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European Review



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The 17th Socialist International Congress in Lima last month—its first in Latin America—was only a partial success, and its deliberations were overshadowed by terrorist violence and the suppression of prison riots in Peru. The congress focused on Third World economic problems, disarmament, protection of the environment, and regional conflicts. Several leaders departed early, and the congress ended in confusion without formally approving the "Lima Manifesto."		25X1
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Much of Greece's modest but steady program of military improvements over the last 15 years has been directed toward strengthening its capabilities against Turkey. Although these improvements also have increased Greece's capabilities to meet the Warsaw Pact threat, its forces will fall short of NATO standards and would need substantial Allied assistance to perform wartime NATO missions.		25X1

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[Redacted]

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France: Modernizing the Financial Markets [Redacted] 13

[Redacted]

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The French Government over the past two years has engineered a near revolution of French financial markets. These reforms should also better equip France to compete in the face of worldwide capital market integration and bring the French financial system more closely in tune with that of the United States. [Redacted]

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Poland: The 10th Party Congress [Redacted] 17

[Redacted]

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The recent Communist Party Congress strongly endorsed party leader Jaruzelski's contention that Poland is fast returning to normal despite continuing economic problems, an active underground opposition, and a hostile but resigned populace. Despite the superficial calm at the congress, Jaruzelski still has a long way to go in implementing policies that will make his regime a political and economic success. [Redacted]

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[Redacted]

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Some articles 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 views of a single analyst; these items will be designated as uncoordinated views. Comments may be directed to the authors. [Redacted]

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European Review 

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Briefs

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United Kingdom

Maintaining the 50-Ship Commitment to NATO 

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Defense Secretary George Younger has announced that the Royal Navy will receive three new Duke-class, Type-23 antisubmarine frigates to help maintain its 50-warship commitment to NATO, according to the US Embassy. The ships will be fitted with the new Type-2048 towed array sonar, which will improve the Navy's passive-detection operations against Soviet nuclear submarines. The frigates will also carry a medium ASW helicopter, replacing the light helicopter on earlier ships, the new one having a greater combat radius and an independent search and attack capability. Although Younger has stated that the government

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intends to maintain a fleet of about 50 warships, the number of frigates to be ordered in any one year will continue to depend on the Defense Ministry's financial resources. As Britain's defense budget continues to decline, the Royal Navy will probably be forced to rely even more heavily on programs to extend the service of its aging fleet to carry out its NATO commitments. [redacted]

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Younger was under considerable pressure from Cabinet colleagues to order three ships to help ease the severe unemployment problem plaguing Britain's shipbuilding industry. Two ships will be built at the Yarrow shipyard on the Clyde River and a third at the recently "privatized" Swan Hunter Yard on Tyneside. This is the first new order for British warships in nearly 18 months. Each frigate will cost about \$175 million, and the total order will provide about 10,000 jobs for the depressed shipbuilding industry. While the contracts will not materially arrest the industry's declining fortunes, it may temporarily counter the opposition Labor Party's criticism that the Thatcher government is insensitive to the unemployment problem. [redacted]

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Austria

Green Party Formed [redacted]

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Austria appears likely to see a united environmentalist ticket in the federal election next April. Three of the country's fledgling ecological groups—the Alternative List, the Green Alternative Assembly, and the Citizens' Parliamentary Initiative—have agreed to terms for a joint party, which they will ratify formally at a convention in October in Hainburg. Although nearly 300 environmentalists and alternatives already sit on municipal councils, and one even has entered Voralberg's provincial parliament, the ecological movement has had little impact at the national level, largely because of its inability to form a united front. [redacted]

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Past efforts at cooperation have foundered over profound personal animosities among factional leaders, as well as the ideological differences between the more conservative Greens, who wish to concentrate on environmental issues, and the more radical Alternatives, who want to represent all sorts of fringe and minority groups. The presidential candidacy of Freda Meissner-Blau demonstrated that a substantial protest vote is available to an ecological ticket when she polled 5.5 percent of the vote in the first ballot in May. [redacted]

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If the Green ticket holds together, it could play the spoiler in next April's federal election. Some Green votes almost certainly would come from the left wing of the ruling Socialist Party, which is already suffering from voter alienation after 16 years in office. Others would probably come from the junior coalition partner, the Freedom Party (FPO). The FPO, which traditionally has benefited from protest votes directed against the two larger parties, is already losing popular support through discontent with the leadership, internal division, and dissatisfaction with the party's current role in the government. Further defections could drop the Freedom Party below the minimum required for entry into the *Nationalrat*, spelling the end of the current coalition government. [redacted]

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San Marino**New Governing Coalition**

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Agreement to form a governing alliance between the Christian Democratic and Communist Parties in the tiny, ancient, landlocked Republic of San Marino (one-third the size of the District of Columbia) is sending political tremors into the surrounding Italian polity. The outgoing leftist governing coalition formed by the Communist Party, the Socialist Party, and the Unitary Socialist Party fell on 11 June when the Communists withdrew over the involvement of some members of both socialist parties in kickback scandals and evasion of Italy's currency export controls and value-added tax provisions.

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The US Consulate in Florence reports that the San Marino Christian Democrats (who hold 26 of 60 seats) have been out of power since 1978 and appear determined to forge the unprecedented governing alliance with the Communists (who hold 15 seats) to the point of giving the Communists five of 10 cabinet posts. No party is prepared for immediate elections, and rancor between the Christian Democrats and the two socialist parties precludes a coalition among them. The Consulate also reports that the San Marino Christian Democrats have received the blessing of the Italian Christian Democratic Party to pursue the alliance. This alarms some Italian political observers who worry that events in San Marino may augur increased willingness on the part of Christian Democrats to consider governing arrangements with the Communists in Italy.

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Turkey-Bulgaria**Minority Dispute Persists**

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Prime Minister Ozal's public complaints in mid-July about Bulgarian treatment of its ethnic Turkish minority—and Bulgarian retaliations—have heightened the visibility of Turkish-Bulgarian differences but probably do not reflect a major increase in tensions. Other developments also have highlighted the dispute. These include emotional statements by Turks of Bulgarian origin before a Council of Europe meeting in Istanbul in early July and Bulgarian Embassy harassment of Bulgarian Turkish demonstrators in Ankara. As a result, Turkish officials and politicians, as well as several Western ambassadors, boycotted farewell ceremonies for the outgoing Bulgarian Ambassador to Ankara.

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Ozal's recent outspokenness partly arises from posturing in preparation for 11 parliamentary byelections this fall. It also reflects public outrage at Bulgaria's actions and Sofia's continued refusal to allow outside observers any access to the ethnic Turkish areas. Relying on active US support, Turkey will continue to raise the issue in appropriate international forums as opportunities arise. Ankara, however, has not yet devised any comprehensive plan for resolving the issue in the face of Bulgarian denials that any minority problem exists.

