The President's Daily Brief

January 16, 1975

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USSR

Moscow, thus far, seems to be playing down the broader implications for detente following its rejection of the US-Soviet trade agreement.

Premier Kosygin made repeated references to the necessity of continuing detente in the course of a banquet speech on January 14 honoring Australian Prime Minister Whitlam. Kosygin, the first Soviet leader to speak on foreign policy issues since the USSR's note to the US last Friday, specifically reiterated Moscow's goal of making detente "irreversible." His evident effort to indicate, without mentioning the US, that detente is still on the track will be reinforced for the Soviet public by an otherwise routine Soviet press announcement Wednesday regarding the resumption of SALT.

Moscow Radio informed its domestic audience of Secretary Kissinger's statement in a Tass summary broadcast 12 hours after the US announcement. The Tass summary, carried in Izvestia on January 15, said the Secretary noted the Soviet government's message that it does not intend to accept a trade status which is discriminatory and subject to political conditions and accordingly would not bring into force the 1972 trade agreement. The report concluded with the Secretary's assurance that the administration would continue to pursue all avenues, including legislation, to promote mutually beneficial trade relations.

A possible sign that the leadership has hope of an eventual reversal of its fortunes on the trade issue occurred on Tuesday when a Soviet commentator laid the blame for the trade impasse on an anti-detente faction in the outgoing Congress. He said that many of this faction remain in the new Congress, but he also noted that the new Congress would have a different complexion. Moscow may hope that its tough line will convince Congress to reconsider its action.

Internal Impact

The decision not to accept the conditions of the US trade and Export-Import Bank bills, and the events that led up to it, were a sharp setback to

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a major element of General Secretary Brezhnev's detente policy and may ultimately affect his basic political position. He has also suffered a recent setback in his consumer program and an embarrassing postponement of his visit to Egypt.

Brezhnev has remained out of public sight since December 24, except for attendance at the funeral of his mother on January 8. He entered the hospital on December 26, and returned there after the services on January 8. [redacted] 25X1 25X1

There is no evidence of a crisis atmosphere within the leadership or signs of a concerted challenge to Brezhnev's position. He faces the problem, however, [redacted] 25X1 25X1 from leading to an erosion of his authority. To prevent this, he must resume an active work schedule and give a new impetus to domestic and foreign policies. The pressures to take an active role will increase as politicking for next year's party congress picks up.

Economic Impact

The Soviet rejection of the agreement should not substantially affect the volume of US-Soviet trade in 1975. Two-way trade was approximately $1 billion in 1974--down from a high of $1.4 billion in 1973, when the USSR imported large quantities of grain. Trade in 1975 is expected to be above the 1974 level. Exports of US capital goods to the USSR in 1975 will be determined largely by Soviet orders placed in 1972-1973, when Export-Import Bank credits were available. Three fourths of the roughly $1 billion in US orders backed by Export-Import Bank financing have yet to be exported. US exports also will be boosted by deliveries of some $350 million in grain previously ordered by the USSR.

The lack of Export-Import Bank financing could, however, reduce substantially the volume of future contracts placed in the US. Western Europe and Japan, which continue to grant lower interest credits, could be the principal beneficiaries.

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The Soviets may be able to obtain commercial loans from US banks to cover US exports of equipment as long as the USSR is willing to pay market interest rates and guarantee the loans. Furthermore, the USSR currently enjoys the strongest financial position it has had at any time in its history, and could keep buying from the US even on a cash basis. The prospects of major cooperative projects such as the development of Yakutsk natural gas will be dimmed considerably, however, without Export-Import Bank funds.

EGYPT

President Sadat has linked the continued presence of the UN Emergency Force in the Sinai Peninsula to further Israeli withdrawals on all Arab fronts. He stopped short, however, of imposing conditions for the extension of the UN Sinai mandate, which expires on April 24.

