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Page 1 of 1

<u>Doc #</u>	<u>DocType</u>	<u>Doc Info</u>	<u>Classification</u>	<u>Pages</u>	<u>Date</u>	<u>Restriction</u>
07a	report	"Military Assistance Reappraisal" <i>sanitized 3/7/18 per RAC 2/18</i>	TS	90	8/65	A
13	memo	Handley to Komer	S	2	11/8/65	A
15	memo	"Interest Rate for Military Sales..."	C	2	10/22/65	A
19	cable	Bonn 353	S	1	8/5/65	A
20	cable	Deptel 310 to Bonn	S	2	7/31/65	A

Collection Title National Security File, Files of Robert W. Komer (1963-66)**Folder Title** "MAP - Korea/Iran (December 1963 - March 1966)"**Box Number** 42

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7/10/2007

Initials

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November 22, 1965

Mac:

Iran interest rate on arms sales. I've held this up for over 8 weeks now, in order to keep it tied to Peshawar package. But we're going nowhere fast, and heat is mounting (see Tehran 743 attached).

Case for holding up has been that giving away a goodie too long before we ask for something in turn vitiates the leverage. But State and DOD think the Shah would still remember and also argue the case for going ahead now anyway on general grounds of keeping Iranians happy. Also Iran is talking about purchasing arms elsewhere at cost to our balance of payments. Past rate has been 5%. State/DOD want to cut it to 3-1/2-4% (ultimately about \$350 million in sales over next several years may be involved).

Other problem is that McNamara wants to lay off this paper with Ex-Im, thus freeing MAP credit fund for other sales. It will take a WH whip, of course, to get Linder to do this.

I favor going ahead now at 4%, so long as I have your backing in beating up Harold when necessary.

RWK

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Att: Tehran 743, 11/18/65.

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Authority FRUS, Vol. XXII, #107

By rg NARA, Date 8-9-05

² *file*
Shah Map
Shah

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June 9, 1965

RWK:

There wasn't any NSAM signing JFK onto 162,000 force level for Iran. However, the record of his April 1962 talks with the Shah makes it absolutely clear that he personally approved and proposed a level in the 150-160,000 range. Attached papers document this record, as well as the fact that the eventual agreement grew from exchanges at the JFK-Shah level.

So I would propose this paragraph for the outgoing cable:

Personnel. While we recognize pressure for 172,000 force level and difficulty of pressing further cuts in existing units, 160,000 level represents principle to which we firmly committed, i. e. that economic development is Iran's first need and that military establishment must be forced to sort out its priorities within an economically reasonable ceiling. We fully appreciate irrational elements which make Iranians argue for security at any cost. However, President Kennedy personally pressed principle involved during Shah's 1962 visit and Shah eventually accepted it. So before agreeing to retrogression on force level, we would appreciate further look at how Iranians might meet modernization needs through modest reorganization.

If you agree, I'll push this wording to replace para. 3 of current draft. Also attached is ARMISH/MAAG recommendation to which we're responding.

HHS

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DECLASSIFIED
E.O. 13292, Sec. 3.4
NSC Memo, 1/30/95, State Guidelines
By *sgf/bm* NARA, Date 7-9-07

3 file
Iran map
X Iran

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RWK:

June 8, 1965

FYI. Here's a cable approving the second tranche of Iran's five-year military purchase. Chief issues decided this way:

1. Shah asked us to lift the \$200 million ceiling to \$230m. to raise war reserve ammo from 30 to 60 days. Our military go along with this (Greece, Turkey, 90 days; Korea, Thailand, China, small arms 90, other 60; Pakistan, India 60.) However, decision recommended in this cable is to go ahead with the ammo but not raise the ceiling yet. Since this \$90 million brings two-year total to about \$140 million, we'll be pressing the ceiling well before five years. Embassy says greatly improved revenue prospects warrant slight increase in ceiling. But leaving it intact now maximizes our leverage later.

2. Iranians want to go back up to 172,000 man force level. DOD goes along, and even AID isn't ready to fight over this.

3. Stall on advanced aircraft, HAWK and Sheridan (which is still in R & D anyway). The planes will be the toughest to handle, and there's some thought of putting the Bullpup missile and F-5 together but not this year.

AID feels the economic review this spring was a major step forward. Iranians worked from sound economic projections for the first time. The Shah is still working on the principle of putting hardware above everything else, but AID feels this is the resurrection of a useful economic dialogue.

So while the Shah is probably pushing reasonable economic ceilings, we may make progress by going along on the war reserve and force level in order to drag our feet on less reasonable requests. Any objection to the attached?

HHS

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Authority FRUS, Vol XXII, #87
By rg NARA, Date 8-9-05

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July 2, 1964

Jim N. J. 4

McGB:

We have reached a compromise on our new 5-year MAP agreement with Iran. RWK has dropped his idea of writing a foreign exchange ceiling into the memo of understanding provided we send Holmes tough instructions to tell the Shah our help will continue only so long as his military purchases don't slow Iran's development.

Defense and AID couldn't go along with including a ceiling because (1) they don't have a realistic figure and (2) they don't think the Shah would stand still for such hand-tying. They think an annual US-Iranian review of the effect of arms purchases on the economy would give us better control. They say they'd even be willing to shut off credit altogether if the Shah goes too fast. The key point is to be sure Holmes gets this idea and explains it clearly to the Shah because the memo of understanding doesn't sound that tough.

Kermit Gordon will be looking at the 1550 Determination this afternoon and may talk to you about it. State will also send over instructions to Holmes for clearance, which I'll check.

*O.K.
McGB*

HHS

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Authority FRUS, Vol XX II, #46
By *rg* NARA, LHM 8905

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June 29, 1964

MEMO FOR MESSRS. TALBOT & MACOMBER

Bob asked me to send you a copy of attached
for your personal information.

Hal Saunders

Attach.

RWK Memo to McGB
6/27/64 on Iran Problem

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DECLASSIFIED
E.O. 13202, Sec. 3.4
NSC Memo, 1/30/95, State Guidelines
By ag/cbm, NARA, Date 7-10-07

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June 27, 1964 *map* ⁶

Mac -

Iran Problem. Though 5-year \$300 million Iran MAP plan (a real breakthrough) still has three years to run (FY63-67), Shah recently got all fired up about buying some fancy new hardware. He alleges growing Arab threat to oil-rich Khuzistan, but more likely his rapidly growing oil revenues have gone to his head (he told LBJ he expected \$1.2 billion annually by 1970--he gets \$400 plus million now).

We're happy to sell for hard currency, since otherwise Shah will simply buy elsewhere. However: (a) chief threat to Iran's stability is still internal, not external--so nation-building remains the basic need; (b) since Iran is oil-rich, we want to phase out AID money and let it finance its development through oil revenues; (c) ergo, we want to limit Shah's overall military outlays to reasonable figure, using MAP credit sales plus some continued MAP as the lever.

So we've cooked up a so-called Cooperative Logistics Agreement under which we: (a) promise Shah good credit terms for some \$250 million in sales of M-60s, C-130s, F-5s, etc. during FY65-69; (b) as a sweetener promise to continue a MAP grant program through FY69 (\$53 million beyond present agreement); (c) want in return a promise that Iran will restrict its own military outlays to what we think reasonable so that development program is not short-changed.

McNamara is pushing hard for closing this deal immediately, saying he's discussed it with LBJ. One story is that LBJ told him either to sell \$1.5 billion a year in hard goods to balance our payments or to cut troops in Germany. Bob pressed Bell and Alex Johnson last week.

Whatever the cause, Bob has panicked his people, and seems to be listening only to his salesmen, not to politico-military types. For example, he reversed his OK to Sloan to steer Shah to M48A3 (our Israeli ploy) and plugged M-60s. This will cause havoc with Turks, Paks and others, who will now want M-60s and can't pay for them.

AID and I can't see cause for rushing in so fast (Shah is quite happy with promises of M-60s and C-130s he got here). But above all we think this military carrot (to which we've no objection) should be used to get an agreed ceiling on Iran's overall hard currency military outlays, so Iran's future isn't jeopardized to satisfy Shah's military whims. Embassy Teheran says Shah wouldn't like any attempt to impose ceiling (Teheran 1188) and promises to achieve same result through provision for annual reviews of Iran military program, upon which each year's MAP and sales increment would be contingent. But I don't trust Embassy

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Ambassador FRUS. Vol XXII, #45
By *16* NARA, Doc 8905

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2.

or DOD here, and would prefer a real stab at an agreed ceiling, a la the successful Indian exercise we just went through. At least let's make a try for an agreed ceiling, before retreating to annual reviews as a fallback.

We still have control of this, because a 1550 Determination is needed. I'm sure DOB will agree with us, and probably AID too. So I hope we won't let Rapid Robert's passion for promptitude panic us into premature pusillanimity. Saunders will keep you clued.

RWK

cc: Phil Talbot
Bill Macomber

William J. ...

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INTERNATIONAL SECURITY AFFAIRS

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ASSISTANT SECRETARY OF DEFENSE

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WASHINGTON, D. C. 20301
McGEORGE BUNDY'S OFFICE

1965 AUG 16 AM 11 49

12 AUG 1965

In reply refer to:
I-36008/65

Honorable McGeorge Bundy
Special Assistant to the President
for National Security Council Affairs
Washington, D. C. 20501

Dear Mac:

I am pleased to transmit herewith the country study on Iran, another in the series of reappraisals of military assistance to the Forward Defense Countries being prepared by ISA. Papers on four Far Eastern countries were circulated previously, and similar papers covering India, Pakistan, Greece and Turkey will be issued before the end of August.

This study was prepared under the direction of Townsend Hoopes, Deputy Assistant Secretary of Defense for ISA. I believe you will find the study to be a competent, provocative analysis, but I stress the point that, in its present form, it is a working draft that is being circulated to the interested departments and agencies for considered written comment. On the basis of such comment, and after further discussion with the interested departments and agencies, ISA will prepare recommendations for the Secretary of Defense. As we must send forward our recommendations in the near future, if they are to have an impact on MAP programming for FY 67, we would greatly appreciate receiving the comments of your staff not later than 2 September.

Mr. Hoopes has alerted Mr. Komer to the fact that this study is coming, and has indicated its general scope and purpose.

Sincerely,

Enclosure
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MILITARY ASSISTANCE REAPPRAISAL FY1967-1971

OSD REVIEWED 29-Sep-2003: NO OBJECTION TO DECLASSIFICATION

VOLUME II REPORT



PREPARED BY
OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
(INTERNATIONAL SECURITY AFFAIRS)

AUGUST 1965

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PREFACE

Background of the Study

In late 1964 the Secretary of Defense directed the Assistant Secretary of Defense for International Security Affairs to carry out a major reappraisal of the Military Assistance Program. The purpose of the study was to recommend a military assistance program for the FY 1967-1971 period. The method of study was, with respect to each of the major recipients of MAP, to re-examine the threat, the proposed strategy of defense, the strength and missions of local forces, the strength and missions of US forces likely to be available--to review, in short, the military rationale for military assistance.

The study was undertaken in January 1965 by a small civilian-military staff in ISA under the direction of Townsend Hoopes, Deputy Assistant Secretary of Defense for International Security Affairs. Participants are listed in Annex 7. The work has been focused on nine of the eleven Forward Defense Countries, which together account for about 75% of MAP expenditures. Given the pace of events, a long-term examination of the Vietnam and Laos programs was judged to be unproductive. The studies have been limited, therefore, to Taiwan, Korea, Thailand, Philippines, India, Pakistan, Iran, Greece, and Turkey.

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The reappraisals have been based on a critical review of the existing documentation, including National Policy Papers, Military Assistance Manuals, JSOP, JCS memoranda, intelligence estimates, special studies by the Joint Staff and individual Military Services, and a wide variety of departmental and interdepartmental memoranda. They have been based also on extensive discussions in Washington, and on visits to each country under study, during which MAP activities were reviewed and useful talks were held with the US Embassy, AID mission and MAAG.

This document (Volume II) contains a draft study on Iran. Reports on Taiwan, Korea, Thailand and Philippines were previously issued, and papers on the remaining four countries under study will be released in the near future. This paper is a working draft; it has not been approved by the Assistant Secretary of Defense (ISA). It is being circulated to interested departments and agencies with a request for review and written comment. On the basis of such comment, and following further discussion with the interested departments and agencies, ISA will prepare recommendations for the Secretary of Defense.

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Summary of the Iran Paper

The Iran paper examines the political, social and economic situation, analyzes the several threats to Iran, evaluates the capabilities of Iranian, US and other forces to meet these threats, and concludes as follows for the 1967-71 period: (1) the USSR poses the most serious external threat to Iran, but a Soviet attack is unlikely during the period under study; (2) Iraq, Egypt, and Afghanistan pose lesser threats, but an attack by any of these countries, alone or in combination, is also unlikely; (3) the forward defense strategy is judged valid, and the present deployment of major Iranian forces along the northern and western borders appears sound and prudent; (4) present Iranian military forces, acting alone, are not capable of halting or seriously delaying a major Soviet attack; (5) but if external reinforcements equivalent to 7 divisions and 700 aircraft were rapidly introduced, a major Soviet attack could probably be stopped in central and southwest Iran at a line in the Zagros Mountains; (6) present US contingency planning to support Iran calls for a rapid, but rather more limited buildup of ground and air forces, and implies a resort to nuclear weapons if such reinforcement cannot defeat the aggression or otherwise stabilize the situation; (7) a moderately serious threat arises from the internal situation in Iran, which is inherently volatile and which has been

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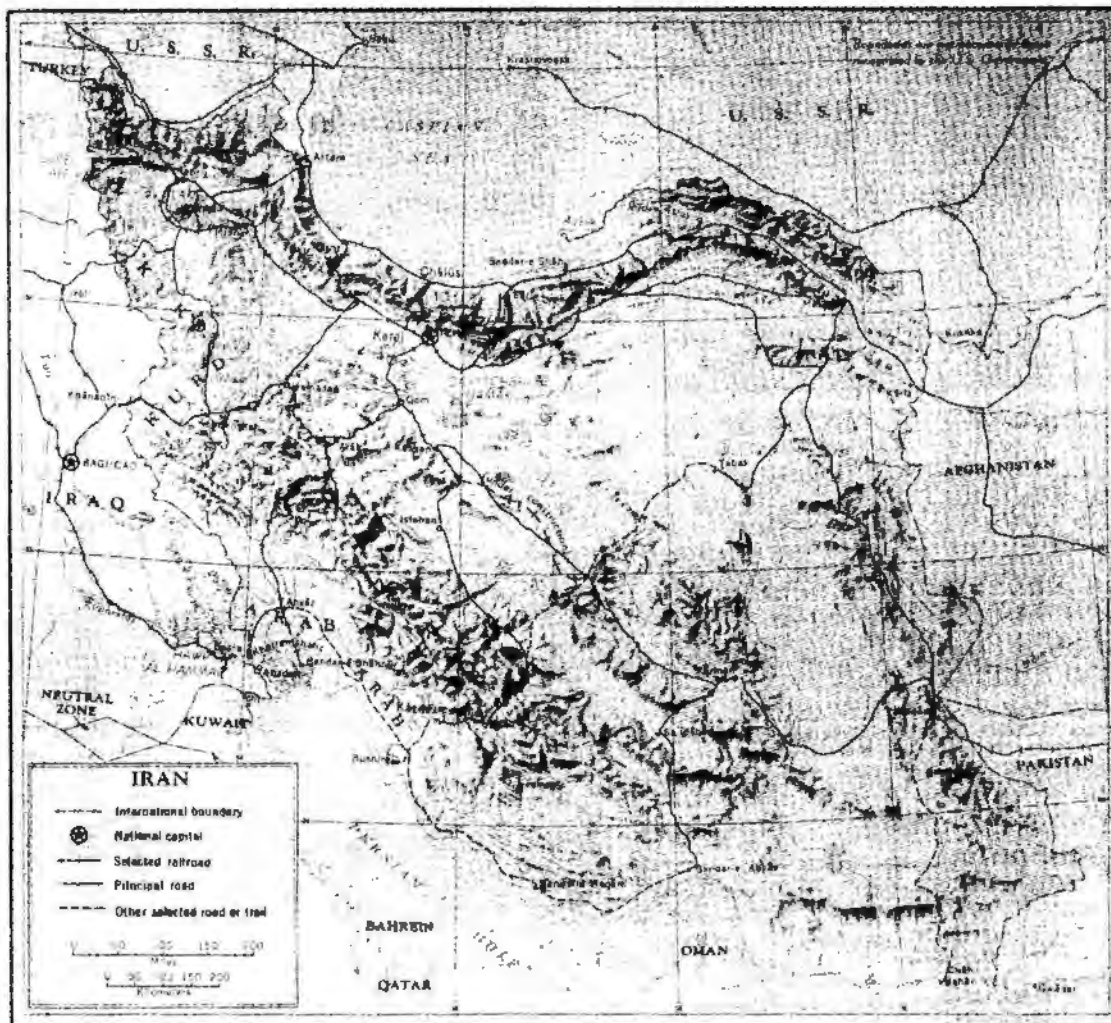
made more so by the resistance of influential groups to the Shah's comprehensive program of national reform; (8) but the Shah's regime is accepted by a majority of the people and the opposition is not well organized; (9) the internal security forces, supplemented as necessary by the regular military forces, are considered capable of coping with any internal situation likely to arise; (10) the US military assistance relationship with Iran is expressed in two documents of recent date, the 1962 and 1964 Memoranda of Understanding; (11) because these documents represent recent sound and continuing undertakings by the two Governments, proposals at this time for alternative arrangements, with respect either to MAP levels or Iranian force composition, would be lacking in intrinsic merit and political wisdom; (12) certain suggestions as to future modifications of force levels and MAP programs may however be useful as reference points in future discussions with the Shah, particularly if it becomes necessary or desirable to exercise restraint upon Iran's defense expenditures; (13) assuming Iran's oil revenues continue to grow, it is probable that a moderately higher credit sales program and a moderately lower grant aid program will be compatible with the interests of both countries after FY-69.

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IRAN

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TABLE OF CONTENTS

	<u>PAGE</u>
A. <u>BACKGROUND.</u>	2
A discussion of the political, social and economic structure of Iran, followed by a definition of US objectives.	
B. <u>THREAT ANALYSIS.</u>	10
An examination of the external threats posed by the USSR, Iraq, Egypt and Afghanistan, and of the internal security situation.	
C. <u>IRANIAN MILITARY POSTURE.</u>	20
A description of Iranian military and paramilitary forces and their missions, and an appraisal of their capabilities.	
D. <u>US MILITARY POSTURE IN RELATION TO IRAN.</u>	30
An assessment of US commitments and US forces likely to be available to assist in Iran's defense.	
E. <u>NET CAPABILITIES ANALYSIS.</u>	34
A discussion of the rationale for the Iranian force structure, and an examination of the total forces required to fight an effective delaying and holding action against Soviet attack.	
F. <u>MILITARY ASSISTANCE TO IRAN.</u>	41
A review of past military assistance programs and current projections of military assistance and credit sales to Iran, followed by comments and recommendations to assist in future negotiations with Iran.	

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A. BACKGROUND

This section of the paper briefly describes the country and its political, social, and economic structure. It also defines US objectives in Iran.

I. General.

Iran is a country about one-sixth the size of the United States, with a population of 23 million. Ringed by formidable mountain ranges and great uninhabitable deserts, it gives the impression of isolation from neighboring regions, and this geographical fact has indeed been a principal reason for Iran's long tradition of political independence. The population comprises about 15 million Persians and about 8 million members of other ethnic groups, of whom the Arabs of Khuzistan in the southwest (about one million), the Kurds in the northwest (about one million), and the Ghashghahi, Bakhtiari, Lurs, and Baluchis are the most important. Nearly the entire population is Moslem by religion, and of the Persianized Shi'a sect, which distinguishes them from most Arabs, Turks, Afghans and Pakistani who belong to the Sunni sect. Common religion and a common language (Farsi) partially offset the diversity of ethnic backgrounds in Iran. A basic data sheet is at Annex 1.

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II. Profile of Iran.

1. Political and Social Situation.

Although Iran is ostensibly a constitutional monarchy, with substantial power vested in Parliament, the Mossadeg era saw virtually all political forces discredited and, since 1953, the country has been in effect ruled by the Shah with the support of the armed forces. Strong monarchy and one-man rule have been the historic norm in Iran. For a decade after 1953, the Shah enjoyed not only the active support of the armed forces, but also the passive acquiescence of the traditional upper-class elites--the landlords, clergy, leading merchants, and some tribal chiefs. However, the Shah's progressive efforts to build a broader popular base for the regime have brought him increasingly into conflict with these latter groups.

As indicated in a CIA special report of December 1964, the Shah "became convinced that he could not indefinitely maintain his regime on the traditional feudal system." The major feature of his top-down revolution is land reform. The first phase concentrated on large holdings, involving 10,000 of Iran's 50,000 villages; land was redistributed to more than 340,000 peasants. A second phase is aimed at smaller holdings in some 25,000 additional villages, and is potentially more disruptive to the old landed interests.

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The chief political effect of the reform has been to alienate the Shah from the traditional upper-class elites. Already in opposition to the regime was the loosely organized National Front, a combination of urban middle-class and intelligentsia who desire to carry out their own form of political revolution, but whose program of reform has been largely pre-empted by the Shah. Endemic corruption and inefficiency in government have also been major causes of dissatisfaction among these elements of the population. On the other hand, the main beneficiaries of land reform, the peasants, are not yet an active political force in the Shah's behalf and may not be so for a decade. Their long history of non-participation, preoccupation with the assumption of land ownership, and extraordinarily high illiteracy (estimated at 75 to 80%) contribute to their political apathy.

If the Shah were assassinated, power would probably be assumed by military leaders. NIE 34-64 indicates that "a successor government, if controlled by the senior officers, would probably, without attempting to reverse the Shah's programs, pursue a generally more conservative program. However, if younger officers gain a dominant voice, the government might reflect the more radical outlook of the nationalist opposition. In any event, conditions would be so disturbed that any successor regime would probably find it difficult to

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consolidate power and a prolonged period of instability would probably ensue."

2. International Orientation.

Iran's foreign policy historically has been dominated by a fear of Russia. Until recently, the nation strove for a neutral position while reaching out and loosely attaching itself to a counter-balancing major power. This search for security found expression in dependence on Britain in the early years of this century and in pro-German attitudes during the two World Wars. In the face of Soviet intransigence and aggressiveness after World War II, Iran made an active commitment to the principles of Free World collective security through adherence to CENTO (then the Baghdad Pact) in 1955. A pro-Western alignment is likely to continue through the period under study, although a segment of opinion in Iran would prefer a neutral course between East and West.

