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National Intelligence Bulletin

February 6, 1976

CONTENTS

ITALY: Way cleared for formation
of Christian Democratic government 1

MOROCCO-ALGERIA: Antagonists silent
after Egyptian mediation efforts 5

ICELAND-UK: British frigates
return to fishing zone 7



25X1

WEST GERMANY: High-level
consultations with Bonn's closest allies 9

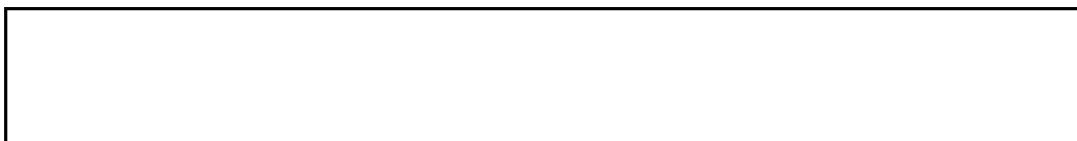
PORTUGAL: Military and
political parties revising pact 10

YUGOSLAVIA-SPAIN: Movement
toward reestablishment of relations 11

FRENCH TERRITORY OF THE AFARS AND ISSAS:
Somali border territory remains quiet 12

LEBANON: President Franjiyah
will visit Syria tomorrow 13

INDIA: Last opposition-controlled
state government may end 13



25X1

JAPAN: Planned expansion
of territorial waters 16

THAILAND: Condensation of
interagency intelligence memorandum 17



National Intelligence Bulletin

February 6, 1976

ITALY

The way has been cleared for Aldo Moro to form a Christian Democratic minority government in Italy, although his Christian Democrats still have misgivings about doing so.

The stop-gap solution became possible yesterday when the Socialists and Republicans, who have been at loggerheads over economic policy, agreed to abstain in parliament on Moro's package of emergency economic measures.

Their abstentions, coupled with support Moro obtained from the Social Democrats, would enable the Christian Democrats to win a confidence vote and secure approval of their economic legislation.

The Socialist Party admitted that it had failed to achieve the objectives it sought in toppling the previous government a month ago—a larger Socialist role in a new government and more open consultations with the Communists.

The Socialists tried to put the best face on this by saying, in effect, that their decision to abstain was taken in the national interest. They made clear that they would merely tolerate a Christian Democratic government and would continue to criticize its policies.

There is no enthusiasm in the Christian Democratic Party over the prospect of governing alone. The Socialist and Republican offers of abstention fall short of the "majority support" on economic policy the Christian Democrats desire.

The government Moro has in mind would have a narrower parliamentary base than any formed in the last four years and would expose the Christian Democrats to criticism from all sides if the economy continued to deteriorate.

Some Christian Democratic leaders are reportedly arguing that a parliamentary election is preferable.

Factors that encourage the Christian Democrats to push ahead are the need for a government that can take action to support the weakening lira and the need for more time to sort out their political options.

Such a government would probably last only a few months, but would permit the Socialists and Christian Democrats to hold scheduled party congresses and debate in a calmer atmosphere the pros and cons of a parliamentary election.

National Intelligence Bulletin

February 6, 1976

An early election would probably result, if, after the congresses, the parties failed to put together a coalition based on Christian Democratic collaboration with the Socialists.

Moro's compromise economic program combines the austerity and credit squeeze sought by the conservative Republicans with the job-saving provisions sought by the Socialists.

The program will help restore a modicum of confidence, but is unlikely to propel the economy toward recovery.

The most important parts of the package are:

- Raising tax revenue by imposing new taxes on profit-margins, tightening up on collection.
- Limiting spending by monitoring state expenditures.
- Holding down incomes by a partial wage freeze for the top 10 percent of white collar workers and urging moderation on blue collar workers.
- Creating jobs by establishing an apprenticeship program to employ up to 50,000 young people and revising current income maintenance programs for unemployed.