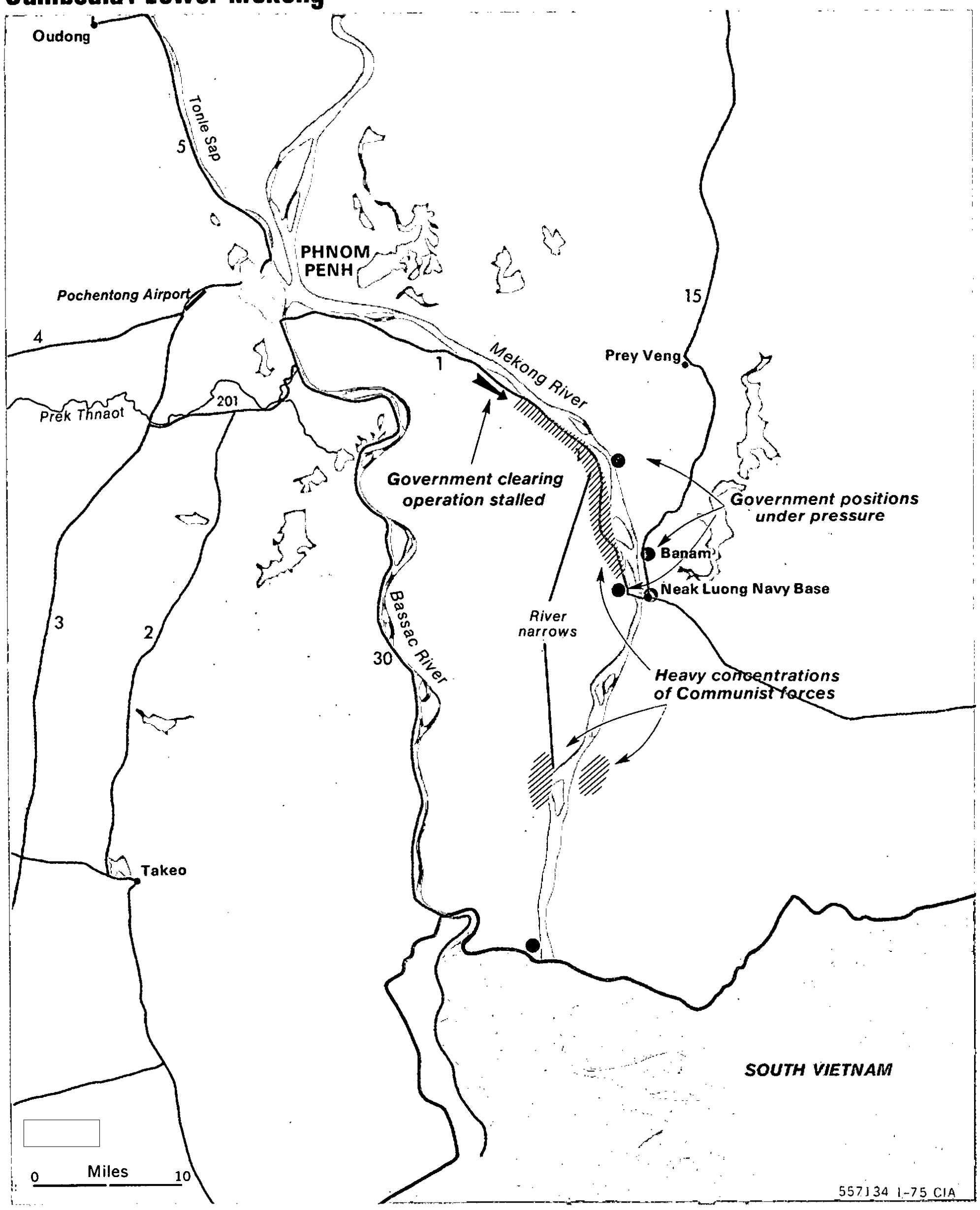
According to an authoritative Cairo news service account of the President's meeting with a group of French legislators, Sadat said, in a reference to renewal of the mandate, that Israel "must withdraw a further distance on the three fronts"--Sinai, the Golan Heights, and the West Bank. He did not explicitly demand, however, further pullbacks on all fronts before the status of UN forces in the Sinai comes up for review. He noted only that Egypt would decide the mandate issue "in the light of the situation and of Israel's behavior."

Sadat probably intended by his remarks to press for quick progress on a second-stage Sinai withdrawal by hinting he would not renew the UN mandate unless a withdrawal agreement has been concluded by late April. He may, in fact, intend to cancel the mandate if there is by then no satisfactory progress toward an agreement.

Despite Sadat's linking of the situation on the other Arab fronts with the status of UN forces in the Sinai, it is unlikely he would condition continuance of the UN Sinai mandate on agreements in the other areas. Should Egypt achieve an agreement with Israel in the Sinai by April, cancellation of the UN mandate would jeopardize that agreement by removing the force that polices the disengagement lines and keeps Israeli forces behind those lines.