Relations with the Soviet Union have improved and tensions have been reduced since 1962, when the Shah declared that foreign missiles would not be permitted on Iranian soil. Limited commercial and trade agreements have also been concluded; quite recently the Soviets offered to construct a steel mill in Iran, and the Iranian regime appears ready to accept the offer. But close affiliation with the USSR

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is unlikely. NIE 34-64 indicates that "Iranian fears of Soviet designs remain alive, and will probably serve to check any significant danger to Iran's western orientation..."

3. Economic Situation.

In many respects Iran is typical of underdeveloped nations. The economy is basically agricultural, with 60-70% of the labor force employed on the land; industry is developing slowly; unemployment varies from 5% in the summer to 15% in the winter. But Iran is atypical in possessing a booming oil industry that is the fifth largest producer in the non-communist world. The industry employs a small portion of the Iranian labor force, but produces great wealth for the state. Foreign exchange earnings from petroleum amounted to \$462 million in 1963 and \$555 million in 1964.

In 1963 Iran's GNP was about \$4.8 billion. The per capita income was \$215, a figure which is relatively high for the underdeveloped world, but is also misleading owing to the severe maldistribution of income. The 2.5% rate of population growth does not pose a severe problem. GNP growth averaged about 6% annually for several years, but has leveled off since 1961 at 3.6% because of inflation, recession and a balance of payments problem. NIE 34-64 estimates however that "Iran's underlying economic strength will

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probably enable it to overcome these difficulties and within the next few years return to a more rapid rate of growth." A 6% rate of growth is anticipated during the FY 1967-1971 period, primarily because of an expected 8 to 10% annual increase in oil revenues. Per capita GNP of \$250 is predicted by 1970.

The expected improvement in Iran's economy is further reflected in tentative plans to terminate US economic aid by FY 1968. Total US economic aid to Iran from 1946 to 1963 was \$783.6 million, or an average of \$44 million per year. Future aid will probably not exceed \$12-13 million annually, comprising \$3 million a year for technical assistance and the balance in developmental loans.

While the basic outlook for economic development is thus optimistic, Iran still lacks the administrative and managerial competence to achieve its growth without considerable waste of resources and governmental revenues.

4. Military Expenditures.

The Iranian Government is expected to increase its military budget, as the Shah uses oil revenues for purchases of military equipment. Self-financed defense expenditures are expected to increase as a percent of GNP from a level of 4.1% in 1963 to 4.7% in 1966, and may rise to 5.7% later in the FY 1967-71 time period. Such a level of

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defense expenditure is comparatively high, and will, over the long term, divert resources that might better be applied to the economic sector; in the short term, however, Iran is probably not capable of putting substantially higher levels of financial investment into economic development.

III. US Objectives in Iran.

A 1962 paper called "Guidelines for Policy and Operations, Iran" which has not been superseded by an NPP, states that "Iran is a weak, exposed, and vulnerable channel for Soviet expansion southward towards the warm waters and the oil fields of the Persian Gulf and beyond. The prevention of Soviet domination...is extremely important to the national security of the United States." US objectives in Iran as stated in the same document are:

1. A stable Iranian regime friendly to the West.
2. An Iranian state with the will and the ability to resist Soviet pressure.
3. A unified Iranian Government with a broad political base and with effective channels outside the existing elites and would-be elites.
4. An Iranian economy capable of continuing economic development in an orderly and more efficient pattern, so that a modern

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state may be supported and standards of living may be raised.

These appear to represent currently valid US objectives in Iran.

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B. THREAT ANALYSIS

This section examines the nature and extent of the external threats to Iran posed by the USSR, Iraq, Egypt, and Afghanistan, as well as the threats posed by the internal situation.

I. External Threats.

1. USSR.

The Soviet Union poses the most serious external threat. As the Over-all Intelligence Estimate for Planning for Iran (January 1964) indicates, "The USSR, with its past history of interest in and aggression against Iran, remains a major contender in possible external conflict involving Iran. Historically, the USSR has viewed possession of Iran as one means of obtaining a warm-weather port."

The gross Soviet threat to Iran consists of 27 Soviet line divisions (20 motorized rifle, 5 tank and 2 airborne) in the Trans-Caucasus, North Caucasus, and Turkestan military districts, plus approximately 405 tactical aircraft, including 245 jet fighters (70 MIG-17, 70 MIG-19, 70 MIG-21, 35 SU-7), 25 jet light bombers (YAK-28), 50 light bomber recce (IL-28), 25 jet fighter recce (MIG 15/17) plus 20 transports and 40 helicopters. The Soviet naval threat is limited to a small Caspian Sea flotilla.

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These military forces in the southern military districts of the USSR are not, of course, directed solely against Iran, but also pose a threat to eastern Turkey, Afghanistan and Pakistan. Moreover, because of terrain and logistic considerations, only about 11-12 Soviet divisions (6 from the Trans-Caucasus, 3-4 from the Turkestan military district, and 2 in airborne operations) could be supported in northern Iran. Intelligence reports indicate further that of the Soviet forces in southern Russia only 3 divisions are now combat ready; the other 24 are either at two-thirds of wartime strength, or in cadre status (about 20% of wartime strength). These units can be brought to readiness in periods ranging from a week to several months. Prior to an effective overt attack, a build-up and re-deployment of forces would be necessary, affording strategic warning estimated at a minimum of 10 days and more probably 21 days.

NIE 11-14-64 indicates that, on a world-wide basis, about 50% of Soviet ground divisions are combat ready. A comparison of the above described Soviet forces with this indicator of over-all Soviet readiness suggests that the situation on the northern border of Iran is not a matter of immediate military concern to the USSR. The same NIE also predicts a moderate reduction of world-wide Soviet ground strength by 1970.

Not only the military posture, but also the foreign policy of the USSR suggests the unlikelihood of an attack upon Iran in the near

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future. Since 1962 when the Shah pledged not to permit the establishment of foreign missile bases on Iranian soil, the Soviet Union has reduced tensions, made offers of economic assistance, and concluded limited commercial and trade agreements. Also, the Shah has recently made a cordial state visit to the USSR (June 1965).

In 1961, Premier Khrushchev stated that the USSR would not intervene militarily in Iran, but would wait for the misery of the masses and the corruption of the government to produce a revolution.

A basic factor contributing to the stability of Iran's northern frontier is the demonstrated US interest in Iranian sovereignty and integrity. US pressure forced the Soviets to withdraw from Azerbaijan in 1946, and continuing US concern has been expressed in the Military Assistance Program and the CENTO arrangements. NIE 11-9-65, discussing main trends in Soviet foreign policy, states that "the Soviets appreciate that their unfavorable power relationship with the US argues against a policy of confrontation, and they are not likely to seek open challenges carrying high risks of war with the West." A joint US-Iranian military training exercise conducted in Iran in 1964 was undoubtedly noted by the USSR.

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2. Iraq.

The OIEP for Iran (January 1964) indicates that "a possible source of external dispute is with Iraq with which, in addition to the Kurdish problem, there could be serious disagreement relative to the oil producing land along the head of the Persian Gulf, and to the use by Iran of the Iraqi waterway Shatt al Arab to the Iranian refinery at Abadan." Granted these sources of friction, Iraq (a nation of 6.5 million people) poses a small military threat to Iran unless it is supported by Egypt or the USSR. Iraq could expect little or no assistance from other Arab states in a war against Iran, and would indeed be forced to consider the question of its Syrian border before contemplating any adventure in Iran.

The Iraq Army of 82,000 men comprises 1 armored division and 4 infantry divisions. The armored unit and 2 infantry divisions are in or near Baghdad; the other 2 infantry divisions (styled "mountain") are in the north. The Iraq Air Force has 75 jet fighters of which 56 are operational; 14 jet light bombers, 10 medium bombers, and 17 transports, all of Soviet origin. The naval element consists of 19 poorly maintained patrol boats.

The Iraq Army is the principal force, but its capabilities are considered very limited; defeat by the Kurdish rebels and frequent

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political purges have weakened its morale and reliability. The Air Force has also suffered purges, and these have weakened its capability, especially for offensive operations. On balance, an Iraqi attack on Iran is considered very unlikely in the period under study.

3. Egypt.

Since Iran's recognition of Israel in 1960, relations with Egypt have been strained, and the Shah professes to see Nasser as a serious threat. According to DIA he believes that Nasser, working through Iraq and the Persian Gulf sheikdoms, intends to commit aggression against Iran by military action, subversion, or both. An Egyptian military contingent is in Iraq to bolster the Iraqi regime, and is estimated to include about 50 technicians and pilots, and an Army element of 1,000 men manning about 90 Iraqi T-54 tanks.

The hostility which some elements of the Iraqi population hold for Egypt will, however, probably preclude any large scale increase in the Egyptian military presence in Iraq; and the Egyptian preoccupation with Israel, Nasser's present difficulties and heavy troop commitments in Yemen, and US warnings against aggression in the Middle East are further deterrents to Egyptian military moves against Iran.

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4. Afghanistan.

Afghanistan has an 80,000 man army organized into 3 armored and 10 infantry divisions (5,000 men each). Only 1 infantry division is positioned near the Iran border, and the mountainous approaches to Iran limit an invading force to 2 divisions in the north and 2 in the south. The army is supported by 67 jet fighters and 27 jet light bombers, all of Soviet origin.

In the past, Afghanistan has been considered a serious potential threat, but NIE 34-64 states that "relations with Afghanistan have improved markedly since Iran served as mediator in the Afghanistan/Pakistan dispute (May 1963) and prospects for the future here are good." Afghanistan would become a serious threat to Iran only in the event of a Soviet takeover.

II. Internal Threat.

A more serious threat to the stability and independence of Iran arises from the internal situation. "Enigmatic Persia" has been the subject of widely varying estimates by observers over the past decade, ranging from predictions of the regime's imminent overthrow to very optimistic prophecies of stability. What is clear is that the Shah's program of reform has set in motion a fundamental reorientation of the

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social and political situation; profound change is an inevitability and the question at issue is whether the form will be evolution or revolution.

The disaffected elements in Iran are strong and influential; on the other hand, opposition to the regime has thus far been quite disorganized, and the Shah appears to enjoy general acceptance by a majority of the population. The memory of the personal misery and public disorder of the Mossadegh days is still fresh enough to serve as some inhibition to disorder and rebellion, although Iran's modern history is replete with violence and revolt. Between January 1960 and January 1963, there were 11 major demonstrations against the regime; and in the summer of 1963 the most violent of all recent civil disorders occurred--in part as a protest against land reform. The Prime Minister was assassinated in January 1965, and an attempt made on the life of the Shah in April 1965.

Following is a brief summary of the present and potential dissident groups in Iran:

- a. The loosely organized National Front, combining urban middle-class elements and the intelligentsia, have, according to NLE 34-64, "been unwilling to support the reform program, since their real objective is not so much benefits for the

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population at large as it is power for themselves.

Yet when they have combined with the conservatives to criticize the Shah's program, they have forfeited popular support. "

- b. The traditional, conservative upper-class elites are particularly alienated by the Shah's reforms; but according to the CIA "while their influence remains strong, they are disorganized at present and probably have no effective means of opposing the Shah, except to hamper reforms. "
- c. The Kurds are a possible source of subversion in the north (the USSR has a Kurdish minority) and in the west (Iraq has a Kurdish population of almost one million). The Iranian Government recognizes this problem and has, through covert support of the Iraqi Kurd revolt, gained the good will of the Iranian Kurds. Moreover, social and economic reforms have been pushed diligently in Kurdistan.
- d. The Arabs in Khuzistan are another potential source of subversion, but at present are unarmed and sunk in poverty and apathy. The Country Team reports

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that the Government is taking some of the needed economic measures to deal with the problem.

- e. With regard to tribal disorders in other parts of Iran, NIE 34-64 estimates that "such conflicts are easy to contain and isolate, and it would be extremely difficult for the diverse tribal groupings to coordinate action against the regime." Moreover, tribal groups have been the subject of intense governmental attention over the past 40 years, designed to reduce their potential for dissidence and insurgency.
- f. The Communist Tudeh Party is weak, ineffectual, and illegal; it is also heavily penetrated by government security forces. It has 200 active members in Iran and several hundred more in exile; its leadership is largely outside the country, in East Germany.
- g. It is always possible that rural and urban workers will become disaffected, particularly if Iran should undergo an economic crisis. This could be caused by a continued run of bad weather and consequent drought. Also, any real slowing of reform efforts could cause dissatisfaction in this group.

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The OIEP on Iran concludes that "these dissident elements lack strong leadership, effective organization and positive goals, and they will almost certainly experience great difficulties in overcoming their shortcomings. Outbreaks of insurgency are likely to occur in both urban centers and the rural area during the next few years, but we believe they will be uncoordinated and will not erupt into large scale, country-wide organized attempts to overthrow the Shah's Government."

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C. IRANIAN MILITARY POSTURE

I. General.

Iran's military posture has been importantly shaped by two agreements concluded with the United States, the 1962 Memorandum of Understanding and the 1964 Memorandum of Understanding. The full texts of these agreements are set forth in Annexes 2 and 3. In sum, the 1962 agreement provided that the United States would furnish specified military assistance to Iran over a five-year period if Iran would take certain steps to reorient and improve its forces and would reduce their total strength to 160,000. The agreement stated that "the concept for the defense of Iran against external threats is based upon a forward strategy utilizing the natural mountainous barriers on the northern border." The 1964 agreement reaffirmed the force structure and the defense concept set forth in the 1962 Memorandum; it also extended US military assistance through FY 69 and provided for credit sales as well as grant aid, in recognition of Iran's improved economic position. Both agreements are considered more fully in a later section of this paper.

In addition, Iran has a formal defense link with the West through membership in CENTO. The other CENTO members are Turkey, Pakistan, and the U.K. (the U.S. being a member of the Military

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Committee, but not of the Treaty Organization itself). The CENTO Treaty commits its members to collective action in a general way: "to cooperate for their security and defense", and the CENTO Joint Campaign Plan sets forth general security commitments in terms of a concept of wartime military operations, wartime missions, and an estimate of the required forces. There is however no CENTO command structure.

II. Iranian Forces.

Following is a summary description of Iranian military and paramilitary forces.

1. Total Forces.

Iranian armed forces consist of a conscript army, a relatively small air force, and a small navy. These forces are detailed at Annex 4. The Shah, as Commander-in-Chief, exercises actual command. The Imperial Iranian Gendarmerie and the National Police operate under the Ministry of the Interior. The National Intelligence and Security Organization, SAVAK, is separate from both the armed forces and internal security forces; it reports directly to the Shah and has responsibilities for the security of the state. The total forces are apportioned as follows:

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Iranian Armed Forces:

Army	145,700
Navy	3,900
Air Force	<u>10,400</u>
Total Armed Forces	160,000
Imperial Iranian Gendarmerie	36,400
National Police	23,000
SAVAK	- - - -

Iranian and US officials have recently agreed to an increase in the total strength of the Iranian armed forces from 160,000 to 172,000 by 1968, based upon requirements generated by new equipment being furnished Iran under the 1964 Memorandum of Understanding.

2. Army.

The Iranian Army consists of 7 infantry and 1 armored divisions, plus supporting units that include 4 tank battalions and 7 armored cavalry regiments. Attached to each division are Frontier Force units which provide early warning against hostile attacks, man demolition sites, and conduct the initial delaying actions along the avenues of enemy approach. The present deployment of Army forces is set forth at Annex 5. Four infantry divisions are stationed in the northwest and west, 1 in the Teheran area, 2 in the northeast and east;

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the armored division is in the southwest. This disposition of forces, designed to meet an external attack, also places the units in proximity to major ethnic minorities, which facilitates the maintenance of internal security.

3. Air Force.

The Iranian Air Force has 5 air defense/tactical fighter squadrons, 4 equipped with F-86F aircraft and 1 with F-5s. There is also a reconnaissance squadron (RT 33), a tactical control squadron (LT-6G), and 2 troop carrier squadrons (C-47 and C-130). Three AC&W sites are manned. Military assistance deliveries in FY 1966 will add one squadron of F-5s, bringing the total to 6 tactical fighter squadrons. This will increase jet fighter aircraft from 65 to 78. There are four jet-capable airfields, with another under construction (at Mashed), and 3 others suitable for limited jet fighter operations.

4. Navy.

The Iranian Navy, based in the Persian Gulf, has no major combatant ships, but is equipped with 2 modern patrol frigates, 4 patrol gunboats and 6 minesweepers; all are new ships with modern weapons and equipment. Additionally, there are 4 obsolete patrol ships not yet retired.

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5. Internal Security Forces.

The National Police has responsibility for maintaining internal security in 153 Iranian cities with populations exceeding 5,000. The Imperial Iranian Gendarmerie, a completely volunteer organization, has responsibility for rural law and order, and mans about 2,000 posts (8 to 10 men each) of which 450 are in territory where there are no roads; animal transport is used. In 1963 the Gendarmerie absorbed the Border Guard and assumed its responsibilities for information gathering, border security and antismuggling. The Gendarmerie has also recently organized a small special operations company, a boat battalion to provide patrol and surveillance in the inshore and inland waterways of Iran, and an aviation battalion to provide aerial surveillance, command and control, medical evacuation, and emergency logistical support.

III. Missions.

Missions are assigned to Iranian forces by Iranian, U.S. and CENTO plans. In the main, they are similar and compatible.

1. The Iranian View.

DIA has indicated that missions assigned to the Iranian armed forces by their own plans are to:

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- a. Maintain internal security.
- b. Defend the western border against an Arab-supported Iraqi attack.
- c. Defend as far forward as possible against Soviet attacks emanating from west and east of the Caspian Sea.

2. The U. S. View.

The U. S. view of Iranian military missions is based on Annex J to JSOP-70. It lays greater stress on internal security missions, and does not distinguish between external enemies. According to JSOP, the missions of the Iranian armed forces are to:

- a. Prevent spread of Communist influence.
- b. Attain qualitative improvement in military capability.
- c. Assist and support civil agencies in maintaining internal security.
- d. Develop logistic self-sufficiency to the maximum extent possible, and compatibility with US systems to the extent feasible.
- e. Employ military capabilities in civic actions, disaster relief and road building.
- f. Counter Communist subversion and defeat insurgency.
- g. Conduct operations unilaterally or in conjunction with US/UN forces to defend sovereign territory, and be prepared to assist in counter-offensive efforts to restore lost territory.

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h. Develop, maintain, and provide local security for necessary bases, facilities, and ground environment for US/Allied use.

i. Conduct UW operations, including a vigorous guerrilla role, and psychological operations as required.

3. CENTO Missions.

Missions assigned to the Iranian armed forces by CENTO plans are as follows:

a. "General CENTO mission: defend the CENTO area, ensuring the integrity of the region as a whole and in accordance with the accepted concept of operations, which is 'to hold main defensive positions as far forward as possible along the line of ... Azerbaijan and the Elburz Mountains... supported by adequate mobile forces behind the main defensive position!."

b. "Specific mission for Iran: conduct air, land and naval operations in accordance with national plans... recognizing the need for position contact whenever possible with Turkish forces."

It is interesting to note that the Iran and CENTO versions of Iranian missions reflect the concept of holding "as far forward as possible" against external (essentially northern) attack. This phrasing is curiously absent from Annex J to the JSOP, even though

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the concept was explicitly stated in the 1962 Memorandum of Understanding.

4. Internal Security.

The OIEP on Iran further indicates the important internal security role of the armed forces: "Under normal situations the three military services are charged with the defense of Iran against external aggression; whereas the police and gendarmerie are responsible for the prevention of internal threats to law and order in their respective areas of responsibility. In cases of widespread internal disorders which cannot be controlled by the police and/or the gendarmerie, the military forces have the mission of assisting in restoring order."

IV. Capabilities.

According to the OIEP, Iranian forces alone could neither contain nor seriously delay a major Soviet attack; on the other hand, they are judged sufficient to halt any other external aggression. The Country Team, in responding to questions posed in connection with the preparation of this paper, has made the more optimistic judgment that Iranian forces could delay even a major attack, provided external reinforcements were rapidly introduced. These considerations are further analyzed in Section E of the paper which deals with net capabilities.

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The OIEP further assesses the following specific strengths and weaknesses of the Iranian forces:

"Enlisted personnel have good physical endurance, and discipline is generally good. The number of U.S.-trained junior officers who may eventually replace conservative, if not inept, senior leadership is growing. Enlisted personnel generally have a low level of education and technical training. The military establishment as a whole is handicapped by cumbersome, over-centralized systems of command, supply and administration and by a widespread lack of combat experience."

The question of loyalty to the Shah is important. In the Mossadeg era, the armed forces went over to Mossadeg for a time, but subsequently supported the Shah's return; there is thus a precedent for defection. The enlisted conscripts might support the activities of the social echelons from which they came and to which they will return, but this group is largely illiterate and would lack cohesiveness. More important are the attitudes of the officer corps. NIE-34-64 has stated that "some of the middle-grade and junior officers probably share the outlook of the nationalist opposition... (but) .. dissent within the military does not appear to be growing. We believe that the overwhelming majority of the officer corps are loyal to the Shah."

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Iran's internal security forces are credited by the Country Team with the capability to maintain law and order, but they are not concentrated sufficiently in any one place to handle major riots, disorders, or uprisings without assistance. On those occasions when they have been unable to handle civil disturbances, military forces have been called in as planned. NIE-34-64 states that, "In these actions, the armed forces have generally performed creditably, and we believe they can successfully cope with any likely disorders." The Country Team believes that Government forces could cope even with widespread disorders that were coordinated and supported from outside Iran.

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D. U. S. MILITARY POSTURE IN RELATION TO IRAN

This section examines U.S. commitments and U.S. military capabilities in relation to the defense of Iran.

I. Commitments.

The U.S. is not a member of CENTO, but was instrumental in its establishment in 1955 (then the Baghdad Pact) and has frequently expressed its support for the organization. US obligations to Iran center on:

1. The Joint Resolution to Promote Peace and Stability in the Middle East, of 1957 (the so-called Eisenhower Doctrine), which states that "the United States regards as vital to the national interests and world peace the preservation of the independence and integrity of the nations of the Middle East. To this end, if the President determines the necessity thereof, the United States is prepared to use armed forces to assist any nation or group of nations requesting assistance against armed aggression from any country controlled by international Communism; provided that such employment shall be consonant with the treaty obligations of the United States and with the Constitution of the United States".

2. The Bilateral Agreement of Cooperation (identical Executive agreements were signed with Iran, Turkey, and Pakistan in 1959),

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which states that "the Government of the United States of America, in accordance with the Constitution of the United States of America, will take such appropriate action, including the use of armed forces, as may be mutually agreed upon and as is envisaged in the Joint Resolution to Promote Peace and Stability in the Middle East, in order to assist the Government of Iran at its request. "

In addition to these formal obligations, public and private assurances have been frequently voiced by US officials. President Eisenhower in a letter to the Shah, dated March 12, 1960, stated: "Iran can always count on the United States in meeting the threat of international Communism". General Lemnitzer at the CENTO Military Committee Meeting of April 24, 1961, said, "the initiation of any Soviet or Soviet satellite aggression in the CENTO area must be met with whatever appropriate tactical or strategic force may be mutually agreed to be necessary...the United States, for its part, is determined to take whatever action and accept whatever risks are necessary for the defense of the CENTO area".

