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US Financial Interests

US financial interests in Italy transcend the narrow definition of Italian indebtedness to US firms and banks. Our most important financial interest is the continued functioning of the international monetary system and the economic institutions which support that system. Political developments in Italy could disturb these arrangements and impose a cost that, while not wholly measurable, is nevertheless important.



It is, of course, difficult to assess the impact of PCI participation in the national government on these general financial interests. The US has a definite self-interest in maintaining a smoothly functioning international exchange system which facilitates trade and investment among all countries. PCI accession to Cabinet seats, especially in the case of a leftist coalition, would stimulate a renewed burst of capital flight which would result in a further depreciation of the lira. In the context of floating rates, the excessive depreciation of a major currency -- i.e., a movement in the rate not reflecting relative underlying economic conditions -- affects other currencies. Some other countries might be tempted to allow or encourage depreciation of their own currencies to maintain their relative competitive positions.

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Faced with this kind of a situation, Italy might attempt to resist market pressures through direct intervention. This runs the risk of avoiding movement in the rate and, over time, of producing an exchange rate seriously out of line with fundamental economic conditions. However, Italy's sharply reduced level of reserves limits its ability to pursue such a policy.

In general, US financial interests are served by our participation in multilateral institutions like the IMF or the OECD. Although an Italian government with PCI participation would probably not withdraw from either organization, our political reaction (as well as the reactions of other countries) could affect our relations within these organizations.

Finally, bilateral US-Italian financial relationships are not insignificant. Italy has drawn from the Federal Reserve swap network and these credits come due during the next few months. In addition, long-term assistance has been available to Italy through the Export-Import Bank in connection with specific projects for financing US equipment exports to Italy. As of April 1, 1976, the Eximbank exposure in Italy was \$351 million. A description of US private financial claims on Italian borrowers is at Tab 8.

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Policy Issues

Many levers are available to exert pressure on a new Italian government on bilateral issues should we choose to do so. Chief among these levers would be financial decisions whether or not to extend new bilateral or multi-lateral credits and whether or not to roll over existing short-term credits. Short-term swaps between the Bank of Italy and the Federal Reserve will come due or be extended on July 22 and September 22. A decision can also be expected this summer or early fall on whether to extend additional medium-term IMF credits to Italy.

Tab 9 contains a detailed discussion of the specific economic policy issues and ways in which policy decisions could be applied under the various Options presented in section VI.

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VI. US POLICY OPTIONS

The fact of Communist entry into the Italian government, whether the government were left alliance, historic compromise or national coalition, would be of such importance as to require some American reaction. In the widespread uncertainty following such development we would also hold an opportunity through leadership and our own actions to influence those of the Europeans.

The problem the US and our Allies will face would be the fact of Communist entry into the Italian government. Our reaction will be guided by the form in which the problem presents itself -- a left front, the "Historic Compromise", or a grand coalition -- and we have therefore considered a spectrum of options.

There would be five general choices: positive, acquiescent, conditionally neutral, opposed, and interventionist, as follows:

Option I: Support and Co-optation

This Option envisions a positive and active response designed to bring the PCI into the Western camp. The US would take the initiative to demonstrate positively that the new Italian government continues to enjoy the confidence of its NATO Allies and of the US. This policy seeks to envelop and absorb the PCI in such a way that it identifies

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present and future success with its place in the Western camp and therefore establishes a stake in preserving and defending the values we desire in a loyal ally. This Option would be implemented primarily by political dialogue, with actions consisting of a linear continuation of our previous linkages to non-Communist Italian government. Specifically, we would:

-- maintain Italian participation in all present NATO bodies and continue the flow of classified NATO information to the GOI;

-- offer enhanced bilateral military exchanges; encourage and publicize joint exercises;

-- make friendly public statements acknowledging the democratic choice of the Italian people and our willingness to continue our traditional friendly relations;

-- publicly acknowledge the PCI's own statements that it supports continued Italian participation in NATO and the EC;

-- make available financial support on the same basis we would to a non-Communist government, i.e., only in support of a sound economic program.

Pros

-- would provide the best chance of avoiding any Italian action to reduce our military presence in Italy,

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and would avoid raising difficult problems between Italy and NATO in the initial period of PCI participation in power;

-- would give us the initiative and advantage of surprise, forcing the PCI to either reciprocate our goodwill or bear the onus of rejecting our support;

-- would rob the PCI of a valuable excuse for blaming its own problems and difficulties on a hostile US;

-- would probably provide the best opportunity for a stable economy and a solution to Italy's structural economic and social problems;

-- would, if it succeeded, annoy the Soviets, and perhaps provoke a Soviet-PCI split, pushing the PCI firmly into the NATO camp. (An annoyed USSR could also be a disadvantage to this policy);

-- might cause PCI hardliners to surface, betray the party line of cooperation with us and split the PCI into factions over the issue of the US connection;

-- would appear consistent with our respect for the results of a free election.

