



**Director of
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25X1

Page Denied

25X1

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Contents

Situation Reports

Iran 1



Briefs and Comments 25X1

Argentina-Chile: *Agreement on Mediation* . . . 5

Spain: *King's Speech to Military* 6

North Yemen - South Yemen: *Border Incursion* . 7

Peru: *General Strike Threat* 8

Nicaragua: *Anniversary Protests* 9

Egypt: *Economic Dissatisfaction* 9

Nigeria: *Political Trouble in Kano* 10



25X1

Special Analysis

Iran and the World Oil Market 11

Overnight Reports 14

25X1



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25X1



624543 1-79

Top Secret



25X1

SITUATION REPORTS

25X1

IRAN

[redacted] the US Embassy in Tehran reported yesterday that retired General Jam has refused to become Minister of War in Prime Minister Bakhtiar's government and intends to return to London as soon as possible. After a meeting with the Shah, Jam reportedly concluded that the Bakhtiar government is a hopeless proposition. Debate on the new cabinet in the lower house of the legislature has been delayed until Thursday; the Senate will consider it on Friday. Meanwhile, pressure on military and police forces continues to mount as violent demonstrations occurred yesterday in Tehran, Tabriz, and other cities. [redacted]

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Jam's departure will severely weaken and embarrass the Bakhtiar government. Jam was the one prominent figure in a cabinet consisting mostly of political unknowns. We believe Jam's departure will also erode Bakhtiar's ability to deal with hardline military officers who are pressing for a harsh crackdown on the opposition. The chances that these officers will attempt to seize power have probably been increased. [redacted]

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The Shah's apparent unwillingness to give Jam the power to control the military raises the possibility that the Shah does not really want the Bakhtiar government to succeed. The Shah--or at least his hardline advisers like Ambassador Zahedi--may in fact hope that if Bakhtiar fails to restore order the stage will be set for a military crackdown. [redacted]

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Demonstrations continued yesterday in Tehran, Mashhad, Esfahan, Abadan, and other cities. In Tabriz rioters burned eight theaters and up to 100 stores. An estimated crowd of 10,000 listened to speeches in Shiraz by political and religious opposition leaders. [redacted]

Continuing opposition activities are putting considerable strain on military and security forces. [redacted]



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[Redacted] Attacks on individual soldiers by demonstrators and threats against officers and their families have contributed to a siege mentality within the military. 25X1

[Redacted]

Concern by religious and political opposition leaders that further provocations might lead to a backlash by military units has led them to take a more cautious and conciliatory attitude toward the Army and the police. Two leading religious figures--Ayatollah Taleqani in Tehran and Ayatollah Dastgad in Shiraz--yesterday urged demonstrators not to take the law into their own hands. [Redacted]

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BRIEFS AND COMMENTS

ARGENTINA-CHILE: Agreement on Mediation

Argentina and Chile have accepted formal Vatican mediation of the Beagle Channel dispute. Last night in Montevideo the Foreign Ministers of the two countries signed an agreement to this effect under the auspices of papal emissary Antonio Cardinal Samore. Although the controversy could still ultimately lead to the use of force, Samore's recent shuttle diplomacy appears to have made some progress toward a peaceful solution.

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In exchange for the Vatican mediation, the cardinal extracted from the two countries a promise not to resort to force, to return to the military deployment that existed at the beginning of 1977, and to abstain from any provocative actions. Presumably these pledges will extend throughout the mediation effort.

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These agreements appear to represent a significant concession on the part of the Argentines, who have insisted on a division of the disputed islands as a precondition for mediation. The lack of such a precondition is at least a momentary political victory for Argentine President Videla, who has argued vigorously for a diplomatic solution over the strenuous objections of hardline military leaders. These officers will closely follow the mediation to ensure that Argentina's maritime claims in the disputed area are respected. If they are not, Videla will be held strictly accountable.

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On the Chilean side, the mediation may be viewed as merely a further opportunity for foot-dragging. Continued Chilean intransigence would cause the mediation to fail and rekindle demands of Argentine hardliners for a military solution.

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SPAIN: King's Speech to Military

King Juan Carlos, in a speech to the military on Saturday, appealed for discipline and solidarity in the face of terrorism. In unusually explicit language, he denounced the lack of discipline displayed by some officers after the funeral mass late last week for the slain military governor of Madrid. Although the speech has eased tensions within the military, more occasional outbursts are likely, and discipline problems could grow if Basque terrorists kill more high-ranking officers.

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The King also praised Defense Minister General Gutierrez Mellado, who has become highly unpopular among the military for his role in bringing needed reforms to the armed forces.

