurgency, such as arbitrary arrests and postponing elections, have eroded traditional Sri Lankan freedoms. Anti-insurgent legislation has been used by the government to restrict activities of opposition political parties and to entrench in power Jayewardene's ruling United National Party (UNP). Despite the controversial measures undertaken by the government, we believe that in the long run Sri Lanka's basic democratic institutions will remain largely intact.

### Background

Sri Lanka is one of the longest functioning democracies in the Third World. Upon gaining independence from Great Britain in 1948, Sri Lanka established a Westminster-style parliamentary system headed by a Prime Minister, with a unicameral legislature and an independent judiciary. The original 1947 Constitution has been amended several times, most recently in 1978 following the electoral victory of the United National Party under J. R. Jayewardene. In that year, the government was reconfigured along the Gaullist presidential/parliamentary model, centralizing the essential powers of the executive branch in the office of the President, while retaining the one-house Parliament, which shares power with the President.

Colombo has held generally free and fair national elections and has carried out smooth transitions of power, even following the assassination of the Prime Minister in 1958. Numerous political parties have formed in Sri Lanka, many along ethnic lines, and have often played decisive roles in forming ruling coalitions. Since 1948, primary control of the government has alternated between the two political parties of the majority Sinhalese ethnic group: the United National Party and the Sri Lankan Freedom

Party (SLFP). The chief executives have been drawn from just three Sinhalese upper-caste families.

### Cause for Concern

***Prevention of Terrorism Act, 1979.*** In the first two years of Jayewardene's term, the Tamil insurgency consisted of sporadic attacks by small bands of Tamil militants against government troops and installations in the north. By late 1979, however, the security situation had deteriorated so severely in the north that the Jayewardene administration enacted the Prevention of Terrorism Act, granting the government special powers to arrest without warrant and to detain those suspected of antistate activity for up to 18 months without bail or charges. This law, enacted as a temporary measure in 1979, became permanent in 1982.

Under the provisions of the act the government has carried out large-scale roundups with hundreds of mostly Tamil youth arrested and jailed on suspicion of involvement with the Tamil separatist movement, according to the US Embassy. The Sri Lankan Government says there are about 2,300 persons jailed under the act, but other human rights organizations estimate the number at between 3,000 and 5,000, according to the US Embassy in Colombo. The Embassy also reports that about 80 members of a radical Sinhalese leftist group have been detained under the act.

Beginning in 1983 and lasting through July 1985, press censorship was enforced under the provisions of the Prevention of Terrorism Act and the Emergency Regulations. The restrictions held that all documents, photos, and films relating to terrorist activity or security operations for publication in Sri Lanka or in foreign media must be submitted to the government's official censor. After a brief relaxation in mid-1984, the restrictions were officially lifted in 1985, but editors are expected to exercise self-censorship with regard to reporting terrorism and security operations.

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**National Referendum, 1982.** The second major abuse of the democratic process occurred in 1982, over a year before President Jayewardene's first term was to expire, and was directed primarily at opposition political parties. Sensing waning popular support in the fall of 1982, Jayewardene called, in quick succession, an early presidential election—which he won, guaranteeing himself a further six years in power—followed by a national referendum to ratify postponing parliamentary elections for six years, thereby extending the life of the UNP-dominated Parliament. The referendum motion passed, and the President—who possessed signed resignations from all UNP Ministers and members of Parliament—forced 18 members to resign and called new byelections to fill their seats. The byelections resulted in a very small increase in seats held by the opposition SLFP, which won three of 14 that they contested, but overall the outcome was regarded as a landslide victory for the President and the UNP.

Although the referendum and subsequent byelections were carried out successfully, their legality is still debated in Sri Lankan circles:

- Open sources point out that there was widespread voter fraud and impersonation as well as many reports of voter intimidation at the polling booths.
- Because the referendum was held under a limited State of Emergency, important opposition presses were shut down and several publications were banned
- The opposition SLFP was substantially handicapped since the UNP-dominated Parliament had revoked the civil rights of its leader, former Prime Minister Sirimavo Bandaranaike, in 1980 for misuse of power during her rule in 1970-77.

