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Weekly Review

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8 February 1974

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The WEEKLY REVIEW, issued every Friday morning by the Office of Current Intelligence, reports and analyzes significant developments of the week through noon on Thursday. It frequently includes material coordinated with or prepared by the Office of Economic Research, the Office of Strategic Research, and the Directorate of Science and Technology. Topics requiring more comprehensive treatment and therefore published separately as Special Reports are listed in the contents.

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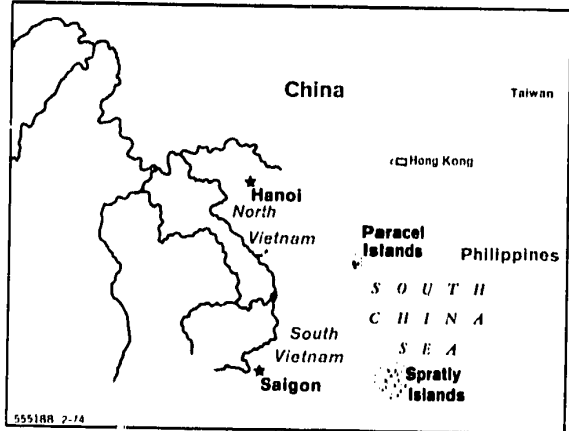
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South Vietnam: Quarreling Over Islands

China and South Vietnam have stepped up their war of words over the Paracel and Spratly Islands, but thus far there are no signs that fighting will resume. This week, Peking reacted to Saigon's dispatch of a small naval task force to the Spratlys with a tough statement charging that the South Vietnamese action is a "new military provocation," and asserting that China will not tolerate such infringement of its territory. Subsequently, Saigon stated that its action in the Spratlys, which lie some 400 nautical miles south of the Paracels in the South China Sea, is a natural defensive measure following Chinese "aggression" in the Paracels.

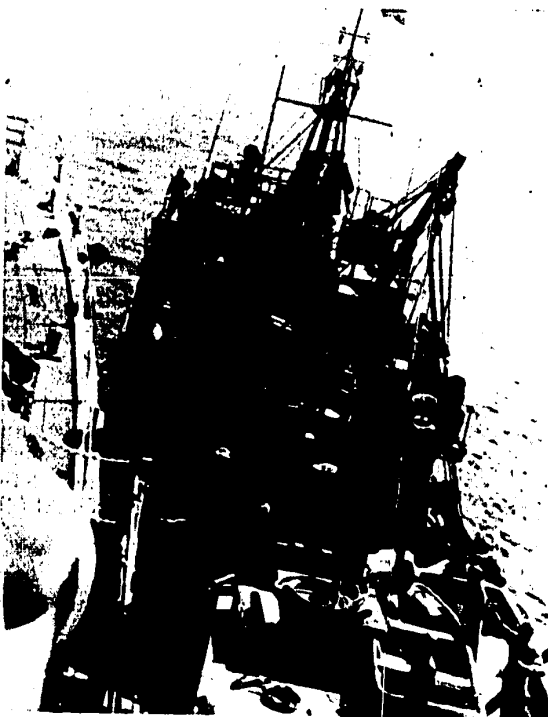
Saigon now has at least 200 troops in the Spratlys, and more troops may be on the way; South Vietnamese military spokesmen have stated that their troops are now on six of the islands. China has no forces in the area and has not patrolled the islands. Taiwan and the Philippines, which also claim the Spratlys, have had troops on several of the islands for some time, and both countries have protested Saigon's action.

South Vietnam's reinforcement of the Spratlys is almost certainly designed to under-



score its claim in the event that oil exploration ever becomes a serious possibility. Saigon seems reasonably confident that under present circumstances its action will not be contested, other than verbally. Military operations such as occurred in the Paracels would be hard for any of the claimants to undertake because the Spratlys lie near or beyond the outer reach of their military range, especially for air cover.

A forceful reaction from mainland China cannot be ruled out, but there are no signs of preparation for such action. In addition to logistic difficulties, a military response would present complicated diplomatic problems for Peking. China wants to avoid a clash with Taiwan, which would risk involving the US and disrupt relations with China's neighbors in Southeast Asia. Trouble with Manila would also upset the countries of Southeast Asia.



Chinese patrol boat

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JORDAN: ARMY MUTINY

King Husayn was forced to cut short a visit to London and hurry back to Amman this week to quell an army mutiny. The insurrection—organized by disgruntled non-commissioned officers—has developed into the most serious internal crisis for Husayn since the showdown with the fedayeen in September 1970.

other civilian officials whom they hold responsible for escalating living costs.

Thus far, the army's loyalty to the King has held firm and there has been no bloodshed. But the rebellious troops have made far-reaching demands that have won widespread sympathy among the lower ranks of the army and air force and apparently among the civilian population as well.

Since his return on February 5, Husayn has been making the rounds of rebellious army units trying to restore discipline and prevent a threatened march on Amman. Husayn has promised an immediate pay increase for the army and for the internal security service, but this step may not be enough to cool the situation. Unless the King dismisses Bin Shakir and Rifai, which he is apparently resisting, the two men will almost certainly continue to be the focus of smoldering resentment, not only among the rank-and-file but among those at higher levels in the army who also resent the chief of staff's and prime minister's aloofness and high style of living.

The trouble started last weekend when enlisted personnel from the elite 40th Armored Brigade, which had just returned from Syria, mutinied and demanded to see the King's brother, Crown Prince Hassan. The mutiny seemed to subside almost as quickly as it began after Hassan listened to the dissidents' grievances and promised to take their case to Husayn. Before the King returned, however, the insurrection picked up momentum again and spread to other units of the 3rd Armored Division, headquartered at Zarqa 15 miles north of Amman, and to armored, artillery, and antiaircraft units stationed in Amman and the port city of Aqaba.

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In addition to a pay raise and a general rollback of consumer prices, the mutinous troops are calling on Husayn to dismiss both the army's unpopular chief of staff, Sharif Zayd bin Shakir, and air force commander Brigadier Abbud Salim. Bin Shakir, who is at odds with many officers and men, is being blamed for all the army's ills, including corruption, an inability to obtain more advanced weapons from the US, and the lack of an adequate pay increase for enlisted personnel.

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The dissidents want Husayn to appoint Sharif Nasir, the King's uncle and an influential figure among Jordan's Bedouin tribesmen, as both commander in chief of the armed forces and prime minister. They are demanding the resignation of Prime Minister Zaid Rifai and several

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THE ENERGY CONFERENCE: PRELUDE

Most of the nations participating in the Washington energy conference next week favor some form of international cooperation on energy matters but are reluctant to undertake any actions that might antagonize the oil-producing nations. Perhaps the subject of strongest common interest to the visiting participants—the EC-nine, Canada, Japan, Norway, and top officials of the EC and OECD—will be the proposals to develop alternative sources of energy. The most contentious issue is likely to be the question of whether the group of industrialized, oil-importing countries should meet periodically to review energy-related problems.

The opening plenary session on February 11, which will be devoted to the present energy situation and its impact on the world economy, promises to be time-consuming but non-controversial. EC officials expect to explain their view of the causes and consequences of the changed relationship between supply and demand as well as the basic causes and significance of price movements. The fact that others, including the US, may wish to cover much the same ground has added to skepticism about whether the two-day conference will be able to explore any new territory. Some may welcome a lack of time for debate; a senior British official, for example, has expressed the hope that ample time would be provided for the ministers to "talk themselves dry."