The program recognizes that structural reforms will be required if chronic inflation and balance-of-payments problems are to be alleviated. The program reaffirms—without going into contentious detail—the government's interest in longer range plans to invest \$26 billion over five years in industry, to restructure the industrial sector, and to revise the southern development fund.

The package contains something for everyone, although the Socialists apparently yielded the most. They did not succeed in gaining as vigorous an employment policy as they wished, nor did they gain approval for a scheme to transfer the costs of many social benefits from manufacturers to the state.

The government is not proposing a stringent credit squeeze, as the Socialists demanded, but is allowing monetary authorities to adopt measures to soak up excess liquidity.

The labor unions—now in the midst of contract negotiations—avoided direct controls on wages.

The Republicans are likely to lament the lack of teeth in the emergency program.

National Intelligence Bulletin

February 6, 1976

The lira is up 2.5 percent from its low point this week. It grew stronger in response to government monetary action including increased reserve requirements and a higher discount rate. The increase may also have been in anticipation of the new economic policy announced Wednesday.

The restrictive policies will dampen economic expansion, but if they halt the decline in the lira they will lessen the likelihood of renewed import controls.

25X1



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Approved For Release 2007/03/08 : CIA-RDP79T00975A028600010010-3

National Intelligence Bulletin

February 6, 1976

MOROCCO-ALGERIA

Both Morocco and Algeria have remained silent about Egyptian Vice President Mubarak's week-long effort to mediate their dispute over Spanish Sahara, suggesting that little progress was made.

In a press conference on his return to Cairo yesterday, Mubarak sounded a note of optimism, saying that the situation had been defused. He said he had paved the way for further diplomatic efforts and for direct contact between the two sides that would lead to a restoration of normal relations.

Mubarak provided few details, but the Egyptian press has indicated that Cairo is urging the two sides to suspend further military operations, to send their foreign ministers to Cairo for a meeting which would be followed by a meeting of heads of state, including President Sadat.

The Egyptians view the Algerian-Moroccan dispute as an opportunity to regain the credibility they lost in the Arab world because of their inability to influence the Lebanese situation. Cairo is anxious to show that its Syrian antagonists are not the only ones capable of mediating an Arab dispute.

Rabat has strengthened its military forces in Spanish Sahara over the past week.

DIA25X1 [redacted] the US defense attache in Rabat says that nine F-5 fighters are now flying operations from El Aaiun. [redacted]

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The defense attache reports that many Moroccan reservists have been called up recently. Some 7,000 reportedly will be used to form 10 new infantry battalions. It is unlikely that Morocco can outfit the new recruits with anything more than light equipment and weapons.

According to a Moroccan official, Moroccan forces occupied Tifariti, some 65 miles east of Amgala, without opposition on February 4. Another Moroccan official told the US embassy Tuesday that the military sweep in Spanish Sahara is being conducted in a deliberate manner so as to give mediation efforts a chance.

[redacted]

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National Intelligence Bulletin

February 6, 1976

ICELAND-UK

Britain yesterday ordered its warships back into Iceland's disputed 200-mile fishing zone to protect its trawlers.

The move came after an Icelandic patrol boat cut the trawls of a British fishing boat. It was the first such incident since British Foreign Secretary Callaghan warned that further harassment by Icelandic patrol boats would automatically trigger the return of the frigates.

The British frigates were withdrawn from the zone on January 20 to meet an Icelandic pre-condition for summit talks between Icelandic Prime Minister Hallgrimsson and British Prime Minister Wilson. The Icelandic cabinet later rejected British proposals for an agreement worked out at the summit meeting and offered instead to discuss a three-month agreement.

Icelandic Foreign Minister Agustsson recently warned London that the return of the frigates would "inevitably" result in a break in relations. Agustsson also suggested that the Icelandic move would take place in "a matter of days."

Despite his inclination to compromise, Prime Minister Hallgrimsson will be under heavy domestic pressure to retaliate quickly. A break in relations with London may satisfy some, but his more strident critics will demand that Reykjavik follow through on an earlier threat to withdraw its NATO delegation.