**Sixth Amendment to the Constitution, 1983.** The enactment of the Sixth Amendment is another case where government action has eroded Sri Lankan democracy. Following the massive communal riots of July 1983, Parliament passed an amendment requiring all members of Parliament to swear allegiance to the Sri Lankan unitary state. The Tamil representatives from the north and east—who

belonged to the moderate Tamil United Liberation Front (TULF)—refused and consequently lost their seats. New elections to fill these seats have been postponed indefinitely because of the security situation in the north and east, so those persons living in areas formerly represented by the TULF have been without parliamentary representation since late 1983. The TULF and the Tamil minority parties that preceded it have supported the establishment of a semiautonomous Tamil state since the early 1970s.

**Emergency Regulations, 1983.** A State of Emergency has been in effect continuously since May 1983—imposed several times previously on an ad hoc basis—and is extended monthly by the UNP-dominated Parliament. Emergency regulations overlap to some degree with the Prevention of Terrorism Act and include provisions for press censorship, imposition of curfews, and special police power for preventive detention. In 1984, under the emergency regulations, a security and surveillance zone was established in coastal areas of the north, putting them off limits to boats other than fishing vessels or those engaged in “other lawful occupation.” Security forces are empowered to detain vessels and may arrest on suspicion of illegal or insurgent-related activity. Under the regulations—intended to restrict insurgent movement between southern India and Tamil strongholds in northern Sri Lanka—an officer may halt a vessel by opening fire or using any other force he deems necessary. This provision has resulted in the death of many Tamil fishermen and civilians working in the coastal area around Jaffna and the Palk Strait.

#### **Democracy Hanging On**

Although the fabric of Sri Lankan democracy is fraying at the edges, some of its democratic institutions—particularly the independent judiciary and press—continue to function well despite Colombo's controversial measures. The best example of this is Sri Lanka's judiciary, which demonstrated its independence last year in two widely publicized trials of individuals charged under the Emergency and Prevention of Terrorism regulations. In the first case a Tamil Catholic priest was acquitted in March

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of charges that he withheld information from the police on a 1982 bank robbery, according to the Embassy in Colombo. The case was the first real opportunity for judicial interpretation of the Prevention of Terrorism Act, according to the Embassy, and the priest's acquittal indicates that Sri Lanka's judges are not constrained in their rulings by the central government.

The second example of judicial independence—and one of the first cases ever tried for an offense under the emergency regulations—involved a Sri Lankan-born Canadian citizen who was acquitted of sedition charges in July 1986. He was chairman of an influential east coast Citizens' Committee, and his case received considerable attention from international human rights groups, according to the US Embassy in Colombo. The case was seen as an attempt by Colombo to intimidate the Citizens' Committees, which had been effective and credible sources of information on insurgent and security forces activity. The defendant was accused of sedition in 1985 after he told foreign correspondents about security force involvement in three attacks on local civilians that spring; the committee had also given the information to the police. In an 82-page ruling, the judge found the accused not guilty of spreading rumors or false statements and included in the ruling an unusual commendation of the work of the Citizens' Committees, according to the Embassy.

The Sri Lankan press also has been active in criticizing the government and Jayewardene's leadership since official censorship was lifted in 1985. Most of the Sinhalese and English-language papers are biased toward either the ruling UNP or the opposition SLFP and tend to skew reporting accordingly. These biases are well known to Sri Lanka's largely literate public. The most worrisome development regarding freedom of the media was last year's formation of the national Media Center, run by the National Security Ministry. This center serves as the sole source of information on "terrorist activities"—Tamil insurgent activity—for both domestic and foreign media, according to Sri Lankan press reports. With the independent Tamil press gone and the Sinhalese press dependent on the government

for information, distorted or partial information about the status of the insurgency is probably being presented as fact.

The credibility of the electoral process—which suffered a blow in the 1982 referendum—received a boost in April last year when the opposition SLFP won a parliamentary byelection in Akmeemana District. Although the opposition has won other byelection victories since 1982, it is important to note that, despite election irregularities by both sides in the past, the opposition party can still win in a free election. Islandwide local elections for municipal councils are scheduled to be held later this year. Colombo's ability to guarantee that these elections are open and unprejudiced, in our judgment, will be an important test of Sri Lanka's democratic tradition.

The Sri Lankan democratic system has some institutions that act as a watchdog to limit presidential powers. One such institution is the independent Election Commission. Its independence was highlighted in December 1986 when the commission presented a finding to Parliament on the legality of the 1982 referendum. According to Indian press articles, the commission's report cited serious official malpractices during the referendum, but no further details were provided.