A subsequent foreign ministers' session—in parallel with separate sessions of finance, energy, and technology officials—will have to deal with the repeatedly expressed anxieties of almost all participants over relations with the oil producers and the lesser developed countries. Paris may seek to crystallize these worries into support for the proposals for a special UN conference on energy. The EC position paper calls for discussions with developing and producing countries to begin by April 1, a decision apparently designed to get talks with producers under way before the next OPEC ministerial meeting later in April.

The widespread desire to broaden the discussions to include producers and developing countries will make it extremely difficult to reach any agreement on further high-level meetings of

the February 11 group. The Nine have left the door open, however, for setting up short-term working groups to examine certain specific topics; the other participants would not balk at this.

US proposals for a session of finance officials have met widely varying reactions. Bonn was particularly favorable, although a senior German official hoped the meeting could discuss a roll-back of oil prices "as a means of reducing the complex and interrelated problems of oil purchase and international finance." Paris has been so negative that, as late as February 1, a concerned French official was unable "to ignite even a flicker of interest" in preparing for French participation.

A proposed session devoted to emergency sharing, which is to be taken up along with conservation, restraints on demand, and alternative sources of conventional fuels, could attract particular interest in view of the fact that the Nine agreed to include this topic in their position paper. Britain, however—along with Canada and Norway—is likely to favor discussion only of those supplies that enter international commerce.

Participants in the proposed session on science and technology are likely to pursue their interest in gaining access to US technology for enriching uranium. A feasibility study is under way for a projected Canadian gaseous diffusion facility. The project has some Japanese and German financial support for its initial study, while the US Atomic Energy Commission is giving technical advice. The backers of the project would be interested in longer term US assistance. The French Atomic Energy Commission has opposed efforts to seek US help for the French-sponsored Eurodif consortium's facility but Italy and Belgium, who are also backers, are interested, as is the principal French utility company. Britain, the Netherlands, and West Germany cooperate in the rival—and more experimental—Urenco project for an enrichment facility using the centrifuge process. US technological help evidently would be particularly helpful to this group.

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USSR

VINTAGE YEAR FOR SOVIET ECONOMY

The Soviet economy recovered sharply in 1973 from its exceptionally poor performance the previous year. An 8 percent surge in gross national product was largely due to the record performance in the agricultural sector. Industry also recovered from its 1972 slowdown, with most of the gain occurring in the machinery sector. Substantial growth is scheduled for 1974, but Moscow's prospects for achieving the original goals of the 1971-1975 plan are extremely bleak.

Exceptionally good weather and increased supplies of fertilizer were mainly responsible for

the surge in farm output. The record grain harvest, together with continuing grain imports, will enable the Soviets to rebuild stocks and to export some grain to non-communist countries. Moreover, the bumper harvests of wheat and corn will help alleviate shortages of feed grains for the expanding livestock herds and promote increased meat production this year.

The output of all industrial materials, except energy products, grew at higher rates than in 1972. Depletion of the more easily exploitable oil and gas reserves accelerated last year, requiring more new capacity to maintain previous levels of

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	Annual Growth Rate (Percent)		
	<u>1971</u>	<u>1972</u>	<u>1973</u>
Major aggregates			
GNP	4.2	1.7	7.9
Industrial production	6.0	5.2	5.9
Agricultural production	0.3	-7.2	15.3
Energy			
Coal	2.7	2.2	2.0
Oil and Gas	6.9	7.3	6.9
Electric power	8.0	7.1	6.7
Per capita consumption:			
Food	3.2	0.1	3.9
Soft goods	3.3	1.3	2.1
Durable goods	4.2	6.0	5.3
Housing	2.3	2.4	2.1
Investment			
New fixed investment	7.2	7.1	4.0
Gross additions to fixed capital	6.3	3.4	7.7
Volume of unfinished construction	10.3	12.6	2.8



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output. The increases in fuels and power, however, were enough to assure continued self-sufficiency in energy.

In the machinery sector, gains in the production of passenger cars, vacuum cleaners, and furniture led the field of consumer durables while generators, instruments, and agricultural machinery posted the greatest gains for producer durables. Consumer nondurables made a substantial recovery, aided primarily by large increases in soft goods.

Soviet consumers benefited from substantial increases in food supplies—especially fruits, vegetables, and dairy products. Meat consumption remained at about the 1972 level, as increases in meat production apparently were deferred in order to expand livestock herds. Consumption of soft goods recovered from near stagnation in 1972, and construction of new housing in 1973 more than offset the deterioration of existing housing and the population growth.

The chronic economic problems of slow assimilation of new technology and delayed completion of new facilities persisted in 1973. Nevertheless, programs to curtail the proliferation of new construction projects and to concentrate investment in projects nearing completion were more successful than usual. Gross additions to new fixed capital stock increased at nearly twice the rate of the previous year, while the increase in unfinished construction dropped from 13 percent to less than 3 percent.

Soviet trade with the developed West increased by about one third in 1973 after a 25-percent increase in 1972. Moscow's trade with the West grew faster than its trade with the communist countries; it exceeded \$9 billion, including large imports of machinery, equipment, and grain. Soviet imports from the West continued to grow much faster than exports; the hard currency deficit in 1973 was a record \$1.7 billion. The USSR financed this deficit by selling gold and by drawing on Western credits.

Moscow's economic goals for 1974 indicate that the economy will continue essentially on its

present tack. The major thrust of the 1974 plan is to ensure an uninterrupted supply of fuel to industry while providing an additional boost to consumer-goods production. Although the scheduled industrial goal (6.8 percent) is within reach, prospects for achieving the planned 7.3 percent gain in agricultural output are dim unless the above-average weather conditions of last year are matched in 1974.

The original goals of the 1971-1975 plan called for continuous upward growth, with particularly high rates scheduled in the final two years. The 1972 slump delivered a severe blow to these plans, and the recovery last year only partially made up the deficit. Thus, despite the continued expressions of optimism in the Soviet press, Moscow cannot realistically expect to achieve many of its original goals.

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WARPLANE DELIVERIES UP

Soviet military aircraft deliveries to Third World countries last year were nearly double those in 1971 and 1972.

A record 550 aircraft, worth more than \$550 million, were delivered in 1973; about 80 percent of these were jet fighters. Deliveries included the first exports of the TU-22 supersonic medium bomber, the KA-25 helicopter, and an improved version of the SU-17 (Fitter B) fighter-bomber.

The Middle East received the bulk of these aircraft; Syria alone received half. Damascus obtained some 150 jet fighter aircraft prior to the October war, and 100 more were delivered as part of the Soviet resupply effort. In addition, Syria received the KA-25 helicopter, which can be used in antisubmarine warfare as well as for reconnaissance and utility missions. This is the first time this helicopter has been exported outside the Warsaw Pact. The Syrians were also sent MI-8 helicopters and improved SU-17 swing-wing fighters.

The only aircraft delivered to Egypt before hostilities broke out were a few MI-8 helicopters and a squadron of the new SU-17s. As part of the resupply operation, Egypt received about 100 jet fighters and six MI-8 helicopters. The decline in the number of jet fighters delivered during the first nine months of last year may have been caused in part by the fact that Egypt was having difficulty absorbing the 145 fighters delivered in 1972. Many of these remained in storage until mid-1973.

Iraq became the first country outside the USSR to receive the TU-22; 14 were delivered in September. The TU-22 is an improvement over the subsonic TU-16 bombers that Moscow previously gave Iraq. Both aircraft have similar ranges and payloads, but the TU-22 has a supersonic-dash capability that improves its chances of penetrating air defenses. In addition, Iraq received the new SU-17 and the 65-passenger MI-6 helicopter. Elsewhere in the Middle East, Yemen (Aden) received four MIG-21s, the first in its inventory, along with some MIG-17s and MI-8 helicopters.