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East Germany

Strengthening Nuclear Safety [redacted]

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East Germany appears increasingly committed to improving nuclear power plant safety since the Chernobyl accident. East Berlin agreed in May to cooperate with West Germany on safety and accident-reporting procedures [redacted]

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[redacted] Nuclear power provided 11 percent of the country's electricity in 1984. [redacted]

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East Berlin's concerns go beyond offsetting the domestic reaction to its clumsy handling of the Soviet accident. Its four main operating reactors are of an early Soviet design different from those at the Chernobyl plant, but they are not designed to contain a radioactive release. A Finnish firm—I.V.O.—that operates and markets Soviet reactors modified with Western safety technology will offer the best solution to improving the safety at existing plants. East Germany remains committed to reducing its dependence on increasingly expensive and highly polluting lignite and has six advanced reactors under construction. [redacted]

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Romania

Further Reshuffling in the Foreign Ministry [redacted]

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A major shakeup in the Foreign Ministry begun several years ago reportedly is continuing with the replacement of experienced diplomats with party apparatchiks and security officials less friendly toward the West. [redacted] the changes—symbolized by the replacement of longtime Foreign Minister Andrei by the relatively inexperienced Vaduva last year—are accelerating. They suggest that President Ceausescu's wife, who appears to be assuming increasing authority over both policy and personnel matters, is behind the shifts. [redacted]

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The changes in the Foreign Minister mirror Ceausescu's tendency in recent years to replace experienced administrators with party hacks loyal to the President and his family. He has become less tolerant of officials willing to bring him bad news or to recommend policies at odds with his own preferences. Mrs. Ceausescu probably is exploiting her husband's increased suspiciousness and xenophobia by recommending officials whose careers were shaped by the party apparatus she controls. This has abetted erratic domestic policies and now probably will lead to less adroit foreign policies as well. [redacted]

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The new officials appear committed to maintaining Bucharest's nonconformist stance in foreign policy, but they deeply resent Western criticism of Romania's human rights record and may be more sympathetic to Soviet perspectives on world affairs. They probably will be less capable of explaining Western concerns to President Ceausescu and are likely to recommend less responsive policies. The USSR almost certainly will try to take advantage of any cooling in Romania's relations with the West to nudge Bucharest back into greater conformity with the Warsaw Pact. [redacted]

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Yugoslavia

Considering the MIG-29 [redacted]

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The Yugoslavs are moving toward a decision on what could be their first major weapons purchase in several years as they eye some 20 to 40 Soviet MIG-29 fighters. Belgrade is weighing the MIG-29 as a stopgap until it begins serial production of its own advanced fighter in the mid-1990s. While the Yugoslavs need a fighter like the MIG-29 to replace some of their aging MIG-21s, they are almost certainly bargaining hard to minimize Soviet influence and extract the best financial terms possible. The negotiations coincide with talks with the West over joint production of an advanced fighter and reflect Belgrade's interest in balancing relations between East and West. [redacted]

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The Yugoslavs are looking to the West for their longer term needs. Belgrade hopes to incorporate sophisticated Western technology in the production of their own planned fighter—designated the Novi Avion—and have been negotiating for a year exclusively with Western firms and governments over the terms of a coproduction agreement. [redacted] the Yugoslavs are hoping that a British firm will design the airframe and a US company will supply the engine. Negotiations have bogged down recently over restrictions on technology transfer and control over exports, and an agreement seems unlikely any time soon. [redacted]

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Articles

Socialist International: The Lima Congress

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The 17th Socialist International (SI) Congress in Lima in June—its first in Latin America—was only a partial success, and its deliberations were overshadowed by terrorist violence and the suppression of prison riots in Peru. The congress focused on Third World economic problems, disarmament, protection of the environment, and regional conflicts. Willy Brandt of West Germany and Pentti Vaananen of Finland were reelected President and General Secretary, respectively. A number of prominent SI leaders such as Felipe Gonzalez of Spain did not attend, and security concerns led the prime ministers of Israel, Sweden, Norway, and Italy to cancel planned appearances. Other leaders departed early, and the congress ended in confusion without formally approving the “Lima Manifesto.”

Foreign Debt

Peru's President Garcia made the debt problem the central focus of his welcoming speech, and this issue dominated much of the congress. About a third of the concluding manifesto is devoted to a lengthy analysis of the debt crisis since the 1973 oil-price increases and warns that “the debts of the poor nations are a threat to the wealth of the rich nations.” Particular blame for the Third World debt crunch is placed on private bank financing exacerbated by the “monetarist assault on inflation in the United States.” It claims that nothing has been done to deal with underlying causes of the crisis. Proposals recommended by the working group on debt, however, such as the creation of a new international debt organization to resolve debt servicing problems and limiting debt payments to a percentage of export earnings did not appear in the final document. SI President Brandt has said the debt issue will remain the central theme of future SI

The Socialist International and Its Congresses

The Socialist International dates from a congress held in Frankfurt in 1951. Originally consisting mainly of European parties, the SI has expanded its membership in the Third World, notably since Willy Brandt became president in 1976. The main policymaking body is the congress, which meets every three years. In the period between congresses policy is determined by a bureau that meets twice a year. The next bureau meeting will be held in May 1987 in Italy.

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SI congresses are primarily public relations operations, but they do provide an occasion for members to make contacts, exchange views, and promote special interests. Members are often quick to blame the United States for world tensions, and congress resolutions often have an anti-US tone. In the past year or two, however, SI positions on arms control and Latin America have become less one sided.

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meetings, but, given the divergent interests of the membership, any agreement on specific measures is unlikely.

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Arms Control

Arms control fits in well with the desire of SI leaders to deal with important problems, and over the years delegations from the SI's Advisory Council on Disarmament and Arms Control (SIDAC) have traveled back and forth between Washington and Moscow to discuss security issues and arms control.

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The positions of the group are shaped heavily by representatives from Austria, Japan, and the Scandinavian countries, which have an especially keen interest in arms control. The Lima Manifesto echoes the most recent draft of SIDAC's disarmament report in opposing SDI and in appealing to Washington to abandon its negative stand on a comprehensive test ban treaty. It calls for the United States and the Soviet Union to eliminate nuclear arsenals, beginning with a 50-percent cut. SIDAC intends to continue to exert pressure on Washington and Moscow to negotiate binding agreements at the Geneva talks. [redacted]

Regional Issues

Central America. The SI has been shifting its stance toward the problems of Central America. A more critical attitude toward Nicaragua has emerged since an SI factfinding trip in February. The mission returned highly disturbed about Sandinista internal policies, especially on human rights, and made its dissatisfaction with the situation public. The resolution on Latin America approved by the congress noted that the Sandinista government "has not yet fulfilled its objectives of achieving nonalignment, pluralism, and a mixed economy," but continues to take the United States to task for supporting the Contras and other "destabilizing" actions. In El Salvador the SI has come to view the election of Jose Napoleon Duarte as part of a genuine democratic process there, and criticism of the US role has decreased markedly. [redacted]

