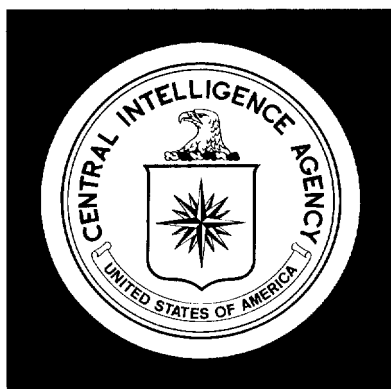
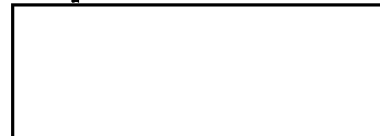


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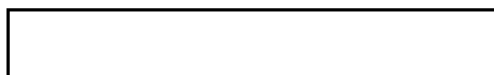
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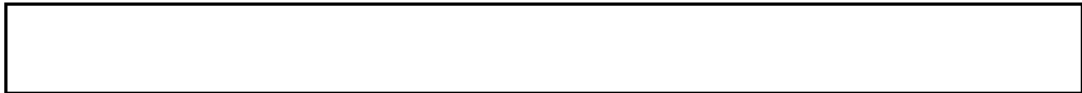
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EUROPEAN COMMUNITIES: At meetings in Copenhagen and Brussels this week the West Europeans made progress in overcoming French resistance to accommodating the US on a number of issues.

The political consultations of the Nine in Copenhagen focused on President Nixon's expected visit to Europe in the fall. French Foreign Minister Jobert, initially contending that Europe should express its "identity" by refusing to develop a concerted approach to the visit, later conceded that the visit could be the starting point of a US-European dialogue. The political committee will now work toward developing a consensus on the issues to be raised by the Europeans and on the communiqué to be issued after the meeting of the President with top community officials.

The French insist that defense matters be kept out of the US-EC discussions; such matters, they say, should be reserved for the NATO forum, where they would be the only questions addressed. Paris was satisfied on this point, and the resulting division of tasks between the NATO and EC forums argues against the development of a single, all-encompassing Atlantic declaration.

Still, the effect of these two meetings has been to affirm the beginnings of a community personality that bridges economic, political, and defense concerns. The permanent representatives to NATO of the EC countries--i.e., minus Ireland--will, according to Belgian Political Director Davignon, coordinate on the defense aspects of the President's visit. Representatives of the Nine also met this week to provide "some analysis" of the recent US-Soviet agreement to prevent nuclear war. It was also agreed, despite French reluctance, that conversations of an individual EC member with the US would henceforth be reported "fully" to the others of the Nine.

In Brussels, the Nine rejected a French proposal that the coming multinational trade negotiations be held up until the dollar had returned to