Besides aiding New Delhi's indigenous MIG-21 production program by shipping sub-assemblies and parts, Moscow delivered about 50 MIG-21s. Some of these were replacements for losses suffered in the 1971 Indo-Pakistani War. India also received a few helicopters. The fledgling Bangladesh Air Force received its first Soviet aircraft—a squadron of MIG-21s, three transports, and five MI-8 helicopters.

Guinea received two helicopters and Somalia two military transports from the USSR. After a hiatus of some five years, Moscow resumed aircraft deliveries to Uganda. At least five MIG-17s were delivered to Uganda via Mombasa, Kenya, in November.



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KA-25 helicopter



Indian MIG-21



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EASTERN EUROPE: A PROSPECT OF PROSPERITY

The economies of the six members of the Council for Mutual Economic Cooperation in Eastern Europe grew rapidly last year and ambitious plans have been announced for 1974. Fulfillment depends on avoiding balance-of-payments pressures as a result of higher world prices for raw materials and on achieving the substantial gains slated for agricultural output.

The 1973 targets for national income, industry, and agriculture generally were met or exceeded. Romania, Bulgaria, and Poland achieved the fastest growth rates; Czechoslovakia, East Germany, and Hungary recorded moderate growth. All countries had good harvests—even Bulgaria and Romania, which fell short of production goals.

East European consumers came in for their share of the growth in 1973. Most of the countries have increased domestic supplies of meat and consumer goods, and all of them continued to hold the line on retail prices. Retail trade is increasing faster than national output, however, and imports of consumer goods are on the rise throughout the area. These gains have helped to ease the pain of longer term problems such as the shortage of housing. Waiting time for apartments still approaches eleven years in some major cities and huge investments will be needed to reduce the lag noticeably. The consumer fares worst in Romania, where an increased output of consumer goods has been largely siphoned off into exports.

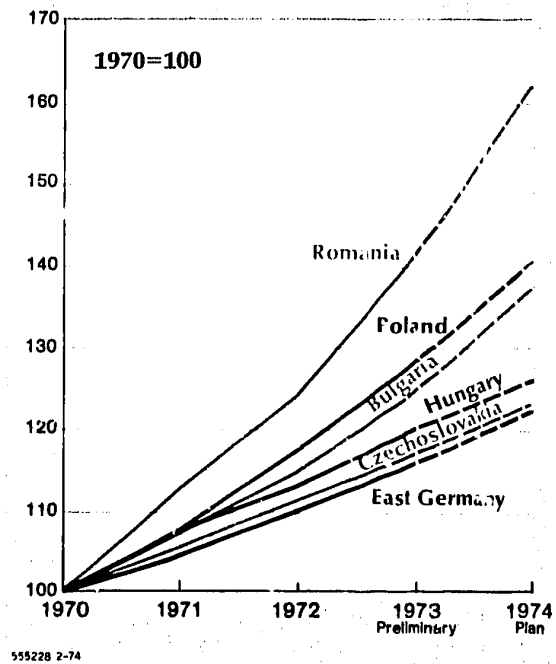
Current plans reflect the successes of last year; even higher growth rates are earmarked for national income and industrial production than were planned for 1973. Meanwhile, as long as the results continue to be favorable, the governments of the East European countries are not likely to rock the boat by instituting economic reforms. The plans for this year should not be seriously affected by energy shortages, since the USSR will continue to supply almost all of Eastern Europe's oil needs under trade agreements due to run through 1975. Some conservation measures have been taken to hold back hard-currency imports of

petroleum and to deal with long-standing inefficiencies in fuel consumption. Romania's rationing program also is designed to generate more hard-currency oil exports.

Import prices of agricultural products and other materials not related to the energy field are probably of more importance to the 1974 plan. Eastern Europe is banking on a good harvest to reduce its agricultural import bill, which almost doubled last year. Czechoslovakia is planning for a 33-percent increase in the price of imported raw materials, while Hungary and Romania expect similar increases. If prices increase faster, or if harvests do not meet planned levels, balance-of-payments strains will occur. Some adjustments—such as cutting imports of machinery and equipment or reducing consumer imports—might be necessary

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Communist Economic Growth



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MBFR: TALKS BOGGED DOWN

No progress has been made in resolving the major substantive differences at the force reduction negotiations that resumed in Vienna on January 17. The NATO and Warsaw Pact participants are each questioning whether the other is hardening its position. The Soviet delegates and Soviet party boss Brezhnev have signaled Moscow's impatience about the lack of progress and about what the Soviets believe is a reluctance on the part of the West Europeans to reduce their forces. The Soviets, however, have done little to speed the pace of the talks. They initially rejected a proposal that the unproductive plenary sessions be curtailed and negotiations be conducted in informal meetings of small groups; the Soviets then reversed themselves and agreed to such a meeting this week.

Nothing the Soviets and their allies have said suggests that they have altered their goals, the principal one being to obtain reductions of West European—and particularly West German—forces. In the plenary sessions, the Pact representatives have made two general points:

- they have examined carefully the Western proposals presented on November 22 and found them wanting;
- the Soviet draft agreement, submitted on November 3, can serve as the basis for a rational reduction scheme that will not endanger the security of any state.

In particular, the Pact spokesmen have emphasized that:

- all parties to an eventual agreement must simultaneously reduce their forces and participate in all phases of reductions;
- the Pact's superiority in ground forces is balanced by NATO's superiority in nuclear and air forces;
- hence, air forces and nuclear weapons must be reduced;
- there should be sub-ceilings on individual European as well as US and Soviet forces;

- with the exception of the US, the Western allies no longer appear interested in reducing their forces.

Brezhnev's unusually negative comments on MBFR in a speech during his visit to Cuba, reflected this reserved attitude toward force reductions and the less enthusiastic Soviet approach to detente in general. In informal bilateral meetings, however, the Soviet delegates in Vienna have continued to suggest that the Pact might accept the NATO proposal that a first phase of reductions involve only US and Soviet forces. The Soviets insist that they must receive iron-clad guarantees that there will be a second phase of reductions, and that the West Europeans—particularly the West Germans—will cut their forces.

The Soviet representatives have also indicated interest in the NATO "common ceiling" approach, while continuing to stress that air force manpower must be included if a common ceiling is to be established. They have also suggested that the common ceiling should be set at 800,000 men rather than 700,000 as NATO has proposed. A Soviet delegate has also admitted that, according to Soviet analysis, the Pact has about 50,000 more men under arms in central Europe than NATO does.

The Western allies, for their part, have used the plenary sessions to present various aspects of their proposal in greater detail, but have presented nothing new. Now that the Soviets have agreed to hold informal meetings, the allies will propose that the negotiators focus their attention on a first-phase agreement that would lead to reductions in US and Soviet ground forces. To win Soviet acceptance, the allies have agreed to inform the Soviets that a first-phase agreement could contain a provision for a second phase of negotiations and that the other direct participants—the West Europeans—would participate in a second phase of reductions leading to a common ceiling.

The Soviets are having problems with some of their allies, particularly the Romanians. The latter have made clear to Western representatives that they are the odd men out on the Pact side,

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and have suggested that they would leave the talks if they were not included in discussions of substantive problems.

On the Western side, the British remain the most skeptical about the negotiations and are reluctant to concede anything to the Soviets. They have advocated submitting detailed information to demonstrate that the Soviets have greatly increased their forces in central Europe since 1968. Such a course of action would probably lead the Soviets to bring up allied force improvements and could lead to arguments about data that would delay the talks.