II. US Forces.

No U. S. combat forces are stationed in Iran on either a permanent or rotational basis, but the following personnel and activities are present: US Army Corps of Engineers Gulf District Headquarters

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(about 300 personnel), a mobile STARCOM installation (50 personnel),
a US Army Topographic Training Team (90 people),

The Commander of US Middle East Forces, located in Bahrein, has command of 2 destroyers and a small sea-plane tender. These are the only US combat forces stationed in the Middle East-South Asian area.

2. Current Military Planning for Augmentation.

In anticipation of a request from the Shah, arising from the Eisenhower Doctrine, to protect Iran "from any country controlled by international Communism", current US military planning considers the deployment of limited US and allied forces to deter Soviet intervention or, if deterrence fails, to attempt a defense of Iranian territory with limited means. Four US airborne battalions could be in-country not later than D + 4, and tactical fighter squadrons could also be readily available. Current planning calls for a maximum commitment of 2 US Army divisions, 5 tactical squadrons, 1 Marine division/air wing team, and 3 bomber squadrons.

A recent joint US/UK military staff study on Iran has suggested that the United Kingdom might make available 6 ground battalions, up to 14 air force squadrons, and a navy contingent of one

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carrier group, one cruiser, one commando carrier, three frigates, 17 minesweepers and an amphibious squadron. This estimate of available British resources may be optimistic.

The implication of US planning is that, if the aggression persists beyond the capacity of limited allied forces to contain it, the US will then face the question whether to accept a local defeat or to introduce nuclear weapons either locally in Iran or against the territory of the USSR.

Theoretically, the US could choose to fight a major ground war in Iran. In that event, it could presumably call on a major portion of the CONUS reserve of 9 ground divisions and 34 tactical fighter squadrons, and a large naval force comprising 3 to 5 attack carriers, 5 to 9 cruisers and 40-60 destroyers. However, a major land war in the Persian Gulf area would result in a recognized maldeployment of US forces, and could create a situation that would leave Western Europe or other areas open to major attack after the US was heavily committed in Iran. Fortunately, the threat of a major Soviet drive into Iran is extremely unlikely; but the planned US response to it is not a major land war in Iran; it appears to be a limited conventional response to emphasize the seriousness of the situation and, thereafter, if the situation cannot be restored, a resort to nuclear weapons.

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E. NET CAPABILITIES ANALYSIS

This section first discusses the rationale for the present Iranian force structure; it then considers the capabilities of Iranian and US forces to meet a major Soviet attack.

I. Rationale for Force Structure of the Iranian Military Establishment.

The Iranian armed forces are structured and deployed, in the main, to counter a major Soviet attack; they also are designed to handle other external threats to the country, which could probably be met by a smaller total military establishment.

Prior to 1958, the Iranian armed forces totaled 130,000 and were deployed for, and capable of, internal security only. The coup in Iraq and that country's subsequent withdrawal from the Baghdad Pact were catalysts leading Iran to a basic re-evaluation of its military position and to a reorganization of its armed forces. Iran appealed to the US for closer advice and assistance, increased its forces to 200,000 men, and deployed them in forward positions to counter attacks from the north and the west.

US strategy at that time was beginning to move away from a main reliance on massive retaliation to deter or deal with Soviet aggression. The deployment of reasonably strong Iranian forces on the northern

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borders thus served to assure that a Soviet attack would not quickly overrun the country; it forced an attack to be of such magnitude as would attract world attention and thus buy time for a considered US/allied response.

The present disposition of Iranian forces--placed forward along the northern and western borders--seems correct and prudent, for while a direct Soviet attack is unlikely during the period under study, the USSR clearly poses the most serious external threat to Iran. It is to a more considered examination of this posture, and of the required size and composition of total defense forces, that the paper now turns.

II. Evaluation of Total Force Requirements.

The current structure of the Iranian armed forces evolved substantially from US studies accomplished in 1962, specifically an appraisal of requirements for US General Purpose Forces accomplished by the Working Group of the Chairman of the Joint Chiefs of Staff, and the findings of a US Military Planning Team designated by the Chairman, JCS. A later analysis (1964) by the Special Studies Group of the Chairman, JCS concerning rapid US deployments was consistent with, and up-dated in some respects, the 1962 evaluations. What follows here is a summary and evaluation of these studies based on new factors and slightly different interpretations. The areas of inquiry are strategic warning, the air battle, and the ground battle.

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1. Strategic Warning.

The 1962 and 1964 studies indicated that required Soviet preparation for an attack on Iran would afford strategic warning of ten days; and in the war gaming, US forces were alerted for deployment on receipt of warning, but were not deployed to Iran prior to the attack. As indicated in the threat analysis (Section B), a strategic warning in the FY 67-71 period might be as much as 21 days in view of low level of manning and combat readiness among Soviet ground units deployed against Iran. In addition, the US would now have the option, in view of its substantial strategic reserves in CONUS and its greater capability for rapid deployment, to commence limited deployments to Iran on receipt of warning; such a move would underline US intentions to support Iran and would thus reinforce the deterrent.

2. The Air Battle.

The 1962 study credited the Soviets with 630 jet fighters to support a major Soviet attack; it also assumed that the Iranian Air Force would be quickly overwhelmed and destroyed by Soviet air forces. The US air augmentation assumed by the study was substantial--700 aircraft, of which 325 aircraft (13 squadrons) would be in place by D+7 and an additional 300 aircraft (12 squadrons) by D+22. With this heavy and prompt infusion of air support--for counter-air,

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close-air support, and interdiction operations -- analysis indicated that Iranian ground forces might be able to delay the Soviet attack long enough to permit external reinforcements to stabilize the situation.

In 1965, DIA asserts that the Soviet jet fighter inventory in the southern military districts of the USSR is approximately 245 aircraft, or about one-third of the 1962 estimate. While the projected Iranian Air Force of about 100 jet fighters could not match even this reduced Soviet air strength, it seems clear that it would be a more significant factor in the battle, although it would still require reinforcement by US tactical airpower.

3. The Ground Battle.

The 1962 and 1964 studies both postulated Soviet attack by 11 and 2/3 divisions. In the war gaming, Iranian ground forces, deployed in forward defensive positions near the borders, conducted delaying actions from successive fall-back positions until reinforcement by a total of 7 US divisions brought the Soviet attack to a halt. US deployment capabilities at that time were considered insufficient to permit a forward defense on the borders of Iran, unless substantial reinforcing forces were in place prior to the attack, but a strategy

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of US build-up in time to establish and hold defensive positions in the Zagros Mountains--in central and southwest Iran--was judged feasible. In delaying actions, the Iranian ground forces were estimated to suffer 50% losses; thus for later defensive operations with US forces in the Zagros Mountains, only 4 Iranian divisions were assumed to be available.

Two new factors now warrant consideration. The first relates to the present effectiveness of Soviet ground forces. The 1962 studies considered that 1 Soviet division was equal to 3-4 Iranian divisions, and was comparable in effectiveness to 1 US division. Recent changes in war gaming factors, based in part on a known reorganization of Soviet forces, produce the conclusion that 1 Soviet division is equal to 2-3 Iranian divisions and to 75 to 80% of a US division. Without attempting a precise mathematical calculation of the consequences, it is clear that these new estimates, if valid, enhance the Iranian capability for delaying Soviet advance, and improve the prospects of a combined US/Iranian defense along a line in the Zagros Mountains.

The second new factor relates to forecasts of improved US movement capabilities in the FY 67-71 period. Recent decisions to improve airlift, sealift and the prepositioning of equipment will reduce the time required to move US ground forces to the Middle East-South Asian area, particularly large units and their supporting gear. It is

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conservatively estimated that, with the advent of the C-5 aircraft, 2 full US divisions could be committed to action in Iran 20 days from the order to go, and 3 divisions in 30 days. Earlier arrival of US ground forces would of course help in the ground battle. Additional ground forces would strengthen the delaying action and slow the Soviet advance; they would also cause the Soviets to mass their ground forces to a greater extent, thus creating better targets for air attack. With larger ground forces to effect delaying actions, Iranian forces might suffer less attrition, and might reach the Zagros positions with more than the 50% effectiveness postulated in the 1962 studies.

4. Conclusions.

It appears that the present balance of opposed forces, in the context of a Soviet conventional attack on Iran, has shifted perceptibly in favor of the defending forces. The USSR ground forces are at a lower level of readiness and will therefore give an earlier warning if they undertake to prepare for attack; Soviet air strength in southern Russia is estimated at about one-third the 1962 strength. Conversely, the Iranian forces are regarded as stronger and better equipped; and the US capability for rapid reinforcement is expected to improve in the FY 67-71 period.

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While it would be a mistake to draw definitive conclusions from these new factors, especially as to the size and composition of required Iranian armed forces, they may nevertheless constitute useful points of reference for both US contingency planning and future MAP negotiations with the Shah.

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F. MILITARY ASSISTANCE TO IRAN.

This section reviews past military assistance, and current projections of both military grant aid and credit sales, pursuant to the long-term, US-Iran agreements. It then makes certain comments and recommendations for future MAP negotiations with Iran.

I. Military Assistance in Retrospect.

During the 1951-1965 period, US military assistance (grant aid) totaled \$714.5 million. The following table, indicates the figures for the past 5 years and the proposed program for FY 66.

FY 61	\$75.9 million
62	53.1 "
63	70.0 "
64	50.3 "
65	37.2 "
66	45.3 " (proposed)

MAP has provided virtually all the equipment for the Iranian armed forces, and has since 1951 brought them from a small, poorly equipped military organization, capable of little more than punitive operations against primitive tribes to a well-equipped, reasonably modern and competent force of 160,000. In 1958, when the Iranian armed forces were reorganized and substantially increased in size,

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the level of military assistance was increased to \$90 million, but it became apparent to US and Iranian officials that Iran could not support a military establishment of 200,000 men. This and other factors led to a re-evaluation of Iran's defense needs in 1962, resulting in the singular five-year military assistance agreement expressed in the 1962 Memorandum of Understanding (Annex 2). The agreement specified, among other things, the size and composition of the Iranian armed forces. At Annex 4 is a comparison of forces-in-being, JSOP goals and force objectives agreed in the two Memoranda of Understanding. In summary, the US-Iran agreed force goals now are:

- 8 ground divisions (or equivalent)
- 8 tactical fighter squadrons
- 1 recon squadron
- 4 transport squadrons
- 11 patrol ships
- 6 minesweepers

The 1962 Memorandum of Understanding also described a grant aid program amounting to \$298.6 million for the period FY 62-66, to include 2 minesweepers, 2 patrol frigates, 20 H-43B helicopters, 4 C-130s, 12 C-47s, 4 squadrons of F-5As, 100 M-113 personnel carriers, 10,000 vehicles, airfield construction, barracks, 30-day ammunition supply for

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light and heavy weapons; also communications, combat support equipment, and support for a civic action program.

By the 1964 Memorandum of Understanding, the US and Iran established a similar pattern of MAP grant aid and Iranian defense efforts, including credit sales, for the 5-year period FY 65-69. This overlapped the first agreement for the fiscal years 1965 and 1966. By the 1964 Memorandum the two governments reaffirmed "the concept for the defense of Iran and the force structure for the Imperial Iranian Armed Forces set forth in the Memorandum of Understanding of September 19, 1962." They also took note of the "improved financial situation of Iran and the need for modernizing Iran's military forces on a long-range basis". The agreement described equipment amounting to a grant military aid program of \$178 million for the 5-year period (\$95.5 million net addition to the FY 62-66 agreement). Equipment specified in the 1964 agreement include 39 F-5 aircraft, a 30-day reserve of ammunition, significant amounts of artillery, and additional vehicles, communication, engineer and other support equipment.

The US also agreed to provide credits up to \$200 million during the period to facilitate Iranian purchases of military equipment. The 1964 agreement stated in this regard that Iran will assure that

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"military purchases will not cause undue strain on its foreign exchange reserves, or the nation's economic and social development", and that Iran will "limit its purchases of military equipment to the requirements of agreed attainable force objectives..." Iran will make cash purchases of about \$50 million (primarily for spare parts) and will purchase new equipment, spares and related services under the \$200 million credit arrangement. The agreement provides for a maximum of \$250 million in Iranian purchases during the period. The first Iranian transaction totaled about \$50 million, and negotiations are under way for the second increment which will total \$85-95 million in credit sales. The grant aid portion of the 1964 agreement is summarized in the following table:

FY 65	\$ 37.2	Supports 1962 Agreement
FY 66	45.3	Supports 1962 Agreement
FY 67	40.6	Supports 1964 Agreement
FY 68	30.2	Supports 1964 Agreement
FY 69	<u>24.7</u>	Supports 1964 Agreement
	\$ 178.0	

II. General Conclusions.

This paper sees neither intrinsic merit nor political wisdom in an attempt to recommend an alternative Iranian force structure

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at this time. The efforts of the US and Iran are clearly charted in the two Memoranda of Understanding, which provide clear guidance not only as to the Iranian force structure, but also as to MAP grant aid and credit sales. Patently, it is not in the US interest to abrogate these agreements, nor to upset them by initiating a proposed renegotiation. Moreover, increasing Iranian oil revenues permit the Shah to modernize and otherwise strengthen his military forces. If it is the desire of the Iranian Government to take this course of action, and to pay for the forces in question, it is not in the interest of the United States to oppose such a course, provided only that Iranian economic development and balance of payments are not adversely affected, and that the Iranian force structure is held within the bounds of the agreements. Within such limits strong military forces in Iran are politically desirable, for the armed forces provide the primary support to the Shah at present; their modernization enhances both their ability to support the Shah and their willingness to do so.

It is accordingly not a purpose of this reappraisal to attempt to overturn recent arrangements that seem basically sound, and that indeed constitute a unique arrangement in the history of MAP. It

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is the purpose of this paper to suggest certain considerations that may assist US negotiators in the years immediately ahead, in dealing with further Iranian MAP programs and in seeking to balance the Shah's interest between military and non-military matters. For the Shah's keen interest in military matters, combined with his growing oil revenues, could lead to a situation that would strain both Iran's economy and the boundaries of the 1964 Memorandum of Understanding. He has, for example, already voiced serious interest in securing a follow-on to the F-5 aircraft, specifically the F-111; he has expressed a desire for the US Sheridan tank, which is still developmental; he has indicated a desire to buy a second Hawk missile battalion, without a clear idea as to its end use; and he has requested a 90-day level of war reserve ammunition. These items are perhaps illustrative of the general problem of restraint that may confront US officials dealing with Iran.

III. Suggestions.

The paper accordingly turns to a listing of suggestions regarding force levels and force composition that may be helpful in discussions designed to restrain an Iranian arms buildup. They derive from both the threat analysis and the conclusions as to Iranian strength, US commitments and US deployment capabilities.

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1. The unlikelihood of an overt Soviet attack, and the clear fact that present Iranian forces overmatch all other potential enemies, suggest that the Iranian ground forces could be reduced to the level of 6 infantry divisions without the incurrence of unacceptable risk.
2. A strict military rationale for an Iranian armored division is difficult to develop. There is no single enemy avenue of approach particularly suitable for defense by armor, nor do the various routes converge sufficiently to permit concentration of armor as a reserve force. Conversely, defense of the various borders does require some tank support of infantry. The Shah developed the present armored division by reorganizing an infantry unit in the southwest, and transferring into it 3 tank battalions previously designed to provide support for infantry divisions in the north; this left only 4 tank battalions to provide support to the remaining 7 infantry divisions. In terms of the major external threats, the wisdom of this reorganization is at least arguable. If the infantry divisions were reduced to 6 and the armored division were eliminated, the total number of tank

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battalions could be reduced from 10 to 6. This would produce a standing force of about 276 M-60 tanks as opposed to the present 460.

3. In view of the reduced Soviet tactical fighter strength in southern Russia, the forthcoming modernization of the Iranian Air Force, and the rapid and substantial air augmentation capability of the US, it is arguable that the Iranian Air Force could be held at a level of 6 tactical fighter squadrons, instead of rising to the planned level of 8, without incurrence of unacceptable risk. There are five squadrons at present. An air force of six squadrons would appear strong enough to deal with all threats to Iran, except from the USSR, without US air assistance.
4. The requirement and desirability of a second Hawk missile battalion is debatable. It is doubtful whether the Iranian armed forces can operate and maintain additional units of this complex weapons system without serious drain upon other requirements for technically qualified personnel. Iran has not indicated how it might deploy such a second battalion or where.

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5. A navy even more modest than currently projected may be adequate to meet the minor naval threat to Iran. Two new patrol frigates are now in inventory (plus two obsolete PFs not yet retired), with two more planned, one in the FY 66 MAP program, and another to be included in the second increment of Iranian purchases, now being negotiated; the need for these two additional ships seems arguable. Seven patrol gunboats (PGM) are provided by the US-Iran agreements and are reflected by Annex J to JSOP-70, but CINCSTRIKE in the FY 67-71 Military Assistance Plan has programmed to a level of 8 such ships. Seven would appear sufficient.
6. Discussions with the Country Team in April, in connection with the preparation of this paper, led to the impression that current and projected MAP support for the Imperial Iranian Gendarmerie is somewhat smaller than desirable. In view of the serious internal security problems in Iran and the availability of ample Iranian funds for military and para-military equipment, additional equipment for the Gendarmerie might be warranted.
7. These various considerations and suggestions, if taken cumulatively, could result in manpower savings of about

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20,000 -- 19,000 in the Army, 800 in the Air Force and 300 in the Navy.

8. The suggestions set forth above could result in savings of about \$95 million through FY 69. Such savings would accrue to both MAP and Iran in amounts that reflected the actual mix of grant aid and credit sales. The details of this calculation are set forth at Annex 6.
9. If the 1964 Memorandum of Agreement is carried out either in full accordance with its terms, or as modified by the suggestions set forth herein, and if the Iranian oil revenues continue to grow as projected, it would appear that thereafter a moderately lower level of MAP grant aid and a moderately higher level of credit sales would be compatible with US and Iranian interests. It would probably be a mistake for the US to place its MAP relationship with Iran entirely on a credit sales basis, for this would give the Iranians more latitude to purchase equipment from non-US sources. Continuing US influence on Iran's expenditures for defense and on the structure, composition and training of the Iranian armed forces may well depend upon the maintenance of a grant aid program beyond FY 69.

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In this regard, it is noted that the OSD dollar guidelines
for FY 70 and 71 are \$15 million and \$13 million.

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ANNEX 1

3 August 1965

BASIC DATA - IRAN1. Population:

23.1 million (1965 estimate)

2. Area:

636,000 square miles

3. Literacy Rate:

15%

4. Fiscal Data (General): (Sources: AID Economic Data Book, Near East South Asia, Iran, Nov. 64, and IMF Statistics, July 1965.)

(Fiscal years beginning March 21)	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>Projected 1965</u>
a. GNP (\$million, 1962 prices)	4,476	4,561	4,790	5,030	5,330
b. Per capita GNP (\$, 1962 prices)	212	211	215	222	231
c. Total Exports (\$ million)	873	963	1,025	1,254	
d. Trade Balance (\$ million)	284	364	485	581	
e. Foreign Exchange Reserves (\$ million)	79	77	87		
f. Cost of Living Index, Tehran	126	127	128	132	

5. Military Structure Data:

(Fiscal years beginning March 21)	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>
a. Defense Expenditure as % of GNP (calculated)	4.3	4.1	4.1	4.6
b. Military Budget (\$ million)	194	188	195	233

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ANNEX 1

6. Accumulated MAP data (\$ million): (Source: MAP Table 36, 30 June 1965)

a. Cumulative Programs, FY 50-64:	677.3
b. Undelivered Balance, 30 June 1964:	98.0
c. FY 1965	37.2
d. Current Program, FY 66	45.3
e. Projected Programs:	
FY 67	40.6
FY 68	30.2
FY 69	24.7
FY 70	15.0
FY 71	13.0

7. Data on other U.S. Assistance Programs: (Sources: U.S. Overseas Loans & Grants, July 1, 1945-June 30, 1963, Spec. Rept. for House Foreign Affairs Committee, prepared by AID, and AID unpublished data - FY 64 and FY 65 figures.)

a. AID (\$ million)

	<u>FY 62</u>	<u>FY 63</u>	<u>FY 64</u>	<u>FY 65</u>
Loans	19.7	17.4	1.3	-
Grants	<u>33.3</u>	<u>4.6</u>	<u>3.0</u>	<u>2.9</u>
Total AID Assistance	53.0	22.0	4.3	2.9

b. Export-Import Bank Long-term loans

<u>FY 64</u>	<u>FY 65</u>
8.7	18.5

c. Food for Peace & Other U.S. Economic Programs (\$ million)

1961	26.3		
1962	18.3		
1963	34.2		
1964	12.6	(PL 480)	1964 - 12.6 (Food for Peace)
1965	26.9	(PL 480)	1965 - 26.9 (Food for Peace)

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ANNEX 1

d. Total U.S. Economic Aid

	<u>FY 62</u>	<u>FY 63</u>	<u>FY 64</u>	<u>FY 65</u>
Loans	26.5	23.2	14.3	24.2
Grants	<u>44.8</u>	<u>33.2</u>	<u>12.2</u>	<u>9.2</u>
Total	71.3	56.4	26.5	33.4

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ANNEX 2

September 19, 1962

MEMORANDUM FOR HIS IMPERIAL MAJESTY, MOHAMAD REZA PAHLEVI
THE SHAHINSHAH OF IRAN

The United States at the request of His Imperial Majesty The Shahinshah of Iran has completed a study of matters pertaining to the defense of Iran. A military planning team representing the United States Joint Chiefs of Staff consulted with His Imperial Majesty and the Iranian military staff and made a study of the defensive terrain and of Iran's military forces. Having considered all aspects of the defense of Iran, the team submitted a detailed report thereon.

This report together with the views expressed by His Imperial Majesty during his visit to the United States and in his subsequent letter to the President of the United States has been given full consideration at the highest levels in the Government of the United States. The resulting recommendations have been reflected in the development of a comprehensive and well-rounded multi-year program of military assistance to be provided to Iran by the Government of the United States. The basis for and general content of this program are outlined below.

Iran's security involves military, economic and political aspects. The development of a defense concept for Iran takes into account the necessity for assuring military security within the broader context of the need for strengthened political unity and internal capacity to resist subversion, and the need for continued economic development accomplished in an orderly and efficient manner.