Sadat also told the Frenchmen that when the Suez Canal is reopened, Egypt will permit passage by ships of "all nations except Israel as long as the state of war continues." This restriction would not necessarily preclude the passage of Israeli cargoes and crews in ships flying the flags of other nations. The Israelis have said that these indirect passage rights were part of the disengagement agreement last year, and they will insist on a recommitment from Egypt in return for another withdrawal in the Sinai.

Cambodia: Lower Mekong



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CAMBODIA

Heavy fighting along the Mekong River north of the navy base at Neak Luong and continued Communist control of the river banks south of Neak Luong have forced the postponement of a large resupply convoy originally scheduled to move upriver from South Vietnam at mid-week. Phnom Penh has a five-week supply of rice and enough fuel and ammunition to support military operations through the end of the month. These stocks are being supplemented by increased air deliveries.

Communist ground attacks in the Neak Luong area are still centered on the town of Banam and on government positions on the west bank of the river opposite the navy base. Government troops are fighting well; navy convoys from Phnom Penh are still getting through to Neak Luong but are running into heavy Communist shellings. Government forces trying to push down Route 1 toward Neak Luong are still meeting stiff resistance some 15 miles southeast of Phnom Penh.

In the immediate Phnom Penh area Communist initiatives remain limited to shellings and ground probes--primarily against the Cambodian army's 7th Division northwest of the city. Government counterattacks on the east bank of the Mekong opposite the capital are beginning to make some progress.

Insurgent commanders have exhorted units in outlying areas to increase pressure against a number of government-held provincial capitals, but so far only small-scale attacks have materialized.

OPEC INVESTMENT

OPEC states quadrupled their holdings of dollar assets, including Eurodollars, during the first nine months of 1974. At the end of September, they held at least $34 billion. Unless OPEC members reduce the dollar component of their total investment, their dollar holdings will approach $100 billion by the end of 1975.

The foreign official assets of the OPEC states grew from $21 billion at the end of 1973 to $52 billion at the end of the third quarter of 1974. Dollar-denominated holdings increased from about $8 billion, 40 percent of the total, to at least $34 billion, or nearly two thirds of the total.

The growing concentration in dollar holdings reflects both the ability of international dollar markets to satisfy OPEC investment goals and the lack of attractive alternatives. The depth and versatility of the Eurodollar and US capital markets have enabled producers to retain effective control over their investment, to earn a reasonable return, and to minimize the risk of political seizure. Investment in other currencies has been constrained by greater concern over devaluation (as in the case of sterling), by capital controls, and by the limited size of domestic markets.

About 45 percent of OPEC dollar holdings are located in the London Eurodollar market and 35 percent in the United States. The remainder has been placed in other European countries, Canada, and Japan and with international organizations.

$34
.35
170
102
$12 in the U.S
.9
$11 in US
short term

Because of the premium placed on security and liquidity, short-term bank deposits and government securities account for 90 percent of OPEC dollar assets. Holdings of real estate and equities rose from 5 percent of the total in December 1973 to 10 percent in September 1974.

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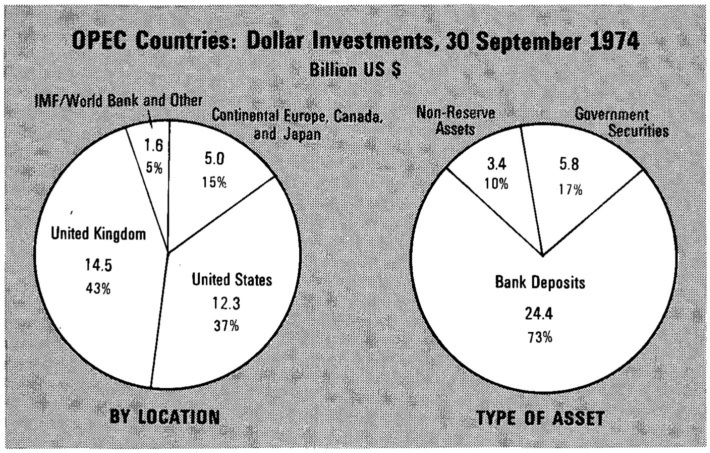

Four countries--Saudi Arabia, Kuwait, Iran, and Venezuela--accounted for 80 percent of OPEC dollar holdings on September 30, 1974. Saudi Arabia alone accounted for about 35 percent. Venezuela, Saudi Arabia, Kuwait, and Nigeria were the largest holders in the United States, with more than 75 percent of that total.