[Redacted]

and, eventually, total withdrawal of US forces. This stimulated the party's dormant right wing, which backed the signature campaign, to increase support for the base against the wishes of the party majority. Progressive Prime Minister Johansson is now desperately trying to keep the left, center, and right factions of his party together.

Journalists and some politicians have suggested submitting the base issue to a referendum as a way of minimizing fragmentation within the parties, but most leaders are reluctant to face the finality of a referendum. Next to fishing rights, the base is the only foreign policy issue of any consequence in Iceland, and even the parties of the center have been able to use it to advantage in the past.

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BASE ISSUE STIRS ICELAND

The question of whether to close the NATO base at Keflavik or simply reduce the number of US personnel is the consuming foreign policy issue in Iceland today. Unlike the fishing dispute with the UK, which united all Icelanders, the base issue has not only split the coalition but has also fragmented the political parties. The initial success of a pro-base petition campaign is worrying opponents of the base, particularly the Communists, and has increased pressure on other government leaders to resolve intra-party differences and proceed with the base negotiations.

Talks between the US and Iceland began last November in Reykjavik. The Icelandic side was represented by Foreign Minister Agustsson of the Progressive Party—the main partner in the three-party coalition that includes the Communist People's Alliance and the Liberal Left Organization. The talks were adjourned after a few days, however, and Iceland has postponed the second round three times.

The pro-base petition has collected some 30,000 names since it was started in mid-January, leading the Communists to step up the tempo of their own anti-base drive. The signature campaign also prompted Progressive leaders to finally put together a counter-proposal to the US position. It calls for sharp reductions in base personnel now

The current situation seems to favor the supporters of the base. Although Foreign Minister Agustsson recently reiterated his hope that ways could be found to fulfill Iceland's NATO obligation without having foreign troops in the country, a member of his party's right wing stressed the necessity and desirability of having the US forces remain. The leader of the Liberal Left Organization said he believed that Iceland's defense problems could still be handled best by the US and NATO, with perhaps some minor reductions.

The opposition Independence Party—Iceland's largest—favors retention of the base but it has not been in the forefront of the signature campaign in order to avoid "scaring off" moderates from other parties. The other opposition group, the small Social Democratic Party, is believed to have drafted the pro-base petition. While not calling for maintenance of the status quo at the base, the Social Democrats probably seek only minor changes in the agreement with the US.

According to Article VII of the US-Icelandic base agreement, either signatory must give a one-year notice before the forces can be withdrawn. If the current Icelandic Government is to honor its coalition agreement to have the defense force leave during the current tenure, it will have to make a decision about the base before summer because its mandate expires in June 1975.

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ITALY: LABOR DRAWS THE LINE

Primo Minister Rumor's credibility with organized labor is being tested by top union leaders who are demanding faster progress on a broad range of social and economic reforms. Italy's three major unions called a general strike this week in Milan and have threatened a nationwide strike if they are not satisfied with the results of a meeting with Rumor on February 8.

Labor's continued cooperation is essential to Rumor's efforts to solve the country's serious economic problems. Since his center-left coalition of Christian Democrats, Socialists, Social Democrats, and Republicans took office last summer, Rumor has benefited from labor's moderate policy of refraining from major strike activity and excessive wage demands. The main impetus for labor's restraint has come from the powerful Communist Party, which is seeking to demonstrate, through its influence with the unions, that Italy's economic and social problems cannot be solved without Communist participation.

Labor leaders were able to defend this policy to their militant rank-and-file until the energy shortage wiped out some of the government's progress against inflation and began to erode earlier wage gains. As compensation for these setbacks and to keep the militants in check, union chiefs have been calling for the immediate implementation of a series of social and economic reforms that would improve worker benefits and create more jobs.

Action on reforms, however, has been held up by long-standing differences among the coalition parties. They differ over the priority that should be assigned to expensive social programs at a time when the government is trying to stimulate economic recovery. As usual, the main dispute is between the Socialists, who vigorously defend labor's demands, and the Republicans who, as advocates of budgetary austerity, insist that costly reforms be put off until the economic situation improves.



Workers demonstrate

Labor leaders have reportedly lost confidence in Rumor's ability to resolve differences among the coalition parties—a trend illustrated by one top union official's characterization of the Prime Minister as a "cadaver." In their view, Rumor's government is becoming increasingly preoccupied by issues unrelated to labor's problems, such as the impending national referendum on legalized divorce.

The government's failure to deliver on reforms might also force the Communist Party to stiffen its opposition. Much of Communist chief Enrico Berlinguer's prestige is riding on his program of increasing cooperation with the governing parties. Continued refusal by the coalition to implement reforms would make this policy less defensible in the eyes of the party membership. The growing pressure on the Communist leadership from the rank-and-file was reflected in the resolution that emerged from the party's last directorate meeting. Although the resolution stopped short of calling for Rumor's ouster, it was the party's harshest attack so far on the government's shortcomings.

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PEKING, MOSCOW, AND CONFUCIUS

Peking's current propaganda campaign against Moscow is focusing largely on domestic political issues in both the USSR and China. Not only have the Chinese vociferously condemned Moscow's handling of its own internal affairs, but, more significantly, they have injected an anti-Soviet line into the still boiling "anti-Confucius campaign," an on-going political movement within China that is almost certainly connected to differences within the Chinese leadership.

The current round of attacks began with a blast against Moscow occasioned by the publication in the West of Solzhenitsyn's *Gulag Archipelago*. After having avoided comments on dissidents in the USSR for a number of years, Peking accused Moscow's leaders of being "fascists" and of administering a police state. While Solzhenitsyn was not mentioned by name, it is clear that they had him in mind and that they were intent on adding to the problems of the Soviets on this sensitive issue.

This broadside was followed closely by the expulsion of five Soviet diplomats on espionage charges, the first such action since the Cultural Revolution. Peking drew special attention to this incident by publishing a lurid account of the case and followed with a harshly worded official note protesting Moscow's retaliatory action of "expelling" a Chinese diplomat already on his way home. Rubbing salt into the wounds, Ambassador Tolstikov was then involved in an auto accident which he—and many in the diplomatic community in Peking—considered to be a deliberate provocation.

Running through the Chinese polemics on the "spying" incident are charges that Moscow not only is conducting espionage against China, but that it is attempting to fish in troubled Chinese political waters. Just five days after the expulsion of the Soviet diplomats, *People's Daily* republished an article charging that Moscow was "worshipping Confucius" as a means of subverting the Chinese regime, restoring capitalism, and turning China into a Soviet "colony." "Worshipping" Confucius, the article added, was the equivalent

of backing such modern Chinese Confucians as Liu Shao-chi and Lin Piao, both of whom were accused of having "pro-Soviet" views after their disgrace. Significantly, the recent diatribe against Italian film-maker Antonioni's 1972 video documentary on China also charged the Italian film maker with spying and with doing the bidding of the Soviet Union.

These developments strongly suggest that the current, well-orchestrated accusations of Soviet meddling in Chinese domestic affairs may in part be designed to discredit elements within the Chinese political hierarchy. In the past several years, and particularly since the Tenth Party Congress last summer, Chinese officials have expressed considerable concern that Moscow might try to exploit disagreements within Peking for its own ends. Peking may now be preparing to make specific allegations along these lines. This is at least one conclusion that could be drawn from a recent remark by Vice Foreign Minister Chiao Kuan-hua that Peking has "bigger fish to fry" in connection with the spying incident.

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LAOS: NEGOTIATIONS AND DEMONSTRATIONS

The last major sticking point in the protracted negotiations over procedures for neutralizing Vientiane and Luang Prabang has been resolved. Prime Minister Souvanna this week capitulated to Lao Communist demands that the Joint Police Force, called for under the terms of the September 1973 protocol, assume all the functions and responsibilities of the present government's urban police in both capitals. Negotiators on the government side had for weeks argued that the metropolitan police must not be disbanded, and that the Joint Police Force should limit itself primarily to protecting members of the new coalition government.