The concept for the defense of Iran must provide for all contingencies, insuring a balance of capabilities to meet each threat. It recognizes the capability of the United States and its allies to deter Soviet aggression and, should deterrence fail, to defeat it. It also takes into consideration the collective security arrangements embodied in the CENTO Treaty, on the agreement of March 5, 1959, between Iran and the United States and takes into account Iran's need for improved capability for self-defense in the event of aggression not envisaged by these agreements.

The concept further anticipates that Iran's armed forces could be called upon to support other Iranian security forces, directly responsible for Iran's internal security. Finally, it assumes that Iranian armed forces would participate in suitable civic action programs designed to contribute to the welfare of the Iranian people and to engender national recognition of and respect for the essential role of the armed forces in the preservation of Iran's security.

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ANNEX 2

The concept for the defense of Iran against external threats is based upon a forward strategy utilizing the natural mountain barriers on the northern border. Military operations in support of such a strategy should be conceived and conducted in a manner visualizing the mutual support of ground, sea and air arms. Essential also to the implementation of such a strategy is the provision of an adequate measure of mobility to the ground force elements conducting the defense.

The concept for ground defense based upon this forward strategy contemplates making maximum use of terrain to achieve economy of force. It would be implemented by the provision of specially tailored frontier-type forces capable of effecting defense of border areas as a necessary contribution to deterrence, furnishing timely and accurate reporting of border incursions or threats thereof and carrying out the forward defense and delay along avenues of approach with emphasis on critical passes and defiles. Heavier units of divisional size, so located as to take maximum advantage of their mobility and firepower, would execute the defense in depth along main avenues of approach. These divisions and their supporting forces should be afforded sufficient mobility to permit rapid employment from more centralized locations to designated primary or alternate defense or delaying positions. Armor units would be disposed and employed so as to maximize their use along likely avenues of armored approach. To reinforce critical areas and to respond to contingency situations, including enemy airborne operations, maximum utilization of available airlift is envisioned.

Within the overall defense concept the mission of the Air Force would involve the execution of tactical air, air defense, and air transport operations including interdiction of key routes of ingress and the air defense of key target areas. The mission of the Navy would involve surveillance and reconnaissance, protection against infiltration, the conduct of mine warfare operations, and the protection of shore facilities including ports to assure vital logistical support through the Persian Gulf and the Shatt-Al-Arab.

The force structure designed for the Iranian armed forces should take into account not only the concept for defense, as set forth above, but also the capabilities of the forces and the equipment and resources which can be presumed to be available to these forces. The development of the force structure is influenced by the necessity to provide increased mobility to the divisional units and necessary support units charged with executing the defense, by the necessity for additional and more effective training efforts and for the provision of substantial numbers of highly skilled personnel needed for the maintenance and operation of increasingly complex materiel, and by the high cost of creating and maintaining an efficient modern armed forces. If due consideration is given these factors, the most effective Iranian military force which could be supported for the next five years is one limited to a total strength of approximately 160,000 personnel.

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ANNEX 2

Within this total force there should be an army of seven infantry divisions of 10,000 personnel strength, each with necessary combat supporting units, a frontier force to provide visible defense, specially tailored and equipped totalling approximately 10,500 personnel, and necessary force-wide logistical support; an air force of approximately 12,000 personnel strength including eight tactical fighter squadrons, three transport squadrons, one tactical reconnaissance squadron, and one air defense wing including personnel necessary to man an aircraft control and warning system; and a navy of approximately 3,000 personnel, including two patrol frigates, four patrol boats and six minesweepers.

The United States in recognition of the need for improvement of the patrol and escort capability of the Imperial Iranian Navy in the Persian Gulf proposes to furnish two patrol frigates. These frigates would replace the two obsolescent ships of this class now in service in the Iranian Navy.

To permit effective utilization and employment of fighter and transport aircraft now available and those planned for the Iranian Air Force, expansion of operative airfield capability and development of an aircraft control and warning system is visualized. Steps to provide for each of these capabilities are necessary for implementation of the concept for defense.

It is proposed that an airfield development program be undertaken giving consideration to the capability and radius of operation of existing and planned aircraft to accomplish assigned missions, while at the same time giving consideration to the resources which can be made available to construction requirements. The concept envisages three main operating bases consistent with permanent base maintenance and support requirements; the use of a forward operating base in northeast Iran with minimum essential facilities for extension of operating radius; and the utilization of existing commercial airfields as emergency forward operating bases. Within this concept one main operating base would be developed at Hamadan in addition to those now existing at Teheran and Dezful and a forward operating base would be constructed in Northeastern Iran at Mashed.

The United States proposes to contribute to the development of the aircraft control and warning system by construction of radar stations at Hamadan and Dezful. The development of the system would be facilitated by construction of a radar station within CENTO early warning system at Mashed by the Government of the United Kingdom and subject to CENTO agreement thereto. The United States would also provide an adequate and reliable communications system linking all existing and proposed radar stations and the air defense operations center.

The United States' proposal to undertake the airfield expansion and construction projects at Hamadan and Mashed and the aircraft control and warning radar stations at Hamadan and Dezful, as set forth above, anticipates that the

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ANNEX 2

Government of Iran will undertake to provide from its resources necessary ancillary facilities. This combined effort should vastly improve the operational effectiveness of the Imperial Iranian Air Force.

In furtherance of its intent to assist Iran in providing for its defense, the U.S. is prepared during the next five years to provide equipment and other support for Iranian forces as set forth in the attachment hereto. It is understood that provision of this support by the United States will be dependent (A) upon the transition of the Iranian armed forces over the next two or three year period to the agreed manpower level; (B) upon the demonstrated ability of the Iranian armed forces to absorb and effectively utilize and maintain existing and newly delivered equipment; and (C) upon maximum effective utilization of existing troop housing and support facilities.

Qualitative improvement in the Iranian armed forces, particularly in the army, is essential to effective implementation of the concept for defense set forth herein and for the effective utilization of equipment to be furnished. To this end procurement and training of long-term technicians, specialists, and non-commissioned officers in all areas should be accomplished on an accelerated basis; a personnel management system to assure full and appropriate utilization of skilled personnel should be established; a sound fiscal management system should be employed to assure effective utilization of resources; maintenance and logistic support capability should be broadened; and command structure and force organization should be tailored to the requirements of the force structure being developed. In accordance with the wishes of His Imperial Majesty the United States/ARMISH/MAAG is prepared to assist in the accomplishment of these improvements through the provision of detailed recommendations and guidance, as required.

This undertaking of the Government of the United States is, of course, subject to the approval by the United States Congress of annual appropriations of the necessary funds. The United States Government believes that the above force level and proposed equipment and supplies for the Imperial Iranian Armed Forces together with the qualitative improvements visualized would substantially improve the capability of the Iranian forces to carry out their missions.

The Government of the United States proposes that, if the program outlined above is acceptable in principle, that designated representatives of His Imperial Majesty and the Chief of ARMISH/MAAG undertake discussions for the purpose of arriving at the details of the program for the defense of Iran.

Summary of proposed deliveries of military equipment to Iran, July 1 1962 through June 30, 1967 (NOTE A).

1. Additional firepower

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ANNEX 2

A. Requirements for all light weapons will have been met through provision of:

Rocket launchers, 3.5 inch
Submachine guns
200 mortars, 60mm

B. Ammunition will be supplied for light and heavy weapons in quantities sufficient for reasonable training requirements and to bring stocks to the planned 30-day level.

2. Additional communications equipment

Radio sets of all types and other communications equipment as necessary will be provided to meet all essential requirements.

3. Approximately 100 M-113 armored personnel carriers.

4. Additional vehicles

- A. 5,000 jeeps
- B. 1,500 3/4 to 1 ton trucks
- C. 3,500 2 and 1/2 ton trucks
- D. 250 - 5-ton trucks

5. Combat support equipment

Cranes, water trucks, graders, tractors, Bailey bridges, etc.

6. 2 minesweepers, inshore

7. 2 patrol frigates (NOTE B)

8. 20 helicopters (H43B)

9. Civic action program support

A. Construction equipment including rollers, crushers, concrete mixers, water distribution trucks, well drilling equipment.

B. Vocational Training equipment.

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ANNEX 2

10. Ground force construction project

Guchon barracks and facilities for 1 regimental combat team.
(NOTE C)

11. Liaison aircraft

45 CESSNA 180 or 185 aircraft

12. Transport aircraft

A. 1 squadron C-130B (4 aircraft)

B. 12 additional C-47 aircraft

13. Additional combat air capability

A. 4 squadrons jet supersonic fighter-bomber aircraft (F5A)
(13 aircraft per squadron). (NOTE D)

B. Completion of facilities at Hamadan airfield to establish it as a main operating base. (NOTE C)

C. Construction of minimum essential facilities at Mashed airfield to establish it as a forward operating base. (NOTE C)

D. Construct aircraft control and warning radar stations at Hamadan, and Dezful, and provide communications system linking all radar stations. (NOTE C)

NOTES

(A) Subject to approval by U.S. Congress of annual appropriations requests.

(B) To replace two ships of this class now in service in the Imperial Iranian Navy.

(C) Construction of an RCT facility at Guchon, airfields at Hamadan and Mashed, radar stations at Hamadan and Mashed, radar stations at Hamadan and Dezful, and aircraft control and warning sites are understood to involve joint participation by the Governments of Iran and the United States. Specific contributions to the total requirements for each project to be made by each participant are to be agreed upon.

(D) Subject to improvement of the operational and maintenance efficiency of the Imperial Iranian Air Force.

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ANNEX 2

"Le Ministre de la Cour
Teheran, September 20, 1962

Dear Mr. Ambassador:

I have the honor to inform you that by command of His Imperial Majesty the memorandum addressed to you and bearing the date of September 19, 1962 has His Majesty's full approval. The text of the memorandum follows:

"Teheran, September 19, 1962

Memorandum to the American Ambassador

This is to confirm the understanding reached orally this morning. The Five-Year Military Program presented by the Ambassador in his memorandum of today's date is hereby agreed.

The military desirability of providing three additional tank battalions is noted and it is understood that consideration may be given to providing them in the future should the requisite resources be found from either American or Iranian sources.

It is likewise understood that it would be desirable from a military point of view to have two radar stations, one between Babolsar and Mashed and one at Zahedan if means may be found in the future, from whatever source, to provide them.

Should the international situation develop during the five-year period envisaged by the program, in such manner as to pose threats to Iran not now foreseen, it is understood that the program may be reviewed."

I am commanded to say on His Majesty's behalf that although in the agreed understanding contained in the foregoing text, it is stated in the third paragraph that "it would be desirable from a military point of view to have two radar stations, one between Babolsar and Mashed and one at Zahedan if means may be found in the future, from whatever source, to provide them", it (is) His Majesty's opinion these radar stations are necessary from a military point of view.

I am etc., etc.....

/Signed/Hussein Ala"

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ANNEX 3

MEMORANDUM OF UNDERSTANDING

I. The Imperial Government of Iran and the Government of the United States have reviewed the following defense considerations of their respective countries:

A. The Mutual Defense Assistance Agreement between the two governments of 23 May 1950, as supplemented by the exchange of notes of April 24, 1952, and the exchange of notes of July 12 and October 31, 1957.

B. The Agreement of Cooperation between the Government of the United States of America and the Imperial Government of Iran of March 5, 1959.

C. The Memorandum of Understanding between the Government of the United States of America and the Imperial Government of Iran of September 19, 1962.

D. The exchange of correspondence prior to, and discussions held in June 1964, between His Imperial Majesty, the Shahinshah of Iran, and the President of the United States of America, and other officials of the Government of the United States of America.

II. In the light of these considerations, the two Governments reaffirm the concept for the defense of Iran and the force structure for the Imperial Iranian Armed Forces set forth in the Memorandum of Understanding of September 19, 1962. The Governments also restate their commitments to carry out their respective obligations undertaken in the memorandum. In particular, the United States Government will, subject to the availability of funds and continued Congressional authorization, deliver on a grant basis the remaining equipment, material and services specified in the 1962 memorandum. The Imperial Government of Iran will make satisfactory provision for the effective utilization and operation of all equipment provided to and within its military forces and will limit its purchases of military equipment to the requirements of agreed attainable force objectives. The Imperial Government of Iran also undertakes to assure that its program of military purchases will not cause undue strain on the nation's foreign exchange reserves or jeopardize plans for the nation's economic and social development.

III. In view of the improved financial situation of Iran and the need for modernizing Iran's military forces on a long-range basis, the two Governments agree to an additional program of mutual defense cooperation for the

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ANNEX 3

period FY 1965-69 as set forth below. It is understood that, except as specifically modified herein, the new program is subject to those conditions and obligations undertaken by the two Governments in the Memorandum of Understanding of September 19, 1962.

A. The Government of the United States will:

1. extend additional grant military assistance during FY 1967-69 to be programmed as set forth in Annex A for delivery by the end of FY 1970,

2. subject to the request of the Imperial Government of Iran,

a) assist in the formulation of long-range plans for the equipping, training and modernization of the Armed Forces of the Imperial Government of Iran;

b) provide procurement, contracting and inspection services to the Imperial Government of Iran for the material which Iran desires to purchase in the United States;

c) provide technical advice and training services to the Armed Forces of the Imperial Government of Iran to enhance the effective installation, operation and maintenance of the equipment concerned.

3. In order to assist the Imperial Government of Iran in financing the purchases referred to in paragraph III B,

a) assure credits within 30 days from the date of signing this Memorandum of Understanding for the equipment, spares and services enumerated in paragraph III C;

b) assure credits during U.S. FY 1965-69 from available private and government financial institutions or, subject to the availability of funds, from funds made available under the Foreign Assistance Act of 1961 as amended, in amounts which, including the credits referred to in paragraph III A. 3 a) do not exceed a total of \$200 million and are consistent with the foreign exchange and other limitations contained in III C. Negotiations with available private and government financial institutions to obtain such credits will be conducted by the Imperial Government of Iran in cooperation with the Government of the United States. These credits will be repayable on terms which will allow payments over the ten-year period FY 1965-74 to be negotiated at the time of the conclusion of each credit sales program or contract under this agreement and shall take into account Iran's repayment capabilities. The interest rate to be negotiated will not exceed an average of 4-5 per cent per annum on the unpaid balance.

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ANNEX 3

B. The Imperial Government of Iran will purchase from the United States during FY 1965-69 military equipment, material and services over and above that to be furnished on a grant basis. These purchases have an estimated value of \$250 million, including:

1. Cash purchases of an estimated value of \$50 million (principally spare parts for equipment provided under military grant aid programs).

2. Purchases, utilizing above credits as necessary, of an estimated value of \$200 million (principally new equipment, spares, and related services). Illustrative list is at Annex B.

C. To implement this modernization program, the Imperial Government of Iran will place orders and the Government of the United States will provide credits within 30 days from the date of the signing of this Memorandum of Understanding for the following equipment, at approximately the indicated price:

4 C-130 aircraft with spares and aerospace ground equipment	\$ 12.0 million
176 M-60A1 tanks with spares	39.0 million
Other related items and services including packing, inland transportation, port handling and ocean transportation to Iran	6.0 million
(TOTAL)	\$ 57.0 million

Programming of the other equipment to be offered to Iran under the line of credit cited above will be divided into separate increments and phased over subsequent years. In the course of the negotiation of the credit agreement for each increment, the Iranian balance of payments and budgetary situation and progress of the development program will be reviewed in order to determine the amount of credit to be offered in the increment and a feasible amortization schedule.

IV. The Government of the United States designates the Chief of the United States Military Assistance Advisory Group to Iran to meet periodically with a representative designated by the Imperial Government of Iran to perform the following functions:

A. Serve as the focal point for all matters pertaining to the United States-Iran military modernization equipment procurement program;

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ANNEX 3

B. Develop detailed plans and arrangements for the implementation of this agreement;

C. Develop force objectives and determine valid military equipment and training requirements for the Imperial Government of Iran which are deemed attainable in future time periods.

V. A ranking representative designated by the Imperial Iranian Government will meet with the United States Ambassador to Iran periodically, but not less frequently than once a year, to review the progress and execution of this understanding and its relationship to Iran's economic and social development program. This will include a joint assessment of the effect of military purchases on the Iranian balance of payments and budgetary situation.

Dated: July 4, 1964

Dated: July 4, 1964

For the Government of the
United States of America

/s/ J. Holmes

By Command of
His Imperial Majesty
the Shahinshah of Iran

(H. Ghods-Nakkai)

Minister of Court.

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ANNEX 3

Annex A to the Memorandum of Understanding

Additional equipment, supplies and services over and above previous United States commitments contained in the 19 September 1962 Memorandum of Understanding to be furnished by the United States through Grant Aid Military Assistance by 30 June 1970, subject to approval by United States Congress of annual appropriations requests.

- a. 39 - F5 aircraft (13 to replace 1 squadron of RF-33 aircraft, and 26 to replace 2 squadrons of F-86 aircraft).
- b. 110 - 105-mm. Howitzers (to increase number of four-gun batteries per battalion from 2 to 3).
- c. 28 - 8" Howitzers (to increase guns per battery from 2 to 4).
- d. 1,000 - Vehicles (to increase mobility).
- e. 1 - Airborne Battalion, TO & E equipment (to complete an airborne regiment of 2 battalions).
- f. 4 - Twin-engine Command-type aircraft (for command and control).
- g. 30-day War Reserve of ammunition and reasonable training allowance (except for items produced in-country).
- h. Additional Civic Action support.
- i. Additional communications and electronic equipment.
- j. Additional engineer equipment.
- k. Additional material-handling equipment.
- l. Continued training assistance to include CONUS training, provision of MTTs, technical assistance, and further development of the in-country military training capability.
- m. Miscellaneous additional military equipment, supplies and services.

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ANNEX 3

Annex B to the Memorandum of Understanding

Illustrative list of items to be procured by Iran from the United States with 200-million dollar United States credit:

	<u>Millions of dollars</u>
a. 460 - M-60 A1 Medium Tanks, including 1-year spare parts and radios (to replace all M-47 tanks in Iran)	101
b. 8 - C-130 aircraft, including aerospace ground equipment (to replace 2 squadrons of C-47 aircraft)	20
c. 163 - M-113 A1 Armored Personnel Carriers (to increase mobility)	6
d. 1 - Hawk Battalion of 4 batteries (in southern Iran to improve Air Defense capability)	21
e. 26 - F5 aircraft, including aerospace ground equipment (to replace 2 squadrons of F-86 aircraft)	18
f. 1,610 - M1919 A6 Machineguns (to increase firepower)	.35
g. Miscellaneous military items	3.65
h. Packing, handling, crating and transportation expenses (averages approximately 20 per cent cost of items shipped, excluding C-130 aircraft)	30
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ANNEX 3

LE MINISTRE DE LA COUR

5th July, 1964

Dear Mr. Ambassador,

Pursuant to my letter of 4th July concerning the signed Memorandum of Understanding, I have the honour to bring to Your Excellency's attention that the phrase in the last paragraph of the above letter "... requirements of the Imperial Iranian Armed Forces ..." is hereby altered to read "... further requirements of the Imperial Iranian Armed Forces ...".

With high esteem, I am,

Yours sincerely,

/s/ H. Ghods-Nakhai

His Excellency
the Hon. J. C. Holmes
Ambassador of the United States of America,
Teheran.

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ANNEX 3

LE MINISTRE DE LA COUR

4th July, 1964.

Dear Mr. Ambassador,

The signed Memorandum of Understanding dated July 4th, is herewith enclosed for Your Excellency's attention.

By command of His Imperial Majesty, His Excellency General Abdol-Hossein Hejazi, Chief of the Supreme Commander's Staff is hereby designated as the representative of the Imperial Government of Iran for the implementation of paragraph IV of the Memorandum.

I am further commanded to inform you that in future the requirements of the Imperial Iranian Armed Forces will be communicated by General Hejazi in accordance with paragraph IV of the Memorandum.

With high esteem, I am,

Yours very sincerely,

/s/ H. Ghods-Nakhai

His Excellency
the Hon. J. C. Holmes,
Ambassador of the United States of America,
Teheran.

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ANNEX 4

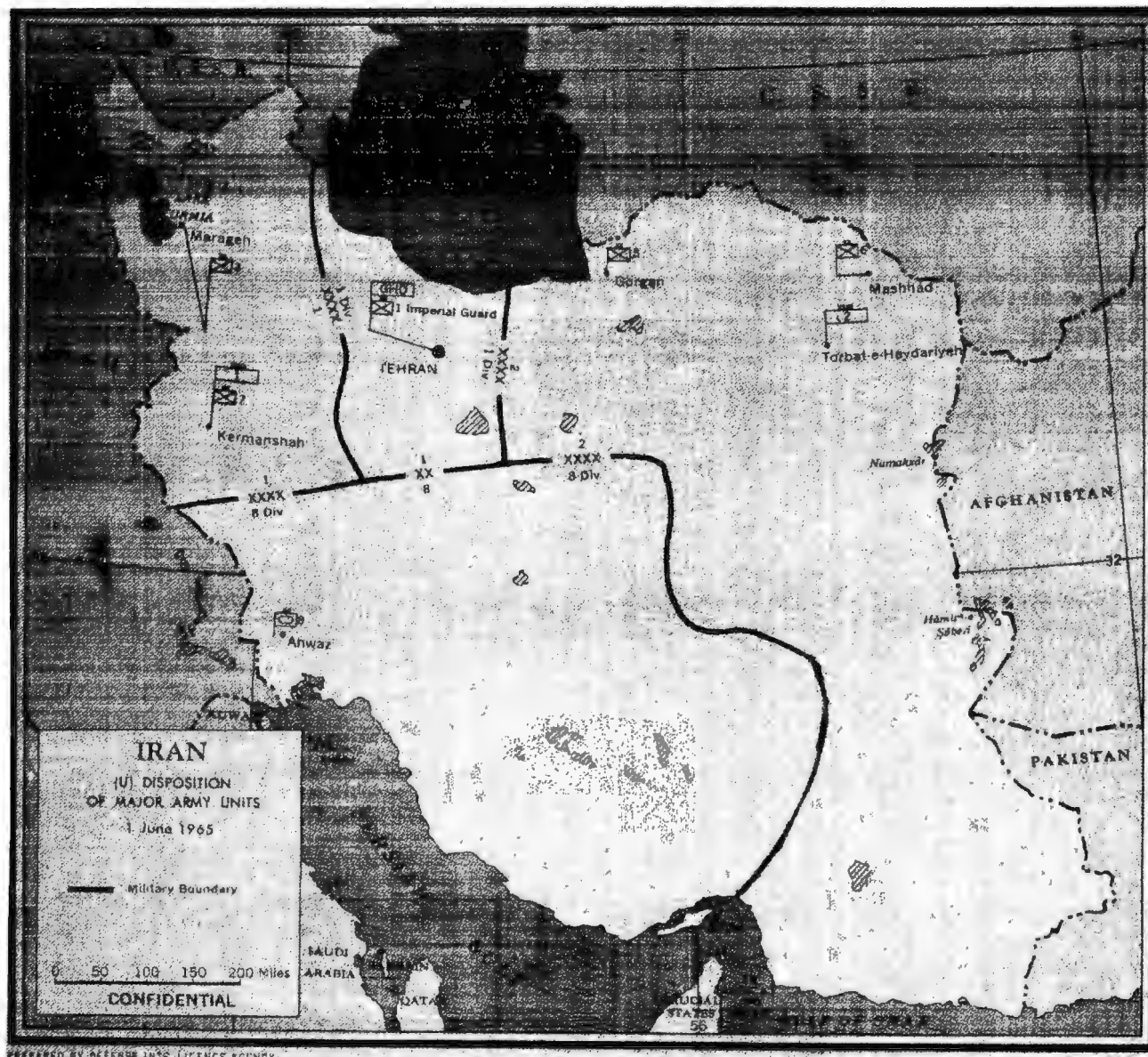
<u>Units</u>	<u>FORCE GOALS</u>			
	<u>In Being</u>	<u>Annex J to JSOP 70</u>	<u>1962 Agreement</u>	<u>1964 Agreement</u> (Where Different from 1962 Agrmt)
Inf Div	7	7	8	
Armored Div	1	1		
Tank Bn	4	7		
Armored Cavalry Bn	7	7		
Composite Artillery Bn	4	4		
Combat Engineer Bn	4	4		
Aviation Bn	1	1		
Signal Group	3	3		
Special Forces Group	1	1		
Airborne Bn	1	2		2
Air Defense/Tactical Fighter Sq.	5	8	8	
SAM Sq (Bn)	0	2		1
Tactical Recce Sq	1	1	1	
Tactical Control Sq	1	1		
Air Rescue Sq	1	1		
Transport Sq (Medium)	1	3	{ 3	3
Transport Sq (Light)	1	1		1
Minesweepers	6	6	6	
Patrol Craft (PGM)	4	7	4	7
Patrol Escort (PF)	4*	4	2	4
Patrol Craft (SC)	2*			

~~SECRET~~

* 2 PF's and 2 SC's are obsolete.