The dominance of the dollar in international trade and finance assures a continued heavy inflow of OPEC investments. Assuming stable oil prices and output, foreign official holdings of OPEC states should increase by about $60 billion in 1975. If the shares of investment in dollars remain unchanged, OPEC dollar holdings will grow to almost $100 billion. Even in the event of a sharp decline in US and Eurodollar short-term interest rates, we would not expect a substantial drop in the share of OPEC wealth going into dollar assets. A fall in short-term interest rates could, however, force a larger share of OPEC dollar holdings into assets with longer maturities.

The continued concentration of OPEC investment in dollar-denominated assets intensifies the recycling problem. Because banks are unwilling to undertake a substantial long-term exchange rate risk, consuming countries are forced to borrow dollars to finance oil-induced balance-of-payments deficits. Dollar liabilities, unlike those denominated in domestic currencies, carry the additional burden of an exchange rate risk. The potential loss from currency realignments and other international payments uncertainties could reduce consumer-country willingness to finance higher oil import costs for a sufficient period to allow gradual adjustment to an acceptable pattern of current account deficits.

UNITED KINGDOM

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MULTILATERAL TRADE NEGOTIATIONS

Multilateral trade discussions resume in Geneva next week, in the wake of the enactment of the US Trade Act of 1974. In spite of the precipitous rise in oil prices and emergence of widespread stagflation since the Tokyo discussions of 1973, some of the basic positions of the participants remain unchanged. Certain countries will doubtless voice concern about liberalizing trade in the midst of recession. Differences over the use of export controls will also emerge.

One of the major issues of concern within the EC, particularly in France and Italy, is that new trade concessions will increase domestic unemployment. In this connection, the European and Japanese press characterize the US Trade Act as a "double-edged sword" with protectionist provisions that could be invoked if the economic decline continued.

Assured access to goods in short supply also has become a major issue. Japan and the EC favor substantial limitations on the use of export controls. Canada and Australia, however, regard control over raw material supplies as their main bargaining chip and will probably use their leverage in this area to obtain concessions in others. LDCs, meanwhile, prize their new-found market power and will try to maximize their benefits without conceding any freedom to restrict supplies.

Objectives of the Developed Countries

Overall, the EC has more limited objectives in the trade negotiations than does the US. The Community views the talks as a means of preserving economic peace with the US and avoiding a trade war. The EC has two basic aims: preservation of Community institutions and maintenance of trade peace. The EC will push for harmonization of tariffs on industrial goods (reducing high tariffs by a greater percentage than low tariffs) and for international agreements covering all aspects of trade in major agricultural commodities. While it recognizes that it may have to make concessions allowing freer access to community markets for some commodities, the EC intends to preserve the basic principles of the Common Agricultural Policy (CAP). The Community position will represent a compromise between the limited objectives of the French and the more liberal aims of the British and Germans.

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Paris views the EC as an integrated independent grouping that should be largely free of external influence. It regards the Common External Tariff and the CAP as linchpins of European unity and will resist any changes that would weaken these. As the French see it, the harmonization principle could involve raising as well as lowering tariffs.

Bonn believes that tariffs should be cut appreciably and that harmonization is not an end in itself. West Germany is more willing than France to negotiate on agriculture, since it is disenchanted with various aspects of the CAP. While the Germans support the idea of world commodity agreements, they oppose the inclusion of food aid and internationally supervised storage facilities in such arrangements.

London shares Bonn's positions on tariffs and agriculture. Though favorably disposed toward the talks, the British feel that current economic uncertainties could stifle progress at Geneva.

Less is known about the Japanese and Canadian negotiating positions, since they, unlike the US and the EC, do not have to develop a negotiating mandate. Japan favors uniform percentage reductions in tariffs on all industrial products and supports the concept of agricultural commodity agreements. The Canadians want to negotiate tariff reductions sector by sector rather than to apply an overall formula. While Ottawa is closer to the US than to the EC position on agriculture, preferring freer market access for agricultural products, it probably will not vigorously oppose the Community proposals.

LDC Positions

The less developed countries are expected to insist on preferential application of any new trade arrangements. They are concerned about market access for their products and the effects of tariff reductions on advantages conferred by trade preferences. They are likely to push hard for improvements in the generalized system of preferences.