Southern Africa. The SI congress reiterated Brandt's call for an end to apartheid and for tougher economic sanctions against South Africa. The linkage between Cuban troop withdrawal in Angola and Namibian independence is termed "unjustified," and the manifesto calls for support for the African National Congress, the South-West Africa People's Organization, and the United Democratic Front. [redacted]

Other Issues. In taking note of other world trouble spots, the declaration expressed concern over the protracted Iran-Iraq war, welcomed "people power" in the Philippines and the pressure for democratic reform in South Korea, and reaffirmed SI solidarity

with democratic forces in Chile and Paraguay. It also condemned the Soviet occupation of Afghanistan and the deteriorating situation of Soviet Jews. The document mentioned the Chernobyl nuclear reactor disaster in the context of the SI position that all states have the right to be informed about nuclear accidents. [redacted]

Outlook

SI members believe they can play a useful role in promoting peace and stability worldwide, but the organization is likely to remain ineffectual in helping to resolve specific international problems. It tends to seize upon issues, only to move on to something else if they prove difficult to resolve. Terrorism currently is attracting members' attention, and an Italian socialist party representative has been charged with the task of forming a new committee on the Mediterranean and terrorism. [redacted]

In pursuit of its goal of building a worldwide organization, the SI intends to develop relations with the socialist parties of the small island states of the South Pacific, where it previously has not been active. Expanded membership over the past decade has come primarily from Latin America, and the three new parties admitted at the congress were from Brazil, Bolivia, and Panama. European members, however, are making an effort to be more selective about offering membership because of past difficulties created by smaller, extremist groups. General Secretary Vaananen cited the Grenada New Jewel Movement as an example of an SI "mistake." [redacted]

A future problem on the horizon for the Socialist International will be the search for a successor to Brandt, who has been an active and influential president during the past decade. The assassination of Swedish Prime Minister Palme earlier this year removed the leading candidate for the position. SI meetings will continue to generate media coverage, but without increased funding for its limited budget, improved organizational efficiency, and continued strong leadership, little can be expected in the way of concrete accomplishments. [redacted]

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Greece: An Update on Military Modernization

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Greece's "new defense dogma," announced in December 1984 and identifying Turkey as the main threat to Greek security, essentially has formalized Athens's traditional anti-Turkish policy and shifts in Greek military deployments that have occurred over the past 10 years. The Papandreou government is giving higher priority to this orientation than its predecessors by channeling manpower increases and equipment modernization to Greek forces in Thrace and on the Aegean islands. The focus on Turkey has limited Greece's cooperation with NATO and the United States. Athens continues to refuse to participate in NATO military exercises, has stymied NATO's attempts to establish an Alliance command and control structure in the Aegean region, and presses its case against Turkey fervently in both Alliance and US-Greek forums.

Force Improvements

As seen by Athens, Greece's long-term military planning is driven by two imperatives: the need to improve its capabilities against Turkey and the need to respond to NATO Force Goals in support of NATO missions. A modest but steady program of improvements over the past 10 years—particularly in the Air Force and Navy—has substantially enhanced Greek capabilities against Turkey to the point where we believe a rough strategic balance now exists between the two:

- Turkey clearly remains superior on Cyprus where its ground forces are better equipped and outnumber Greek and Greek Cypriot forces by 2-to-1. Greece, however, appears to have a qualitative air and naval edge,

Table 1
The Greek Armed Forces

Army	
Active manpower	126,000
Tanks	1,700
Armored personnel carriers	1,500
Major antitank missile systems	350
Artillery	1,300
Major air defense systems	500
Air Force	
Active manpower	23,600 (750 pilots)
Combat aircraft	247
Reconnaissance aircraft	34
Combat-capable trainers	85
Transport aircraft	75
Navy	
Active manpower	18,000
Destroyers/frigates	20
Submarines	10
Patrol boats/combatants	32
Amphibious ships	22
Mine warfare ships	16

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The Greek Navy is slightly smaller than the Turkish Navy, but its ships and submarines generally are newer and its large surface combatants better equipped for air defense.

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- In Thrace, the numerically superior Turkish ground forces
- The key Greek advantage lies in the quality and readiness of its Air Force.

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Table 2

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The Greeks have ambitious modernization plans to meet many of their NATO Force Goals, but we believe the gap between their capabilities and those of their Warsaw Pact neighbors is not likely to diminish. Even with continued US military aid, Greek forces will remain plagued by aging equipment.

[Redacted]

[Redacted]

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[Redacted]

[Redacted]

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• [Redacted] the Air Force will complete its modernization program with the delivery of US F-16 and French Mirage 2000 aircraft starting in about 1988.

[Redacted]

Funding Problems and the US Aid Issue

The major constraint on the scope and pace of Greek military modernization will continue to be availability of funds. The government's new austerity program is likely to limit severely the availability of additional

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• By 1990, most of the Navy's major surface ships will have exceeded their service lives by 25 to 30 years.

[Redacted]

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The Warsaw Pact Threat

[Redacted]

the primary Warsaw Pact threat to Greece would be posed by Bulgarian ground and air forces, possibly supported by Soviet forces from the Odessa and Kiev military districts. Although the Romanians are capable of supporting Pact combat operations in the region, it is not clear what role they would play in wartime. [Redacted]

The principal task of these forces in offensive operations would be to penetrate Greek (and Turkish) defenses in Thrace and to seize the ports and coast along the Aegean Sea. They probably would also assist in attempts to capture the Dardanelles.

[Redacted] *the Bulgarian front, if not reinforced by either Soviet or Romanian forces, would probably concentrate on capturing and holding positions in Thrace. If Soviet forces were moved in strength to Bulgaria before the outbreak of hostilities, the Soviets probably would have primary responsibility for the straits area while Bulgarian forces would concentrate on Thrace.* [Redacted]

obligations under the Defense and Economic Cooperation Agreement with the United States and US base arrangements. [Redacted]

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Continued Limited Role in NATO

Despite some recent positive signs—increased air and naval force commitments to NATO’s integrated military forces, participation in the NATO early warning aircraft program, and agreement to participate in a noncombat merchant shipping map exercise—the Greek relationship with NATO will continue to be clouded by the Greek-Turkish dispute. We believe Athens will hold firm in its boycott of NATO combat exercises, on Aegean command and control issues, and on other Alliance projects and programs affecting both Greece and Turkey. [Redacted]

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national funding to support military programs, making the level of outside assistance even more important. Aid from the United States in 1985 was equivalent to more than 20 percent of the defense budget. Despite US assistance of some \$1.75 billion over the last five years, Greek defense spending has declined in real terms by over 1 percent since the Socialists came to power in 1981. Defense spending constituted 23 percent of the national budget in 1981 but only 15 to 17 percent in 1985. [Redacted]

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The United States can expect continued strong Greek pressure to increase its military assistance program. Athens’s request for FY 1987 totals some \$1.5 billion—far in excess of the US proposal of \$500 million—and encompasses the bulk of the programs needed to implement Greece’s NATO Force Goals. At a minimum, the Papandreou government will press for maintenance of the 7-to-10 ratio in aid to Greece and Turkey. We believe Athens may try to gain more by threatening to delay implementation of its

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France: Modernizing the Financial Markets

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The French Government over the past two years has engineered a near revolution of French financial markets. The final 18 months of the Socialist government—ending in March—saw an unprecedented freeing and rationalization of the markets that should improve their efficiency and the allocation of capital. These reforms will allow Paris to control the money supply through open market operations rather than quantitative credit controls. They should also better equip France to compete in worldwide capital market integration and bring the French financial system more closely in tune with that of the United States.