#### **Outlook**

We believe that the viability of democratic institutions in Sri Lanka is tied primarily to the future of the insurgency. Jayewardene views the insurgency as a direct threat to Sri Lankan stability. If Colombo can negotiate a workable peace agreement with the insurgents or, less likely, weaken them significantly, we expect Jayewardene will rescind most of the restrictive legislation. During last summer's round of peace negotiations, the Embassy reported that Jayewardene planned to suspend the Prevention of Terrorism Act as a sign of his commitment to the peace process and also intended to repeal the Sixth Amendment. Although neither move was implemented—due to increased fighting and civilian casualties—we believe they provide significant insight into Jayewardene's intentions.

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Conversely, another motivation that may have prompted Jayewardene to implement the measures detailed above is his longtime effort to ensure that the UNP remains a dominant player in Sri Lankan politics. A US scholar says that, despite the UNP election victory in 1977, Jayewardene is plagued by the memory of the defeat delivered to the UNP by the SLFP in the mid-1950s. That defeat almost destroyed the UNP, and the US scholar believes Jayewardene will make every effort to ensure it never happens again, even if it means undermining some of Sri Lanka's traditional democratic freedoms.



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**Portrait of a Fictional  
Sri Lankan  
Drug Trafficker**

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Sri Lanka's Tamil militants have been involved in a four-year-long struggle for independence from the Sinhalese-dominated central government in Colombo. More than 150,000 Sri Lankan Tamils have fled the island since 1983 in the face of rising ethnic violence, and most now live in refugee camps in the South Indian state of Tamil Nadu. Militant Tamil leaders from several competing factions have established recruiting and training centers in India and maintain a complex support system that stretches through the overseas Tamil community.

Increasingly, Tamil militants have turned to high-risk, high-profit international crime—particularly drug trafficking—to maintain their war chests. Sri Lankan Tamils annually account for a large proportion of the Asian drug couriers apprehended in European and North American drug arrests. On the basis of documents and other materials collected during these seizures, we believe Sri Lankan Tamil dissidents are becoming:

- More actively involved in directing drug rings.
- More willing to make contact with other forms of international crime, particularly the gray arms market.
- Readier to remain active in drug trafficking regardless of the political outcome of the autonomy struggle in Sri Lanka.

**A Trafficker's Life**

The following is a fictional presentation of a Tamil trafficker's history of insurgent and drug activities. Although it is a fabrication, the general relationships and activities it illustrates can be substantiated. By creating this fictional account, we hope to graphically demonstrate:

- The complex web of international contacts that dissident groups enter into when they turn to drug trafficking.
- How traffickers manipulate this web of relationships to meet group and personal goals.
- The seductive effects of narcotics profits on Tamil traffickers.

In late December 1986 customs authorities at Berlin's Tempelhof Airport pulled Ramaswamy Krishnapillai from the line of travelers arriving on a Sabena flight from Brussels. Although he had no goods to declare at customs and his flight originated in a European capital, officials had received an Interpol message revising previous drug courier profiles and alerting all European services to increased narcotics activity by young Sri Lankan Tamils. A physical examination revealed that Krishnapillai had taped several small balloons containing a white powder to the insides of his legs and in the small of his back. Authorities remanded the man to a local hospital, where full-body X-rays revealed several small capsules in his digestive tract which later proved to be filled with heroin. In all, Krishnapillai was carrying nearly .75 kg of pure heroin hydrochloride, or injectable heroin.

*Comment. Tamil traffickers have been apprehended by Western authorities carrying several sorts of illicit drugs. Heroin from South and Southeast Asia offers the greatest profit per courier per trip. Tamils, like other Asian and African traffickers, have explored numerous ways to conceal the drug, including wrapping small amounts of heroin in condoms. The drug-filled condoms are then either swallowed or placed in other body cavities unlikely to be noticed during a cursory customs search. More than a kilogram can be carried in this manner.*

The suspect was carrying appropriate travel documents: an Indian passport made out in the name Rajasundaram Swaminathan with a West German visa issued in Bombay. Under questioning, the man declared he was not carrying the heroin for anyone else, that he knew no one in Germany, that he had never been to Europe before, and that he was an Indian national of the Tamil ethnic group and a longtime resident of Bombay. He said he had no future plans but had hoped to sell his return trip ticket in Berlin, then live on the proceeds of his heroin sales