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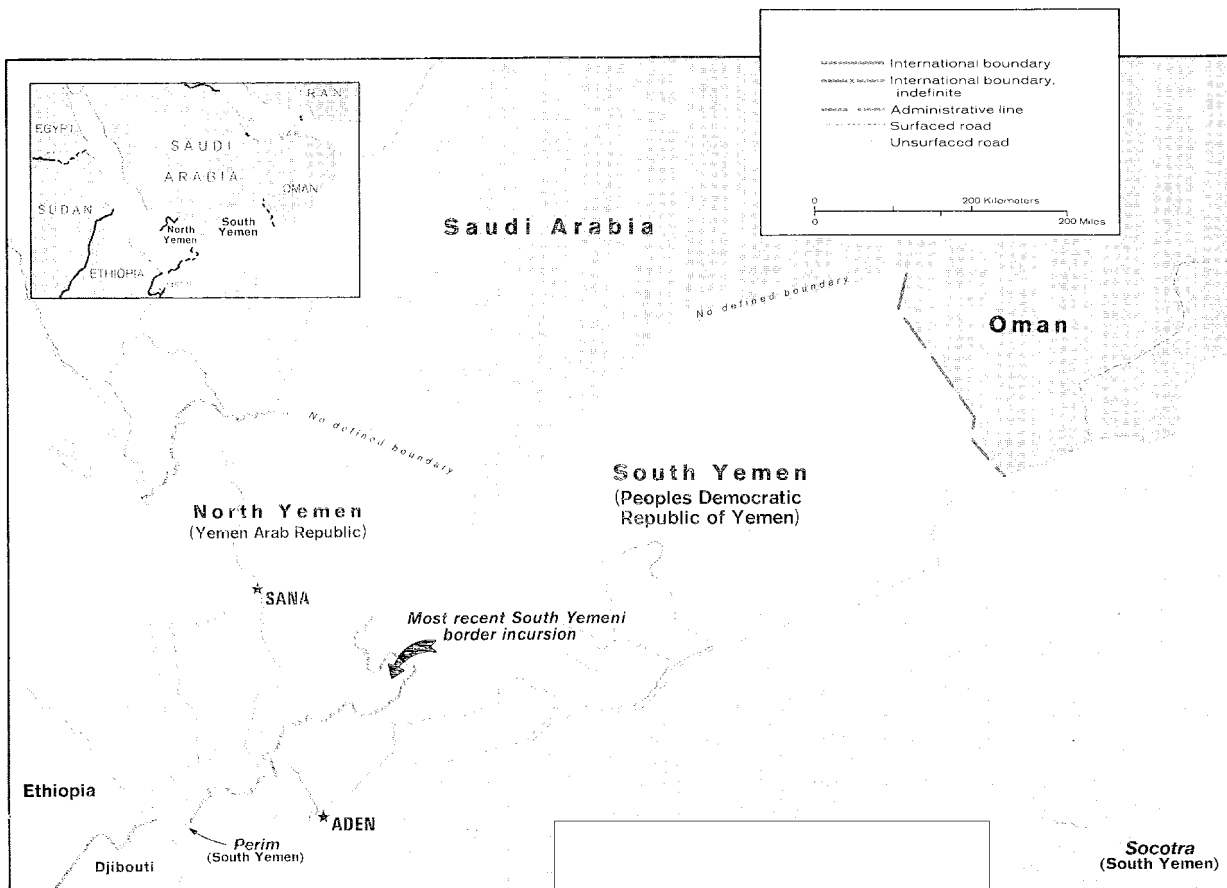
Spanish media have termed the speech necessary and appropriate, and the King's intervention has probably given pause to many in the military who are unhappy with the government. Despite the continuing danger terrorism poses to military discipline, most key command positions are held by moderate officers who remain loyal to the King and are fully aware of the problem.

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NORTH YEMEN - SOUTH YEMEN: Border Incursion

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[redacted] a small military force from South Yemen supported by tanks and artillery pursued a group of dissidents into the southeastern part of North Yemen late last week and occupied three villages. [redacted] the South Yemenis withdrew, apparently yesterday, after mining the area. Border incidents such as this are likely to occur sporadically as long as the two Yemens continue their subversive activities against each other.

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Officials in Sana apparently decided not to contest the incursion into this remote area, probably in part because of the weakness of their armed forces. They have appealed to Jordan's King Hussein in hopes that he can moderate South Yemen's stand through approaches to Syria and Libya, both friends of the Aden regime. Any such effort by Hussein, however, is likely to fail.