Assurances from Suth Phetrasy, currently the senior Pathet Lao representative in Vientiane, that resolution of the contentious neutralization issue could lead to the formation of a new coalition as early as February 21—the first anniversary of the Laos peace agreement—apparently persuaded Souvanna that the time was ripe for some significant concessions. For their part, the Lao Communists have agreed to allow the incumbent civil administrators in the two capitals to remain in place after the new government is formed.

The Prime Minister's decision to take a personal hand in moving the negotiations forward may also have been influenced by reports from Soviet Ambassador Vdovin, who recently returned to Vientiane following visits to Sam Neua and Hanoi. Vdovin said that after conferring with top Lao Communist leaders, Prince Souphanouvong and Phoumi Vongvichit, he was encouraged about the prospects for rapid progress toward formation of a new coalition.

Although both sides now appear reasonably confident that a new government can be formed in the near future, implementation of the neutralization agreements may require considerable time. Moreover, the Pathet Lao have yet to return their chief political negotiator, Phoun Siprasouth, to Vientiane with a list of Lao Communist ministers for the new government. There is also the still unresolved question of whether the new government can be invested without constitutional approval by the National Assembly.

Meanwhile, the Prime Minister and other senior political and military officials are apprehensive that student protest demonstrations may spread from the provinces to Vientiane, possibly embarrassing the government in its negotiations with the Pathet Lao. They are also worried that an unruly demonstration requiring the intervention of security forces might lead to a clash between government and Pathet Lao troops in and around the capital.

The normally quiescent Lao student community began peaceful demonstrations against fuel shortages, inflation, and governmental corruption in the southern city of Pakse on January 23-24. The demonstrations have since spread to Savannakhet and Kengkok in central Laos and to Khong Island on the Lao-Cambodian border. Leaders of the Vientiane-based Lao Student Federation, which has organized and supported the provincial protests, have threatened demonstrations in the administrative capital unless Souvanna personally attends to their grievances. The Prime Minister met with federation leaders on February 5, and reportedly won assurances from them that no demonstrations would be staged in Vientiane in the near future.

The recent exploits of students in Thailand have apparently had a profound impact on the federation, and current economic difficulties in Laos have provided convenient grist for their mill. There is no hard evidence that the Lao Communists are actively seeking to exploit the current student unrest, but there are indications that Souvanna's opponents in the National Assembly may be preparing to jump on the protest bandwagon in an effort to embarrass him.

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VIETNAM

ATTACKS EXPECTED IN HIGHLANDS

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Saigon's Joint General Staff believes the Communists are preparing for new military action in the central highlands.

Staff officers expect Communist diversionary attacks in Quang Duc Province, with the main thrust coming farther north in Kontum and Pleiku provinces, where the Communists have been strengthening their forces.



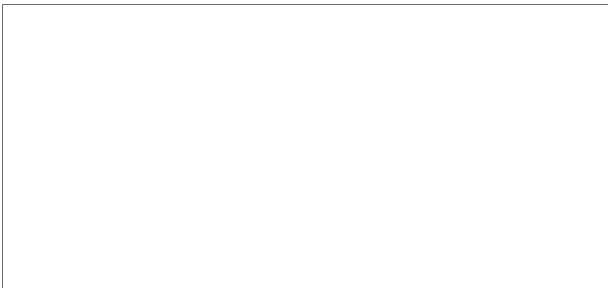
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North Vietnam's stiffer demands regarding recognition of the PRG appear related to decisions made in Hanoi last fall. At that time, the Vietnamese Communists apparently decided to stress political action and diplomacy in pursuing their aims in the South and to forgo heavy military operations for the time being. One facet of this policy is to try to give the Viet Cong a shot in the arm by seeking expanded diplomatic recognition of the PRG. Hanoi has pressed the issue hard in negotiations with the British, the Japanese, and several European countries.

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These moves and plans for the highlands appear aimed at discouraging further government probes into the Communists' western redoubts. It seems unlikely that they will try to take any of the major population centers, such as Kontum and Pleiku cities. Neither side has enough strength to deal a knockout punch in the highlands, but both have sufficient troops and firepower to maintain a fairly intense rate of fighting for several weeks.

Diplomacy and the Viet Cong

Hanoi's hard campaigning to attract broader recognition for the Viet Cong's Provisional Revolutionary Government has met with no visible success, and may even have aggravated North Vietnam's relations with Europe and Japan.

After agreeing in September to exchange ambassadors with the British and later accepting the diplomat designated by the UK, Hanoi suddenly asked London in December to delay the arrival of its envoy, who was already en route. Hanoi claimed that arrangements were not final because London had not yet recognized the PRG. The North Vietnamese objected when the British threatened to downgrade the envoy's title to charge and to publicize the incident. Nevertheless, although the British ambassador entered North Vietnam on January 23, Hanoi has not yet accepted his credentials and apparently plans to delay doing so indefinitely.

CAMBODIA: MORE INCONCLUSIVE COMBAT

Cambodian Army units made moderate gains on Phnom Penh's southern front this week as Khmer Communist ground units showed signs of weakening. The insurgents offered little resistance to a flanking maneuver around the western end of the battle line along the Prek Thnaot River. At mid-week, army units in the center of the defense line had bottled up the few insurgent elements on the river's north bank.

Communist artillery units in the south remained within range of the capital, however, and rained shells on the city's southwestern sector on February 2, causing more civilian casualties. Insurgent mortar and recoilless-rifle crews also carried out daily shellings of Phnom Penh's southern suburb of Takhmau, adding to civilian losses.

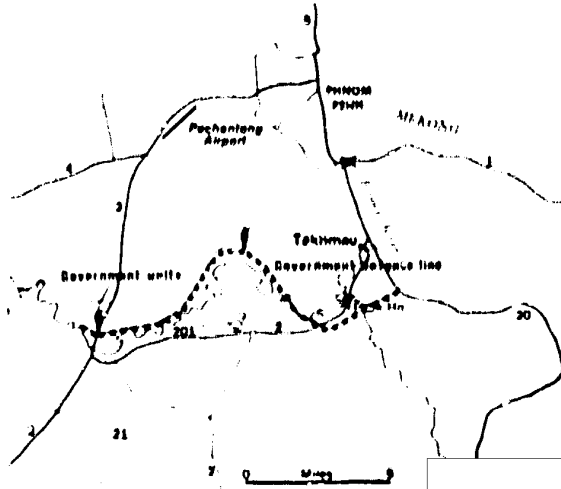


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Khmer Communist prisoners

On the domestic political front, the government's cautious strategy for containing student unrest was put to another test with the disclosure that four students detained by army personnel have been killed by their captors. The four had been arrested on charges that they were inciting

panic in Phnom Penh during intense shellings of the city late last month. The government's public pledge to investigate the incident fully and the arrest of the military men involved has helped to lessen tensions. The recent enactment of tough new decrees further curtailing such constitutional rights as freedom of assembly also helped keep radical students in check.

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SOUTH KOREA: SILENCING CRITICS

In the months since President Pak Chong-hui threatened to imprison critics of his regime, most opposition politicians and dissident intellectuals have sought the safety of the sidelines. Some militant clergy and students, however, chose to test the government's resolve and have suffered the consequences. Two leaders of a reform campaign have been sentenced to 15 years in prison—the maximum allowable punishment under the current emergency decrees—and a number of students involved in a mid-January demonstration have received terms of up to ten years. More arrests and trials are certain.