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**The "Evidence"**

**Item 1.** *Diary of Ramaswamy Krishnapillai—entries made in various hands over the period 5 May 1983 to 20 November 1986.*

**Item 2.** *Passport A: issued New Delhi, found on Ramaswamy Krishnapillai on day of his arrest, West Berlin. Name: Rajasundaram Swaminathan; visas: Italy, France, West Germany.*

**Item 3.** *Passports B, C, D, found in apartment allegedly rented in the name R. Krishnapillai, Zurich, Switzerland.*

- *Passport B: name: R. Swaminathan, issued: Colombo, Sri Lanka, visas: India, United Kingdom, West Germany.*
- *Passport C: name: Gamini Francis Perera; issued: Colombo, Sri Lanka, visas: United States, Canada, France, Italy.*
- *Passport D: name: Martin Fernando; issued: London, United Kingdom, visa: India.*

**Item 4.** *Tamil insurgent literature found in subject's Zurich apartment:*

- *Tamil Eelam Now, published by the Eelam Revolutionary Organization of Students—500 copies.*
- *Student identity card for the Peoples' Liberation Organization of Tamil Eelam, in the name R. Swaminathan.*
- *Pamphlet: History of the Oppression of the Tamil Peoples of Eelam, with articles by A. Balasingham and V. Prabhakaran.*

**Item 5.** *Pocket litter found on R. Krishnapillai on day of his arrest, including:*

- *Canceled international airlines vouchers for return trip flight Bombay-Dubai-Rome in the name R. Swaminathan.*
- *Canceled airlines voucher for return flight Rome-Paris-Brussels-Berlin.*
- *Folded sheet of paper with instructions and key for railroad station locker, Rome. Contact telephone number found on paper later shown to be for the residence of Antony Fortunato, currently under investigation by Interpol on charges of international drug and arms running. Fortunato also sought by Swiss authorities in connection with several money-laundering investigations.*
- *Letters from Mrs. Ida Krishnapillai of Montreal, Canada.*
- *Letter from Nimal Perera, New York.*
- *\$420 (US).*
- *DM 325.*
- *Sealed packet condoms (1 dozen).*

**Item 6.** *Testimony taken during interrogation by West German authorities at time of arrest.*

**Item 7.** *Interpol reports with numerous name-check hits and cross-references to Krishnapillai/Swaminathan/Perera.*



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on the street until he “could get something together.” Swaminathan demonstrated a more than casual understanding of German immigration law, mentioning that he anticipated remaining at large while the Berlin courts ruled on his application for political asylum as a member of a persecuted minority.

*Comment. Western customs and drug enforcement authorities became aware in 1984 that Sri Lankan Tamils were increasingly the couriers of choice for international drug traffickers, because they rarely appeared on enforcement officials' trafficker profiles. Tamils displaced Nigerians as customs and antidrug services began closer screening of African passengers transiting South and Southeast Asia.*

Closer examination of the subject's personal effects revealed that Swaminathan was probably not the subject's real name; that he had traveled extensively in Europe; that he had in his papers the names and addresses of major European drug and gray arms dealers; and that he was in contact with one or more Sri Lankan Tamil insurgent groups. Name checks through Interpol and inquiries to other West European criminal investigation services confirmed he had transited Italy, France, Switzerland, Belgium, and the United Kingdom at least once but had not been previously charged with drug trafficking.

*Comment. Sri Lankan Tamil militants abroad are predominantly male, young, and poorly educated. The leaders of the militant groups generally remain with the parent organization in Madras or northern Sri Lanka. Established overseas Tamil communities such as those in Singapore, Canada, the United Kingdom, Australia, and the United States often provide sympathy, support, and a ready-made organizational infrastructure for militant groups to work through. US Drug Enforcement Agency officials theorize that Tamil militants carry literature and false identity papers suggesting membership in opposing insurgent factions to incriminate rival groups in the event they are charged with drug trafficking.*

West German police could not fully exploit the suspect's Tamil diary and correspondence, but they recognized many of the international contacts whose names and addresses were sprinkled throughout the materials. US authorities confirmed that N. Perera maintained a Manhattan apartment; Scotland Yard confirmed that M. Fernando was listed on the lease of a London flat apparently shared with a number of other Sri Lankans. Interpol's files contained extensive cross-references on the name Antony Fortunato. Fernando and Perera had several joint Swiss accounts, some of which also bore Fortunato's name. Canadian authorities confirmed the address and legal immigration status of Mrs. I. Krishnapillai.

