The President's Daily Brief

February 14, 1975

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USSR

Recent statements by influential Soviet spokesmen amount to the strongest endorsements of detente since the Vladivostok summit in November.

President Podgorny, in an article appearing in Izvestia on Wednesday, said the USSR wants to improve still further its relations with the US and other Western nations. He said Moscow is willing to take practical new steps to advance military detente, as well as economic and political cooperation.

On Tuesday, N. V. Mostovets, a key Central Committee official concerned with US-Soviet relations, spoke privately to an embassy officer in highly optimistic terms. He emphasized the urgent need to build on an already good beginning. Mostovets, fresh from a trip to the US, professed to be encouraged by the vast improvement in US public attitudes toward the USSR since his visit in 1963. He noted that congressional action on "discriminatory" trade legislation had provoked widespread criticism in the US as well as abroad.

Mostovets predictably stressed that Brezhnev's foreign policies had been formulated collectively at the 24th Party Congress in 1971 and continued to enjoy the support of all the top leaders. He asserted that General Secretary Brezhnev would head the Soviet delegation to a "very successful" summit this summer.

Mostovets said the avoidance of war is the main task of our time, a theme that has appeared with regularity in recent Soviet commentaries on detente. Amid recent bilateral friction over trade and emigration policy and persistent mutual suspicions regarding motives in the Middle East, Soviet commentators have increasingly cited the effort at strategic arms limitations as the mainstay of detente.

Two major articles on SALT in Soviet journals this month make the same point. The authors--leading strategic analysts in the USA Institute--heap praise on the Vladivostok accords and are optimistic about the prospects for SALT II. They say the growing strength of the communist states has forced the US to negotiate with the Soviets on the basis of equality. The authors anticipate progress in other areas of US-Soviet relations as a result of success in arms limitations.

CAMBODIA

Following is the precis of the latest National Intelligence Estimate, Prospects for Cambodia Through August 1975, *which the US Intelligence Board approved yesterday.*

The military situation in Cambodia is critical.

--The Khmer communists have embarked on an ambitious dry season campaign aimed at closing the Mekong River.

--They have severely curtailed the flow of supplies reaching Phnom Penh via the Mekong. At this point, there is a three- to fourteen-day supply of critical munitions items in the Phnom Penh area.

--In conjunction with this interdiction effort, the communists are keeping pressure on Phnom Penh in an effort to prevent the Cambodian army from reinforcing the Mekong front.

--For the first time, the Cambodian government faces the threat of collapse from economic factors because food stocks will cover consumption only through mid-March if convoys do not make it up the Mekong.

The communists will be unable to interdict the Mekong continuously, but delays and shipping losses will continue to be such that the "heavy" airlift now scheduled--600 tons per day--will be required to supply the government's minimum ammunition needs for at least the next few weeks.

--The Central Intelligence Agency and the Department of State believe that this heavy airlift will be required until the rainy season widens the Mekong in July or August.

--The Defense Intelligence Agency and the intelligence representatives of the US Army, Navy, and Air Force regard this judgment as overly pessimistic. They believe that the government will order extraordinary measures to regain security along the Mekong and that some essential convoys will get through.

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Thus, they believe that a heavy airlift need not be as prolonged as the Central Intelligence Agency and the Department of State expect.*

--In either case, the risks to aircraft and crews will be substantial, since Pochentong airport would become even more of a priority target for the communists.

Aside from this immediate supply problem, the government's ability to get through the whole of the dry season ending in August depends on its receipt of supplemental US military and economic aid.

--If no additional aid is forthcoming, the military situation will deteriorate rapidly, starting in late March or early April at the latest. The economic situation will also steadily worsen. In such a situation, pressures against the government for a settlement, even on communist terms, could become overwhelming.

--If the Cambodian government receives additional aid in this fiscal year, it should be able to get through to the end of the dry season. But this situation would offer little prospect of the government regaining the overall initiative and would allow the communists to further consolidate their control over most of the country.

--War-weariness is widespread in Cambodia and increasing numbers of Cambodians are coming to the belief that there is no relief in sight.

--The chances for a breakthrough on the negotiations front are poor. Although they currently lack the ability to bring Phnom Penh down by a frontal assault, the communists appear to have the incentive, tenacity, and external support to continue the war indefinitely.