The Previous System

The French financial system traditionally has been heavily regulated and rigidly compartmentalized. Three distinct submarkets—a money market, a mortgage market, and a securities market—operated under different rules and the rates charged different borrowers varied greatly. In addition, credit controls, fixed fees, and regulated interest rates destroyed competition among banks and brokers, raising the cost of financial operations and reducing options for investors.

The absence of a unified financial system responsive to market forces also made monetary policy less effective. Because, at most, one-half of all credit was sensitive to market interest rates, large rate increases were required to stem the demand for credit—increases that threatened the solvency of many small and medium-sized firms. Consequently, monetary policy after 1972 relied mainly on quantitative credit controls imposed on a monthly, bank-by-bank basis with substantial penalties for banks exceeding the limit. The controls were inefficient, however, because some financial institutions were practically exempt, some forms of credit were only partially controlled, and the Bank of France was obliged to supply funds to refinance export credits at fixed rates, guaranteeing banks easy access to liquidity.

The Socialist Reforms

After decades of study and inaction by the right, it was ironic that a Socialist government began liberalizing the financial system. Under the direction of Finance Minister Beregovoy, the government in late 1984 began a series of financial reforms that together constitute an almost revolutionary change. Most of the impetus for reform came from economic factors, although the desire to curb the monopoly powers and privileged position of banks also played a role. In addition to seeking greater capital market efficiency, the government recognized that without modernization France would be left far behind in the competition for international financial business. Moreover, the Socialists realized that streamlining French financial markets would aid in the fight against inflation and might also lower the government's own substantial financing costs.

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New Financial Instruments. One of the focal points of the Beregovoy reforms was the creation of new financial instruments, particularly in the short-term market, to better suit the needs of both investors and borrowers. This also tended to unify the market by allowing capital to flow more freely and efficiently. The chief reforms include:

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- Opening a market in negotiable short-term government bills—initially with maturities of 2 to 6 years—and the creation of certificates of deposit for 6-month to 2-year terms, with negotiable interest rates for amounts greater than \$750,000. Both measures will provide firms, mutual funds, and individuals with an important alternative to bank deposits, and the competition should help lower the cost of financing.
- Authorizing firms to issue commercial paper for 10- to 180-day terms, thus giving them direct access to capital markets and reducing their costs. A private

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credit rating agency, set up to evaluate the risks in this market, should help provide the public with more information about traditionally tightlipped French firms.

- Creating long-term, government-guaranteed, mortgage-backed bonds similar to Ginnie Maes. This should make more mortgage money available and increase the liquidity of financial institutions by allowing them to sell their real-estate-backed assets. It will probably also give a boost to the beleaguered French construction industry.

Deregulating Financial Markets. A second goal has been to relieve financial institutions of burdensome regulations, allowing them to operate more efficiently and respond more easily to competition. Among the major reforms in this area are:

- Easing foreign exchange controls to permit more French foreign investment, to give French firms more flexibility in their international operations, and to allow them more leeway to hedge against foreign exchange risks.
- The creation of a financial futures market that will enable companies to protect themselves against changes in interest rates.
- The introduction of negotiable bank fees and brokerage commissions to increase competition and reduce charges to customers.
- The opening of a limited morning trading session on the Paris stock exchange, as a step toward a system of continuous trading. Related stock exchange reforms include authorizing brokers to become market makers by trading on their own accounts and holding inventories and the creation of an unlisted securities market.
- Treating interest, dividends, and capital gains equally for tax purposes.
- Reducing the volume of government-subsidized loans—from \$40 billion in 1984 to just over \$30 billion in 1986.

- Allowing bond issues of less than \$150 million without prior authorization to improve bond market access for small and medium-sized firms.

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Improving Monetary Control. Beregovoy loosened the so-called Encadrement du Credit, or system of credit ceilings, and moved toward replacing it with a regulatory mechanism based on depositing reserves with the Bank of France. The object was to allow a greater leeway in lending and to permit more effective central bank control of the credit base. In addition, the government imposed the same reserve schedule on all banks. Eventually, the Bank of France hopes to be able to transmit interest rate signals through its open market operations to control credit growth more quickly and effectively, although this may come at the cost of more short-term interest rate volatility.

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Outlook Under the New Government

The conservative Chirac government has taken some steps to continue the reforms begun under Beregovoy, notably the further easing of exchange controls. It has also abolished the much maligned *devises titres* system under which investors wishing to purchase foreign securities had to pay a premium for the necessary foreign exchange. Meanwhile, the Finance Ministry has announced that, barring an unexpected increase in inflation, it will abandon all quantitative credit controls by 1 January 1987. It has also expanded the maturities permitted for some bonds, commercial paper, and certificates of deposit, and has permitted banks to set their own hours.

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Despite these initial steps and the free market rhetoric of the Chirac government, the continuation of the reform process is not assured, in our view. The controlled financial system in France was, after all, largely the ad hoc creation of previous conservative governments. Although we believe the conservatives will try to press ahead with financial deregulation, they may backtrack in the event of resurgent inflation or an otherwise deteriorating economic situation. A key indicator of the government's commitment to reform will be the speed with which it pushes denationalization and the extent to which it

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**Prereform Barriers to a
Dynamic Financial Market**

- *About one-half of all French credits were subsidized through numerous channels at greatly varying rates. Housing and exporters, rather than industry, were the main beneficiaries.*
 - *The medium- and long-term bond markets were regulated to keep interest rates low, and credit was rationed by a system favoring official or quasi-official borrowers. Since small- and medium-sized borrowers had little direct access to long-term credit, they were heavily dependent on bank loans.*
 - *Monetary policy relied primarily on credit controls rather than reserve requirements and interest rates. Controls generally heavily penalized any bank growing faster than its allowed norm, preventing more efficient banks from growing relative to their competitors.*
 - *The system created special deposit-taking institutions—the Post and National Savings Banks—that collected deposits and were required to lend them to special borrowers or to retail banks. This limited the access of some retail banks to low-interest funds and made them vulnerable to small interest rate changes.*
 - *Most interest rates on deposits as well as banking and brokerage fees were regulated.*
 - *Firms and individuals did not have direct access to the money market, but rather had to go through banks.*
 - *Short-term government liabilities could be held only by banks. Financial markets were not innovative, and savings instruments for small savers were particularly limited.*
 - *The Paris stock exchange was anachronistic, with prices being fixed once a day in a brief afternoon session, during which brokers matched buy and sell orders. In addition, brokers did not buy for themselves or keep inventories to make markets but only engaged in pure brokerage, which meant the market was thin and clumsy.*
-

encourages the denationalized banks to take full advantage of the less restrictive operating environment. In addition, by further reducing subsidized credits and by announcing continued increases in reserve requirements, the Bank of France can signal its intentions to move toward a full dismantling of credit controls.