*Comment. We believe Tamil traffickers regularly use multiple passports, often with Western or Sinhalese names, to confuse drug enforcement authorities. Similarly, stopping in several countries en route to their final destination with multiple sets of papers is an easy way to prevent immigration and customs authorities from devising a standard profile to identify Tamil traffickers. As Tamils grow more sophisticated and take a more active role in designing and carrying out drug deliveries, we believe they have created a system of safehouses and other forms of shared facilities with Tamil and other international dissident groups.*

After continued investigations failed to reveal further reason to charge Krishnapillai, West German authorities remanded him to police custody and charged him with “trafficking a significant amount of proscribed substance” through the country. Under German law, he is likely to be released from jail within 18 months, at which time he could exercise his right to apply for political asylum. If granted, he will receive full legal resident alien status.

#### **The Reality Behind the Fiction**

We believe that most Sri Lankan Tamils arrested in the West as drug couriers have been individuals working for themselves, rather than as members of sophisticated, Tamil-dominated trafficking

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**Main Events in the Sri Lankan Tamil Insurgency  
and in Ramaswamy Krishnapillai's Life**

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|------|--|--|
| 1982 | <i>Localized violence in Jaffna; demonstrations, some police violence.</i>   | <i>Krishnapillai living with his family in Mannar; fisherman of LTTE leader Prabhakaran's karaiyyar caste.</i>                                       |
| 1983 | <i>July riots in Colombo; Tamil refugee exodus to South India.</i>   | <i>Krishnapillai and family flee to refugee camp in Tamil Nadu in November; Krishnapillai joins Tamil militant group in December.</i>                |
| 1984 | <i>Insurgent activity grows in the Northern Province.</i>  | <i>Krishnapillai part of Tamil group running weapons to camps in Sri Lanka's Eastern Province.</i>   |
| 1985 | <i>Insurgent violence spreads to Eastern Province and Sinhalese areas. Anuradhapura massacre of Buddhist pilgrims.</i>               | <i>May—Krishnapillai goes to Singapore with group to buy weapons.<br/>Nov—Krishnapillai makes first drug delivery, Bombay to Rome.</i>               |
| 1986 | <i>Alternating violence and peace initiatives backed by New Delhi. Insurgent leadership shifts from India to northern Sri Lanka.</i> | <i>Apr—Krishnapillai makes second drug delivery, Madras-Bombay-Dubai-London.<br/>Dec—Krishnapillai arrested, Berlin, during third drug delivery.</i> |

syndicates. Most are opportunists, hoping to use the income of one or two good runs to establish themselves in the West and to avoid returning to Sri Lanka.

International investigations of Tamil drug traffickers rarely get past this point. Interpol and the other relevant agencies are not well prepared to handle the sort of complex interactions that characterize the drugs-weapons-false documents network that underlies the activities of Tamil and other Asian insurgent groups involved in international narcotics trafficking. Furthermore, nontraditional smuggling groups such as Sri Lankan Tamils fit few of the standard profiles used to recognize and analyze international drug syndicates.

A personal interview with our fictional drug runner, Krishnapillai, would perhaps have revealed a story that parallels that of many other young Sri Lankan Tamils whose lives have been disrupted by the ethnic violence in that country. His education has been interrupted for several years, making it unlikely he will ever finish school or be prepared to compete for university entrance. During that period, he has lived and traveled extensively abroad, taking advantage of the relatively large earnings he has made in the narcotics trade. In the event a durable political solution is hammered out between Tamil militants and Colombo, Krishnapillai and the thousands like him are unlikely to be satisfied returning to their former lives as fishermen living in huts on the shore of Sri Lanka's Northern Province. For such people, the insurgency's greatest effect on their lives has been to project them into the world beyond the narrow confines of the traditional culture they have abandoned.

Several factors suggest that at least a core of ideologically committed Tamil insurgents are using the proceeds of narcotics trafficking to subsidize the separatist violence:

- Increased involvement of other parts of the overseas Tamil community—specifically, overseas shipping interests that have been identified with weapons and drug shipments.
- Reduced remittances from overseas Tamils to the militant groups. Militant leaders have publicly admitted that the drug trade has become an essential part of making up this shortfall.
- Indian Government pressure on the Tamil militant groups based in southern India to moderate their growing criminal activity, particularly drug trafficking.