*The Department of the Treasury believes that the estimate is not sufficiently clear regarding the prospects for delivery of economic aid supplies up the Mekong in the event the necessary funding is provided.

CYPRUS

The Turkish Cypriot declaration yesterday establishing a separate state pending agreement on a proposed Cyprus federation has prompted the Greek and Greek Cypriot governments to refer the issue to the UN Security Council. President Makarios called the Turkish Cypriot action a "very severe blow" to negotiations for a settlement of the Cyprus problem.

Turkish Cypriot negotiator Denktash, who is president of the new state, conveyed his proposals for a settlement to Greek Cypriot negotiator Clerides and requested another session of the intercommunal talks on February 17. His proposals presumably call for a biregional federation with a weak central government. The size of the proposed Turkish Cypriot region and its share of the island's resources is likely to be substantially larger than would be commensurate with the Turkish Cypriot share of the population, 18 percent.

The Turkish Cypriot actions are apparently in response to the Greek Cypriot position paper submitted earlier in the week. It called for a multiregional federation and a strong central government in which the total area controlled by Turkish Cypriots would approximate their percentage of the population. The Turkish Cypriots may now be trying to take back the initiative and place the onus of breaking off negotiations on the Greek side.

The Greek Cypriot proposals reflect President Makarios' belief that international pressure for concessions by the Turkish side will fade if the talks drag on inconclusively. Makarios has been pessimistic about the outcome of the talks for some time and had threatened to internationalize the issue if no progress were made by the end of this month. Proclamation of the separate Turkish Cypriot state may convince him to abandon the talks altogether, but Athens will probably want to examine the Turkish Cypriot position paper closely before breaking off the talks.

In the meantime, Turkish troops in the Nicosia area were placed on alert in anticipation of a possible Greek Cypriot military reaction. While this appears unlikely, demonstrations could occur within the Greek Cypriot sector and threaten foreign diplomatic missions.

NOTES

Soviet *General Secretary Brezhnev yesterday made his first public appearance since December 24.*

He joined Premier Kosygin and Foreign Minister Gromyko at the Kremlin for talks with visiting British Prime Minister Wilson and Foreign Secretary Callaghan. [redacted] 25X1

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Brezhnev did not welcome Wilson at the airport, but this was not required by protocol. Despite 51 days out of public view, Brezhnev showed no unusual physical problems and acted as he usually does in such situations for the media.