Con

-- would undermine credibility in our stated opposition to Communist participation in Western governments;

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-- might only make PCI behavior unobjectionable, but would give it no real roots in Western values or cause it to share common US-European priorities;

-- would undercut and perhaps destroy the will of the Christian Democrats, the CDU, and other non-Communist forces to confront Communists in Italy and other Western European countries;

-- would add to the conclusion that Marxism has become necessary to the functioning of at least one modern Western democracy, thus strengthening arguments that Communism is the wave of the future;

-- would allow the PCI time to consolidate its power and exploit our forthcomingness while providing no guarantees of a lasting link to Western cohesion and defense; the PCI could still move against the US and/or NATO at a time of its choosing;

-- could risk compromising US and NATO classified information;

-- would likely be difficult to sell to American public opinion.

Option II: Acquiescence

Under this Option, the US would not pose any obstacle to Communist participation in the government but would do nothing positive to signal our welcome to the PCI. While letting it be known that we had hoped the Italian people would decide differently, we would maintain business as

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usual in our economic and basic security relationships. Our political relationships would naturally take on a different tone. We would avoid being in the forefront of moves to include Italy at high-level meetings or to devise financial assistance for Italy. We would coordinate carefully with our allies, leaving to them the initiative for taking any positive measures called for by circumstances or consensus. We would try to apply a case-by-case rule on restrictions of classified information, basically assuming that Italy remains eligible to receive what it had a "need to know".

We assume that this Option would become inoperable if the PCI were to itself take actions against US and NATO facilities in Italy, or to seek to undermine the workings of the Alliance generally.

Pro

- presents the PCI with an incentive to live up to its professed loyalty to NATO and the EC;
- seeks to preserve our rights and presence in Italy by denying the PCI any excuse for actions against them;
- avoids forcing difficult issues with the Italians in NATO or between us and our other allies;
- is consistent with our belief in democratic elections;

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-- avoids any particular commitment to the PCI while letting it bear maximum responsibility for its own success or failure;

-- avoids most of Option I's demoralizing effect on the DC, particularly if the Christian Democrats have made their own compromise in joining a PCI government;

-- is the option probably preferred by most of our allies.

Con

-- would, like Option I, act to legitimize Communism as a solution to the problems of an advanced industrial society, giving further impetus to Communists in France, Spain, Portugal, and elsewhere;

-- would indicate to the non-Communist forces in Italy and Europe that we have adjusted to a new reality and that therefore they need not resist on principle Marxist parties or leftist fronts;

-- would tend to leave the initiative in the hands of the PCI and the other Europeans and thereby create the impression that US leadership in Europe has faded and that we would also accept the more "autonomous" Europe desired by the PCI;

-- would risk compromise of US and NATO information;

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-- the PCI would retain the option of moving against the US or NATO at a time and on an issue of its choosing.

Option III: Conditional Neutrality

This policy is aimed at putting the PCI further to the test in matters of concern and interest to us and our allies. It is essentially a carrot and stick approach designed to flush out the PCI's real tactics and loyalties. The goal would be to force the PCI into choices which either made it compatible with Western interests and values or else expose it as antithetical to those interests and values. It sets the standards by which we expect members of the Western community to act and bases our actions and attitudes on Italian behavior on specific issues. It is a damage-limiting position, taken to minimize risk to our substantial assets in Italy while offering no comfort to the PCI. It avoids any prejudgment of the ultimate success or failure of the PCI in its domestic program or international commitments. For this reason, the Option would be fluid and should naturally evolve with events in the direction of Option 2-1 or 4-5. In order to win our confidence and support, the PCI would have to prove itself by concrete actions, bargaining its honesty and loyalty for the advantages of a Western connection. The standard we set



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could be relatively tough or lenient depending on the form of government (leftist, historic compromise, or grand coalition) the Communists have joined. It would not, however, be so aggressive as to overplay our hand and appear to be setting conditions impossible for the PCI to meet. It should not be so demanding as to jeopardize European support or place ourselves on the defensive. The policy would aim at making the PCI prove over time that its policies and actions would not harm Italy and the Western partnership.