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**Near East and South Asia Briefs**

**Cuba-Sudan**

**Reported Training for Sudanese Rebels** [redacted]

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A number of Sudanese who recently completed military training in Cuba have returned to Ethiopia to join the Sudanese People's Liberation Army (SPLA)—a rebel group operating in southern Sudan. [redacted] perhaps as many as 60 of these newly commissioned SPLA officers were honored at a ceremony attended by SPLA chief Colonel Garang and Ethiopian Chairman Mengistu. Although some of these trainees undoubtedly will be assigned political rather than military duties, [redacted] that this group apparently is the first contingent of Cuban-trained southern Sudanese returning to join the SPLA. [redacted]

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Most Cuban training for the SPLA probably is still carried out at bases inside Ethiopia, but it appears likely that limited numbers of SPLA personnel are also undergoing military training in Cuba. [redacted]

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**Libya**

**Status of Tajura Nuclear Center** [redacted]

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International Atomic Energy Agency (IAEA) officials who visited Libya last December have found that research at Libya's Tajura Nuclear Center is being cut back significantly, mainly because of a lack of trained scientists. [redacted]

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[redacted] Libyan nuclear activities, with the exception of medical facilities, are confined to the well-equipped Tajura Nuclear Center. The Libyans made no mention of their other nuclear activities, such as laser and centrifuge research, to the IAEA team. The Tajura Center is underutilized, and the reactor operates only for limited periods because of a lack of experienced Libyan operators and a significant reduction in Soviet and other foreign experts. The Organization of Atomic Energy, which oversees all Libyan nuclear activities, has also been downgraded from a secretariat to a commission, and a new chairman has been appointed. [redacted]

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Although Libyan nuclear research has suffered an obvious setback, we believe Qadhafi still views the program as important not only for its prestige value but also for possible weapons development in the future. Libya continues to send scientists abroad for training and is constantly trying to recruit foreign experts. It probably will be years, however, before Libya has the trained personnel to develop an indigenous nuclear power or weapons program. Many countries are reluctant to engage in nuclear cooperation with Libya because of concerns about the long-term stability and radical nature of the Qadhafi regime, as well as pressure from the United States and other major nuclear suppliers who question Libya's commitment to the Nuclear Non-Proliferation Treaty. [redacted]

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**India****New Atomic Energy Commission Chairman** [redacted]

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M. R. Srinivasan will replace Raja Ramanna in March as chairman of India's Atomic Energy Commission and secretary of the Department of Atomic Energy. The US Embassy in New Delhi reported that his appointment, originally intended to take effect on 1 February, was delayed because the other leading candidate, P. K. Iyengar, and some key nuclear scientists threatened to resign if Iyengar was not chosen. Iyengar, who is director of the Bhabha Atomic Research Center, has since announced he will retire. Srinivasan announced his first priority will be increasing nuclear power output. [redacted]

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Although Srinivasan has said he is against developing nuclear weapons and Iyengar favors them, the controversy over Ramanna's replacement probably was due more to disagreements over the future of the nuclear power program. The engineers in India's nuclear establishment favor a technologist, such as Srinivasan, who wants to push power projects, while the scientists want more emphasis on basic research. There is also disagreement over whether to import foreign nuclear technology. India's indigenous nuclear power program has suffered a number of setbacks in the past year, mainly because of design problems, and Srinivasan probably is more willing than Iyengar to consider such imports. He is unlikely to play an extensive role in decisionmaking about nuclear weapons development—an issue reserved for Prime Minister Gandhi and his senior political and military advisers. [redacted]

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**Secret****Kuwait****Labor Movement Experiencing Growing Pains** 

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Kuwait's labor movement is increasingly pursuing political issues—often at odds with government policy—because high wages and good working conditions have all but eliminated traditional union concerns. Since its inception in 1961, Kuwait's labor movement has demonstrated a leftist, antigovernment outlook on domestic matters and a pro-Soviet orientation internationally, according to the US Embassy in Kuwait. Government intervention to quash a protest against the US strike against Libya last April and to remove a key union official in August has added to conflict between progovernment union leaders and the rank and file. Currently, Kuwait's labor movement lacks sufficient organization or freedom of action to pose a significant threat to the regime. Unless the union changes its focus to more traditional economic issues, labor's political ambitions almost certainly will lead to additional restrictions on union activity and increase prospects for strife.

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