Reykjavik is in no hurry to work out a fishing agreement with London, and the return of the frigates all but destroys prospects for a new round of talks. The Icelanders are aware that the British position regarding the illegality of a 200-mile fishing zone is quickly eroding. The British position may be even less tenable if, as is expected, the UN Law of the Sea Conference approves the 200-mile concept after it convenes in March.

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Approved For Release 2007/03/08 : CIA-RDP79T00975A028600010010-3

National Intelligence Bulletin

February 6, 1976

WEST GERMANY

West German Chancellor Schmidt is beginning a week of high-level, but routine, consultations with Bonn's closest European allies. He arrives in London today for an exchange of views on European and bilateral issues with Prime Minister Wilson. He proceeds to France next week for the latest round of semi-annual Franco-German talks.

The Schmidt-Wilson meeting will focus on the current economic problems facing Western Europe. Wilson also intends to raise the issue of renewing the five-year bilateral agreement to offset the costs of maintaining British troops in West Germany. He will push hard for increasing German payments considerably above the \$40 million paid Britain each year under the current agreement that expires on March 31.

Schmidt is likely to be reluctant to go into this issue too deeply. At most, probably only a broad understanding will be reached, with the details being left to the foreign ministers, who will meet in London later this month.

On other European issues, Schmidt will attempt to draw out the British on their plans for electing representatives to the European Parliament beginning in 1978. Concerned about NATO unity, he may also counsel the British to accommodate Iceland in the fishing dispute.

The Franco-German summit in Nice, France, on February 12-13 will build upon the mutual trust and respect that developed between Schmidt and Giscard even before they assumed their present positions in the spring of 1974. The climate of bilateral relations is now largely free of major frictions, in contrast to French nervousness over Ostpolitik that marred the Pompidou-Brandt relationship.

There is no fixed agenda because both leaders prefer informal dialogue. Given their common background as finance ministers, economic and monetary issues will be at the forefront of their discussions. The Tindemans report on the future of the European Community and the status of the European Parliament will also receive attention.

The exclusion of the defense ministers from participation in the Franco-German talks suggests that neither side expects to discuss military issues in depth. The importance ascribed to European defense cooperation in the Tindemans report and the new interest France has shown over the last six months in beginning talks on European cooperation on arms production and standardization does suggest that these topics could be raised during the talks.

25X1

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National Intelligence Bulletin

February 6, 1976

PORTUGAL

A new agreement revising the April 1975 pact between the Armed Forces Movement and the political parties, which called for military dominance in government for three to five years, may be signed next week.

Revolutionary Council negotiators have completed the first round of discussions with each of the major political parties and will hold a second round when a new draft proposal embodying agreements reached thus far is prepared. The Council has reportedly given in on all important points, dropping its proposals for a military veto over the selection of the prime minister and for extensive Council legislative authority. Moreover, the Council is said to have agreed to weaken considerably its proposal for military review of the constitutionality of laws. A joint military-civilian tribunal reportedly will be established to review only limited types of legislation—probably those dealing with military issues and perhaps foreign policy.

The negotiations have progressed despite opposition from the Communist Party which, recognizing its electoral weakness, would prefer continued military domination of government. The successful conclusion of a new pact within the near future would allow the Constituent Assembly to finish its work, removing one of the last obstacles to holding legislative assembly elections, as hoped for, in late April.

25X1

National Intelligence Bulletin

February 6, 1976

YUGOSLAVIA-SPAIN

Yugoslavia and Spain may re-establish diplomatic relations. No formal relations have existed since the Spanish Civil War. Both countries are represented by trade missions.

A Yugoslav journalist will visit Spain shortly to write a story designed to prepare the Yugoslav public for the eventual re-establishment of diplomatic ties with Madrid.

Representatives of the Yugoslav Foreign Secretariat visited Madrid on January 26 and may have discussed bilateral problems and exchanged views on international issues. One impediment to normalized relations was removed when Madrid promised to stop anti-Tito broadcasts in the Croatian language from Spanish radio stations.