This tactic would work best if the lead were taken by Italy's European Community partners. The EC relationship gives its members a tacit but well acknowledged voice in each other's domestic and foreign policies. Signs of West European approval would be as important to the PCI as US acceptance (it would suit the Communists only too well to split us from our other European allies on the issue of accepting democratically-elected Communists in government). It is on issues of EC political cooperation that the PCI might best be challenged to prove its Western orientation.

Specifically, we would:

-- say nothing which indicates we have formed a judgment on the acceptability ^{of} longevity of an Italian government with PCI participation;

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-- seek a public commitment from the PCI on US and NATO presence in Italy and Italy's NATO obligations;

-- avoid any special gestures of political, economic, or military solidarity such as joint maneuvers, ceremonial portcalls or exchanges of high-level visits;

-- avoid any military operations that could be seen as signals of either support or hostility towards the new Italian government;

-- lean on the EC to require responsible democratic behavior by the PCI;

-- carefully screen US classified documents before releasing to our NATO Allies and thus to Italy, and inform key allies that we are doing so;

-- consult with the UK and FRG about possible limitations on Italian participation in NPG activities;

-- advise investors, bankers, and others with financial stakes in Italy that we are reserving judgment about our relationship with the GOI until we see what actions and policies it actually follows:

-- avoid any actions that appear to punish the Italians until it can be clearly established that the PCI has failed to live up to the standards of democracy and alliance expected of an Italian government;

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-- keep the GOI in doubt as to our ultimate intentions by not forecasting in advance exactly how we will decide issues on which the PCI has yet to take a clear stand;

-- seek a demonstrable loosening of the PCI's ties with Moscow.

We could also smoke out the PCI by sharpening the normal alliance review of key political and military policies, including force levels and defense expenditures, trying to force them to debate the issues and thus be seen publicly as supporting (or not) the policies of the Western alliance. In economic policy, we would condition bilateral and multilateral lending on strict (but not unfair) fiscal and monetary policies, making the PCI either support responsible management of the economy or lead Italy towards isolation from its sources of Western support. In short, we would focus attention on the new government's behavior, keying our response to the domestic and international demands the PCI makes.

Pro

-- would provide us maximum flexibility, protecting our option to change or reverse course depending on the course the PCI adopts;

-- would be less risk to US and NATO facilities in

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Italy than Option IV and V, giving the PCI little cause of move against them;

-- would have the support of our European partners (France, FRG, UK), particularly in the EC context;

-- would place the burden of proof even more on the PCI than Option II;

-- would, more than Option II, give the DC and other non-Communist forces an incentive to stand up to the PCI on matters of principle;

-- would provide the greatest leverage of all options by equalizing both the "carrot" and "stick" elements of our influence;

-- would probably enjoy relatively more US domestic support than any other option;

-- might by its ambiguity entice the Soviets into a political mistake in Soviet dealings with the PCI which galvanized Western solidarity and/or discredited and even split the PCI.

Con:

-- would be extremely hard to manage; given the likely charged political atmosphere, even minor carrots and sticks may risk being interpreted as shifts away from neutrality in one direction or the other, with possible cumulative

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effects. Issues will arise quickly within NATO on which it will be very difficult to be neutral;

-- the PCI might easily appear to pass every reasonable test with flying colors -- but with no ultimate commitment-- paying a relatively modest political cost;

-- by making no waves and straddling our hurdles, the PCI could gain valuable time to consolidate its power and break down resistance in Italy and abroad to a Communist role in government;

-- though not as much as the first two options, the policy would imply a willingness to work with the Communists, adding to the appeal of other Communist parties (particularly the PCF), whose intentions are considerably less moderate;

-- by its very ambiguity this Option could make the US look indecisive and leaderless and give rise to considerable carping from the wings here and abroad by those who demand a clearly positive or negative stance;

-- it leaves the initiative for developments somewhat in PCI and Italian hands, but less so than previous options. We might even find ourselves undergoing a form of blackmail by the DC, which, in an effort to maximize its own power and relevance, could seek to broker our support for an

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"Historic Compromise" government by threatening to leave the GOI in control of a left front;

-- Option III ultimately puts to the test our own assertion that Communist participation in Allied governments is incompatible with Western values and cooperation. We could be proved wrong.