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ANNEX 5



NO FOREIGN DISSEM EXCEPT U.K., AND CANADA

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~~SECRET~~

ANNEX 6

COST SAVINGS5-Year Savings
in MillionsARMY

M60 A1 Tanks (Requirement for 276 instead
of 460 tanks. Cost \$60.7 instead of \$101
million)

40.3

Support for 1 Infantry and 1 Armored Div.,
and Supporting Forces (1 Artillery Bn,
1 Combat Engineer Bn, 1 Tank Bn)

10.3

TOTAL

\$50.6

AIR FORCE

2 F-5 Squadrons

23.0

(Secong Hawk Bn not currently financed
but estimated to cost \$25 million.)

--

NAVY

2 Patrol Frigates & 1 PGM

10.3

PCBT COSTS10.9

TOTAL

\$94.8

~~SECRET~~

~~SECRET~~

ANNEX 7

PARTICIPANTS IN THE MAP REAPPRAISAL STUDIES

The Staff primarily responsible for assisting Mr. Hoopes with the studies has consisted of:

- 1) Mr. Peter L. Szanton, OASD/ISA
- 2) Lt. Colonel Harry J. Shaw, USA, OASD/ISA
- 3) Lt. Colonel Harry D. Latimer, USA, HQ PACOM
- 4) Captain Eric W. Pollard, USN, JCS (SACSA)
- 5) Colonel Kenneth B. Smith, HQ, USAF
- 6) Colonel Fred E. Haynes, USMC, OASD/ISA
- 7) Mr. Robert Murray, OASD/ISA

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~~**TOP SECRET**~~

NOFORN

~~**TOP SECRET**~~

8
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TRAN

OUTGOING TELEGRAM Department of State

03240

INDICATE: ☐ COLLECT
☐ CHARGE TO

~~CONFIDENTIAL~~

46

Origin

ACTION: Ambassador TEHRAN IMMEDIATE

NEA

INFO: CINCSTRIKE

EmbTel 889

Following Priority OSD/ISA message DEF 7926 Dec. 061905Z sent MAAG

SS

channel repeated your info. (CINCSTRIKE was not on INFO for message):

G

L

New interest rate of 4% for GOI credit of \$90 million second tranche will

NSC

require following changes in credit arrangement previously presented you and

INR

Governor Sami:

DOD

AID

E

1) Delete all references in the document and its annexes to the 5% rate and substitute 4% for interest.

TRSY

2) Delete "15 Oct. and 15 April" from Section 3(a) of the Agreement and insert the times "31 Dec. and 30 June."

3) Assume/initial payment of principal and interest starting 30 June 1966, and semi-annual repayments of principal and interest thereafter 31 Dec. and 30 June until final repayment 31 Dec. 1972.

4) The interest, principal, totals and balances calculated for the repayment schedule in Annex D should be revised in accordance with new schedule being hand-carried by Hirschberg to Tehran. Repayment dates and disbursement amounts for the revised schedule remain the same as previously shown in Annex D.

Disbursements to contractors are not related to date of signing credit arrangement but to acceptance of Letters of Offer. In order to attempt satisfy

Drafted by: 12/7/65

OSD/ISA/ILH:CS:evens:djg

Tel. Ext.

Telegraphic transmission and

classification approved by:

NEA/GTI - K. W. Bracken

Clearances:

DECLASSIFIED
E.O. 13292, Sec. 3.4
By sp/ckm, NARA, Date 7-10-07

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demand for early delivery dates, prior to availability of actual credit funds, we would authorize military departments to proceed immediately with procurement upon receipt of GOI signed Letters of Offer, under a "Dependable Undertaking" arrangement. After signing of credit arrangements military departments will revise these Letters of Offer reflecting current funding system.

We are aware that Samii desired to defer payments on principal. We have considered deferment of initial principal repayment until 31 December 1966. By that time, however, military departments will have disbursed more than \$35 million. Such deferment would therefore add considerably to interest burden of GOI. If, in spite of this, Samii still ^{desirous} desires of this postponement in first principal repayment, we are agreed, and Hirschberg has been provided with appropriate alternate schedule for Annex D. Banking requirements, however, will necessitate the first interest payment being made 30 June 1966.

Date of signing should be on or before 31 December 1965. No other changes to body of agreement, promissory note, disbursement schedule, or other annexes appear necessary. U.S. and GOI signatories remain as previously arranged. Three signed copies should be provided OASD/ISA/ILN. GP-4

END

RUSK

~~CONFIDENTIAL~~

10

INCOMING TELEGRAM *Department of State*

42-S

~~CONFIDENTIAL~~

Action VV QVA887 QTA471 EMB355 019727

NEA RR RUEHCR
DE RUQTAN 363 3281443

Info ZNY CCCCC
R 241415Z

FM AMEMBASSY TEHRAN
TO RUEHCR/SECSTATE WASHDC 774

SS RUEKDA/DOD WASHDC UNN

G INFO RUCJHK/CINCSRIKE/CINMEAFSA 56

SP STATE GRNC

NSC BT

~~CONFIDENTIAL~~ NOV 24

CIA REF: DEPTTEL 606

NSA
AID COUNTRY TEAM MESSAGE

RSR DOD TEAM VISIT TO IRAN

1. COUNTRY TEAM WELCOMES VISIT BY DOD TEAM TO IRAN. WE URGE TEAM BE PREPARED TO DISCUSS WITH US DETAILS OF CONCEPT, AVAILABILITY, PRICE STRUCTURE INCLUDING POSSIBLE DELETIONS FROM LETTER OF OFFER, AND METHODS OF FINANCING IN ORDER DETERMINE BEST METHOD PRESENTATION TO IRANIAN AUTHORITIES. SINCE THERE IS NO HAWK SPECIALIST WITHIN ARMISH/MAAG ARMY HAWK

PAGE TWO RUQTAN 363 ~~CONFIDENTIAL~~
SPECIALIST SHOULD ALSO BE PREPARED TO DISCUSS CONCEPT OF FIXED, SEMI-FIXED AND MOBILE BATTALION PLUS CONCEPT OF DEPLOYMENT, TRAINING REQUIREMENTS BASED ON TWO-SITE DEPLOYMENT OF BATTALION, AND ALL ASPECTS OF COST INVOLVED. ESTIMATES OF COST OF SUPPORTING STRUCTURE TO BE BUILT BY GOI SHOULD BE BROUGHT BY TEAM.

2. AS MADE CLEAR IN EMBTEL 715 SHAH IS MOST CONCERNED WITH SUBJECT HAWK BATTALION. HE SERIOUSLY QUESTIONING OUR PROPOSAL LIMIT IRAN TO ONE BATTALION AND HE IS INCREASINGLY SENSITIVE ON COST FACTOR. GENERAL KHATEMI HAS INDICATED TO US THAT SHAH RECENTLY RAISED WITH HIM QUESTION OF PERFORMANCE, CHARACTERISTICS, AND COST OF HAWK BATTALION AS COMPARED WITH BRITISH AIR DEFENSE MISSILES, INCLUDING SUPPORT COSTS. WE ARE AT LOSS HERE TO ACCOUNT FOR SUDDEN PROJECTED RISE IN COST HAWK BATTALION. WE HAD BEEN ASSURED THIS BATTALION WAS IN STORAGE, EARMARKED FOR USE IN IRAN WHEN TIME CAME. UNDER CIRCUMSTANCES WE BELIEVE IT WILL BE MOST DIFFICULT TO EXPLAIN TO SHAH AND GOI OFFICIALS WHY COST OF HAWK HAS MOUNTED SO PRECIPITOUSLY OVER \$21 MILLION FIGURE QUOTED IN

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E.O. 13292, Sec. 3.4

By ag/kbm, NARA, Date 7-10-07

~~CONFIDENTIAL~~

-2- 774, November 24, From: Tehran

ANNEX B TO JULY , 1964 MEMORANDUM OF UNDERSTANDING AND STILL CARRIED AS PRICE IN HOOPES REPORT AS LATE AS AUGUST THIS YEAR.

3. COUNTRY TEAM FEELS STRONGLY THAT UNLESS WE ARE PREPARED

PAGE THREE RUQTAN 363 ~~CONFIDENTIAL~~
TO PROVIDE FIRST HAWK BATTALION TO IRAN AT PRICE REASONABLY,
AND WE EMPHASIZE REASONABLY, CLOSE TO \$21 MILLION FIGURE,
WE CAN EXPECT MOST UNFAVORABLE REACTION HERE WITH DELETERIOUS
IMPACT ON OUR ALREADY SENSITIVE AND STRAINED MILITARY RELATIONS
EASILY PREDICTABLE AS AFTERMATH. GP-4. MEYER
BT

~~CONFIDENTIAL~~

U.S. DEPARTMENT OF STATE

DIRECTOR OF INTELLIGENCE AND RESEARCH

RECEIVED
N. S. C.

Nov 18 10 31 AM '65

Research
Memorandum

RNA-60, November 16, 1965

47

To : The Acting Secretary
Through: S/S
From : INR - Thomas L. Hughes *H.C.D. In TH*
Subject: Iran Increases its Allocation for Military Equipment

Iran has recently allocated \$200 million for the purchase of additional military equipment. This paper evaluates the ostensible reasons and probable underlying motivations which induced the Shah to take this step.

ABSTRACT

The Iranian government recently has allocated an additional \$200 million for military procurement for air defense, the expansion of the air force, and additional naval units. As justification for this expenditure, the government cited the alleged danger of Arab aggression and the alleged Arab claim to the Iranian province of Khuzistan.

The Shah has long been preoccupied with the potential threat to Iran which he feels comes from Nasser and Nasserist influence in Iraq and the Persian Gulf area. His concern has been reinforced by the presence of a large Arab minority in oil-rich Khuzistan which he alleges to be a target for Arab nationalist subversion. For some time, the Shah has been frustrated by his failure to convince the US of the immediacy of the direct and indirect threat from the UAR. Moreover, he has long been uncomfortable about his dependency in military matters on the US. This discomfort has been heightened by the cessation of US military assistance to Pakistan during its conflict with India. As a consequence, the Shah's desire to diversify the sources of military procurement has been greatly increased. He has expressed the

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By *ag/cbu*, NARA, Date 7-10-07

NOV 18 1965

- ii -

hope that the bulk of the equipment would come from the US, but has indicated that procurement would be based on considerations of quality and price regardless of country of origin.

While the \$200 million allocation for military equipment may be the first step in an involved bargaining process with the US, it appears to have several immediate purposes: to put pressure on the US to increase the military credit sales program and to improve its terms; to acquire, in addition to US-supplied equipment, military items whose use would not be subject to external restraints and which could be used to deal with regional contingencies; to direct Iranian attention to an external threat, thereby mitigating the unpopularity in certain quarters of Iran's costly military buildup, and dispelling the impression that this arms buildup may be designed primarily to strengthen the regime internally.

The Shah's preoccupation with his military establishment is bound to have a long-range impact on economic development. The Shah, however, does not yet regard the allocation of resources between the developmental and military sectors as a major problem and believes that Iran can afford both substantial economic growth and a modern military establishment. This attitude does not do justice to the magnitude of the development task, which is illustrated by the fact that the annual population increase now absorbs the rise in GNP.

On November 9, 1965, Prime Minister Hoveyda asked the Majlis (Assembly) to authorize the expenditure of \$200,000,000 for military procurement for air defense, the expansion of the air force, and additional naval units. Cited as justification for this measure were the alleged danger of Arab aggression and the Arab claim to the Iranian province of Khuzistan, which had been mentioned routinely by the Syrian Prime Minister in a speech on October 12. The authorization was approved by the Majlis on November 10, and Senate approval is expected without delay. Meanwhile, Iran has withdrawn its Ambassador from Syria.

The decision announced by the Prime Minister reportedly was the result of a number of concerns on the part of the Shah: the vulnerability of Iran's petroleum facilities in Khuzistan to air and naval attack and to sabotage by Arab infiltrators who might enter Khuzistan from Iraq; the procurement by Iraq of new MIG aircraft and the UAR's MIG and SAM inventory; the Shah's unhappiness with certain aspects of the US-Iran military credit sales program; limitations on the use of US equipment and resupply problems as demonstrated during the recent Indo-Pakistan conflict, and the resultant desire of the Shah that Iran be able to cope independently with regional threats. The Shah's decision to spend \$200 million for "urgently needed" military equipment reportedly is firm, and he has expressed the hope that the bulk of it would come from the US. However, he has indicated that procurement would be based on the best equipment and the best price regardless of country of origin.

This move by Iran to strengthen its military establishment by acquiring additional military equipment has been in the wind for some time. The Shah has long been preoccupied with the potential threat to Iran which he feels comes from Nasser and Nasserist influence in Iraq and the Persian Gulf area. His concern has been reinforced by the presence of a large Arab minority in Khuzistan which constitutes a possible target for Arab nationalist ambitions and where, in fact, the Iranians have alleged widespread Arab subversion. In addition, the Shah feels that Iran would have a legitimate claim to at least some of the British holdings in the Persian Gulf and should be in a position to assert its claim if and when the British leave.

These needs, the Shah feels, necessitate an urgent strengthening of his military establishment, particularly his air defense capability. To date, the Shah has been frustrated by his failure to convince the US of the immediacy of the threat from the UAR. He has, however, on his own pursued a policy designed to frustrate Nasser's ambitions. He has supported the Kurdish rebellion in Iraq and aided the Yemeni Royalists. He has also had, for some time, close ties with King Husayn of Jordan, has moved toward closer relations with Israel (which has successfully capitalized on the Shah's obsession with Nasser), and, more recently, has established closer ties with Saudi Arabia.

The Shah's concern with the state of his military establishment, especially when compared with the combined Arab arsenal, is not new. Moreover, the Shah has long been uncomfortable about his dependency in military matters on the US. This concern has been heightened by the cessation of US military assistance to Pakistan during its conflict with India. Furthermore, the limitations placed by the US on the use of military equipment supplied to Iran under military assistance

and credit sales programs became even clearer to the Shah when Pakistan requested assistance from Iran. This experience has greatly increased the Shah's desire to diversify the sources of military procurement and to proceed with the military procurement program, even though it could jeopardize Iran's MAP relationship with the US.

More specifically, the \$200,000,000 allocation for military procurement appears to have several immediate purposes:

1) to put pressure on the US to increase the military credit sales program (now \$200,000,000 for the 5-year period FY 1965-69), to improve its terms, and to speed up delivery of the items agreed upon. The Shah may hope that, in view of Iran's importance to the US as the locus of special facilities, the US, in order to maintain its privileges and its position as the primary source of military supply, may be disposed to lend an increasingly sympathetic ear to Iranian requests for sophisticated military equipment. Moreover, the announcement of the procurement program may be the first step in an involved bargaining process which would enable the Shah eventually to make an important "concession" in return for an as yet undefined "favor."

2) to acquire, in addition to the flow of equipment from the US, military items whose use would not be subject to external restraints. In this way, he could hope to obtain greater freedom of maneuver and would be able more effectively to protect Iran's national interests which, in his view, requires a modern military establishment that could be used to deal with regional contingencies. At the same time, the security arrangements with the US would continue to protect Iran from the Soviet threat. In fact, the Shah may calculate that the Soviets themselves might be interested in improving their posture on the Iranian scene by supplying military items on favorable terms. If that were the case, the Soviet response would demonstrate to domestic opinion that the Shah was not overly dependent on the US and to the US that Iran cannot be taken for granted.

3) to direct the attention of Iranians to the grievous external threat to mitigate the unpopularity in certain quarters of Iran's costly arms buildup and to dispel the impression that this military buildup may be designed primarily to strengthen the regime internally.

Prospects

The cost of the Shah's preoccupation with his military establishment, as evidenced by the decision to allocate an additional \$200 million for equipment, may pose problems for the regime over the longer run and is bound to have a long-range impact on economic development. During the past decade, one of the criticisms of the Shah has been that Iran's developmental progress, in spite of substantial and increasing oil revenues, has been inadequate, in large part because of the resources allocated to the military establishment. This problem has long been recognized, but is likely to become more serious, given the Shah's preoccupation with security matters. The Shah does not yet regard the allocation of resources between the developmental and military sectors as a major problem

and believes, as this decision indicates, that security requirements should continue to have highest priority. Moreover, he remains confident that Iran can afford both a modern military establishment and substantial economic growth, even though the magnitude of the developmental task is illustrated by the fact that the annual population increase now absorbs the rise in GNP. Increased demands for sophisticated and costly military equipment may substantially reduce the funds available for important developmental programs.

INCOMING TELEGRAM *Department of State*

12

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~~CONFIDENTIAL~~

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~~CONFIDENTIAL~~ L NOVEMBER 12

NSC

IRAN MILITARY BUILD-UP

INR

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ICA

AID

E

MC

COM

FRB

TRSY

XMB

RSR

1. BUILD-UP URGENT. IN DISCUSSION WITH EXIMBANK PRESIDENT LINDER AND ME ELEVENTH, SHAH STRESSED ONCE AGAIN THAT SUCCESSFUL ECONOMIC DEVELOPMENT OF IRAN IS USELESS UNLESS IRAN HAS ADEQUATE MILITARY SECURITY. REITERATING MANY POINTS MADE PREVIOUSLY AND THOSE DISCLOSED BY FINMIN AMUZEGAR THREE DAYS AGO, SHAH MADE CLEAR THAT IN WAKE OF PAK-INDIAN CRISIS AND PROCUREMENT BY IRAQ OF NEW MIGS AND BRITISH AIRCRAFT HE CONSIDERS AUGMENTATION HIS MILITARY ESTABLISHMENT AN URGENT NECESSITY. HIS FEARS CENTER

PAGE 2 RUQTAN 173 ~~CONFIDENTIAL~~
PARTICULARLY ON VULNERABILITY OF KHUZISTAN AND KHARG ISLAND TO SURPRISE ATTACK. HE SAID HE REALIZED US AND IRAN HAVE AGREEMENT ON MILITARY PROGRAM BUT NEW FACTS REQUIRE ADDITIONAL \$200,000,000 EXPENDITURES ENVISAGED IN REQUEST MADE THIS WEEK AND APPROVED BY PARLIAMENT.

2. US-IRAN COOPERATION. POINTING TO COOPERATIVE ASPECTS OF US-IRANIAN MILITARY RELATIONSHIP, I SAID I FELT WE HAD FORMULATED EFFECTIVE PROGRAM FOR IRAN'S MILITARY SECURITY AS ENVISAGED IN OUR RESPECTIVE AGREEMENTS, LATEST BEING THAT OF JULY 1964. IF THERE WERE CERTAIN WEAKNESSES WHICH REQUIRED AMENDMENT IT STRUCK ME THEY SHOULD BE WORKED OUT BY ARMISH/MAAG CHIEF JABLONSKY AND IRANIAN TOP MILITARY.

3. ALLEGED DELAYS. SHAH SAID PROBLEM IS DELAY. HE SAID HE HAD BEEN WAITING TWO MONTHS FOR PAPERWORK TO BE COMPLETED RE SECOND

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DECLASSIFIED

Authority FRUS. Vol. XXII, #105

By rg NARA, Date 8-9-05

~~CONFIDENTIAL~~

-2- 715, NOVEMBER 12, FROM: TEHRAN

TRANCHE INCLUDING DETERMINATION OF INTEREST RATE. IT NOT POSSIBLE WITH URGENCY FACING HIM MILITARILY TO COUNTENANCE SUCH DELAYS. I ASSURED HIM THAT DELAY OF SECOND TRANCHE PAPERWORK IN NO WAY DELIBERATE NOR WITH ULTERIOR MOTIVE. MEANWHILE, AS GENERAL JABLONSKY HAS ALREADY ASSURED HIM, WE BEEN MEETING TIME SCHEDULE FOR OUR COMMITMENTS WITH REMARKABLE SUCCESS.

4. ANTI-AIRCRAFT NEEDS. SHAH STRESSED HIS ANXIETY OVER LACK OF AIR DEFENSE. HE ASSERTED THAT USG ITSELF CONSIDERED CERTAIN ANTI-AIRCRAFT GUNS OBSOLETE AND PURSUANT TO US ADVICE IRAN DISPOSED OF THEM. NOW, HOWEVER, HE REALIZES THAT HE NEEDS SUCH GUNS OR OTHERS TO DEFEND HIS DEFENSELESS INSTALLATIONS. I NOTED THAT GENERAL JABLONSKY HAD TOLD HIM A WEEK AGO IN THEIR MONTHLY MEETING THAT WHOLE QUESTION OF ANTI-AIRCRAFT WEAPONRY IS UNDER REVIEW IN US AS RESULT OF VIET NAM AND SOME DEFINITIVE DECISIONS EXPECTED IN DECEMBER. AS HE DID TO JABLONSKY, SHAH SAID HE WOULD WAIT UNTIL DECEMBER BEFORE HE MAKES ANY FINAL DECISIONS RE THIS EQUIPMENT. IN TALKING WITH ME, HOWEVER, HE PREFACED HIS STATEMENT EMPHATICALLY WITH THE WORD "MAYBE".