The government calculates that tough measures like these will intimidate the opposition and prevent a resumption of campus unrest when the universities reopen late this month. Students are now viewed by President Pak as the central element in any effort to challenge his regime. Thus, government security agents are once again focusing on student leaders and professors who sympathize with them. There are also contingency plans

to institute martial law if student disorders become serious.

Pak is increasingly concerned about the activities of ministers involved in Christian social-action work. These clergymen are trying to broaden the protest movement to include the many working-class people in Seoul who have not yet shared in the benefits of the South Korean "economic miracle." Moving to crush this brand of social activism, the government has arrested more than 20 ministers. The government-controlled trade union federation has been assigned the task of dismantling the newly formed Protestant-Catholic Labor Affairs Council, which embraces 19 social-action groups.

In the effort to undercut his opponents, Pak is willing to use more subtle tactics as well. Relying on tested formulas, he has launched an intensive anti-communist campaign using themes calculated to appeal to the religious instincts of Seoul's large Christian community. Anti-communism and the Northern threat are also being used to justify arrests and generally to discredit the opposition. In another political tack, Pak has begun a well-publicized anti-corruption campaign which he intends to press beyond the limited efforts of the past. He can also use the campaign to bring wavering government officials into line.



Pak Chong-hui

Pak's mix of tactics has not impaired the resolve of student and Christian leaders to press for major governmental reform, but they are worried by what they face. Pak clearly has the upper hand at this time, and with the extensive powers at his command, it seems likely that he can contain his critics over the next few months. Nonetheless, in Seoul's highly charged political atmosphere, Pak runs the risk that some heavy-handed government move might bring on the sort of incident—the shooting of a student or the refusal of a military leader to sanction firing on demonstrators—that could swiftly jeopardize his command of the situation.

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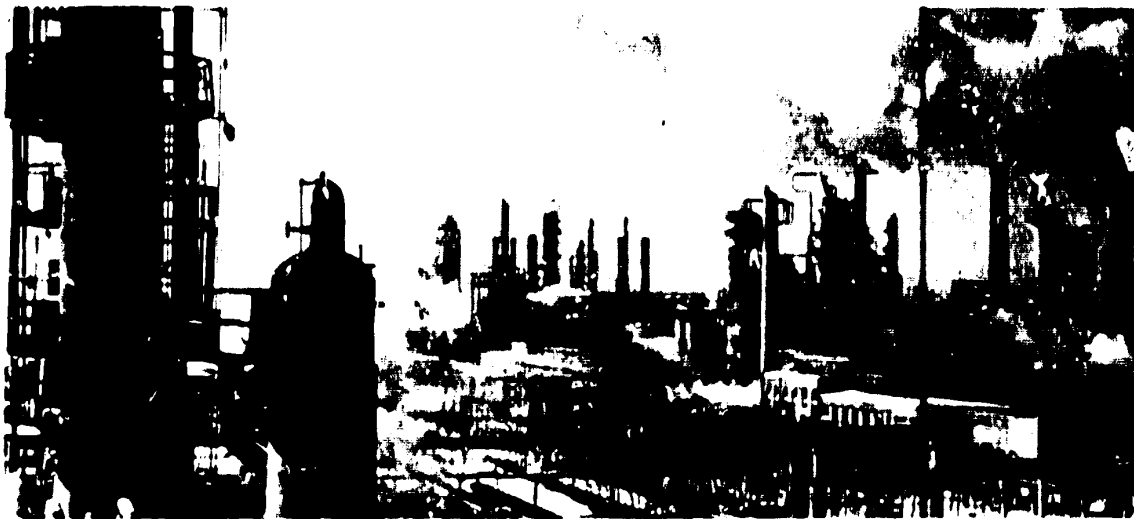
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Chinese oil refinery

CHINA POISED FOR OIL PROFIT

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Production at the rate of 1 million barrels per day gives added credibility to reported Chinese proposals to increase crude oil exports to Japan from the 60,000 barrels per day scheduled for 1974 to 100,000. The most recent proposal to increase exports was put forward by Deputy Premier Teng Hsiao-ping on January 17.

The Chinese have been quick to use their available production to profit from disruptions in the world petroleum market. For example, exports of petroleum products to Hong Kong have been stepped up. Moreover, at the expiration of China's current contract with Japan this March,

Peking reportedly will raise the price of crude oil to Japan from \$3.75 a barrel to \$8.60 a barrel.


In earlier discussions with the Japanese, Peking expressed interest in some form of cooperative development of China's offshore reserves. There have been a number of reports that negotiations are under way, but Peking has probably made no final decision. It is possible that, rather than concluding a bilateral agreement with the Japanese, the Chinese would prefer to deal with a consortium of Japanese, US, and West European firms. Prime Minister Tanaka himself was promoting such an arrangement last fall.

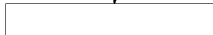
Peking's positive attitude toward cooperative ventures has been influenced by the alacrity with which the large international oil firms have moved into the East and South China seas and by possible future developments in the Law of the Sea that could restrict Chinese access to these oil-rich areas. Peking is apprehensive that, unless it proceeds with the development of these areas, it may

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lose out; recent clashes with the South Vietnamese over control of the Paracel Islands suggest the degree of China's concern. Lacking the technology to develop deep offshore areas independently, the Chinese are being forced to consider cooperative arrangements with foreign firms with the requisite technology. Domestic and international politics complicate China's choices with regard to cooperative ventures, but political problems will have to be weighed against potential economic gains. 

The four include two members of the Popular Front for the Liberation of Palestine and two members of the Japanese Red Army, which has carried out terrorist acts elsewhere in support of the Palestinian cause. A Popular Front statement said the sabotage was a consequence of the alleged anti-Arab stance of both the oil companies and the Singapore Government. 

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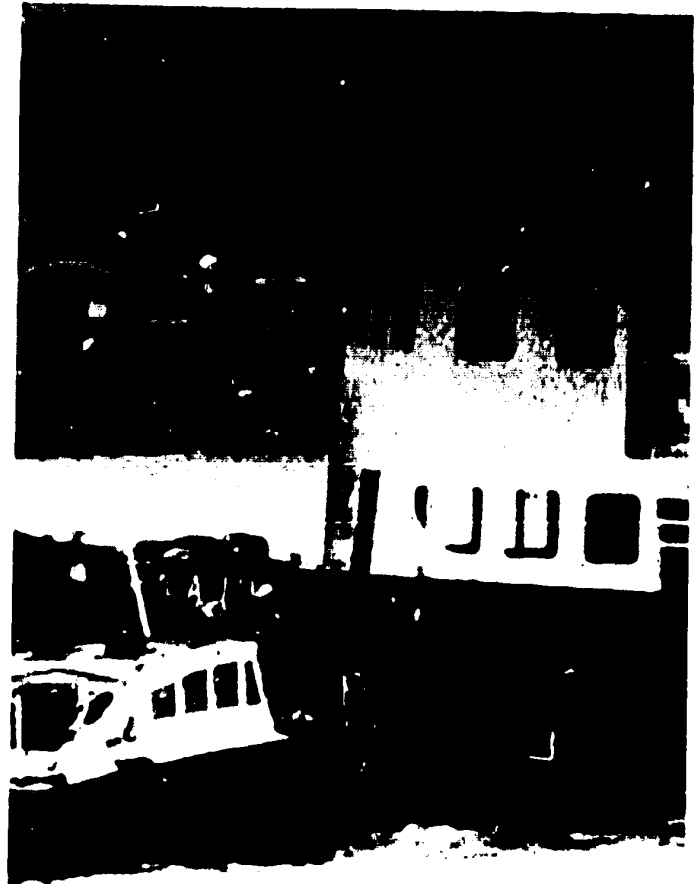
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SINGAPORE: OIL AND ISRAEL

The terrorist attack on an oil facility last week brought home to Singapore the hazards of its relations with Israel. Besides maintaining diplomatic ties with Israel, Singapore has for the past eight years employed Israeli advisers in developing its armed forces. Although it has come to fear that their presence might jeopardize continued deliveries of Arab oil, it decided to keep on the 15 remaining Israelis because the training arrangement is nearing completion and because the Arabs have not made an issue of the Israeli aid.