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Ultimately, the new monetary control system will require greater day-to-day involvement by the Bank of France in managing the price of money through open market operations. The conservatives have already proposed a new charter for the Bank of France to grant it greater autonomy, and the issue is likely to be taken up by the National Assembly this fall.

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Finally, for the modernization to continue and for Paris to compete internationally, the most pressing need now is for the locus of innovation to move from the government to the private sector. The financial sector has been so tightly controlled in the past that most bankers and brokers no longer think in terms of innovation, assuming the government will not allow it. The recent reforms and the election of a government committed to the free market may have brought a suitable environment for private initiative. If the new government reaffirms its commitment to reform and does not discourage innovation by excessive regulation, it will be a healthy sign for continued modernization and the emergence of Paris as a world-class financial center.

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Overall, the financial reforms are likely to have a positive impact on the French economy. Although the French financial market is likely to experience growing pains as it adjusts to a more open regulatory environment, the reforms should lead to more efficient investment decisions and facilitate a more effective monetary policy. They will also make the French financial system more closely resemble that of the United States, and should help further capital market integration in the European Community. Over the long run, the reforms should help open the French economy to foreign investment and boost Paris's standing as an international financial center.

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**Poland:
The 10th Party Congress**

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The recent 10th Congress of the Polish Communist Party strongly endorsed party leader Jaruzelski's contention that Poland is fast returning to normal despite continuing economic problems, an active underground opposition, and a hostile but resigned populace. It also provided an opportunity for Jaruzelski to strengthen his hold over party leadership at both the central and local levels. The highlight of the congress was the warm personal endorsement Jaruzelski received from Soviet General Secretary Gorbachev. Despite the apparent free rein given by Gorbachev and the superficial calm at the congress, Jaruzelski still has a long way to go in implementing policies that will make his regime a political and economic success.

"Normalization" the Keynote

Jaruzelski set the tone of the proceedings with the assertion in his four-hour opening speech on 29 June that, unlike the sometime chaotic Extraordinary 9th Congress in July 1981, this was to be an ordinary congress. The major themes he outlined were clearly aimed at achieving further "normalization": the absence of popular unrest and modest steps toward meeting the political expectations of the people when necessary for economic progress. He held out the prospect of a limited fourth amnesty of political prisoners in the interests of national reconciliation. As for Solidarity, Jaruzelski claimed that "the great majority" of its former members actively participate in public life and warned that the government will not tolerate foreign sponsored, antistate activities. He professed a desire to mend fences with the church and invited its participation in an advisory group to the Council of State. Jaruzelski refrained from launching any vituperative attacks against the United States and expressed a willingness to normalize relations—without, however, making any goodwill gesture.

The congress also signaled normalization through changes in party rules and precedures. Unlike former First Secretary Kania—who faced several challengers at the stormy congress in 1981—Jaruzelski, according to the US Embassy, was elected by acclamation.

Some of the liberal party rules passed in 1981 were brought into line with standard East European practice. The limit on the terms of locally elected party officials was increased from two and one-half to five years. Likewise, the two-term restriction on officials was kept, but procedures were adopted for clearing the way for election to a third term.

Leadership Changes

The new, enlarged Politburo is packed with Jaruzelski's closest collaborators and appears free of extremists of both the right and left who could oppose his policies. Among the seven casualties were the last prominent liberal, Hieronim Kubiak, and the last notable hardliner, outspoken Warsaw construction foreman Albin Siwak. Another victim, Tadeusz Czechowicz, was an ambitious challenger to Jaruzelski's authority, according to a former Central Committee member. The remaining token workers predictable were replaced and reduced in number. The inclusion of the chief of the national trade union organization, Alfred Miodowicz, will probably undermine any confidence workers have in the ostensibly independent unions.

Jaruzelski's political strength is particularly evident in the promotion of more close military comrades despite longstanding criticism of the military's role in the party leadership. In addition to the elevation to full voting status of former candidate members General Florian Siwicki, the Defense Minister, and General Czeslaw Kiszczak, the Interior Minister, Jaruzelski gave a seat to General Jozef Baryla, the party secretary who oversees security. He probably convinced Gorbachev and party ideologues that he needs trusted advisers of his own choosing if he is to achieve his political and economic goals.

The 11-member Central Committee Secretariat also was revamped but retains its generally moderate cast. The only significant addition appears to be writer

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Jaruzelski among friends: Military delegates to the congress [redacted]

Polish Press ©

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Andrzej Wasilewski, who, according to the US Embassy, will be responsible for culture. A former director of the state's largest publishing house, where he presided over the publication of contemporary Western literary works, Wasilewski may liberalize somewhat the regime's cultural policy. [redacted]

The most sweeping change took place in the Central Committee. More than 70 percent of the members were replaced and the institution of candidate membership abolished, reducing the committee's overall size from 283 to 230. In addition, the two top watchdog groups, the Central Party Control and Auditing Commissions, were merged. According to published party documents, these changes were intended to reflect the decline in party membership and fulfill the need for more effective control organs. More likely, however, Jaruzelski hopes to strengthen his personal grip over a leadership body that reportedly gave him trouble in the past. [redacted]

Jaruzelski, however, is still likely to face problems with his new Central Committee. The roster contains several outspoken regime critics, including four provincial party chiefs—Zenon Czech of Przemysl, Czeslaw Staszczak of Biala Podlaska, Jerzy Swiderski of Siedlce, and Alojzy Zielinski of Chelm—who reportedly withstood Jaruzelski's efforts to purge

them last January. A returning member, Jozef Smolarz, accused Jaruzelski of being an ineffective party leader at a Central Committee session in November 1983, and called upon him to give up his government posts, [redacted]

[redacted]. Other aspects of the congress also did not go as smoothly as Jaruzelski planned. The US Embassy reports persistent rumors in Warsaw that hardliner Albin Siwak fought tenaciously to keep his Politburo seat. Perhaps giving credence to the rumors, the election of the Politburo took longer than planned, and Jaruzelski observed afterward that "democratic procedures" are time consuming. The regime's failure to publish the ratified party program after the closing of the congress also suggests that consensus was difficult to achieve. [redacted]

A persistent theme of the congress was the impending implementation of a new personnel policy that will give basic party organizations greater oversight over party and government bureaucrats and ensure that apparatchiks regularly change jobs. Jaruzelski appears intent on purging officials who have blocked implementation of policies they consider threats to their power and positions. [redacted]