5. UNHAPPINESS RE HAWKS. WHEN I SUGGESTED THAT IN LONG-RANGE PROGRAM HAWK MISSILES WERE TO PLAY A KEY ROLE IN IRAN'S AIR DEFENSE, SHAH VIRTUALLY EXPLODED IN COMPLAINING WE ARE LIMITING *him* TO ONE BATTALION. HE SAID IT IMPOSSIBLE TO FRAGMENT ONE BATTALION AND TRY TO DEFEND EACH OF HIS INSTALLATIONS WITH ONLY ONE OR TWO HAWK LAUNCHERS. IN ADDITION TO HIS IRRITATION OVER FACT THAT IRAQIS, EGYPTIANS AND OTHERS HAVE MORE AND FASTER PLANES, SHAH VOICED HIS UNHAPPINESS THAT EGYPT ALREADY HAS EIGHT SAM SITES AND THAT BOTH HIS NEIGHBORS IRAQ AND AFGHANISTAN HAVE SUCH RUSSIAN EQUIPMENT.

6. DECISION RE \$200,000,000 IS FIRM. STATING HE WANTED NO MISUNDERSTANDING, SHAH SAID "IT HAS BEEN DECIDED" THAT ADDITIONAL \$200,000,000 WORTH OF URGENT MILITARY EQUIPMENT WILL BE OBTAINED. HE SAID HE HOPED BULK OF IT WOULD BE AVAILABLE FROM US. AT SAME TIME HE GAVE INDICATION THAT IRAN WILL BE SHOPPING OTHER PLACES AND SAID SOME MILITARY TRAINING FOR IRANIANS IS ALREADY PLANNED FOR GERMANY.

7. INADEQUATE HUMAN RESOURCES. I TOOK OCCASION ONCE AGAIN TO POINT OUT INADEQUACY OF TRAINED HUMAN RESOURCES IN IRAN ARMED FORCES. I SAID I CONCERNED AT PROSPECT OF IRAN IMPORTING MORE HIGHLY TECHNICAL EQUIPMENT, WHEN ALREADY SOME SUPPLIES NOT RPT NOT BEING HANDLED PROPERLY. SHAH ACKNOWLEDGED THIS DEFICIENCY BUT ASKED FOR EXAMPLES. THIS PROMPTED FURTHER EMPHASIS ON MY PART THAT HIS MILITARY AND GENERAL JABLONSKY SHOULD BE IN CLOSE CONSULTATION.

GP-3

MEYER

~~CONFIDENTIAL~~

OUTGOING TELEGRAM Department of State

INDICATE: ☐ COLLECT
☐ CHARGE TO

~~SECRET~~

RUNDY-SMITH

BATOR

BOWLER

CHANCE

COOPER

JESSUP

JOHNSON

KERRY

KOMER

MACDOY

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Origin
NEA

ACTION:

Amembassy TEHRAN
CHARMISH MAAG TEHRAN

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Info:

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BOB

TRSY

JOINT STATE/DEFENSE

Embtel 629

Iran map

State and Defense have approved in principle sale of AGM-12B (BULLPUP) missiles to Iran, subject to availability of weapon and security considerations, (Deptel 1124). Accordingly, you authorized tell Shah USG ready move ahead on project when security, availability considerations resolved. A caveat to this effect should be added to BULLPUP reference in Annex A, Draft Sales Agreement for second tranche. GP-4

END

RUSK

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E.O. 13292, Sec. 3.4

By *16/ebm*, NARA, Date *7-10-02*

Drafted by:

DOD/ISA-Mr. Reed

Telegraphic transmission and

Raymond A Hare

NEA/GTI:FJCrawford *11/1/65*

classification approved by:

NEA - ~~William J. Henderson~~

Clearances:

DOD/ISA-Col. ~~Hagman~~ (in draft)

NEA/NR - Col. Byrd (subst)

JCS/SAMAA - Cmdr. Peters (in draft)

White House - Mr Komer (subs)

NEA/GTI - K. W. Bracken

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Iran MAP

OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE

27 September 1965

16

MEMORANDUM FOR BOB KOMER

The attached message covers in greater detail my discussions with Governor Samii. You will recall my mentioning to you on the telephone last Friday, Samii's plea for a $3\frac{1}{2}\%$ interest rate.

I have told Samii that it will be sometime before a final decision is reached and it is most likely that the decision will be communicated through official Embassy channels.

I am leaving this matter in your hands and would appreciate you keeping me posted on the action you are taking.

*Jim Dunlap
for and in absence of?*
Henry J. Kuss, Jr.

Deputy Assistant Secretary

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E.O. 13292, Sec. 3.4

By ag/ctm, NARA, Date 7-10-07

SEP 30 1965

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		Y	
PRECEDENCE			
ACTION	ROUTINE		
INFO	ROUTINE		
DTG 252221ZSEP65			

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E.O. 13292, Sec. 3.4
By 19/cbm, NARA, Date 7-10-07

CS

16a

FROM: OSD WASH DC

TO: CHARMISH-MAAG TEHRAN IRAN

INFO: AMEMBASSY TEHRAN IRAN

CINCSRIKE

STATE/ZEN

WHITE HOUSE/ZEN

TREASURY/ZEN

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ASM
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CONFIDENTIAL **DEF** 2637 FROM OASD/ISA

Subj: Mtg between Mr. Kuss, DASD/ILN and Mr. Samii, Governor Central Bank of Iran, in Washington, 24 September 65

Subsequent to the 9 September meeting covered in DEF 1376 Message, Mr. Kuss, DASD/ILN, accompanied by Mr. Forman, Assistant General Counsel, DOD, Mr. Dunlap - Deputy to Mr. Kuss, and Mr. Feigl, ILN, met with Central Bank Governor Samii in the Pentagon on 24 September.

Samii reviewed text of Credit Sales Arrangement which he found acceptable with exception of one or two items, of these, the only substantive one referred to the GOI's authorization granted last year for entering into such arrangements which Samii

DATE	TIME
25	
MONTH	YEAR
SEPT	1965
PAGE NO.	NO. OF PAGES
1	4

TYPED NAME AND TITLE	PHOTO	SIGNATURE
Walter E. Feigl Director, Industry/Government Export Programs, ILN	77001	<i>Henry J. ...</i>
SECURITY CLASSIFICATION	REGRADING INSTRUCTIONS	
CONFIDENTIAL		

SEP 30 1965

~~CONFIDENTIAL~~

OASD WASH DC

interpreted as restricting the GOI from entering into credit arrangements with U.S. private banks. He read the GOI authority which he stated restricted him to obtain credit from American banks for a term of 5 to 10 years at a maximum interest rate of 5%. To accommodate Sami minor changes were introduced in the text which now indicate that the U.S. is authorized to sell or assign the payments to U.S. banks. This provides necessary flexibility to us and in Sami's opinion will also meet any likely objections on the part of his lawyers.

Sami's ^{major} point of discussion related of course to the interest rate although he did not take issue with the 7 years repayment ^{spread from a 10% rate of interest.} ~~contained in the draft text.~~ He bolstered his arguments during meeting on 9 Sept with Mr. Kuss regarding a lower interest rate. As a practical and knowledgeable banker he did concede that it would not be possible for him to obtain a 5% rate anywhere else. However, since war materiel is economically nonproductive and since many representatives of the banking community from most of the economically underdeveloped nations are pleading with the World Bank for reduction in its ~~max~~ rates, he feels compelled to press for a more favorable rate. He stated that he would like to obtain credit on terms similar to those of AID. Mr. Kuss explained the sources of funding available to him, the authority for granting credit and the reasons why it was ^{unwise for him} ~~extremely difficult~~ to offer better rates. He also pointed out to Sami that over the past 15 years Iran has benefited from military aid in excess of \$700 million.

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OASD/ISA/ITM

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NR OF

7

SECURITY CLASSIFICATION

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DD FORM 173-1

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FROM:

OSD WASH DC

on which neither interest nor principal had to be repaid. He further mentioned ^{that as a result of} our commitment to the Shah to provide additional grant aid through FY-67 ^{would} at an average of over \$10 million per year and that this too should be considered as in effect subsidizing, if not actually wiping out the interest all together. Samii then pointed out how GOI in the short span of one year has taken on the heavy burden of its defense through both cash outlays and long range credit commitments and he then came to the point toward which he was building up to all along - namely that he would consider 3 1/2% as a more acceptable rate of interest which would also correspond to the interest the U.S. is charging Malaysia. Kuss ~~again~~ explained that Malaysia did not receive any grant aid and that in fact the ^{3 1/2% rate} ~~the credit which the U.S. provided to Malaysia was in the form of a grant.~~ He further explained that over a 7 years repayment period the difference between 5% and 3 1/2% represents about \$2 1/2 million which sum is really quite small considering the \$90 million worth of material ~~is~~ being procured. Samii then related how such a sum is quite sizeable, that with it he could finance a sugar & refinery, subsidize exports or finance other productive projects.

In conclusion Mr. Kuss told Samii that he would refer Samii's pleas to the highest level of our government since if a concession on the interest rate were to be made ~~at all~~, the ^{sum would have to be obtained elsewhere.} ~~for it would have to come from the White House.~~ Kuss assured Samii he would communicate Samii's views to the highest

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SYMBOL

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SECURITY CLASSIFICATION

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INITIALS

DD FORM 1

REPORT MESSAGE FORM - CONTINUATION SHEET

SECURITY CLASSIFICATION

~~CONFIDENTIAL~~

FROM:

OSD WASH DC

level of government and would endeavor to obtain on his behalf a more favorable interest rate. He stressed however he did not wish to sound too optimistic on this matter and in any event it would be two to three weeks before a final decision could be reached. Since Samii would be in the U.S. only until about October 6, it may be necessary to communicate the decision to him via our Embassy in Teheran. Finally, if a favorable decision on a $3\frac{1}{2}\%$ interest rate were forthcoming it should be clearly understood that this would be a very special case and that it should not be interpreted as precedent setting. It was also agreed that we would provide Samii during the early part of next week (27 September) with a revised draft of the Credit Sales Arrangement incorporating the changes agreed to during the meeting and to also provide him with a revised Annex C to the arrangement containing a detailed disbursement schedule for those items to be included in the Second Tranche. By ~~xxx~~ dropping the first Hawk battalion from the ~~xx~~ Second Tranche we were able to keep it within the \$90 million ceiling. This was possible because the Hawk is not due for delivery until CY-1968 and does not require procurement (it is currently in storage).

Dr. Rezsareh, Samii's Assistant, will be in Washington next week and he may be in touch with us if further discussions regarding the draft arrangement are necessary.

GRP 4

2637

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DB FORM 1 MAY 55 173-1

INCOMING TELEGRAM Department of State

17

42-40

Action

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~~TOP SECRET~~

CONTROL: 738

RECD: SEPTEMBER 1, 1965 12:59 PM

FROM: TEHRAN

ACTION: SECSTATE PRIORITY 258

BUNDY-SMITH
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KERRY
KORNER
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036

~~TOP SECRET~~

IRAN MAP

CINCSTRIKE FOR INFO

HOOPES STUDY FOR IRAN

COUNTRY TEAM MESSAGE

AIDTO 155

COUNTRY TEAM CONCURS GENERALLY IN ANALYSIS AND CONCLUSIONS IRAN COUNTRY STUDY. FOLLOWING COMMENTS ON SPECIFIC SUBJECTS ARE SUBMITTED FOR DEPARTMENT'S CONSIDERATION:

GNP AND GROWTH RATE - AVAILABLE DATA NOT SUFFICIENTLY COMPREHENSIVE AND RELIABLE TO PERMIT MORE THAN GUESSES AS TO GNP AND GROWTH RATES. HOWEVER, IT IS CLEAR THAT DURING THE PAST TWO YEARS THERE HAS BEEN SUBSTANTIAL INCREASE IN OUTPUT OIL INDUSTRY AND IN EXPENDITURE PUBLIC FUNDS, INCLUDING THOSE FOR DEVELOPMENT PROJECTS. THERE ALSO HAS BEEN GENERAL IMPROVEMENT IN CONSTRUCTION AND SOME INCREASE IN COMMERCIAL ACTIVITY. THESE FAVORABLE DEVELOPMENTS WERE PARTIALLY OFFSET BY LESS THAN NORMAL CROPS RESULTING FROM DROUGHT CONDITIONS DURING 1964. WHILE THERE HAS BEEN SOME REAL GROWTH IN ECONOMY, IT IS NOT RPT NOT POSSIBLE TO STATE WITH ACCURACY HOW THAT GROWTH RATE MAY HAVE EXCEEDED ANNUAL INCREASE IN POPULATION.

AID LEVELS - FUTURE AID FIGURES INCLUDED IN COUNTRY ASSISTANCE PROGRAM (CAP) BANK RECENTLY SUBMITTED FROM TEHRAN PROJECTS RAPIDLY DECLINING ASSISTANCE LEVEL WITH FY 1966 AT \$2.9 MILLION, FY 67 AT \$1.4 MILLION, AND FY 1968 AT \$1 MILLION. NO DEVELOPMENT LOANS ANTICIPATED AFTER FY 1966 AND QUESTION OF PL 480 TITLE IV ASSISTANCE OPEN AT THIS TIME.

~~TOP SECRET~~

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E.O. 13292, Sec. 3.4

By sg/ctm, NARA, Date 7-10-07

~~TOP SECRET~~

-2- 258, SEPT 1, FROM TEHRAN

11 FORCE LEVELS - SUGGESTIONS TO REDUCE GOI FORCE LEVELS DO NOT TAKE INTO ACCOUNT RECENT ACTION BY WHICH US AND GOI AGREED TO INCREASE FORCE LEVELS IIF FROM 160,000 TO 172,000 AND APPEAR TO CLASH WITH STATEMENT CONTAINED IN GENERAL CONCLUSIONS "THIS PAPER SEES NEITHER INTRINSIC MERIT NOR POLITICAL WISDOM IN ATTEMPTING TO RECOMMEND ALTERNATIVE IRANIAN FORCE LEVELS AT THIS TIME." FURTHERMORE, THESE SUGGESTIONS DO NOT SEEM TO RECOGNIZE SHAH'S DETERMINATION TO MODERNIZE AND OTHERWISE STRENGTHEN HIS MILITARY FORCES AND TO MAINTAIN ARMORED DIVISION AS INSURANCE AGAINST THREAT HE SEES IN NASSER AND PAN-ARAB MOVEMENT. COUNTRY TEAM BELIEVES EFFORTS AT THIS TIME TO BRING ABOUT CHANGES DOWNWARD IN PRESENTLY AGREED FORCE LEVELS, OR TO ALTER PRESENT MEMORANDUM OF UNDERSTANDING LIKELY TO COMPLICATE SERIOUSLY PRESENT US PROBLEMS IN DEALING WITH SHAH. WE BELIEVE US INTERESTS ARE BETTER SERVED BY EFFORTS TO MAINTAIN IRANIAN FORCE STRUCTURE WITHIN BOUNDS PRESENT AGREEMENT.

NAVY PROGRAM - CINCSRIKE IN FY 67-71 MAP HAS PROGRAM FOR 07, NOT, RPT NOT, 03 PGM'S FOR IIN. FIGURES ON PF'S INCORRECT SINCE ONE OBSOLETE PF HAS BEEN RETIRED.

MAP CEILING - PAPER SHOULD CONTAIN RECOGNITION OF U.S. DECISION TO DEFER INCREASE IN \$200 MILLION CEILING UNTIL NEXT ANNUAL REVIEW; THIS INCREASE STEMS FROM \$29.8 MILLION APPROVED BY U.S. FOR ADDITIONAL 30-DAY LEVEL WAR AMMO AND MUNITIONS.

11 MAP BEYOND FY 69 - AS FOR FUTURE OF MAP PROGRAM BEYOND FY 69, IT SHOULD BE RECOGNIZED THAT FOR POLITICAL REASONS OR TO INSURE THE MAINTENANCE OF CERTAIN OF OUR FACILITIES AND PRIVILEGES IN IRAN IT MAY BE NECESSARY TO CONTINUE APPROPRIATE LEVEL OF GRANT MILITARY ASSISTANCE AS WELL AS MILITARY SALES CREDIT ON CONCESSIONAL TERMS.

GP-3.

~~TOP SECRET~~

OUTGOING TELEGRAM Department of State

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☐ CHARGE TO

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Origin
NEA

ACTION: Amembassy TEHRAN PRIORITY 192

Info:

INFO: CINCSTRIKE

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AUG 24 10 PM '65

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Embtel 192

Second Tranche Military Sales Credit

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E.O. 13292, Sec. 3.5
NLJ 032-042-1-4

By sp NARA, Date 3/21/06

Fiscal year 1966 Congressional actions include both authorization and funds which will allow simplification of credit arrangements with GOI. Rather than involving banks directly credit arrangement will be solely between Government of Iran and DOD.

FYI. DOD will obtain authority in FY'66 legislation which will enable it to sell evidences of indebtedness to private banks or to EXIM Bank. It is contemplated at this time that arrangements would be made with EXIM Bank which, if it participates, would determine whether carry these evidences in its own portfolio or transfer them to private banks. EXIM Bank will not be identified in any direct relationship with the GOI. Credit arrangement would be with DOD. DOD would guarantee repayment of GOI's credit. Therefore request you not advise Sami of potential EXIM Bank involvement. END FYI.

We therefore extend invitation to Sami to Visit Deputy Assistant Secretary of Defense, Henry J. Kuss, Jr., prior to any discussions in New York. We will be in touch Iranian Embassy regarding his schedule. During this visit we would hope to lay out procedures for direct arrangements between

Drafted by:

Telegraphic transmission and

OASD/ISA/ILN:CSTEVENS:djg 8/24/65

classification approved by:

NEA/GTI: J. M. Howison

NEA/GTI:FJCrawford

OASD/ISA/ILN-Mr. Kuss (in draft)

BOB -Austin Ivery (in draft)

AID/PC/MAD - Mr. Black (in draft)

EXIM - Mr. Bacon (in subst)

G/PM-Col.Evans (in subst)

AID/AA/PC-Mr. Arrill

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US DOD and GOI. While there is some question as to total amount that might be required we are prepared to initiate discussions for total \$90 million program and related \$72 million maximum credit line. ~~xxxxxx~~
~~xxxxxx~~

FYI. This is on same basis that \$49 million program in first tranche was covered by \$36 million credit line. ~~xxxxxx~~ We are presently planning on MAP credit support of second tranche at ~~xxxxxx~~ level of \$18 million with expectation obtaining balance from sources other than MAP. End FYI

BALL

~~CONFIDENTIAL~~

Excerpt from Defense
Weekly Report
to the President

~~CONFIDENTIAL~~

R Komer
Iron map 21

On 4 July, U. S. and Iran Concluded a Memorandum of
Understanding Providing, Subject to Fund Availability,
Additional U. S. Grant Aid of \$83 Million During FY 1967-
1969 and Iranian Purchases from U. S. During FY 1965-
1969 of \$250 Million of Defense Articles and Services

U. S. has agreed to assure credits up to \$200 million to be repaid during FY 1965-FY 1974. Credit will be assured by + August 1964 for the FY 1965 increment of \$57 million. This credit will be used for:

176 M60A1 Tanks -	\$39 million
4 C-130 Aircraft -	12 million
Miscellaneous Articles and Services -	6 million

Downgraded at 3 Year Intervals;
Declassified after 12 Years.
DoD Directive 5200.10

DoD 14 July 1964

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E.O. 13292, Sec. 3.4
By sp/cbm, NARA, Date 7-10-07

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NEAR EAST AND SOUTH ASIA

CYPRUS TALKS IN GENEVA

UN Mediator Tuomioja will soon commence talks in Geneva with Greek and Turkish representatives in an intensified effort at mediation of the Cyprus dispute. At some point in these talks, representations by certain NATO members with special interests and influence in Greece and Turkey could weigh heavily in persuading the Greeks and Turks of the vital point that the Cyprus problem is a negotiable matter. We therefore alerted our Embassies in NATO capitals that they may be instructed to urge host governments to intervene with Greece and/or Turkey in support of effective talks.

Positions Adamant - The presence of former Secretary Acheson in Geneva emphasizes our deep concern that the talks proceed with full understanding of the dangerous realities of the situation. (A UK special representative will also be present in Geneva.) There is a growing trend in Turkish minds that a solution to the Cyprus impasse can come only through military intervention. On the Greek side, the position seems to be hardening against effective negotiations, with the Greeks regarding US and UK pressures as designed to force them to talk at the point of a Turkish gun. They argue that as a matter of national honor they cannot negotiate with Turkey in the face of Turkish threats.

NATO Concerned - NATO governments recognize that a breakdown of the Geneva talks could lead to a situation gravely threatening NATO and the defense of the Western World. In a North Atlantic Council meeting July 8 there was clear recognition on the part of the Permanent Representatives of the importance of supporting the operation of the UN Mediator in Geneva and of the US and UK special representatives there.

--Current Foreign Relations, Issue No. 28, July 8, 1964

US-IRANIAN MILITARY AGREEMENT EXTENDED

A new Memorandum of Understanding covering grants and sales of US military equipment to Iran was signed July 4. In discussing with the Shah our willingness to assist in Iran's military modernization program, our Ambassador at Tehran emphasized our deep interest in Iran's economic development program and its relationship to the fundamental security of his country as expressed by the President. Since we would not wish the economic effort to be jeopardized, we feel strongly that the foreign exchange and budgetary effects of the military modernization program must be kept in proper bounds. In this respect, we will wish periodically to examine jointly with the Iranian Government the overall economic effects of military expenditures as indicated in the Memorandum of Understanding.

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E.O. 13292, Sec. 3.4

By sp/br, NARA, Date 7-10-07

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Cyprus

Low map

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Specifics of Agreement - The agreement provides for a continuation of grant MAP for three more years after the present five year MAP agreement, which runs through Fiscal Year 1966. It also provides, for the first time, for sizeable Iranian purchases (up to \$250 million) of US military equipment in the years 1966-1969, including about \$50 million in cash sales of follow-on spares and up to \$200 million in credit sales for new equipment. Equipment grants and sales will follow a mutually agreed concept of Iranian modernization requirements and absorption capabilities. The purchases will be subject to periodic determinations that the total program remains within Iranian foreign exchange capabilities and will not jeopardize economic development programs.