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The North Yemenis also asked Hussein to help speed military assistance from Saudi Arabia. Saudi officials are greatly concerned about the border incident and have indicated to the US Ambassador that they think a joint US-Saudi response is needed to deal with the deteriorating situation between the two Yemens.

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South Yemen reportedly still holds North Yemeni territory it seized in November while supporting dissidents against the North Yemeni Government.

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PERU: General Strike Threat

Several leftist labor groups, including the influential General Workers' Confederation, plan to start a three-day general strike today. More moderate unions are not participating, at least for now, which could limit the strike's effectiveness or force it to be postponed. Any widespread work stoppages would pose major economic and political problems for the military government. [REDACTED]

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The left is trying to capitalize on the workers' growing frustration over the worsening effect of inflation. Last week's official price hikes on gasoline, rice, and bus fares seem to have provided the final incentive for calling a strike, which labor leaders have warned could be extended indefinitely unless their demands are met. Previous general strikes have all but closed the city of Lima. [REDACTED]

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The government is taking a tough line to prevent or hamper the strike, but stern measures could affect the military's timing in implementing its promise to return power to civilian hands by 1980, a delicate process that has been under way for some months. Leaders of Peru's major political party, which backs the moderate labor group, see a chance to come to power when the officers return to the barracks. Party leaders may fear loss of popular support, however, if they do not soon stand up to the government on bread-and-butter issues.

[REDACTED]
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Prolonged or widespread work stoppages could worsen the already precarious economic situation by disrupting copper production--a key earner of foreign exchange. The strike could also damage Peru's shaky international financial standing by forcing the government to back away from its agreements with the International Monetary Fund. [REDACTED]

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NICARAGUA: Anniversary Protests

The Somoza government and its opponents are braced for a confrontation during protest activities this week in commemoration of opposition martyr Chamorro, whose murder last January touched off events that led to the civil warfare in September. The most likely flashpoints will be a youth rally this afternoon and a massive march to Chamorro's gravesite tomorrow. The National Guard has warned that the march will not be allowed unless the organizers obtain a permit, which they seem disinclined to do. Other protests probably will include a general strike of one day or more and demonstrations, including a possible march on the US Embassy, by Managua slum organizations. Sandinista guerrillas are planning more hit-and-run attacks this week and may use the demonstrations to try to provoke the Guard.

[Redacted]

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EGYPT: Economic Dissatisfaction

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[Redacted]

price increases had significantly broadened the base of economic dissatisfaction and might diminish Sadat's chances of surviving a serious policy setback--such as a collapse of peace negotiations--or a domestic challenge to his leadership. We believe that the apparently strong public reaction against the price increases--which involved only a few nonessential items--indicates Sadat's continuing vulnerability and underscores his dilemma in trying to improve the economy through basic reforms.

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NIGERIA: Political Trouble in Kano

Nigerian police officials are increasingly concerned over the serious conflict developing in northern Kano State, according to the US Embassy. The trouble has included several clashes between two Muslim-based political parties and has led to a number of arrests. Major political violence is most likely to occur here as electioneering intensifies and the country draws closer to a scheduled changeover to civilian rule next October. Similar situations are likely to crop up elsewhere in Nigeria, testing the government's ability to keep order and its resolve to proceed toward civilian government. [Redacted]

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SPECIAL ANALYSIS

IRAN AND THE WORLD OIL MARKET

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Despite continuing turmoil in Iran, the world oil market picture has changed little since November. Production by other producers is up, and stocks are sufficient to meet world demand through the winter. If Iran does not resume exports by spring, however, the market will tighten, and stockpilers will occupy the key position.

[REDACTED]

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The most important development has been a substantial production increase in other OPEC countries. Most member states would have increased their oil exports in the fourth quarter of 1978 in any case because of high seasonal demand and speculative purchases in anticipation of the oil price hike on 1 January. The reduction in Iranian supplies has further stimulated demand for crude from other OPEC countries.

[REDACTED]

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In the fourth quarter of 1978, Saudi Arabia increased its production by about 1 million barrels per day over planned levels. During November and December, the Saudis produced 10 million barrels per day, near their maximum sustainable capacity. Because December weather was relatively mild, the Saudis were able to maintain high tanker loading rates.

[REDACTED]

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Iraq, Kuwait, Nigeria, and other OPEC members have increased production by another 500,000 barrels per day and are also producing at near capacity levels. Non-OPEC production increased by only about 100,000 to 200,000 barrels per day, slightly less than we had expected.