Exclusion of OPEC members from the trade preference provisions of the US Trade Act has evoked sharp criticism from many LDCs, particularly in Latin America. Venezuela and Ecuador protest that they have not restricted oil supplies to the US and that their exclusion from the generalized preferences offered non-OPEC LDCs undermines hemispheric cooperation.

NOTE

Large Israeli *air force exercises that began over the northern Sinai on Tuesday continued yesterday.*

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[redacted] The Israelis probably are continuing to practice ground support tactics [redacted] 25X1 25X1 25X1

ANNEX

Prospects for Hostilities in the Middle East

We see little incentive for resumption of hostilities by the front-line countries in the Middle East during the next two or three months as negotiations move ahead toward an Egyptian-Israeli agreement in the Sinai. Beyond that period, the likelihood of war rises sharply.

--Fedayeen and Israeli raids along the Lebanese border probably will increase and could escalate into wider hostilities.

--Syria may adopt a more militant stance if it sees no prospect for negotiations on the Golan front.

--Israel would seriously consider a first strike if it believed Syria to be on the point of resuming hostilities.

The period just before and after the expiration of the UN mandate on the Golan Heights in late May will be particularly critical.

<u>Syria</u>

Syrian President Asad seems resigned to another Egyptian-Israeli agreement, and if one should be reached within the next two or three months, Syria will be looking for similar progress on its own front. Moreover, Asad's renewal of the UN mandate last November implied an expectation that broader steps toward a settlement--such as the reconvening of the Geneva conference--would be taken within six months. We doubt that Syria would again renew the mandate solely on the basis of promises of future progress toward Syrian and pan-Arab objectives.

Damascus would not necessarily opt <u>immediately</u> for renewed warfare. The mere decision to let the mandate expire would be viewed by Syria as placing strong pressure on the US and Israel. Damascus would also agitate for a new oil embargo as a further means of forcing serious negotiations on the Syrian question. All this would be accompanied by a build-up in the Golan Heights disengagement zones to increase tensions just short of war.

The Syrians might also exploit the current situation along the Lebanese-Israeli border for their own purposes. [redacted] 25X1

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We believe Syria is supporting the fedayeen in southern Lebanon for defensive purposes--in reaction to Israeli raids into Lebanon and out of fear that Tel Aviv may be getting ready to occupy Lebanese territory.

The Syrians may view the situation differently several months from now, particularly if they should see no hope for negotiating progress on the Golan. They might then actively support increased fedayeen forays into Israel. The risk of escalation would be great, but we think the Syrians would be willing to take that risk to break the deadlock.

Israel

There is always the danger that Israel will strike first against Syria in the months ahead. It is hard to predict just when such a decision might be made, for it could be largely a matter of Israel's perception of the threat against it, rather than an accurate reflection of the actual threat. The danger obviously will increase as the date for the renewal of the UN mandate on Golan approaches.

As long as negotiations for a Sinai disengagement are in train, we do not think Israel would risk blowing up these talks--and drawing Egypt into another war--by launching an attack against Syria. If an Egyptian-Israeli agreement is arranged, however, and Syria steps up the pressure for similar progress on the Golan front, the Israelis may calculate that a more satisfied Egypt would not come to Syria's aid, at least not right away.

Israel's concern over US reaction would clearly be a constraint on a first-strike option. The Israelis might calculate, however, that a quick victory over the Syrians could leave the US with little choice but to acquiesce. Many Israelis also seem to see hope that they can count on US public opinion to counter whatever pressures the US government might exert on them. They might bank on this sentiment in the event of a rapid first strike against Syria.

Egypt

Should no Sinai disengagement develop within the next several months, the Egyptians would probably start planning with the Syrians for a two-front attack, probably reserving a decision to go to war

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again until the political possibilities were exhausted. If Syria were attacked, Cairo would not hesitate to open a second front.

A second-stage Sinai withdrawal would make the Egyptians reluctant to join new hostilities and jeopardize their new agreement. But even in this instance, fighting on the Golan Heights, particularly if initiated by Israel, would find Egypt unable to remain on the sidelines for long.

Sadat has lost much of the popularity he won during the 1973 war and, with it, much of his ability to act independently of the other Arabs. He would be under intense pressure to demonstrate that the gains he had won for Egypt did <u>not</u> mean he had abandoned the Arab cause.

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