Usefulness for US - The new agreement has already proved helpful in reassuring the Shah of our recognition of Iran's legitimate military modernization requirements. It should further be useful in controlling Iranian expenditures for military equipment in the period of transition from grant assistance to sales, as well as in maintaining the exclusive US supply and advisory position, which has had promising results in terms of the sound development of Iranian military capabilities.

--Current Foreign Relations, Issue No. 28, July 8, 1964

NEA NOTES

Syrian Regime Conciliatory

The Bitar Government is continuing to press ahead in what is being called a "new stage of revolution," emphasizing tolerance and conciliation on the internal scene and externally continuing its quest for cooperation with other Arab states, particularly the UAR. The Baath regime has now released most of its political prisoners, including the Nasserists implicated in the Damascus insurrection of July 1963, and the conservatives implicated in the Hamah uprising of May 1964. The civil isolation imposed on a large group of separatists last year has also been lifted.

A party leader has confirmed to our Ambassador at Damascus that the Government has had contacts with pro-Cairo leaders, as well as with Egyptian officials, but that the effort was fruitless. The recent denial by the Arab Nationalist Movement (regional -- pro-UAR) that it had been in conversation with the Baath undoubtedly reflects continuing Egyptian determination to ostracize the Syrian regime in the hope of eventually bringing it down. So far, there is no evidence that the Bitar Government is faltering.

Aref Position Eroding

President Aref's position in Iraq has been undergoing steady erosion. Shia and Kurdish elements, long united in the belief that

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The Director

July 2, 1964

International Division (Ivory)

NSC Action 1550 Determination for a commitment for additional military assistance to Iran

The commitment proposed by the attached document would cover the following:--

1. Grant military assistance of \$83 million in the three fiscal years, 1967-1969, will be provided. This amount has been included in Mr. Molkara's "Table 36" MAP projections and is in addition to the amount of grant aid contained in our commitment of September 1962, for which funds are to be provided through fiscal year '66. The '62 commitment for grant aid was just under \$300 million. It fluctuates between \$40 million and \$70 million per year. The new commitment will involve \$25-\$30 million per year.

2. Credit assistance of \$200 million will be provided during fiscal year '65-'69 for sales totalling \$250 million. The \$50 million cash sales will be for spare parts for equipment we have supplied in the past. This credit is to be repayable over the 10-year period, 1965-1974, and we would agree the interest rate will not exceed an average of 4 $\frac{1}{2}$ -5 $\frac{1}{2}$ on the unpaid balance.

Included in the first year's increment of sales are: 4 C-130 aircraft and 176 M60 A1 tanks. With other related items, the total amount in fiscal year '65 will be \$57 million. It is agreed that this sale will be consummated on a credit basis within 30 days.

In return for the military assistance program being offered by the U.S., the Shah agrees to limit his military purchases abroad and to continue to abide by the conditions of the previous agreement of 1962. In a new Memorandum of Understanding, which is attached, there is to be a review, not less than once a year, of the Iranian balance of payments and budget situation and of the progress of Iran's social and economic development program. The Iranians agree to assure that the military expenditures and purchases abroad will not have an adverse effect on their social and economic development program. At one time, it was hoped that a dollar ceiling could be agreed upon for the foreign exchange expenditures of Iran. However, the agencies in Washington and the Ambassador and his

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E.O. 13292, Sec. 3.4

By ag/ctm, NARA, Date 7-10-07

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staff in the field are not sure what such a ceiling should be. Present estimates indicate that Iran's revenues from oil are going to exceed previous projections. Under these conditions, it is difficult to insist to the Shah that these purchases will have an adverse effect on his development program when already they are finding it difficult to move this program any faster. AID agrees that in the short-term exchange will be available; it is the longer term which gives them pause.

The Department of Defense is pressing us to approve this NSC 1550 Determination this afternoon, even though we have, at 4:00 p.m., only a draft. Furthermore, Bob Koser of the White House staff has indicated to us and to Mac Bundy that he does not see a need for the emphasis on speed being placed by Mr. Mohseni, who has unfortunately made commitments to the Shah to get these documents to him in the very near future. We do not have any objections to the assistance or procedures being proposed. We agree with the position Bob Koser has taken that careful instructions must be sent to Ambassador Holmes in connection with his negotiations on this Memorandum of Understanding, so that the Shah will be perfectly clear that, although no ceiling on foreign exchange expenditures is mentioned in the Memorandum of Understanding, it is agreed that expenditures and plans for use of foreign exchange will be discussed with the Shah at the time these increments are negotiated each year. The instructions to be sent with these papers have not yet been received (4:00 p.m.).

The problems involving this new Memorandum of Understanding have arisen from the efforts of Mr. Mohseni's "salesmen" who have recognized the increased capabilities of Iran to purchase military equipment rather than have it supplied on a grant basis. Because of the U.S. balance of payments, they have felt it advisable to sell the Shah on purchasing U.S. rather than European equipment. Since the Shah is desirous of obtaining the equipment and would buy it from Europe, if necessary, this proposed sale is probably in the U.S. interest. The early negotiations with the Shah were carried out by the Defense Department with minimal consultation with the Department of State and AID. Even in the later stages, communications were not adequate. We understand that without consulting State in advance, the negotiators for Defense suggested to the Shah a RAMP (air-defense missiles) system explaining that one was available and that training spaces for the Iranians could be arranged. One of the reasons such an offer was made is probably the fact that MAP has one or two complete systems on order for which no country now has the need. They were originally ordered for Korea and Turkey. In Iran, the system would be used to protect an important oil port so that it will be usefully deployed, if Iran purchases it.

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As indicated earlier, the pressures for prompt action come almost wholly from Defense. This undoubtedly reflects the zeal with which the logistics negotiators, under Henry Kiss, are selling U.S. equipment to help the U.S. balance of payments.

In spite of all the problems, we believe the program, on balance, is in the U.S. interests and if the instructions to be sent to the Embassy in Teheran are adequate, the proposed agreement would seem to protect our policy interests. Therefore, we recommend you sign the attached determination. If you wish, you could talk with Mr. McGeorge Bundy.

Attachments

cc: Mr. Hal Saunders (NEC) ✓
Mr. Capron
Mr. Amory
Rm. 440 Subj.

ID:AIvory:cs 7-2-64

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INCOMING TELEGRAM *Department of State*

24

BUNDY-SMITH
BATOR
BOWDLER
BOWMAN
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COOPER
HAYNES
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JOHNSON
KEENEY X
KLEIN
KROMER
MOODY
REEDY
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THOMSON

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Action

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TO RUEHCR/SECSTATE WASHDC 1470
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PERSONNEL CEILING - IRANIAN ARMED FORCES

EMB A-590, DEPTTEL 1124, EMBTEL 1468

IN ACCORDANCE 1962 AGREEMENT, PERSONNEL OF IRANIAN ARMED FORCES HAD TO BE REDUCED TO 160,000 "WITHIN TWO OR THREE YEARS". THIS WAS ACHIEVED MARCH 1, 1965. HOWEVER, EVENTS SUBSEQUENT TO 1962 HAVE, IN OUR VIEW, MADE A HIGHER CEILING NECESSARY. BASED ON THE FOLLOWING CONSIDERATIONS, COUNTRY TEAM THEREFORE AGAIN RECOMMENDS THAT CEILING BE ESTABLISHED AT 172,000 FOR PERIOD OF 1964 MEMORANDUM OF UNDERSTANDING. WE CONSIDER SUCH CEILING

RSR

PAGE TWO RUQVWA 366 ~~CONFIDENTIAL~~
NECESSARY TO SUCCESS OF MODERNIZATION PROGRAM.

PRINCIPAL REASON FOR NEED TO INCREASE CEILING IS FACT THAT JULY 4, 1964 UNDERSTANDING PROVIDES FOR ADDITIONAL EQUIPMENT AND UNITS WHICH MUST BE MANNED AND SUPPORTED. IN PARTICULAR ADDITIONAL PERSONNEL REQUIREMENTS ARE NECESSARY FOR NEW AIRBORNE BATTALION, HAWK BATTALION, INCREASED NUMBER OF AIRCRAFT, AC&W EQUIPMENT, ADDITIONAL TANKS AND REORGANIZATION OF 8TH ARMOR DIVISION, NEW PATROL FRIGATES AND OTHER EQUIPMENT.

IN ADDITION, IIF HAS UNDERTAKEN GREATER RESPONSIBILITIES IN CONNECTION LITERACY, HEALTH AND DEVELOPMENT CORPS AND VOCATIONAL TRAINING PROGRAM. THESE RESPONSIBILITIES, ADDED TO REQUIREMENTS FOR MODERNIZATION PROGRAM, RENDER 1962 PERSONNEL CEILING OBSOLETE.

ARMISH/MAAG AND IIF HAVE COMPLETED COMPREHENSIVE AND DETAILED JOINT STUDY OF MANPOWER REQUIREMENTS, INCLUDING TOES/TDS. STUDY ENCOMPASSED ALL POSSIBILITIES REDUCING NON-ESSENTIAL UNITS WHILE INSTITUTING MODERNIZATION PROGRAM. STARTING POINT OF STUDY WAS

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E.O. 13292, Sec. 3.4

By ag/cbm, NARA, Date 7-10-07

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-2- 1470, JUNE 22, FROM TEHRAN

IIF ESTIMATE OF 183,000 FOR NEW CEILING. AS RESULT OF STUDY, THIS FIGURE REDUCED TO 172,000, AND SHAH HAS RELUCTANTLY CONCURRED IN LOWER FIGURE. IT COULD BE REACHED BY YEARLY INCREMENTS THROUGH

PAGE THREE RUQVWA 366 ~~CONFIDENTIAL~~

1969. WE DO NOT RPT NOT THINK FURTHER PERSONNEL SURVEY NECESSARY. AMISH/MAAG WILL CONTINUE INSURE CEILING REFLECTS ESSENTIAL REQUIREMENTS. STRESS WILL BE PLACED ON BRINGING ONLY TRAINED MANPOWER INTO REGULAR FORCES AND ELIMINATION OF UNFIT FROM PRESENT PERSONNEL.

IN CONCLUSION, AS STATED ABOVE AND IN A-590, WE BELIEVE CEILING OF 172,000 JUSTIFIED AND NECESSARY AND RECOMMEND ITS APPROVAL.

GP-3. MEYER

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~~KLEIN~~
~~KOMER~~
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~~REEDY~~
~~SAUNDERS~~
~~THOMSON~~

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Origin

ACTION:

Amembassy TEHRAN PRIORITY 1124

NEA

INFO:

CINCMEAFSA

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JOINT STATE/DEFENSE/AID MESSAGE

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Embassy A-590; Embtels 1311, 1346, 1359, 1402 and DEF 2212.

SAH

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Concur your analysis US policy objectives and evaluation Shah's position outlined A-590. While we share CT's concern about Shah's long-term military spending plans, we agree that so long as he convinced Iran's economic prospects will allow both meeting these plans and financing ambitious development program, there is probably little we can do directly at this time to curtail his military spending without risking impression we reacting completely negatively his desires purchase additional US military equipment and thereby jeopardize what influence we have. We have therefore worked out approach outlined below, which we believe sufficiently responsive to Shah without posing present threat Iran's economic welfare. We trust that you will find further opportunity to impress on Shah that factors affecting control and growth of the economy demand action as urgently as do military requirements. Believe presentation to Shah should be designed: (1) avoid any suggestion advance commitment specific military equipment; (2) exploit opportunity offered by annual review procedure to interest Shah further in administrative improvements required minimize and threat to development effort inflationary dangers/inherent proposed military expenditure increases.

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NEA/CTE: JF Mulligan;

Drafted by: GSD/ISA: R. Murray; AID/NESA -
HTowles: d1g 6/11/65

Telegraphic transmission and
classification approved by

NEA - Mr. John D. Jernegan

Clearances: DOD/ISA-Mr. Solbert (in sub) 7/1/67 AID/PC-Mr. Arrill (in draft) AID/PC/MAD-RBlack (in
(SAMA-Capt. Cain)(in sub) 7/1/67 NEA/NR-DBunte (in draft) 7/1/67 draft)
White House - E. Komer (in draft) BOB - CMann (informed) 7/1/67

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FORM DS-322
8-63

Authority: NCT 03-042-1-5
By: [Signature] NARA, Date: 3/21/06

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Specific points for discussion with Shah follows

1. Second Tranche. Approve second tranche in range \$85-\$90 million covering items as ~~proposed~~ ^{proposed} Enclosure 2, A-590. This decision may be communicated to Shah in general terms, including our willingness help Iran secure 60-day war reserve ammunition by combination various means now being explored (including credit), as proposed Embtel 1402. Re other items in tranche, they may be catalogued, but details implementation must await clarifications discussed paras 7 and 8 below. Details second tranche items should be developed by MAAG with GOI and submitted Military Departments info OSD for preparation Letters of Offer and disbursement schedule. Based on disbursement schedule, instructions for negotiation second tranche credit will be provided by DOD.

2. Five-Year Credit Ceiling. Do not RPT not perceive any utility broaching at this time change in over-all credit ceiling (\$200 million for five-year period) as specified July 4, 1964 Memo of Understanding. Since approved new items second tranche consistent 1964 illustrative list and since sum first and second tranches does not RPT not approach over-all five-year figure, we believe it premature raise issue now. Consideration ceiling change would also cause time-consuming procedural hurdles (new 1550 determination, etc.) which unnecessary face at this time. We would hope Shah would be satisfied this year with second tranche as proposed and our undertakings re other problems as outlined below and would not RPT not question five-year total. If he should question, you may refer at your discretion to above points.

FYI. Believe we will be in better position to address problem at later date, giving us more time to urge Shah in direction ~~higher~~ priority for economic

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development and take advantage later reading Iran's economic situation. In any event, you should be aware that, owing present and prospective tightness MAP funds and especially in view Iran's improved financial condition, it unlikely we could modify agreement in any way requiring more MAP resources for Iran than originally foreseen. Sales additional to \$200 million in five-year period could, of course, be accommodated without more MAP resources if they were for cash or if unguaranteed commercial credit could be provided. END FYI.

3. Aircraft. Argumentation against F-111 as previously provided: no present or future military requirement for Iran to have an aircraft of this capability, too sophisticated, costly, still in R & D stage. In your discussions with Shah you may note that we recognize that Iran may need at some point aircraft of greater capabilities than F-5 RPT F-5. We would be prepared discuss GOI aircraft requirements at greater length with IIAF during course of year if Shah so desires. FYI. DOD plans undertake unilateral study of Iran's aircraft requirements and U.S. aircraft availabilities. END FYI.

4. Second Hawk Battalion. On both Hawk and Sheridan we believe offer "sympathetic consideration" at time next annual review is too strong. On Hawk, we do not wish to convey to Shah idea that we will say "yes" next year only to find that none are available. (See DEF 2212 re problem availability.) Conversely, we do not wish to tell Shah outright that we will not have any available and risk his turning elsewhere at this early stage. Recommend you place chief stress on absorption difficulties, but also refer possible improvements we contemplating to Hawk, and suggest further discussions during coming year.

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5. Sheridan Tanks. Principal arguments already known to you: Sheridan still in R&D, none are available, problem of absorption, and--as in case of all other items--problem of cost. We suggest GOI be informed of problems, that it is premature for commitments, that we recognize their requirement for improved armor capabilities and that we should also watch this over course of year and see where we stand at time next annual review.

6. Bullpup. FYI. While agree your position, we willing consider sale Bullpups at some future time provided they are available and releasable to Iran from security standpoint; and if in your judgment this will help dampen Shah's desires for more sophisticated aircraft. At present time there are none RPT none available from U.S. production, although may be available from European consortium. We have not looked into this in great depth, and will not do so unless you so recommend after your discussions with GOI. END FYI.

7. Other Items. Other items recommended for financing under 2nd tranche approved, subject to availability. ARMISH/MAAG should define requirements for Military Depts. so that Letters of Offer can be prepared. DOD now taking steps authorize Military Depts. proceed in advance of funding with supply actions for second 4 C-130s, radio test equipment, 163 APCs and 1610 LMCs.

8. Price and Availability. Prices and delivery schedules cannot be determined in detail at this time. MAAG must first define requirements more precisely for Military Depts. before deliveries can be projected and prices as stated A-590 confirmed. In any case, there would appear to be no RPT no obligation determine this type detail in connection with annual review.

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9. Force Level. We recognize additional units called for in 1964 Memorandum of Understanding will require some additional personnel nevertheless, principle that economic development Iran's first need and that military establishment must be forced sort out priorities within ^{reasonably economic} ~~economic ceiling~~ ceiling remains key consideration. Ceiling 160 thousand was accepted by Shah only after President Kennedy personally pressed principle during Shah's 1962 visit and ceiling was finally reached only recently. Accordingly, prior ^{to any breaching} ~~decision re/~~ ~~discontinued~~ personnel which subject high level decision, wish your views on ceiling ~~which are being discussed~~ how Iranians might meet modernization needs through perhaps through cutback non-essential units. reshuffling within 160 thousand ceiling/ We are prepared if GOI considers desirable to assist in personnel survey, to include availability of personnel with requisite skills. In any case, we doubt it necessary broach this subject in connection annual review 1964 Memo of Understanding (which limited by terms of agreement essentially to questions financing and training readiness for equipment purchases) and we gather from Embtel 1402 that you do not RPT not expect Shah raise issue June 19 audience. If he should inquire, you may refer in general terms to our concerns as expressed above.

10. Allocation of Economic Resources. We wish stress importance your continued emphasis on value careful economic projections and allocation resources as set forth Embtels 1346 and 1359. Appreciate we must take care not to nip in bud dialogue begun between Shah and economic planners this subject or create suspicion in his mind that economists are "sabotaging" military program, but we will need to reiterate at appropriate opportunities necessity facing hard questions if Iran is to carry out effective development program and attain satisfactory

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growth rate. Certainly US will have gained important advantage from annual review procedure if continuing dialogue can be established with Shah concerning application competent economic analysis to problem military purchases. You might consider introducing your top economic advisers into high-level discussions military/economic problem, as supplement to ongoing discussions technical military matters between Shah and MAAG chief.

We realize discussion this subject with Shah must proceed slowly and carefully. Although projections on which Shah bases optimistic plans for development and military programs probably unrealistic many critical respects, we recognize little advantage debating merits these projections with Shah. Trouble could well ensue if Iran accelerates volume public expenditures at rates foreseen without commensurate increases public savings, but fact remains development program not now competing against military for resources due slowness preparation sound development projects. Since qualitative discussions economic projections apt appear academic to Shah, suggest you strive focus his attention for time being on fact that projections appear indicate that a bright future attainable, but this will not RPT not come about automatically merely because resources available, but will require continued and accelerated actions to upgrade economic administration (along lines represented by initial steps toward modern budgeting system) in order to achieve maximum growth rate under conditions minimal inflation. GF-3

END

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INCOMING TELEGRAM *Department of State*

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STATE GRNC

BT

~~CONFIDENTIAL~~ JUNE 18

ANNUAL ECON-MILITARY REVIEW

RE DEPTTEL 1124, JUNE 12

GENERAL ECKHARDT AND I HAD TWO AND THREE-QUARTER HR SESSION WITH SHAH 17TH FORMALLY REVIEWING ECON-MILITARY PICTURE PURSUANT TO US-IRAN MEMORANDUM OF UNDERSTANDING OF JULY 4. SHAH WAS IN GOOD MOOD, NO RPT NO MAJOR PROBLEMS DEVELOPED. HE WENT ALONG WITH OUT VARIOUS POSITIONS(DEPTTEL 1124) EXCEPT THAT HE WISHES ONE SQUADRON F-5'S EQUIPPED WITH BULL PUPS. GEN ECKHARDT WHO ABLY HANDLED DISCUSSION MILITARY PROCUREMENT IS WRITING UP MEMO FOR RECORD OF UNDERSTANDINGS REACHED WHICH WILL BE SUPPLIED TO SHAH FOR

PAGE 2 RUQVWA 302 ~~CONFIDENTIAL~~

HIS APPROVAL PRIOR TO HIS DEPARTURE FOR USSR.DETAILS OF MILITARY ASPECTS WILL BE REPORTED BY SEPARATE MESSAGE.

NEARLY HR WAS SPENT RE ECON FRAMEWORK#01 LED OFF BY REITERATING ECON DEVELOPMENT IS AS IMPORTANT AS MILITARY. NOTED IRAN HAS EXCELLENT INCOME BUT ALSO LARGE DEFICITS PROJECTED FOR FUTURE. ADDED SHAH'S REFORM PROGRAMS APT TO ADD TO GOI FINANCIAL BURDEN AND CAUTIONED UNLESS RISING EXPECTATIONS MET FRUSTRATION OF IRAN MASSES COULD CAUSE REAL PROBLEM. CONCLUDED THAT WHILE REDOUBLED EFFORT IS GOING TO BE REQUIRED IN ECON FILED OVER LONG RUN, PROSPECTS FOR IMMEDIATE FUTURE SATISFACTORY AND, THEREFORE, WE PREPARED PROCEED WITH SECOND TRANCHE OF MILITARY PROGRAM.

SHAH THEN EXPATRIATED AT LENGTH. FIRST HE EXPRESSED HIS PERSONAL CYNICISM RE ECONOMISTS, NOTING IRAN HAS HAD SAD EXPERIENCES

BUNDY-CHIT
BATOR
BOWDLEN
BOWMAN
CHASE
COOPER
HAYES
JESSUP
JOHNSON
KEENEY
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REEDY
SAUNDERS
THOMSON

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Authority FRUS, UHXXII, #90

By rg NARA, Date 8-9-05

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-2- 1450, JUNE 18, FROM TEHRAN

WITH EXPERTS WHO CLAIM TO KNOW ALL ANSWERS AND WHO DISAGREE AMONG THEMSELVES. HAPPILY IRAN ECON SITATUION HAS NOW RECOVERED FROM HANDIWORK THESE ECONOMISTS. HE PARTICULARLY PLEASED BY WHAT HE CONSIDERS OVERWHELMINGLY FAVORABLE IMPACT OF HIS RECENT ATTACK HIGH COST LIVING THRU SETTING PRICES FOR CERTAIN BASIC COMMODITIES. HE CONFIDENT HIS REFORM PROGRAMS WILL GREATLY IMPROVE WELFARE IRAN WASSES, E.G. BY INCREASED PRODUCTION FROM FARMS

PAGE 3 RUQVWA 302 ~~CONFIDENTIAL~~

WHICH THEY NOW OWN AND BY SHARING PROFITS FROM EXPANDING INDUSTRIAL SECOTR. MEANWHILE, GREAT STRIDES BEING MADE KHUZISTAN AND ELSEWHERE. THUS IN GENERAL PICTURE GOOD ONE.