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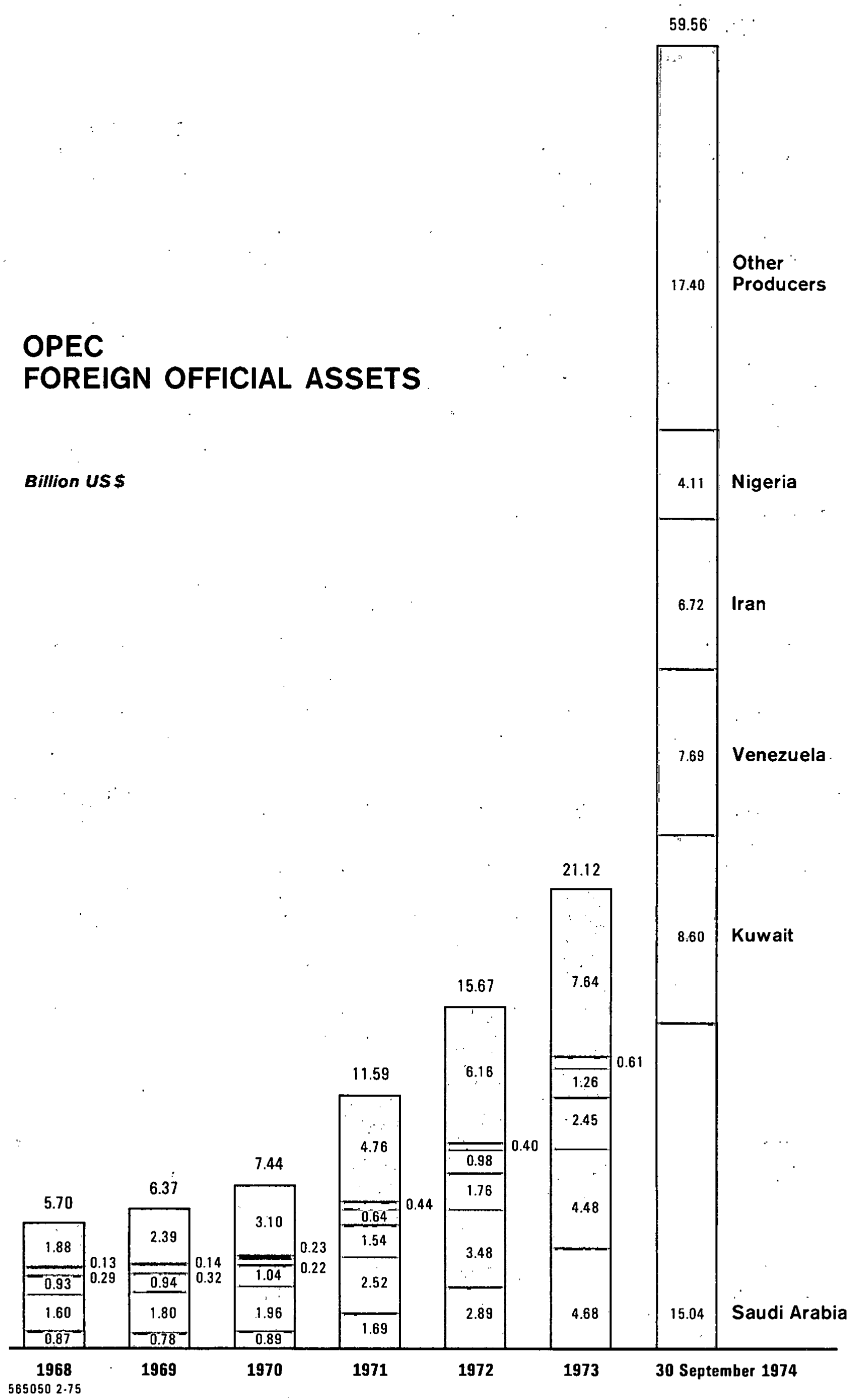
Turkey's *plans to explore for oil in the Aegean have been temporarily set back.*

Ankara has announced that it has canceled a contract with a Norwegian seismic research company because the owners refused to operate in disputed territorial waters. Turkey is now preparing to equip one of its own naval vessels for the job. It is likely to take some time to outfit a ship, however, and the delay will give Turkish and Greek diplomats more time to defuse the issue. The foreign ministers of the two countries are to meet to determine the specific questions that will be referred to the International Court of Justice.

OPEC FOREIGN OFFICIAL ASSETS

Billion US $



ANNEX

OPEC INVESTMENT POLICIES

We present below an analysis of investment policies and the distribution of the foreign official assets of the Organization of Petroleum Exporting Countries' member states in 1974. Data for the fourth quarter are still incomplete, but we have detected no appreciable change in the proportional distribution of assets, their location, or the currencies involved. We estimate that in the fourth quarter OPEC foreign official assets increased some $20 billion to $80 billion.

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The international investment patterns of individual OPEC states are quite similar, despite political, religious, and geographic diversity, and sharp differences in the size of holdings. Their wealth is concentrated in liquid assets, primarily dollar denominated, and is located in the financial markets of the major developed countries, particularly in London and New York.

The similarity in investment pattern is due to a common external environment and shared investment goals, including:

--Insuring holdings against political seizure;

--Maintaining--or increasing--the real value of assets; and

--Retaining effective control over investments.

<u>Asset Composition</u>

Almost all of the OPEC members' wealth is in highly liquid assets. Bank deposits--predominantly with maturities of less than 90 days and often overnight or on demand--account for about 65 percent of the total. On September 30, OPEC's bank holdings approached $40 billion. This is far in excess of short-term requirements, but bank deposits are relatively safe, easily managed, and can be channeled through intermediaries to make seizure unlikely. Moreover, in 1974 the return on short-term instruments was higher than that on many longer maturity assets.

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Another 20 percent of OPEC foreign wealth is in government securities, largely US government issues. While subject to greater risk of seizure, government securities are financially secure and easily managed.

The type of asset held varies little among producers. Countries with higher-than-average absorptive capacities for imported goods, such as Indonesia, Iran, and Venezuela, have a somewhat larger share of their holdings in the most liquid assets--bank deposits and government securities. Even Kuwait and Saudi Arabia, however, with very large foreign balances relative to foreseeable exchange requirements, maintain more than 75 percent of their holdings in such assets.