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Economic Issues

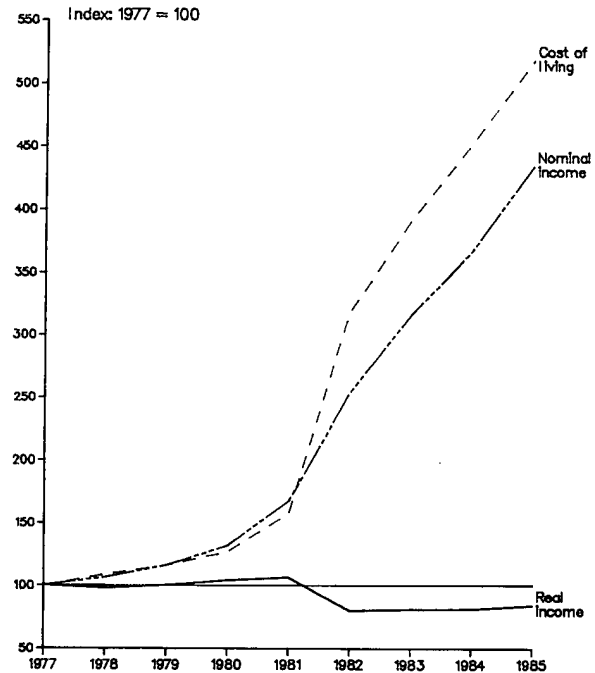
Speeches at the congress echoed familiar East European economic policy themes without introducing any new initiatives. Economic reform, scientific and technological progress, energy and raw material conservation, closer integration within CEMA, and the need for better management were dominant topics. The draft five-year plan for 1986-90 projects modest growth similar to that in the scaled-back plans of other East Bloc countries and the USSR. The final version of the plan, still not available, may have been revised to reflect criticism of its unambitious targets voiced at pre-congress conferences and in the media. [redacted]

Both Jaruzelski and Premier Zbigniew Messner reaffirmed their commitment to the government's four-year-old economic reform plan but, like top Soviet leaders at the CPSU congress, failed to provide details of how they intend to ensure implementation. Instead, Jaruzelski announced the creation of a party-government commission to review organization and management. Both Jaruzelski and Messner leveled harsh criticism at private-sector "profiteers" and suggested that tighter central control over private enterprise was in the works. This may include restrictions on Poland's successful but controversial foreign-owned Polonia firms. [redacted]

Messner's speech concentrated on restoring balanced economic development and market equilibrium, implying that the government would impose tighter controls over wages while continuing to raise retail prices to reduce budget subsidies. He cited rent increases as a means of financing additional housing but called for cutbacks in subsidies for medicine. Although he promised better supplies of consumer goods—including food—he also noted that Poland's long-term development requires that investment be given priority over consumption. The premier conceded that any belt-tightening measures would be unpopular and might heighten social tensions. [redacted]

While Messner acknowledged "enormous pressure" to meet investment needs throughout the economy, competing demands for resources do not appear to have been resolved at the congress. The draft five-year plan gives priority to the completion of outdated

Poland: Income and Cost of Living, 1977-85



Source: Official Polish data

investment projects that are unlikely to bring sustained growth in either production or efficiency. Discussion of investment plans at the congress focused on energy and raw material conservation. In fact, Messner stated that nearly one-third of industrial investment is earmarked for achieving badly needed reductions in consumption in these areas. [redacted]

The congress replayed lukewarm rhetoric about science and technology—with an emphasis on industrial applications—as the engine for economic progress. Congress speakers identified closer CEMA cooperation, especially with the USSR, rather than expanded ties to the West, as the best source for S&T advancements. This may be making virtue out of necessity because Warsaw's financial problems will limit imports of Western technology. Development of

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new homegrown technology also will be hampered by tight central control and inadequate funding, even though Messner claimed that outlays for S&T will double by 1990, with an emphasis on electronics, robotics, industrial automation, and new material technologies. [redacted]

The speeches emphasized that Poland's foreign trade orientation will be primarily toward CEMA, especially the USSR. Both Messner and Jaruzelski lauded recent steps toward closer cooperation between Polish and Soviet enterprises. Several speakers pointed to Poland's desire for normalized trade and financial relations with the West and reassured Western creditors that Poland intends to repay its debt. But they cautioned that debt repayments would not be made at the expense of economic development or living standards—a particularly ominous warning in light of Poland's poor trade performance so far this year. This suggests that the regime will continue to require debt relief and to miss payments. It may also have been intended as a warning to Western creditors and the IMF that Warsaw will not accept Western-imposed austerity measures as a condition for new loans. [redacted]

Gorbachev's Presence

The accolades Jaruzelski received from Gorbachev—more flattering than those accorded to East German party chief Honecker in April—indicate that Poland has returned to good graces. Gorbachev appeared satisfied with Warsaw's current policies and seemed willing to adopt the normalization theme of the congress. Predictably, he emphasized the steadfastness of Soviet support—especially in light of continuing Western economic sanctions—and the value of economic integration and the bilateral military alliance. He obliquely admitted to the deep enmity felt by many Poles for the Soviet Union but blamed class exploitation for the problem. He also thanked the Poles for their "solidarity" over the Chernobyl incident and acknowledged that the accident had its effects on Poland, too. In practical terms, Gorbachev's personal support gives Jaruzelski some leeway to implement his economic reforms and new personnel policy. [redacted]

Outlook

Breaking the stalemate between a hostile populace and the Communist regime depends, we believe, on both economic improvement and national reconciliation. Reconciliation in particular rests on Jaruzelski's ability to create more efficient and accountable government and party structures, a goal that has been consistently blocked by deeply entrenched bureaucrats. Jaruzelski undoubtedly expects the power and prestige he gained at the congress to help him break the hold of the apparatchiks. His first opportunity will come at regional and local party elections this fall. The institutional apparatus, however, has a strong record of surviving and may well resist yet another purge. [redacted]

Repetition of familiar economic themes at the congress suggests that the Jaruzelski regime still lacks a comprehensive strategy for dealing with Poland's serious economic problems. Deep-seated bureaucratic opposition will continue to frustrate the implementation of reforms. While the regime is likely to impose some belt-tightening measures such as price hikes and controls on income growth, its sensitivity to the popular mood, as in the past, may restrain any inclination to enforce harsh austerity. [redacted]

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**Western Europe-United States:
Differences Over Policy
Toward Libya Highlight Deeper Splits
Within the Alliance**

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Viewpoint

This article does not represent a DI or CIA position; it is solely the view of the author. It has not been coordinated or reviewed.