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Iranian Production

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Iran now is producing less than 300,000 barrels of oil daily, compared with a normal production of 5.5 million to 6 million barrels. It has exported no oil since 27 December. [redacted]

[redacted]

even if workers return to the oil facilities, output probably will not reach 4.5 million barrels per day for at least six weeks. Others believe that 3 million to 4 million barrels per day could be produced within two weeks. This level, together with continued high output by other producers, would meet world demand and maintain stocks at reasonable levels through the winter. [redacted]

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Restoration of oil production to near prestrike sustainable capacity--6 million to 6.5 million barrels per day--could take up to a year and would depend on the return of foreign workers, particularly specialists in drilling and oil well maintenance. The willingness of the non-Iranians to resume work will be conditioned by security at the oilfields. The Iranian leadership, moreover, will have to decide the role of foreign petroleum personnel as well as the level of petroleum output necessary to meet new Iranian political, economic, and social goals. Such goals could well dictate lower output in the future. [redacted]

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If Iranian exports are completely shut down through the winter, the oil market will tighten even with other suppliers producing at capacity. The gap between supply and demand will be about 2 million to 3 million barrels per day. Competition for available supplies will intensify, spot shortages of some oil products will occur, and spot market prices will rise. [redacted]

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Current world inventories--equal to 70 days' consumption--would nevertheless remain adequate to meet overall demand. If production shortfalls continue after

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the winter, oil companies will have a difficult time rebuilding inventories sufficient for next winter. (This discussion assumes that Saudi Arabia will continue producing at its present high level. We believe this to be a reasonable expectation through the winter but increasingly uncertain beyond that time because of Saudi concern over technical problems in the fields.) [redacted]

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A key question is whether holders of stocks would release them to cover production shortfalls. If stockholders hang on to their inventories, as happened after the 1973 embargo, consumption cutbacks will be necessary. Thus far, middlemen and consumers have accepted the curtailment of Iranian exports calmly, but their mood could change quickly if a prolonged supply disruption appeared likely. [redacted]

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Some oil-producing countries might try to push up their prices unilaterally if there is a prolonged Iranian shutdown and subsequent market tightness. Moreover, should spot market prices rise, these countries would be especially sensitive to any indication of profiteering by middlemen. If the OPEC countries became convinced that oil companies and brokers were making excessive profits by reselling oil, even if the volumes were small, the price hawks among them could be counted on to lobby for a further boost in official sales prices beyond those set last month. [redacted]

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OVERNIGHT REPORTS

(The items in the Overnight Reports section have not been coordinated within the intelligence community. They are prepared overnight by the Office of Current Operations with analyst comment where possible from the production offices of NFAC.)

Thailand-Kampuchea

Thai Prime Minister Kriangsak told US Ambassador Abramowitz yesterday that his government will not intervene in Kampuchea or supply arms for guerrilla activity by the ousted Pol Pot regime. Kriangsak, obviously deeply concerned, said he hopes the US will issue a statement of support for Thailand, and he particularly urged accelerated delivery of ammunition, mortars, and F-5E aircraft, as well as an expansion of credits for purchasing weapons from the US. Ambassador Abramowitz believes that the Thai will display their usual caution and that they are thus unlikely to become involved in supporting anti-Vietnamese forces in Kampuchea. [redacted]

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North Yemen - UK

According to the US Embassy in Sana, North Yemeni President Salih called in the UK Charge on Saturday and expressed an urgent need for two squadrons of Rapier or Jaguar aircraft and an unspecified number of tanks. Salih also asked for British military training and training in antisubversion techniques. He acknowledged that North Yemen may have some problems in securing Saudi financing for this assistance. Salih was vague in his references to South Yemen's activity in the border area (see Briefs and Comments section). The US Embassy believes that the increasing pressure by South Yemen is pushing Salih to look in all directions for immediate arms assistance. [redacted]

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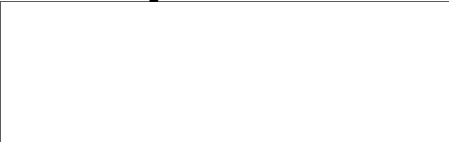
Kampuchea-China-UN

Former Kampuchean leader Prince Sihanouk left Peking today and is expected to arrive late this afternoon in New York, where he will ask that the UN Security Council consider the Vietnamese incursion into Kampuchea. There has been no indication of displeasure from the Chinese or from Kampuchea's ousted leaders over Sihanouk's remarks against the Pol Pot regime during his press conference yesterday. The US Mission at the UN reported last night that the Chinese are having problems in their efforts to lobby for support for their Kampuchean allies; this is their first effort to convene a Security Council meeting. [redacted]

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