Singapore is particularly concerned that its Israeli ties could become a liability in the energy crisis. The bulk of the crude oil refined in Singapore comes from the Persian Gulf, and any disruption in these extensive refinery and ship bunkering operations would be a serious economic blow. This dependency has prompted Singapore to try to improve its image in the Arab world. It joined its partners in the Association of Southeast Asian Nations in deploring Israeli occupation of Arab territory, and Foreign Minister Rajaratnam is now on a good will tour of the Middle East.

Singapore's forbearance in the difficult and drawn-out negotiations with the terrorists also reflects a desire to avoid antagonizing the Arabs.



Terrorist in ferry wheelhouse

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EGYPT: ON THE HOME FRONT**Haykal Ousted**

President Sadat moved against one of the most prominent men in the Arab world when he dismissed *Al-Ahram* editor Muhammad Hasanayn Haykal last week. Haykal's contacts with ruling circles have been sporadic since Sadat assumed the presidency three years ago, but he was a power in Egyptian politics during the Nasir era, and he had retained his prominence in Egyptian and Arab press circles.

Although Sadat has appointed Haykal as presidential press adviser, the assignment is only a polite cover for an effort to silence the increasingly outspoken journalist. The proximate cause of his dismissal from *Al-Ahram* was probably a column he wrote on February 1 attacking the US, but Haykal has been giving Sadat cause for discomfort for some time. Since the cease-fire last October, Haykal has consistently been pessimistic about prospects for a peace settlement and skeptical about US intentions—opinions that run counter to Sadat's views and actions.

Haykal may not be so easily quieted, and might well refuse the advice post Sadat is offering. His ability to cause serious trouble for Sadat is limited, however, now that he has been deprived of his public voice by his dismissal from the newspaper.

Any potential discontent in press circles should be eased by the appointment of Ali Amin to succeed Haykal as managing editor of *Al-Ahram*. Amin is a respected journalist whose return two weeks ago from nine years of self-imposed exile evoked widespread acclaim in the Cairo press. His appointment may also mollify those among *Al-Ahram's* intellectual establishment who will be opposed to the paper's new board chairman, a position Haykal also had held. Deputy Prime Minister Hatim, an unpopular figure because of his involvement in a press purge a year ago, now has the post.

Cabinet Reorganization Possibly Postponed

President Sadat may have decided to postpone his planned cabinet reorganization. Prominent Cairo commentator Ihsan Abd al-Quddus noted in his weekly column on February 2 that extensive publicity on the cabinet consultation last month had given the mistaken impression that Egypt was in a "state of relaxation" that would permit full concentration on reconstruction to the detriment of continued efforts to regain Arab territory.

The cabinet shuffle was expected to bring Economy Minister Hijazi to the prime ministership, which Sadat himself has held for the last year. Hijazi has been heavily involved in a revived program of economic liberalization that Sadat has been attempting to implement for some months, and Sadat's projected cabinet had been widely billed as a government of reconstruction.

Quddus emphasized that his predictions of a postponement were his own opinion and, despite the fact that he often reflects Sadat's thinking, he does not always have the inside track with the President. He is correct in his assessment, however, that Sadat does not want to give the impression that Egypt regards the struggle with Israel as over and is ready to let down its military guard and concentrate solely on domestic moves.

This is particularly important to Sadat at this time when he is suspected by many Arab states of having abandoned the Arab cause in order to seek a unilateral settlement with Israel. His attempts to convince the Arabs, particularly Syria, that this is not the case would lose some of their force if he proceeded with the establishment of a new cabinet that appeared to be geared only to Egypt's "postwar reconstruction."

Sadat may thus feel it advisable to suspend the cabinet shuffle until after a Syrian-Israeli disengagement agreement has been reached. In the meantime, with or without a formal reorganization, he will probably continue, perhaps less ostentatiously, with his plans for reconstruction and economic liberalization.

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USSR-CUBA: BREZHNEV GOES HOME

Brezhnev was less than enthusiastic about his trip to Cuba to begin with, but after a week of back-slapping and speech-making an obviously fatigued General Secretary could take solace that at least he made some headway with Castro. There were no dramatic breakthroughs, no major new agreements, and no evidence that Cuba would be any less of a drain on the Kremlin's treasury. Still, the visit did serve to tie Cuba more firmly to the Soviet orbit, and Brezhnev probably is now more confident than before that Castro can be brought to accept, however grudgingly, the Soviet view of the benefits of detente.

Brezhnev's round of activity on the island resembled his triumphal tours of loyal East European countries. That tone was evident in the final declaration, in which the two leaders expressed "complete identity of views with regard to the present world situation." The Soviet leader laid a wreath at the tomb of a revolutionary patriot, spoke at a mass rally, got an award and opened a vocational school in Havana.

The declaration contained copious references to increasing the effectiveness of bilateral cooperation, wider contacts between Soviet and Cuban personnel, and the integration of the Cuban economy into CEMA. The Soviets clearly intend to keep close supervision over the Cuban economy. There was no mention of future military assistance, but Brezhnev probably agreed to consider Cuban requests for more modern weapons. Cuban Armed Forces Minister Raul Castro flew to Moscow the day after Brezhnev arrived home.

There had been rumors that the Soviets would press Castro to improve relations with the US, and a Soviet news item released after Brezhnev's departure hinted at this. Although Castro praised detente and Brezhnev's personal efforts toward this goal, neither leader publicly referred to US-Cuban relations. Castro seems to have been satisfied that Cuba's interests will not be compromised in Moscow's bilateral dealings with the US. This is evident in the declaration's support



Airport farewell: Brezhnev and Castro

for ending both the "blockade" of Cuba and the US presence at the Guantanamo naval base.

Neither side criticized China by name, but Castro's implicit criticism of Peking and his endorsement of Moscow's Asian collective security proposal brought his regime closer to the Soviet viewpoint than ever before. While the declaration endorsed international communist unity, there was no mention of a world communist conference and no confirmation that a rumored meeting of Latin American communist leaders took place in Cuba during the visit.

Moscow's restraining influence on Havana is most clearly reflected in the declaration's rejection of the use of force in international relations and in its call for respect for sovereignty and territorial integrity in the Western Hemisphere. At the same time, this language falls short of the explicit rejection of communist export of revolution, which Brezhnev included in his Havana speech. The declaration also includes a condemnation of "imperialist" efforts to interfere in Latin American internal affairs, a statement to which both sides could warmly subscribe.

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COSTA RICA'S NEW BROOM

Daniel Oduber of the governing National Liberation Party emerged victorious in the election on February 3 and will be inaugurated on May 8 as Costa Rica's president for the next four years. His program is not expected to differ significantly from that of the incumbent, Jose Figueres. Oduber will, however, be concerned with streamlining the bureaucracy to make it a more efficient instrument in promoting his party's social and economic programs.