The US airstrike against Libya in mid-April sparked as much disapproval in Western Europe as it did support in the United States—highlighting not only a tactical difference in perspective on the two sides of the Atlantic toward the terrorist problem but also a slowly growing divergence of views on the fundamental nature of the Alliance. West European leaders agree, of course, that NATO's core purpose is to defend against the Soviets, and they generally recognize that they get far more from the United States than they give in pursuit of that goal. Their slowness to help Washington in the fight against Libyan terrorism suggests, however, that they tend to accept that asymmetry without feeling a strong corresponding obligation to stand behind the leader of the Alliance when it attempts to uphold Western interests outside of the NATO area.

Introduction

Alliance solidarity fostered by the threats of a Soviet military attack in Central Europe is weakening as that threat recedes in West European eyes—a perception the new Soviet leadership is trying to reinforce. Although the Soviets have continued directly and by proxy to challenge Western interests in other parts of the world, the West Europeans have not reacted strongly to threats that do not involve them directly. As a result, Washington's efforts to defend US and Western interests against challenges from outside the NATO area have attracted little support across the Atlantic; rather, they have tended to feed West European fears that needless US activism could lead them into dangerous conflicts.

These fears, along with the West Europeans' perception that they are entitled to continue benefiting from an unbalanced security relationship,

are likely to increase strains within the Alliance. Already, it is fashionable among many educated West Europeans, for example, to see their continent caught between two "superpowers" which, if not morally equivalent, at least pose nearly equal threats to their peace and well-being. This situation provides the Soviets with a standing opportunity to fan transatlantic estrangement by promoting future out-of-area crises.

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Although each out-of-area crisis will have different implications, we believe that the Libyan episode provided glimpses into a developing split within the Alliance that could reappear more and more frequently. The full dimension and ultimate potential of the problem was only briefly in view because West European leaders—alarmed by the strong anti-American upsurge and parallel anti-European upsurge in the United States after the airstrike—tried to smooth over differences with Washington about how to respond to Libyan support for terrorism. We believe that the limited measures taken by the EC and endorsed at the Economic Summit in Tokyo should be seen more as an attempt to close the transatlantic breach and deter Washington from further military action than as an acknowledgement that Western Europe has a responsibility to fight the international menace of state-sponsored terrorism.

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The Alliance has been shaken by disagreements many times before, but we believe the recent transatlantic tensions highlight some basic differences that have evolved slowly over the years. In the first section of this article, we address the process of transatlantic estrangement that has been brought to light by the Libyan affair and assess the divergence in interests and world views between the United States and Western Europe. In the second part, we examine how this divergence in basic outlook reinforced the more specific tactical reservations that West Europeans had concerning US policy toward Libya and what this may mean for their willingness to cooperate with the United States on terrorism and other issues.

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Differences in Perception and Analysis of the Terrorist Problem

As masters of former colonial empires, the West Europeans believe they have a privileged insight into the interaction between relatively developed and less developed societies, and they see at least the surge in Islamic fundamentalist terrorism—especially that flowing from Hizballah and Iran—in this light. This perspective inclines them to take a long view and to believe that they can do little about some aspects of international terrorism. As they see it, the West can only wait until the most atavistic parts of the Middle East have made their peace psychologically with the modern world. [redacted]

There is also some tendency to see Arab support for Palestinian terrorism in “anticolonialist” terms—as the continuing rebellion of relatively backward Arab masses against Israel, the West’s most salient geopolitical intrusion into the Arab world. This article of faith among a number of West European intellectuals may not be held as such by many average citizens. Nonetheless, both leaders and voters share the conviction that there can be no peace in the Middle East and no solution to the terrorist problem until the Palestinian issue is resolved. West European leaders are not so naive as to believe that Qadhafi or Khomeini would be any less revolutionary or that Assad would be any less treacherous if there were a Palestinian homeland. They are convinced, however, that such a solution would sharply reduce the numbers of radically aggrieved Palestinians who now float around the Middle East providing radical Arab leaders with too many ready tools. [redacted]

We believe it is the West Europeans’ optimistic view of the short-term impact of a Palestinian state on Middle Eastern terrorism that leads them to conclude that the US focus on terrorism is myopic. They argue that Washington is only attacking the symptom and that the United States must turn its attention to the Palestinian origins of the problem if it is to succeed. By this, West Europeans mean that Washington must persuade or coerce Israel into accepting the formation of a Palestinian state in which the PLO would play a leading role. Indeed, some West Europeans almost certainly worry that Washington’s new activism in combating Middle Eastern terrorism has made it an

unwitting instrument of Israeli foreign policy—which they see as essentially inimical to a Middle Eastern settlement. They probably believe that joining in US military or economic pressure on terrorist-supporting states would actually make it harder over the long term to deal with what they regard as one of the principal roots of the terrorist problem. [redacted]

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A final factor in Western Europe’s different perception of terrorism is its own experience with homegrown revolutionaries and urban guerrillas in the 1970s and early 1980s. The domestic terrorist problem persists, but most West Europeans are convinced that the worst is behind them. They credit their success to effective police action, public safety precautions, and the terrorists’ own growing sense of futility with their causes, and they believe that the same path could be followed in fighting Middle Eastern terrorism. In our opinion, however, they fail to recognize that they did not make much progress against their domestic terrorists until they effectively declared war on them and that lapse of memory prevents them from drawing a parallel conclusion in the West’s confrontation with state-sponsored terrorism today. [redacted]

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Differences in International Roles: Western Europe’s Insularity Versus Washington’s Global View

A still more basic ingredient in European reluctance to support US policy toward Libya is the growth in Eurocentrism. Since the loss of overseas empire, many of the separate West European states have turned inward and lost much of their former sense of global mission. This basic shift in world position has led to an equally basic shift in their perception of the Atlantic Alliance. In the 1940s and 1950s, the West Europeans sought Washington’s help in beating back indigenous challenges to their overseas colonies. Now, more than two decades after the loss of their last important imperial holdings, the West Europeans insist that the Alliance’s objective is to safeguard Western Europe’s security—not to stand up for democratic values and Western interests in other parts of the world. Insularity in the EC and EFTA has been highly profitable, moreover, giving rise to the

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paradox that Western Europe has become more parochial at the same time that it has grown richer and stronger—and less deferential to the United States. [redacted]

This insularity and the frustrations of no longer dominating the world stage have combined to breed a resentment among some Europeans toward Washington's active international role. In some cases, this takes the form of a kind of moral arrogance that portrays Europe as the only true guardian of civilization and the United States as a trigger-happy naive superpower that overreacts to the Qadhafis and Castros of the world. [redacted]

Indeed, Western Europe has become the most self-satisfied of continents. As long as only a few innocent people are killed in terrorist incidents here this time or there next time, West European governments are unlikely to become upset over state-sponsored terrorism as a matter of principle even if their growing concern has led them to take limited antiterrorist measures. Indeed, some of the governments would clearly prefer to continue to strike quiet deals with the terrorists to leave their countries alone. [redacted]