There is, however, still a serious problem for Belgrade in Spain's traditional status as a safe-haven for anti-Titoist emigres. Another complication is Belgrade's active support for the Spanish Communist Party in exile.

The renewal of Spanish-Yugoslav diplomatic relations may take some time until these difficulties are set aside.

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National Intelligence Bulletin

February 6, 1976

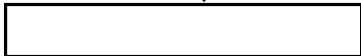
FRENCH TERRITORY OF THE AFARS AND ISSAS

The border between Somalia and the French Territory of Afars and Issas remained quiet yesterday following a clash between French and Somali forces on Wednesday. The exchange occurred when French troops stormed a school bus near the border to free 30 French school children held hostage by guerrillas demanding immediate independence for the territory. Paris reports the Somalis opened fire on the French troops, who then returned the fire.

The guerrillas were members of the Somali-backed Front for the Liberation of the Somali Coast, which is little more than a paper organization. The guerrillas managed to slip one of the children into Somalia and they say the child will be released only if France grants immediate independence to the territory and frees political prisoners held in the territorial capital of Djibouti.

France has flown some two hundred gendarmes to the territory as reinforcements. Local French officials fear pro-Somali forces might attempt to stir up trouble.

France and Somalia were already at odds over French plans to grant independence to the territory. Paris had hoped to convince President Siad's government to abandon Somalia's historical claim to the territory. Siad, however, has criticized French plans to transfer power to the present territorial government led by a long-time Somali foe. Siad reportedly is preparing to support an insurgency in the territory if France does not make acceptable independence arrangements.



National Intelligence Bulletin

February 6, 1976

LEBANON

The government has announced that President Franjyah will make his long-planned trip to Syria tomorrow. Franjyah and Syrian President Asad presumably will try to work out the remaining details of a political settlement for Lebanon, and soon after publicly announce their agreement.

The announcement probably would lead to a general relaxation of tensions in Lebanon, and, according to Prime Minister Karami, would open the way for an expansion of the Lebanese cabinet to include representatives of all political factions.

Palestine Liberation Organization chairman Yasir Arafat will go to Damascus today, almost certainly to seek assurances that Damascus will not agree to Franjyah's expected request that Syria enforce stricter controls on fedayeen movements in Lebanon.



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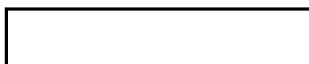
INDIA

The government of Gujarat—now the only state of India's 22 still ruled by parties in opposition to Prime Minister Gandhi—may be on the way out. The disparate coalition that came to power last June after defeating Gandhi's Congress Party appears close to breaking up over disagreements among the partners.

Gandhi has two options: she may wait for the government to fall and then give her party a chance to form a government with the help of opposition defectors and independents; or she may impose direct rule before the coalition falls—as she did in the state of Tamil Nadu last week. She could claim that the coalition is unable to govern effectively. The latter course would give her party time to concentrate on rebuilding its popular support in preparation for new elections, whenever they are held.



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Approved For Release 2007/03/08 : CIA-RDP79T00975A028600010010-3

National Intelligence Bulletin

February 6, 1976

JAPAN

Under pressure from local Japanese fishing interests, Prime Minister Miki promised earlier this week that Japan would extend its territorial limit to 12 miles by the end of the year.

Upset by recent expansion of Soviet and South Korean fishing operations off Japan's coasts, Japanese coastal fishermen have lobbied successfully for extending the territorial limit; over 85 percent of the Japanese Diet members now support their position. The recent US Senate vote to establish a 200-mile fishing zone has added impetus to the move.

Tokyo will defer any action until after the spring and summer sessions of the Law of the Sea Conference. The government is concerned about the international trend toward curbing access to fishing grounds—which will damage long-range Japanese fishing interests—and has spoken out strongly against unilateral actions in advance of decisions by the conference.