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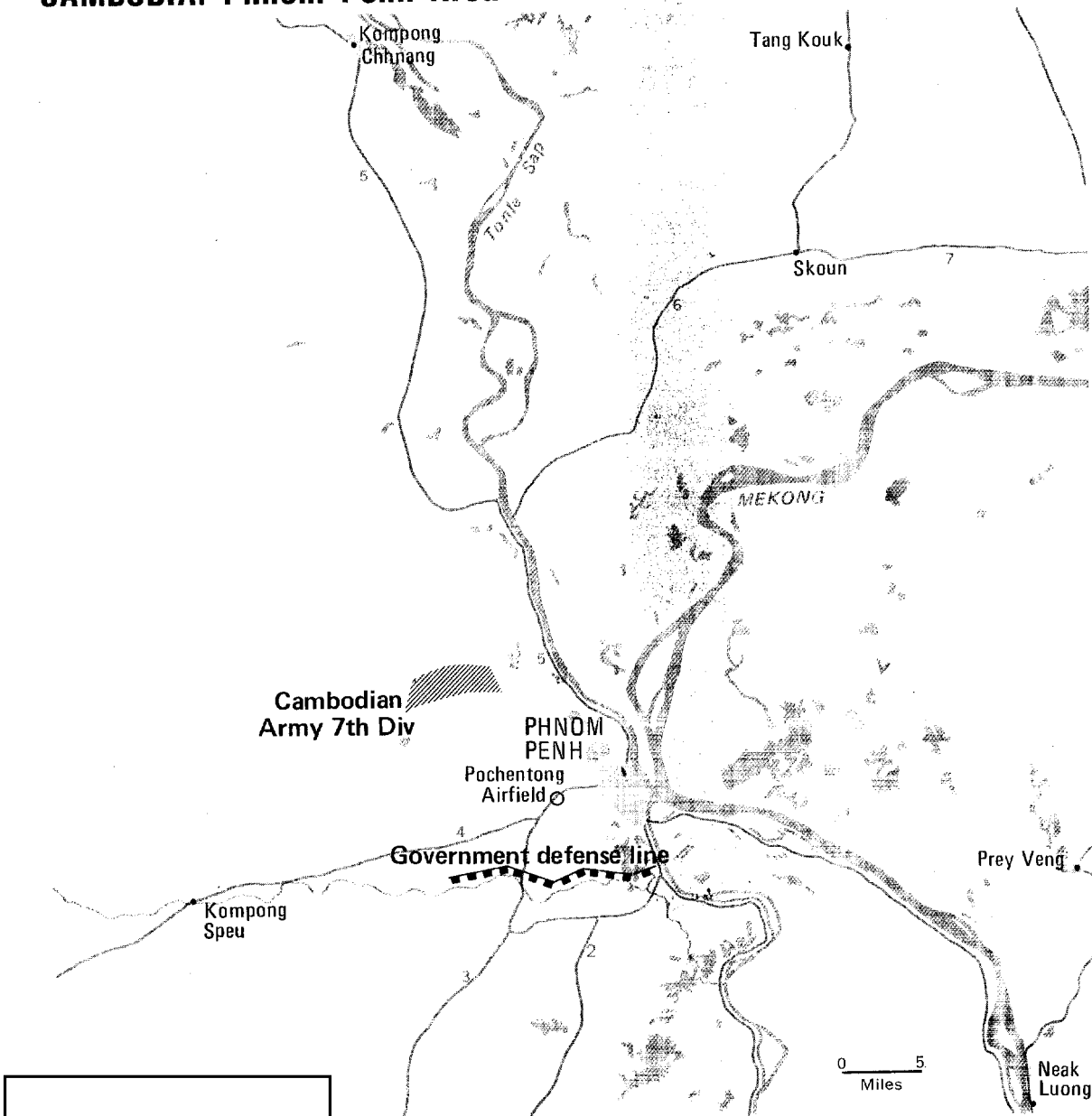
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its parity of 12 February. In a conversation with the US Embassy, the director of economic affairs at the Quai conceded this defeat. He claimed, however, that the French did succeed in "strengthening" the link between the trade and monetary negotiations. Paris is showing some softening in its opposition to EC compensation for the US to offset trade damage resulting from the community's enlargement. [REDACTED]

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CAMBODIA: Phnom Penh Area



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CAMBODIA: The Khmer Communists are edging ever closer to Phnom Penh.

The heaviest fighting is centered five to seven miles south and southwest of Phnom Penh where Cambodian Army troops are strung out along a rough defense line that cuts across Routes 2 and 3 and ends within a few miles of Route 4. The Communists are keeping steady pressure on this front, concentrating most of their efforts along Route 3. Some insurgent elements are now only five miles from the capital's airport; others are in contact with the army's 7th Division in an area ten miles northwest of Phnom Penh. Thus far, the division has held its own.

Despite the fact that a substantial portion of the capital's regular defense force is committed to these two areas, the Khmer Communists have not tried to attack poorly defended installations closer to Phnom Penh or to cut Routes 4 and 5, the capital's vital supply lines. Instead, the insurgents are using conventional tactics in an effort to grind down government strength and slowly tighten the ring around the capital. Although these tactics leave the Communists vulnerable to air and artillery strikes, they seem quite willing to take substantial losses in personnel and equipment.

In a bid to improve the deteriorating situation, the government has ordered a "general mobilization." This move is aimed largely at providing badly needed manpower for the armed forces. A conscription law is being implemented, large numbers of deserters are being rounded up to return to military duty, and personnel from the general staff and other military offices in Phnom Penh are being assigned to field units in the capital area. [REDACTED]

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LAOS: The negotiations in Vientiane are moving forward. Chief government negotiator Pheng Phongsavan says that his Communist counterpart, Phoumi Vongvichit, made significant concessions on 24 July. Phoumi reportedly is willing to drop his demand that Communist leader Souphanouvong be appointed sole deputy prime minister and is no longer insisting that the Communists be given the defense or interior ministry.