Option IV: Opposition

Options IV and V are intended to use our influence in a direction which will lead to the failure of the Communist experiment in Italy, or if it survives, to its effective quarantine from the Western family. Option IV presents a wide variety of policy tools with which to inflict damage on the PCI. All consist of actions to deprive an Italian government including the PCI of the benefits and advantages of Italy's connection with the West. All stop short of directly encouraging and assisting those forces in Italy which seek to oust the PCI from power (Option V). Option IV seeks to cause the Communist cancer to die of lack of nourishment. Option V attempts to assist internal forces which oppose and resist the Communist presence.

Under Option IV, we would pursue actions along the following lines:

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-- make clear from the beginning our opposition to an Italian government with PCI participation, leaving no doubt that it will not have our blessing or assistance;

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-- seek to exclude Italy from the NPG and other sensitive Alliance deliberations such as MBFR;

-- deny Italy access to sensitive classified information (above Confidential) and encourage our Allies to do likewise;

-- publicly discuss options for retrenchment of US forces in Italy;

-- work against extending credits or other financial assistance to Italy;

-- predict that the Communist experiment in Italy will fail, thus discourage private commercial credit and investment;

-- exclude the GOI from high-level meetings such as the Rambouillet Summit, calling such attendance inconsistent with Western solidarity;

-- hammer the PCI with evidence of its Soviet and Eastern connections;



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-- consider withdrawing some of our nonmilitary presence in Italy by closing several consulates or the Milan trade center;

-- encourage speculation that a restoration of government without the PCI would lead to renewed benefits.

Pros

-- puts the US clearly on record consistently supporting our opposition to Communist participation in Western governments;

-- would pose a clear choice to the DC and other non-Communist parties, forcing them to choose between continuing to accept the PCI as a governing partner or cooperation with us;

-- could lead the PCI to withdraw rather than preside over a deteriorating domestic situation (this could become a Con, see below);

-- would protect NATO classified information and sensitive discussions;

-- could lead to a split in the PCI over the temptation to respond with an overtly anti-American, anti-Western line;

-- would greatly hamper other West European CP's.

Cons

-- our policy would almost certainly lack Western support, and could cause a crisis within NATO, with

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serious implications for future US-European relations generally;

-- could play into the PCI's and other European Communists' hands by suggesting that since the US attitude is damaging to Italian and European interests, Italy and Europe should adopt a more autonomous relationship to the US;

-- would seriously jeopardize our continued basing rights and privileges in Italy by provoking nationalist support for retaliatory actions;

-- since there is no satisfactory alternative in the Mediterranean for the bulk of facilities that we now enjoy in Italy, a threat to withdraw could be taken as bluff or could be forced to the point beyond which we would have to implement it with serious damage to our strategic posture;

-- could lead to severe economic and social disarray in Italy, allowing the PCI to whip up resentment against a "hostile" US which has dealt undeserved blows to Italian society and economy;

-- could provoke a serious right/left split leading to aggravated civil disorder, with very uncertain consequences;

-- would probably cause a major confrontation between the US and Western Europe and perhaps a North-South rift in Europe itself;

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serious implications for future US-European relations generally;

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-- would seriously jeopardize our continued basing rights and privileges in Italy by provoking nationalist support for retaliatory actions;

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-- would probably cause a major confrontation between the US and Western Europe and perhaps a North-South rift in Europe itself;

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-- could simply drive the DC into opposition and give the PCI a credible excuse to form a "socialist government" with the PSI;

-- could provoke a domestic reaction in the US from Italo-Americans and others who fail to understand why we are hurting a country which has not done us demonstrable harm;

-- if this policy fails, we would be seen to have done serious damage to Western cohesion and perhaps our strategic position in the Mediterranean without any compensatory leverage over the PCI and other European Communist parties. Euro-Communism will have established success on the basis of confrontation with the US;

-- could severely, if not disastrously, harm our prestige and image in Europe and the world as a proponent of respect for free elections;

-- forces an anti-American stance on the Italian voter who supports the democratically formed government.

Option V: Intervention

This Option includes all the elements of Option IV but carries our opposition further to include actions which stimulate and assist acceptable forces inside Italy strongly and actively opposing a PCI-led government. The

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Option would include a range of possible measures, including, in extremis, reversing the political process by which the Communists would have taken power. While freezing Italy out of all sensitive NATO activities, we would be careful to leave the door open for Italy to return to the NATO fold once the PCI had been expelled. In effect, to the punishing actions of Option IV would be added support, moral or material, for those responsible Italians (i.e., not the MSI) resisting the PCI. The implementation of this Option would be carefully geared to the existing situation in Italy. In the event Italy remained stable and the PCI a model of moderation, and the DC remained in the government, we would, for example, propose only to supplement Option IV with discreet contact with dissident anti-Communist forces, providing them with political encouragement, advice or limited material support. If, however, the PCI advent to power were to take place in a way which drove or seemed to be driving Italy to civil war, a strong DC-led opposition, and a clearly unconstitutional PCI, a more positive and open line of action would be feasible. In extreme circumstances even military assistance to the anti-Communist forces, if cohesive and capable of success in an all-out civil war, would be considered under this Option.