In this respect, many of the factors influencing Western Europe's response to terrorism are reflected in European attitudes on East-West issues. West Europeans have grown complacent about the threat of Communism—either the domestic or the Soviet varieties—and have been generally content to pursue detente with the East Bloc without worrying about Soviet subversion in other parts of the world. Their relatively mild reaction to all but the most bloody terrorist attacks contrasts with their strong condemnation of the US raid in much the same way as their muted responses to Soviet interventions in Afghanistan and Poland differed from their resistance to US pressure to reduce their dependence on the Soviet pipeline. Unless West Europeans are directly threatened themselves, they are far more likely to be unsettled by US calls for collective action against terrorist or Communist wrongs than they are by those wrongs themselves. [redacted]

Changing perceptions of the Alliance are a final factor explaining why the West Europeans take so narrow a view of their responsibilities as members of the Atlantic Alliance. Many in the older generation have lived under the umbrella of US protection for so long that they have come to see it as theirs by right without any corollary responsibilities on their part. The ever expanding majority of West European voters born since 1945 have no first-hand experience of the circumstances that contributed to NATO's birth; many in this group doubt that the Soviets pose a threat. Others in the group believe that the real danger to their welfare is what they call the arms race between Washington and Moscow and that US determination to resist Soviet global pretensions could drag Western Europe into an East-West conflagration. A small but growing number of younger voters has even come to accept Soviet propaganda that US pursuit of Western military preparedness is the principal threat to peace. [redacted]

All of these concerns are heightened because two World Wars fought on European soil this century and numerous colonial struggles lost after 1945 have made West Europeans skeptical about the costs and efficacy of military action and cynical about the role of morality in international affairs. The upheavals of the 20th century have also given their political life a strong pacifist undertow. These negative attitudes have already combined to scupper Allied support for US military action beyond Western Europe's borders. Over time, they could undermine support for collective security in Western Europe itself. [redacted]

Current Differences over Tactics

Despite these underlying fundamental differences of view, the dispute between Western Europe and the United States over policy toward Libya has been argued out so far on a tactical level, focusing on whether military force is an effective means of combating terrorism and whether economic sanctions are workable. Many European leaders almost certainly also shared the perception of their constituents that the raid would be

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counterproductive—that it would provoke a bloodbath of terrorist retaliation, force the moderate Arabs to rally around Qadhafi, drive all of them closer to the Soviet Union, and jeopardize West European economic interests in the Middle East. Fear that striking Qadhafi's hive would only stir up terrorist wasps to sting the nearest bystanders—Western Europe, not the United States—probably overwhelmed any recognition of how much West European passivity might encourage Qadhafi and other state sponsors of terrorism to continue their efforts. [redacted]

West European leaders continue to worry that military retaliation against Libya will escalate if Washington becomes embroiled in a mounting cycle of violence with Tripoli. Indeed, US accusations against Syria sparked fears that a military campaign against Libyan terrorism will expand into conflict with Syria and Iran, drawing in both the Soviet Union and the rest of the Arab world. If this did occur, the West Europeans would then face an extremely difficult choice—either fall in behind the United States and alienate their own voters or stand aloof and jeopardize US support for the defense of Western Europe. [redacted]

West Europeans also worry that participation in economic sanctions against Libya will invite Libyan retaliation. In any case, they oppose sanctions as a matter of principle, contending that history shows they do not work and arguing that there are always countries that will take advantage of boycotts to beat others out of lucrative commercial ties. By and large, the Europeans have found quiet diplomatic efforts [redacted] to be more effective than public threats—which in their mind, expose them to humiliation if they fail.¹ [redacted]

¹ Some, most notably the French, are leery of signing on to any international effort that they cannot control—fearing that it will drag them willy nilly into action inimical to their own interests. The Italians, with more economic exposure in Libya than any other West European country, worry that abrupt moves will kill their chances of recouping some of their investments, while the British are especially anxious to avoid any precedent that might be applied to South Africa, where Britain has invested heavily. [redacted]

Implications for the United States

Given these disagreements, Washington is likely to continue meeting resistance when it presses for military action or economic sanctions against Middle Eastern terrorism. We believe, however, that the Europeans may be amenable to some arguments for enhanced cooperation. Most fundamentally, West European leaders are still too unsure of their ability to stand alone to risk a major break with Washington, and they will probably remain so for some years to come. Moreover, there are signs that the wide disparity in public opinion on each side of the Atlantic toward the US strike worried many Europeans and probably increased public backing for the limited anti-Libyan measures their leaders adopted to placate Washington. [redacted]

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For the medium term at least, we believe Washington will be able to continue squeezing a modicum of support from West European leaders partly with reminders that the alternative may be further military strikes and partly with hints of how much Alliance solidarity on this or that particular point means to Washington. The West Germans, in particular, are anxious to maintain the US military commitment in West European defense, and they might be especially susceptible to appeals made on this basis. West Germany's leverage with other Allies, in turn, is considerable, and this makes Bonn an important starting place for any future US diplomatic logrolling. [redacted]

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West Europeans are likely to look more favorably on economic and diplomatic measures against Libya now that they know the alternative may be further military strikes. Several leaders have already expressed willingness to expand on the tentative steps already taken, especially if Libya is implicated in further terrorist attacks. Appeals to West European leaders for support, however, are likely to wear less and less well if public opinion continues its long-term drift in the other direction and if little progress is made toward resolving key West European concerns about relations with moderate Arabs. [redacted]

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West European leaders have papered over some of the chasm between their countries and Washington with the antiterrorist measures they implemented after the raid on Libya, and West European voters, too, may be looking at US antiterrorist policy a little more dispassionately than they did during their first negative kneejerk reaction. The fact remains that differences persist over how to deal with Middle Eastern terrorism and that, more seriously, these tactical differences overlay more basic and growing divisions of international perspective and interest between the Allies and the United States. This larger process of deterioration can still be stopped, but not unless West European political leaders speak out with courage and conviction on the reasons their countries should continue to support both the Atlantic Alliance and the United States. [redacted]

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Economic News in Brief

Western Europe

UK tourism officials are now projecting US tourism this year only slightly below the 1985 record . . . if widely publicized, could reduce anti-American sentiment . . . Tories still want official US encouragement of travel to Britain.

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West Germany promised \$22 million in project-related aid to the Philippines during Vice President Laurel's recent visit to Bonn . . . team visiting Philippines to assess prospects for additional assistance.

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France has announced \$300,000 in humanitarian aid to Afghan rebels . . . may pave way for more covert military assistance . . . Chirac seeking to underscore toughness with Soviets and foreign policy clout.

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Portuguese parliament approved supplemental budget for 1986 . . . increases expenditures for armed forces, civil service pensions, and health care benefits . . . anticipates higher revenues from recently implemented VAT and savings from lower agricultural prices . . . budget deficit still expected to be 11 percent of GDP.

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Looking Ahead

August
Western Europe

Nordic Council foreign ministers will hold next meeting 13-14 August in Copenhagen . . . will probably coordinate on stricter measures against South Africa . . . may establish Nordic working group to study nuclear-weapons-free zone.

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