In return for these concessions, Pheng stated that the Communists would insist on only one thing-- that they have a veto over the operation of joint Lao mobile inspection teams that are to verify the withdrawal of foreign forces. Pheng believes that Souvanna will accept this demand in order to get a new government formed by 15 August.

Some significant problems must be overcome before the Prime Minister's deadline can be met. If Pheng cannot iron out the remaining issues with Phoumi, Souvanna will personally take charge of the talks. The Prime Minister believes that it is time to reach an agreement and may quickly accept Communist terms on the remaining issues.

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INTERNATIONAL MONETARY DEVELOPMENTS: News of another large West German trade surplus in June, together with continuing tight credit conditions there, drove up the value of the mark against all major currencies yesterday. Despite substantial support from the Bundesbank, the dollar fell almost a full percentage point relative to the mark.

The mark was worth 44 cents yesterday as opposed to 31 cents a year ago, and it is back again at the top of the European joint float band only a month after the latest revaluation. Although the other joint float currencies are being pulled up along with the mark, the gap between the strong and weak has been widening, thus putting the joint float in jeopardy. The weakest ones--the Dutch guilder, the Norwegian and Swedish crowns, and the French franc--all needed substantial Bundesbank intervention to maintain the narrow European currency band.

Germany's trade surplus of \$710 million last month compared with \$390 million in June 1972 indicates how ineffective a parity change can be under unsettled market conditions. The 41-percent appreciation of the mark relative to the dollar since December 1971 has done little to reduce the international competitiveness of German goods. Only 10 percent of German trade is with the US, while over 50 percent is with joint float countries whose currencies relative to the mark have depreciated far less.

Bonn has several options:

--it can continue to purchase dollars and joint float currencies in increasing amounts, thereby undermining the Bundesbank's anti-inflationary policy;

--it can revalue the mark again;

--it can break away from the joint float altogether.

(continued)

Bonn has so far been unwilling to follow the last course, which could have a detrimental effect on European unity.

Meanwhile, the decline of the pound accelerated, and yesterday it reached its lowest level since April. The decline is related to a poor trade performance and continuing inflation in the UK, as well as to high interest rates on the continent. The decline apparently is being fed by trader expectations of further weakness of the pound. Such expectations have been a major factor in the dollar's decline this summer as well.

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CHILE: The formula President Allende has been seeking for easing tensions may be nearer his grasp, but it still eludes him.

In an impassioned speech on Wednesday, Allende reiterated his plea to the opposition Christian Democrats to help avert civil war by entering into a dialogue with his government. The President emphasized once again that this would not mean a retreat from Popular Unity principles or programs, but he dealt with major issues of concern to the Christian Democrats and the armed forces in conciliatory terms.

The Christian Democrats reportedly are ready to begin talks with the government if the armed forces participate as members of the cabinet. In his speech Allende denied rumors that the re-entry of the armed forces into his government is imminent,

[REDACTED]

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Allende's condemnation of leftist "ultrarevolutionaries" as tools of the far right may be a sign that he is trying to rally his more moderate supporters behind a compromise with the armed forces on the conditions under which military officers would re-enter the cabinet. He may also be seeking to split the Socialists and the Communists, in their tough stand on this and other issues, a stand that has been hampering his own ability to maneuver. In so doing, of course, Allende risks seriously straining his governing coalition.

Allende must also try to prevent activities by leftist and rightist extremists and by private groups--such as the truck owners' strike declared yesterday. Such activities could provoke military action against the regime before a political truce can be arranged. Pressure from middle-grade officers for independent military action to resolve Chile's problems is on the rise, and serious plotting at higher levels, especially in the navy and air force, appears to be increasing.

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ISRAEL: Defense Minister Dayan has fired an opening salvo in the campaign for the elections in October by suggesting he might not be able to run on the Labor Party ticket unless he is satisfied with the party platform.

Dayan believes a peace settlement with the Arabs is a long way off, and he favors an activist policy of Israeli settlement and Israeli economic development in the Arab territories. Other notables in the ruling Labor Party--Prime Minister Meir, party boss Sapir, and Foreign Minister Eban--have been decrying this "creeping annexation" idea in their campaign speeches. They point to the economic costs, the demographic threat posed by Arab populations, and the permanent block to a peace settlement that such policies entail.