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Pro

- would cause greatest problems for the PCI;
- would put maximum pressure on the DC not to cave in to the PCI;
- would give the clearest signal to the DC that we consistently reject any compromise with Communism;
- could, if successful, increase reluctance of non-Communists elsewhere in Western Europe to form alliances with the Communists;
- if necessitated by extreme circumstances, could provide virtually the only means of preventing the triumph of a hostile, pro-Soviet Communist government.

Con

- if the PCI were not overthrown, it could emerge strengthened, base its appeal on resistance to US pressures, justify adopting a pro-Soviet course;
- unless clearly justifiable by events in Italy, would lead to retaliatory actions by the PCI with serious damage to our base structure and operational capabilities in the Mediterranean;
- would be strongly resisted, and disavowed, by our other allies, severely shaking NATO cohesion and unravelling the Alliance itself and our overall relationship with Western Europe;

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-- would provide the PCI with ammunition for an appeal to nationalist sentiment, and put the entire onus of its difficulties on US interference;

-- could encourage the Soviets taking similar steps within Italy or elsewhere and lead to heightened US-USSR tension;

-- would sour our relationship with Yugoslavia and Romania and set back our efforts to encourage autonomy in Eastern Europe;

-- might be resisted by the DC itself, which could plead we are destroying Italian democracy and playing into the hands of the neo-fascists;

-- could provide ammunition to other Western European Communist parties by invoking US "imperialism";

-- would shatter US image as a democratic country dedicated to free and open elections;

-- could cause a domestic US debate of volatile proportions;

-- if in extremis we encouraged an overthrow attempt before the outbreak of all-out civil war, we might well bring about that civil war.

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VII. CONCLUSIONS

The unhappy prospect of a PCI role in Italian government does not lend itself to any easy choice of the best way to protect our overall stake in Italy and Europe. Some erosion of Western cohesion and purpose will almost certainly be the product of Communist success. Whether the erosion would be worse if we tolerated and adapted to the new situation or if we attempted to fight it, is the key question. A great deal hinges on the way in which the Communists got in and the resultant attitudes of other Italians, our allies, and the American public. In general, however, we can conclude that:

-- any policy which sanctions or appears to sanction Communist legitimacy in a NATO country cannot help but advance the cause of Communists in other West European countries, regardless of their resemblance to the Italian version of Communism;

-- any policy which attempted to oust the PCI without significant support within Italy, among our allies, and American domestic opinion would probably fail and could defeat our objective of protecting our larger interests in Europe;

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-- no policy will be able to avoid a dilemma in US credibility arising from the long evolution and final advent of a Communist government within a democratic system.

Accordingly, if we are faced with a multi-party government which includes the PCI and DC as cabinet ministers and lacks any significant opposition, we favor Option III, conditional neutrality. We recognize that Option III may allow the PCI to maneuver us into Option II by passing every test we can pose. On balance, however, it affords the greatest flexibility both for ourselves and the Christian Democrats. It includes a retreat to Option IV or a transition to Option II if either should become in our best interests. Option III affords the maximum chance that the PCI would be unable to cope with the dislocations caused by its arrival in power or would react ideologically to them. In either case, it could be defeated politically, bearing the onus for Italy's crises. Option III further limits the damage to our strategic position that we might self-inflict by Options IV and V. It would be unable to blame outside powers for its own failings. Most of all, Option III is the most credible response to an ambiguous situation in Italy.

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If we are confronted with a left front which leaves broad and determined opposition within Italy to a PCI government, we favor Option IV, recognizing that Option III may be preferable to start, if we cannot line up European support. In the unlikely event that a left front is accepted in Italy as a legitimate outcome of the elections, we favor Option III as an initial response, pending recourse to Option IV, if subsequent events called for it.*

Option V should be seriously considered only in the most extreme circumstances, such as actual or anticipated civil war, and even then only if we can obtain sufficient support among our allies and at home.



*DOD believes we should revert to Option IV only if a left-front government seeks to reverse Italy's pro-Western stance and/or abandons its highly-touted democratic principles.

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