The government is also concerned about the question of passage of ships carrying nuclear weapons through straits separating the Japanese islands. The straits are now international waters, but would fall within Japanese territory if the limit is extended. Opposition parties argue vigorously that passage of such ships through Japanese territorial waters would violate Japan's "three non-nuclear principles," which among other things forbids the presence of nuclear weapons within Japanese territory.

The government hopes to finesse the issue by claiming that international law takes precedence over national policy. On February 3, Foreign Minister Miyazawa stated publicly for the first time that if a consensus recognizing free passage through straits emerges from the Law of the Sea Conference, Japan will conform to it. Tokyo clearly hopes the conference will take it off the hook on this issue, and the Japanese delegation reportedly has been instructed to lobby to that end.

25X1

National Intelligence Bulletin

February 6, 1976

THAILAND

The Bulletin today offers a condensation of an interagency intelligence memorandum, The Thai Election and Its Implications for the US, dated February 4.

With an election scheduled for April, Thailand is experiencing a growing sense of malaise concerning the country's experiment with parliamentary democracy.

--This sentiment is expressed by King Phumiphon, the military, and many prominent civilian figures.

In these circumstances, there is a strong possibility that the military might decide to assume control. For the moment, the King appears to be against such a course, and many military leaders would be loathe to act against the King's wishes. The situation is fragile, however, and subject to quick change.

--Some younger officers are maneuvering to force their superiors to take a stand on the question of a military take-over.

--Given the rivalries within the military, it is also possible that one or another military leader might attempt a preemptive coup.

Other developments which would increase the likelihood of a coup are:

--A sharp deterioration of the security situation.

--A breakdown in public order caused by widespread strikes or antigovernment disorders.

--The prospect of a left-of-center coalition coming to power that would threaten the vested interests of the military and conservative elements.

Short of a coup, there is also a possibility that the election may be postponed, leaving Khukrit, the present caretaker prime minister, to rule through emergency decree.

--Khukrit, the military, and the King may well come to prefer this alternative to going through with the election.

Implications for the US during the election campaign:

--By the March 20 deadline on the removal of US combat forces, the US will probably be able to complete the negotiations now in train with the Khukrit government regarding the residual US military presence.

National Intelligence Bulletin

February 6, 1976

--But there is no assurance that an agreement signed by Khukrit will be honored by a new government.

--The election campaign probably will complicate Thai-US relations. The US presence is likely to become an issue in the campaign, and campaign pressures may force some candidates to insist on a total US military withdrawal.

--The recent appointment of Anan Panyarachun, former ambassador to the US, as the Foreign Ministry's undersecretary, adds another element of uncertainty to Thai-US relations. Anan, who takes office at a time when Foreign Minister Chatchai will be concentrating most of his attention on the election, may try to take advantage of the situation to give Thai foreign policy a more neutralist cast.

25X1

Implications for the US after an election:

--If an election is held, it would be likely to bring another centrist-conservative government into power.

Such a government would probably be as fragmented and contentious as the present government, but it would maintain Thai policy toward the US more or less along present lines.

--A less likely possibility is either a coalition based exclusively on rightists, or one including the Socialists.

A rightist government would be cooperative with US interests, but would still be restrained by political considerations on how far it could go, or appear to go, in accommodating the US.

--A government in which the Socialists had a strong voice would make it difficult, if not impossible, for the US to maintain any military presence in Thailand.

Such a government, however, could prompt the military either to force the government to resign or to overthrow it.

In the event of a military take-over, the resultant government would be sympathetic to US interests.

National Intelligence Bulletin

February 6, 1976

--It would be unlikely, however, to reverse the long-term trend toward a more nonaligned Thai foreign policy.

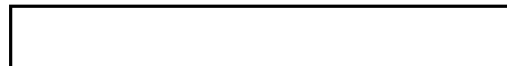
Nevertheless, a military government might call for a substantial increase in US assistance if faced with a greatly expanded insurgency or a breakdown of civil order in the country. [redacted]

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