To keep Dayan in the party, however, they will have to go at least part way to meet his demands. On the other hand, despite his popularity, Dayan does not really want to pursue his political career outside the party or give up his defense portfolio, and in time he too will probably make a pragmatic accommodation with the party leaders. [redacted]

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WORLD YOUTH FESTIVAL: The tenth World Youth Festival opens tomorrow in East Berlin. Its organizers hope to garner international support for Communist, and particularly Soviet, policies from 20,000 young and not-so-young delegates.

Sponsored by the World Federation of Democratic Youth and the International Union of Students, the festival will be dominated by Communist and Communist-front groups. Non-Communist groups, mainly from the less-developed states, will also take part. The nine-day extravaganza will focus on Southeast Asia, the Middle East, national liberation movements, international security and cooperation, monopolies, and fascism.

This will be the first such event since the predecessor festival in Sofia in 1968 was disrupted by the New Left and other unruly groups. This year, the East German hosts, anxious to preserve their new-found respectability in the West, have taken precautions to prevent a repeat of the fiasco in Bulgaria. Stringent security measures have been instituted to counter any demonstrations, whether by West German or other elements. Despite such measures, Pankow still fears that incidents may be provoked by Arab extremists or leftist fringe groups.

The Soviets also hope to keep the conference under control. They will seek to impress the delegates with the need for the unity of anti-imperialist forces, but will defend their pursuit of detente as being in the interest of all progressives. [redacted]

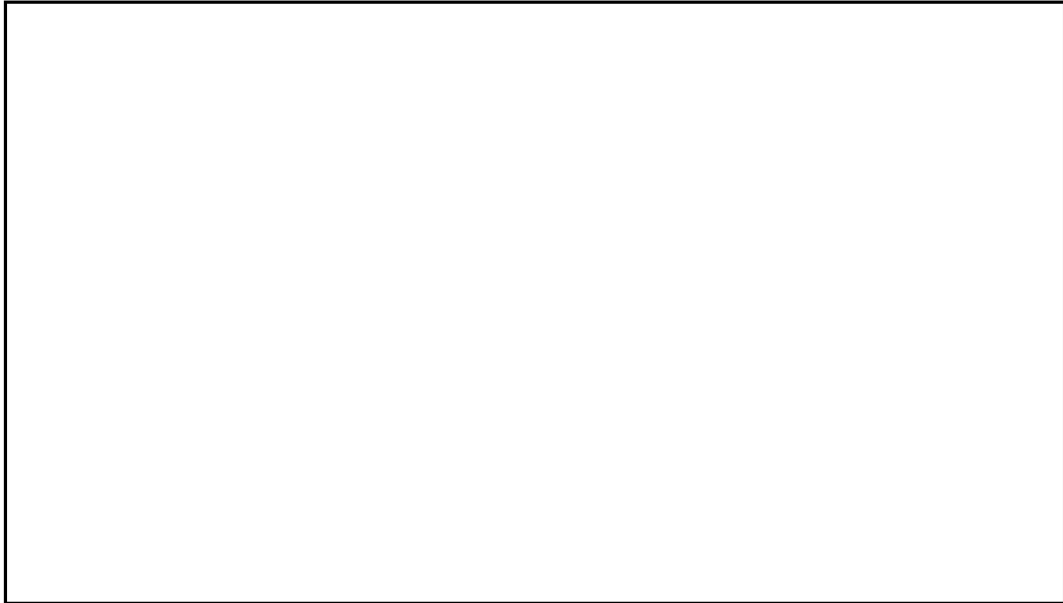
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FOR THE RECORD*



Mozambique: The Portuguese Defense Ministry has named General Tomas Basto Machado to be the new commander in chief of forces in Mozambique. [redacted]

[redacted] Lisbon had been dissatisfied with the former commander's inability to halt the spread of the Mozambique insurgency. Adverse publicity over alleged atrocities during his command may have hastened the day of his removal.

[redacted]

**These items were prepared by CIA without consultation with the Departments of State and Defense.*

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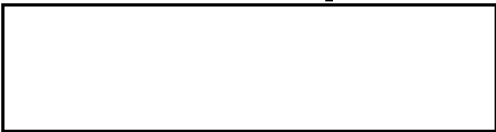
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