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CENTRAL INTELLIGENCE AGENCY
NATIONAL FOREIGN ASSESSMENT CENTER

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ITALIAN SITUATION

Introduction

The major imponderable in the Italian situation remains the impact of the so-called masonic lodge scandal on the country's leadership class and democratic institutions. Charges of a conspiracy to create a "state within a state" already have touched every major party, except the Communists, and have spread to the business, academic and press communities. It is still likely that the scandal is overblown, that it will run its course and fade from view--the pattern followed by most Italian scandals. Nevertheless, fallout from the affair has led to an impasse between the Christian Democrats and Socialists over which party should provide the next prime minister. Because these new strains in Italy's center-left formula probably cannot be worked out without an early parliamentary election, the country will have no choice but to postpone major domestic and foreign policy decisions.

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Socialist chief Craxi, seeing the scandal as a chance to further his own ambitions, refused to cooperate in a minor cabinet shuffle when the names of several ministers appeared on purported lodge membership lists. The Christian Democrats, unwilling to surrender the symbol of their primacy in Italian politics, have rejected Craxi's demands for the prime ministry as the price for his party's cooperation.

This memorandum, requested by Ken Steins of the Department of Treasury, was prepared by [redacted] Office of Political Analysis. Research was completed on 16 June 1981. It was coordinated with the National Intelligence Officer for Western Europe and the Office Economic Research. Questions and comments may be addressed to [redacted]

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The Communists, eager to renew their own bid for a role in governmental decisionmaking, have given tacit support to the Socialists in a move to detach Craxi's party from the Christian Democrats.

The deadlock probably will continue through the important local elections next week. Both the Christian Democrats and the Socialists are looking for a vote of confidence to boost their respective claims for the prime ministry. Only in the unlikely event the results are clearcut--sharp gains for one party and losses by the other--would the issue of governmental leadership be resolved. It is more likely the outcome will be inconclusive and the parties will opt for an early parliamentary election--perhaps in the fall--as a last resort.

Aside from the political class, the Italian security services have been affected most by the scandal. The chiefs of the services, have taken temporary leave after being accused of membership in the P2 lodge. Terrorist groups, such as the Red Brigades, have taken advantage of the situation to step up their activities. In the short run, these developments seem to have hampered Italy's anti-terrorist efforts but it is unlikely that there will be any long-term damage as a result of the scandal. Even if those implicated are forced to resign, the working level cadres would remain intact and the security services would be able to absorb the loss.

The failure of the parties to reconstruct a coalition has set back efforts to stabilize the Italian economy. Key deflationary policies--a freeze on public sector wages and a revision of the wage indexation scheme--will remain on the drawing board. Inflation continues at over twenty percent and there will still be a substantial current account deficit. Italy's total reserves appear sufficient to cover any sudden capital outflow resulting from speculative pressures on the lira in the immediate future. However, without an early improvement in the current account and inflation situations, a currency crisis similar to that Italy experienced in 1976 cannot be excluded. The Bank of Italy has carried on the burden of adjustment in the absence of an effective government economic program, but Bank officials contend that monetary policy by itself is not sufficient to correct Italy's mounting economic woes.

A protracted political crisis also will play some role in determining Rome's attitudes during the Ottawa Economic Summit. The Italian representative almost certainly will maintain an even lower profile than is usual at these meetings. As a caretaker, he is unlikely to object to substantive economic initiatives in principle, but will cite domestic political uncertainty as an excuse for avoiding firm commitments. In addition, he will try to impress on his counterparts that Italy's current domestic problems pose no threat to the country's democratic institutions and will have little impact on Rome's ability to fulfill its international obligations.

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