A possible hindrance to his objectives will be the lack of a majority in the legislature. Although the congressional votes will not be tallied for perhaps another week, most estimates give his party only 25 to 27 of the 57 seats—the first time in over two decades that it will not have controlled the legislature, even when it has lost the presidency. Oduber will, therefore, have to solicit

support from other parties to get his program through congress.

In developing his campaign platform, Oduber relied heavily on teams of specialists, and he will very likely staff his administration with many of these technocrats. Furthermore, his first vice president, Carlos Castillo, is a respected economist and is expected to act as Oduber's executive officer.

The years of 1 to 2 percent inflation are gone, but one objective of the new government will be to keep inflation well below the 15 to 20 percent experienced in 1973. Oduber's monetary and fiscal policies will therefore be more conservative than those of Figueres, and he is expected to support new tax measures. In dealing with rural poverty, he plans to continue many of the present administration's programs, especially the agricultural extension service. He will also concentrate on extension of credit, formation of cooperatives, and the creation of programs to deal with unemployment and under-employment.

The task of making an efficient team out of Figueres' sprawling bureaucracy is one particularly suited to Oduber's talents. He is a good administrator and firm disciplinarian. As foreign minister from 1962 to 1964, he managed to professionalize Costa Rica's foreign service and tailor it to the needs of the nation. He has been described by US officials as a man of action and intellect. In addition to his personal qualifications, he has a well-organized party—in which he swings considerable weight—firmly behind him.

Costa Rica has been edging toward a foreign policy more independent of the US, and Oduber will probably not try to reverse this trend. Nevertheless, he is friendly toward Washington, and the outlook for continued good relations is favorable. Because of the extensive influence exercised by some large US investors in the past, however, his government will very likely set some new ground rules for future foreign investment.



Oduber

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CHILE: THE ARMY WAY

The junta is firming up its grasp on the levers of power. Civilian influence on the military government, which has been limited, may be further restricted as a result. A major restructuring of the government bureaucracy is under way. Although lines of authority are not yet clearly defined, the "Advisory Committee" run by army colonel Julio Canessa is emerging as a key organization. The committee ostensibly functions as a governmental general staff for all the junta members, but Canessa appears to be personally close to junta President Pinochet.

The committee has been at odds with the junta's cadre of civilian economic advisers over the effects of the economic recovery program, certain aspects of which it suspects are geared to benefit the civilians' personal interests. There are also indications that the committee is already crossing the line between neutral staff functions and the policy-makers' realm. It is recommending that the government ease the wage price squeeze on lower income groups and pay more than lip service to its goal of winning over urban workers and rural campesinos.

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[redacted] Pinochet may be disenchanted with the recovery program and with the ivory tower thinking of the young technocrats who designed it. The military's inclination to seek counsel within its own ranks may eventually give Canessa's group the upper hand. The junta's determination to reconstruct Chile the military's way seems stronger than ever. Firm belief that the cause is "just" has begotten a military self-righteousness that leaves no room for political dissent and only a limited opening for civilian advice.

Pinochet and the army apparently intend to retain their positions of dominance in the government. Prospects for a rotating junta presidency consequently have diminished. The navy, air force, and national police are unlikely to challenge the army's claim to "first among equals" status.

An intention to rotate the junta presidency was implicit in statements made by the junta members just after the coup. A one-year incum-



Pinochet

bency reportedly had been agreed upon. Late last year, however, Pinochet apparently had to fend off a bid by Admiral Merino, the navy commander and a member of the junta, to advance the first rotation date to January 1. There are now indications that Pinochet meant a statement on the non-rotation of the presidency to be taken literally, and it is doubtful that he will step down on the first anniversary of the coup on September 11.

The army considers itself the armed forces' premier service and reportedly considers permanent army control of the junta presidency to be both natural and proper. The other services may seek to increase their influence in the government, but they are unlikely to force a showdown over the junta presidency. Pinochet's tenure may thus be indefinite, at least as long as he continues to enjoy the army's confidence and avoids a serious falling-out among the services. [redacted]

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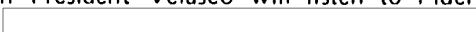


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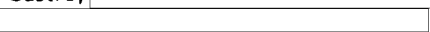

PERU-CHILE: ANXIETIES CONTINUE

Lima's efforts to acquire new arms, including Soviet surface-to-air missiles, are causing increasing concern among Chile's military leaders. Santiago's anxieties most probably are compounded by what it sees as Cuban warnings to Peru to prepare for an attack by Chile.

While Peru currently is looking at arms from a variety of countries, no firm commitments on deliveries appear to have been made since the arrival of Soviet tanks last November and of other undetermined military equipment in January. Peruvian generals remain wary of an influx of Soviet technicians, and this reportedly was the reason Lima recently rejected Moscow's offer of Osa patrol boats and Styx missiles. A number of Soviet military experts apparently are now in Lima, however, and the US defense attache in Santiago reports that Chilean officers are concerned that the group may include missile as well as tank experts.

In addition, Chile probably is worried that Peruvian President Velasco will listen to Fidel Castro, 


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 A Peruvian military delegation that visited Cuba early in January was shown a wide variety of Soviet weapons. Castro is interested in having the Peruvian 

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regime accept military advisers from Cuba and in maintaining access to that country's radical military leaders.

Chile reacted cynically to Velasco's informal proposal last month that neighboring countries join Peru in an arms moratorium. Chilean military leaders reportedly are formulating contingency plans based on an assumption that Peru may attempt to regain territory lost to Chile in the War of the Pacific (1879-83). Chile fears that Peru might move against it as early as this year, while it still enjoys superiority in terms of equipment, but there is no evidence that Peru has committed itself to such a step.

Chilean leaders also are considering non-military plans to meet the possibility of an attack by Peru. One scheme envisages creating a free port or "international" area in northern Chile that would incorporate large-scale foreign investment, presumably to deter Peru from initiating action that might involve it in a conflict with other Latin American countries. The realization of such plans, however, is far down the road at best, and short-run prospects are for continued efforts by both countries to modernize and expand their arsenals. 

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INTERNATIONAL MONEY

Controls on capital movements have been relaxed in a number of European countries since mid-January in an effort to bring in more capital and help offset the higher cost of oil imports.

- Bonn lowered the cost of foreign borrowing while doubling the amount that may be borrowed;
- Brussels suspended its prohibition against interest payments on bank accounts held by non-residents;
- Bern lifted its ban on foreign purchases of domestic securities;

- Paris relaxed restrictions on foreign borrowing and lowered the cost to French banks of accepting deposits from non-residents.

These moves reverse the trend toward greater regulation of capital flows that was evident during the financial crises last year.

The relaxation of controls on capital inflows—coupled with the removal of US restrictions on dollar outflows—was reflected in a weakening of the dollar on major exchange markets last week. The French franc has now returned to near its level prior to January 19 when Paris let the franc float, while other major European



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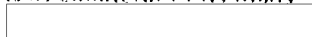
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currencies except the Italian lira have regained the levels they held before the announcement of oil price hikes by the OPEC producers.

manner as well as by government borrowing in the Eurodollar market.

Over the longer term, the relaxation of controls will increase capital mobility between domestic and the Eurocurrency markets. This should facilitate a flow from the Arab oil-producing countries, which have been accumulating reserves since the oil price hikes, to oil-consuming countries that experience deficits. The bulk of the payments deficits resulting from higher oil prices will probably be financed in this

In a related development, the International Monetary Fund has moved to facilitate short-term financing of oil-related balance-of-payments deficits. In late January, the fund approved the Bank for International Settlements in Basel, Switzerland, as a holder of special drawing rights. The Swiss bank, often described as the central bank for other central banks, will now be able to accept special drawing rights as collateral in its loans to members of the fund.



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