Asset Location

The wealth of the OPEC states is located predominantly in financial markets of major developed countries. Holdings in London, including the Eurocurrency market, and New York account for about 65 percent of the total. At the end of September, OPEC members had invested about $25 billion in the UK and about $15 billion in the US. Most bank holdings are in London because of generally higher interest rates there, particularly on short-maturity deposits. The share of assets in the US declined during the oil embargo, but has since grown considerably. About 25 percent of the OPEC states' foreign assets is located in continental Europe and Japan; half of this is in Switzerland. About 5 percent is held through the International Monetary Fund and the World Bank.

Most OPEC states hold more than half their assets in London and New York--except Algeria, Ecuador, Iraq, and Libya. Algeria, because of its ties to France, keeps a large share of its holdings in Paris. Ecuador, with relatively few foreign assets, is believed to rely on the Caribbean and Central American dollar markets. Iraq is unique among the OPEC states, having substantial investments in communist countries, as well as in Switzerland and West Germany. Libya, which for political reasons sold off most of its sterling in 1972, is believed to concentrate its investment in Switzerland and other continental European countries.

Currency Composition

About 70 percent of OPEC's foreign assets are dollar denominated. Dollar holdings totaled more than $40 billion on September 30. Producers apparently prefer greater diversity, but a number of

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factors have discouraged investment in assets denominated in other currencies. Investment in German marks and Swiss francs has been inhibited by capital controls and limited market size. Investment in most other currencies, including sterling, has been limited by concern over future value. The dollar market is presently the only market of sufficient size, depth, and openness to satisfy investment objectives.

Sterling, the other major reserve currency, accounts for another 10 percent of the wealth of OPEC members. Sterling's share declined through the first nine months of 1974 as British economic conditions deteriorated and uncertainty about the pound grew. On September 30, the sterling investment of OPEC states totaled about $6 billion.

About 15 percent of the wealth of OPEC members is in other currencies, largely German marks and Swiss and French francs. Only 5 percent is in gold and International Monetary Fund assets, including the Fund's oil facility. No OPEC state has sought to increase its gold holdings significantly.

Most OPEC states hold at least 70 percent of their wealth in dollars and 10 percent or less in sterling. The sterling area countries--Kuwait and Nigeria--keep a larger share of their holdings in sterling. The radical Arab states--Iraq and Libya--hold more of their wealth in assets denominated in currencies other than the dollar or sterling.

Prospects and Implications

During 1975, the wealth of OPEC states will increase by about $60 billion to $140 billion, assuming oil prices and production remain near present levels. Barring a new war in the Middle East, major shifts in the distribution of existing assets of OPEC states are highly unlikely.

The share of longer maturity assets will probably increase in 1975 as short-term interest rates continue to decline, and OPEC countries gain investment experience. Purchases of government securities should rise, and a number of countries may establish investment funds or offices designed to invest more heavily in loans, equities, and real estate.

The US, because of the size and depth of its financial market, will continue to attract OPEC investors unless a new Arab-Israeli war increases

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the perceived risk of seizure. Direct loans, particularly in return for technology and other development assistance, will absorb a larger share of the surplus of OPEC states than in 1974--likely recipients include France and Italy. OPEC member investment through international organizations will also grow as a number of multilateral recycling proposals now under discussion are implemented.

Changes in the currency denomination of the holdings of OPEC states will reflect decisions about the composition of new investment rather than a change in present holdings. Size and depth of the market will continue to be a primary criterion. This assures that most assets of OPEC members will be dollar denominated. Interest rates and expectations about exchange rate movements, however, will also be considered.

Dollar holdings throughout the world will probably total nearly $100 billion by the end of 1975. The share of the OPEC states' investment in sterling should decline so long as the pound continues to appear overvalued. The potential for shifts away from the dollar and sterling is limited by the fact that countries such as West Germany and Switzerland would tighten capital controls rather than allow a major influx of funds from OPEC countries.

There is little prospect that changes in investment patterns will ease the recycling problem significantly. A shift to longer term assets by OPEC members will not increase private lending to needy countries because such loans are mainly limited by their high risk. Direct lending to importing countries will contribute to recycling but is likely to cover only a fraction of the deficits of hard-hit countries like Italy.

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