FROM THIS POINT, SHAH LAUNCHED INTO HIS USUAL CONTENTION THAT THIS FUTURE PROSPERITY MEANINGLESS IF IRAN NOT SECURE

HE SIMPLY HAS BE ABLE COPE WITH REGIONAL THREATS. VIET NAM IS GRAPHIC EXAMPLE, ACCORDING SHAH, OF WHAT COULD HAPPEN IRAN. US DESPITE ITS MIGHT NOW COMPELLED SEEK "UNCONDITIONAL DISCUSSIONS", WHICH SHAH MEANS NEGOTIATING WITH AND MAKING CONCESSION TO AGRESSOR. HE WENT ON TO EXPRESS CONCERN RE FUTURE OF KUWAIT, ADEN AND BAHRAIN. HE BELIEVES NASSER FRUSTRATED IN YEMEN AND ELSEWHERE BOUND TO LAUNCH ADVENTURE SOME WHERE, PROBABLY AGAINST LIBYA, MUCH LESS PROBABLY AGAINST ISRAEL. NASSERIST THREAT INGULF AREA CANNOT BE IGNORED.

THUS HIS PRINCIPAL FOREIGN POLICY CONSIDERATION IS SAFETY AND SECURITY GULF AREA WHERE IRAN'S WEALTH CONCENTRATED. HE SAID NO RESPONSIBLE LEADER FACING THREAT THIS KIND CAN AFFORD BE TOO CAUTIOUS. AFTER SEEKING DOWNPLAY NASSERIST THREAT, I POINTED OUT THREAT VERY LIKELY BE MORE SUBVERSIVE (AS IN VIET NAM) THAN OPEN MILITARY ATTACK. THUS MORE ATTN-TO COUNTER INSURGENCY WAS DESIRABLE. SHAH RECOGNIZED THIS AND SAID THAT HIS INTEREST IN COUNTER-SUBVERSION EXPLAINS HIS EMPHASIS ON TOTAL "POSITIVE PROGRAM". HE CITED NEW DAMS BEING BUILT IN

PAGE 4 RUQVWA 302 ~~CONFIDENTIAL~~

KHUZISTAN AND OTHER EFFORTS TOWARD ECON AND SOCIAL IMPROVEMENT.

AFTER HE HAD DELIVERED HIMSELF OF REMARKS OBVIOUSLY PREVIOUSLY PLANNED, SHAH AGREED MY SUMMATION THAT HE AND HIS GOVT ARE DETERMINED ACCELERATE ECON PROGRESS AND THAT GOI WILL DEDICATE ITS RESOURCES TO EXTENT NECESSARY TO ACHIEVE THAT OBJECTIVE.

GP-3

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INCOMING TELEGRAM *Department of State*

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REEDY
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THOMSON

CINCSRIKE/CINCEAFSA FOR POLAD

ANNUAL REVIEW OF MEMORANDUM OF UNDERSTANDING

AUDIENCE WITH SHAH NOW RPT NOW MOVED UP BY MINCOURT TO JUNE 17
RPT 17. RECEIPT OF INSTRUCTIONS BECOMING MATTER OF URGENCY.

GEN. ECKHARDT HAD TWO AND HALF HOUR CONVERSATION WITH SHAH TODAY,
MOST OF WHICH DEVOTED TO MATTERS RELATED TO REVIEW. STATING HE
SPEAKING FRANKLY AND SOMEWHAT OFF THE RECORD ECKHARDT TOLD SHAH
THAT HIS IMAGE IN THE STATES NOW RPT NOW EXCELLENT AS
ENLIGHTENED AND FARSIGHTED RULER AND LEADER. MOST DESIRABLE

PAGE TWO RUQVWA 280 ~~CONFIDENTIAL~~
FOR SHAH AND IRAN THAT NOTHING BE DONE TO IMPAIR FAVORABLE
AND USEFUL IMAGE. CONCERN BEEN EXPRESSED BOTH IN US AND IRAN
THAT IRAN NOT RPT NOT UNDERTAKE DISPROPORTIONATE EXPENDITURES
FOR MILITARY EQUIPMENT. ONLY YEAR AGO FIVE-YEAR PROGRAM VALUED
AT AROUND \$250 MILLION WORKED OUT JOINTLY AND IRAN MILITARY
SERVICES NOW RPT NOW EXTENDED TO ABSORB \$49 MILLION WORTH
MILITARY SALES THIS YEAR AND \$80-000 MILLION SALES NEXT YEAR
WOULD BE ABSOLUTE MAXIMUM THAT COULD BE HANDLED. ECKHARDT
ARGUED DESIRABILITY AND WISDOM OF APPROACHING PROBLEM OF NEW
EQUIPMENT YEAR BY YEAR AND NOT RPT NOT ATTEMPTING TO GRAY OUT
LONG-RANGE NEW PROGRAM OF ADDITIONAL WEAPONS. ECKHARDT NOTED
COST OF NEW WEAPONS SHAH DESIRED WOULD EXCEED \$150 MILLION AND
NOTED THAT MAJOR ITEMS (SHERIDAN AND F-111) STILL IN EARLY
DEVELOPMENT STAGE, WITH OPERATIONAL CAPABILITIES NOT RPT NOT
YET CLEARLY DEFINED AND COST AND AVAILABILITY DEFINITELY NOT
RPT NOT KNOWN.

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E.O. 13292, Sec. 3.4

By *light*, NARA, Date 7-10-07

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-2- 1418, JUNE 12, FROM TEHRAN

SHAH RAISED QUESTION OF WAR RESERVE OF AMMUNITION AND PRESSED HARD FOR NECESSITY FOR 90-DAY SUPPLY ESPECIALLY IN SOME ITEMS OF AIR FORCE MUNITIONS. ECKHARDT STATED NO RPT NO DECISION BEEN TAKEN AND URGED WISDOM OF CONSIDERING PROBLEM AT NEXT LEVEL OF NEED BEFORE ATTEMPTING TO SECURE ULTIMATE DESIRES. POINTED OUT SUBSTANTIAL LOGISTICAL DIFFICULTIES THAT MUST BE OVERCOME BY IRAN BEFORE HANDLING SUBSTANTIAL INCREASE IN WAR RESERVES.

PAGE THREE RUEVWA 200 ~~CONFIDENTIAL~~
AFTER LENGTHY DISCUSSION THESE AND OTHER POINTS SHAH CAME AROUND TO VIEW THAT ECKHARDT'S EXPOSITION SOUNDED "REASONABLE" AS LONG AS HE COULD FEEL ASSURED DISCUSSION OF ITEMS INVOLVED COULD BE TAKEN UP IN SUBSEQUENT ANNUAL REVIEWS AND HE WOULD NOT RPT NOT, THEREBY, HAVE "LOST A DAY IN (HIS) PLANS TO STRENGTHEN IRAN'S FORCES TO ACCEPTABLE LEVEL".

I BELIEVE THIS HAS SET STAGE FOR REASONABLY SATISFACTORY OUTCOME OF MY DISCUSSION WITH SHAH NEXT THURSDAY PARTICULARLY IF IT CAN BE MADE CLEAR TO SHAH THAT WE ARE READY TO ACCEPT AND WORK WITH HIM FOR 60-DAY RESERVE AND WE ARE ABLE TO CONVEY CLEAR IMPRESSION WE ARE READY TO CONTINUE TO TALK WITH HIM REGARDING HIS DESIRES FOR HAWK BATTALION, SHERIDAN TANKS AND HIGHER PERFORMANCE AIRCRAFT. TENOR OF ECKHARDT-SHAH CONVERSATION UNDERLINES IMPORTANCE OF INTANGIBLE FACTOR OF OUR ATTITUDE TOWARD CONTINUING DIALOGUE WITH HIM CONCERNING HIS MILITARY DESIRES.

GP-3.

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DEPARTMENT OF STATE
EXECUTIVE SECRETARIAT

May 27, 1964

Date

Mr. McGeorge Bundy
The White House

*Returned to
B Smith 5/28/64
eq*

The enclosed is for White House
clearance prior to transmission.

[Signature]

Benjamin H. Read
Executive Secretary

[Signature]

Enclosure:

Draft cable to Tehran.

[Signature]

DETERMINED TO BE AN
ADMINISTRATIVE MARKING
E.O. 12353, SEC. 1.1(a)

BY Cb ON 3-16-93

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~~CLASSIFICATION~~

MAY 28 1964

28a

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Ambassy TEHRAN PRIORITY

LIMDIS

EMTEL 1065

Begin
Understand Shah's current ^{is with} concern security situation (Arab threat) and preoccupation ^{is} with details military modernization but hope he aware that it would be counterproductive to devote ^{entire} hour with President ^{mostly} these subjects, particularly technical discussion merits various kinds military equipment. President keenly interested progress Shah's reforms, especially land reform, education and health corps, women's emancipation, administrative reform, etc. ^{and in measures to stimulate Iranian economy.} To omit or downgrade these subjects would risk giving impression one-sided preoccupation military-security affairs.

We hope you will find opportunity before Shah leaves to intimate this need for balance in meeting with President. You may wish to refer to opportunity for discussion military problems Iranian Embassy tea June 6 (at which we hope McNaughton, Sloan, and Generals Woods and Adams will be present) and to make it clear again that we expect details concerning timing and equipment content modernization program to be worked out in continuing Tehran discussions with you and General Eckhardt, not during Washington visit.

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E.O. 13292, Sec. 3.4
By *lg/plm*, NARA, Date 7-10-07

END OP-3

NEA:GTI:MCTiger:djg 5/27/64

NEA - John D. Jernegan

ISA
B/B
WHITE HOUSE

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FORM DS-322
MAY 28 1964

NEA-5

AIRGRAM

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A-590
NO.

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TO : DEPARTMENT OF STATE
DEPARTMENT OF DEFENSE

INFO: CINCSTRIKE/CINCMEAFSA
DEFENSE FOR ISA
CINCSTRIKE FOR POLAD

FROM : Amembassy, TEHRAN

SUBJECT : First Annual Review of the Memorandum of Understanding of July 4, 1964

REF : Embassy's A-661, May 28, 1964 DEF 19 265-IRAN
Embassy's A-443, February 23, 1965 - same
Embassy's A-451, February 24, 1965 - same
Embassy's A-454, February 25, 1965 - same DEF 19-3 265-IRAN
Department's A-75, February 9, 1965 - DEF 19-3 265-IRAN
Embassy's Telegram 1204, April 27, 1965
SECTO's 26, April 8, 1965

DATE:

HANDLING INDICATOR

BUNDY-SMITH
BOWDLER
BOWMAN
CHASE
COOPER
HAYNES
JESSUP
JOHNSON
KEENEY
KLEIN
KOMER
MOODY
REEDY
SAUNDERS
THOMSON

SUMMARY AND RECOMMENDATIONS

The July 4, 1964 Memorandum of Understanding provides for an annual review. The current review is addressed to two questions: (1) should the United States proceed to assist Iran to negotiate a second tranche credit under the Memorandum, and, if so, what should be its volume, and (2) what should be the United States' position regarding additional military equipment requested by Iran?

The final stage of this review will involve my discussion and negotiation with the Shah, which I hope to be in a position to undertake in early June, especially as the Shah departs on a trip to the USSR on June 21.

att 2.1.
Enclosures:

- Enc. #1 - ARMISH/MAAG Recommendations for the First Annual Review of the Memorandum of Understanding 4 July 1964.
- Enc. #2 - Proposed Second Tranche - \$200 million Credit Arrangement
- Enc. #3 - Economic Projections of the Central Bank of Iran
- Enc. #4 - Country Team Comments on Central Bank Projections

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Authority: NIT 032-042-1-6
By: [Signature], NARA, Date: 3/2/06

GROUP 3
Downgraded at 12 year intervals,
not automatically declassified.

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☐ In ☐ Out

FORM DS-323
4-62

Drafted by: SA [Signature] A:ap

5/10/65

Contents and Classification Approved by:

DCM:SWRockwell

Clearances:Contributions:ARMISH/MAAG:Col.Barton,Lt.Col.Gerfen; USAID:ABoucher,MFox

Clearances:POL:MFHerz;ECON:JWS wihart;ARMISH/MAAG:Gen.Eckhardt; USAID:HLParnons

The primary factor to be kept in mind is that the present excellent relations between the United States and Iran, which so importantly and directly promote U.S. foreign and national security interests, are due in large part to our successful military assistance program. Despite Iran's increasingly strong and independent posture, arising from the improved financial situation, the military program remains a significant instrument for influencing the Shah and the Iranian military program. This remains true, although the Shah's determination to strengthen Iran's position in the Middle East, and his conviction that he has the resources to do so, are factors which have placed limitations which did not previously exist upon our influence. In view of the importance of the military program to our interests here, we must be careful to live up to commitments made in connection with it, and we must not show ourselves totally negative in the face of new requests from the Shah. The maintenance of our position here depends, in good measure, on the continuation of a military aid and sales program, on a scale which is reasonable and defensible both from U.S. and Iranian points of view.

The Shah has asked for certain items of equipment which can be accommodated within the \$200 million credit of the Memorandum and for the following equipment for which additional credit would be necessary:

- (1) Higher performance aircraft - \$40 to \$130 million - depending on whether one or two squadrons were purchased and whether the planes were F-4's or F-111's.
- (2) Sheridan tanks - (130) - \$54.5 million.
- (3) A second Hawk Battalion for Bandar Abbas - \$22.5 million.
- (4) An increase in his war reserve of ammunition from 30 to 60 days - \$29.8 million.
- (5) Other smaller items - AC and W sites ~~between Bandar Abbas and Dezful~~ between Bandar Abbas and Dezful - \$3.3 million; Bull-Pup missiles - quantity unspecified.

He has also requested agreement to increase the authorized strength of the Iranian Armed Forces from 160,000 (per the Memorandum of Understanding of September 19, 1962) to 172,000.

Leaving aside the political considerations involved, ARMISH/MAAG's military review approved certain items for inclusion in the \$200 million credit, recommended approval of the increased war reserve of ammunition and of the 172,000 personnel ceiling, and recommended postponement of discussion of higher performance aircraft, Sheridan tanks, AC and W sites between Bandar Abbas and Dezful, and the second Hawk battalion. ARMISH/MAAG's review, however, pointed out the need for indicating a U.S. willingness to discuss at some later date Iranian acquisition of these items. ARMISH/MAAG recommended disapproval of the Bull-Pup missiles at this time.

Following our initiative, the Prime Minister had the Central Bank prepare appropriate economic projections. The Embassy-USAID has examined these projections and conducted a review of the financial and economic factors involved. This review concluded that the Iranian present and projected financial position was sufficiently strong to permit Iran to finance a second tranche of the \$200 million credit and to include in that tranche \$29.8 million to cover the increased war reserve of ammunition; the total second tranche would then be \$229.8 million and the \$200 million credit would have to be increased by the \$29.8 million.

Our overall review also concluded that a continuing dialogue with the Shah - and between the Shah and his economic and financial advisors - will be necessary to make him realize the value of careful economic projections as a management tool and to persuade him of the utility of their employment in the examination of his military needs.

The Country Team and I, therefore, recommend

1. That I be authorized to inform the Shah that

- a. We are prepared to assist Iran to obtain an increase in the \$200 million credit to \$230 million in order to accommodate his request for an increase in his war reserve of ammunition to 60 days.
- b. We will proceed to help to negotiate the second tranche credit in the amount of \$229.8 million, which will include the additional war reserve of ammunition. The second tranche will also include equipment for the Bandar Abbas radar site, GCA facilities, engineering equipment, communications and electronic equipment, armored command post vehicles, and the Caspian patrol craft, patrol frigate, radio test equipment and equipment for the armament Department in addition to the other items already specified in the Memorandum and this equipment will be delivered on dates, which we then specify to him.
- c. We agree to amend the Memorandum to authorize an increase in the ceiling of the Iranian Armed Forces to 172,000.
- d. We do not consider that a military requirement^{exists} for the Bull-Pup missile.

2. That we be provided all available considerations which justify our reluctance to discuss Iranian acquisition of high performance aircraft, light reconnaissance tanks and a second Hawk battalion at this time.

3. That I be authorized to say that we will be prepared to give sympathetic consideration to his request for Sheridan tanks and the second Hawk battalion during the 1966 annual review.

4. That I be authorized to tell him that although it is premature to discuss the matter now, we do not exclude a subsequent possibility of Iran's acquiring higher performance aircraft, if he continues to consider that Iran needs them, and we will keep him informed regarding U.S. developments in this field.

Introduction

The July 4, 1964 Memorandum of Understanding between Iran and the United States concerning military assistance and sales provides for an annual review between the Ambassador and "a ranking representative designated by the Imperial Iranian Government," which is, of course, the Shah. The Memorandum stipulates that this review will examine the progress and execution of the Understanding, including its relationship to Iran's economic development and specifically to the Iranian balance of payments and budgetary situation.

The Shah through the Iranian military establishment has made known his desire to undertake the purchase of certain military equipment, some of which only specifies equipment which can be included within the \$200 million credit of the Memorandum and some of which would necessitate additional credit. Subsequently, he invoked the annual review procedure. The Shah's request has been carefully reviewed by ARMISH/MAAG and recommendations covering its military aspects forwarded through military channels. The financial situation and outlook have been reviewed by the Central Bank and other Iranian economic officials in cooperation with Embassy-USAID officers and I will discuss the policy problems revealed by the economic projections with the Prime Minister this week.

This airgram contains our analysis of the political, military and economic factors involved in the review and sets forth our recommendations regarding the position to be taken in the discussions with the Shah.

Policy Objectives

U.S. policy objectives in Iran and their relation to the U.S. military assistance, sales and advisory programs in this country were set forth in detail in A-661, May 28, 1964. The essential points of that message remain relevant and it should be read in conjunction with this airgram. However, events in the last year warrant some modification of actions available to us in our effort to restrain Iranian military expenditures.

As we undertake this review, the Country Team and I wish to stress two closely related factors in the current situation:

1. The U.S. now enjoys excellent relations with Iran, which are importantly and directly reflected in the promotion of U.S. foreign policy and national security objectives. A key component of our good overall relations and a significant instrument for influencing the Shah and his military program is our intimate and highly satisfactory military association. This remains true, although the Shah's determination to strengthen Iran's position in the Middle East, and his conviction that he has the resources to do so, are factors which have placed limitations which did not previously exist upon our influence. In view of the importance of the military program to our interests here, we must be careful to live up to commitments made in connection with it, and we must not show ourselves totally negative in the face of new requests from the Shah. The maintenance of our position here depends, in good measure, on the continuation of a military aid and sales program, on a scale which is reasonable and defensible both from U.S. and Iranian points of view.

2. Although the Iranian regime has been shaken, to some extent, by the recent assassination attempt against the Shah, it has shown no disposition to change its basic policies either internally or in its pro-Western international orientation. The Shah during recent years has come to see Iran as less dependant on foreign support, politically or economically, and he considers that Iran must have the capability of meeting non-communist aggression without foreign help, if necessary. Certainly he has become less amenable to foreign advice during recent years.

These facts of Iranian political life require us to recognize and accommodate our conduct to an increasingly independent Iranian posture, if our diplomacy here is to be effective.

Dealing with Iran is, of course, dealing with the Shah - and this is particularly true with regard to military affairs. It is, therefore, pertinent to this analysis to examine how he has approached the first annual review.

Shah's Position

The factors affecting our relation with Iran - and the Shah - have been undergoing some marked modification, particularly in the last two years or so, as was spelled out in A-661. In the past year some of those changes have continued further along the same lines and some new developments have sharpened existing tendencies.

The Shah's intent to establish a more secure and more independent position for Iran in the Middle East has become still more pronounced. He sees evidence of extensive instability throughout the area. The Cyprus situation, the continuation of the Yemeni crisis and British problems in Aden and the Persian Gulf

area have fed the doubts he has regarding the adequacy of existing political-military arrangements to insure his security and position in the region. Although the Shah remains suspicious of his northern neighbor, the general level of his concern has probably declined, as Iranian-Soviet relations have continued tranquil and additional ties have been established. Iran's basic adherence to CENTO has not been brought into question but the Shah's reservations about it have seemed more pronounced as that organization brushes aside Iranian attempts to induce greater military substance into it and as CENTO refuses to pay attention to the Shah's worries regarding Nasser. Those worries seem to have been confirmed and deepened in the Shah's mind by the demonstrations of Nasser's intransigence over the past year. He has become more determined, as he told Secretary Rusk, to have Iran in a position to handle attack from any country other than the USSR and he assumes that the United States would welcome a situation in which it would not have to become involved militarily in such a contingency.

The Shah is keenly aware that Iran's current receipts from and future prospects for revenues from her oil resources have improved considerably - and above general expectations. He has become convinced that, as he has said over and over, he will be able to borrow \$680 million over the next ten years after provision for an eight percent increase in GNP in the fourth development plan. This expectation appears to be based on an incomplete financial analysis, as is indicated below in the Economic Review Section.

It should be borne in mind, however, that the financial situation and the future financial outlook have, in fact, significantly improved since the signature (July 4, 1964) of the Memorandum. At that time, the Shah accepted the program of military acquisitions contained in the illustrative list of the Memorandum as the maximum he should acquire, given the economic prospects at the time. However, he specified to the Ambassador his desire for additional equipment, which he felt should be considered if the financial situation and outlook improved. He is, with considerable reason, convinced that the situation and outlook have improved and that he can afford more military equipment without undue strain on his economy. Our economic presentation will, hopefully, induce a greater sense of realism into his anticipations, but we are unlikely to eradicate his belief that he can now afford more. If we push our reservations regarding Iran's financial future past a certain limit, he will be prone to interpret it, not as an objective and helpful presentation, but as a screen for our unwillingness to give sympathetic consideration to his requests. The depth of his conviction that Iran can afford more military hardware has been reflected in conversations with General Eckhardt, in having the Prime Minister call in the Charge to make the point, in his talk with Secretary Rusk and in my initial audience with him.

The Shah's specific interest in certain equipment not included in or additional to that listed in the Memorandum was formally communicated by memoranda from the Supreme Commander's Staff to ARMISH/MAAG. It is expected that the Shah will ask in the review for the following equipment, estimated valuations added by ARMISH/MAAG:

- 1) Higher performance aircraft - \$40 million to \$130 million, depending on whether the plane is the F-4 or the F-111 and whether one or two squadrons are to be acquired. In late April the Shah suggested a squadron of 16 F-111's, which would presumably cost in the neighborhood of \$80-\$90 million. These costs would not be a net add-on to the \$200 million credit, as these planes would be in lieu of the two squadrons of F-5's at a cost of \$27.1 million.
- 2) Sheridan tanks - 130 - \$54.5 million.
- 3) A second Hawk battalion - for the Bandar Abbas area - \$22.5 million.
- 4) AC and W equipment - for three sites - Bandar Abbas and two gap-filler sites between Bandar Abbas and Dezful - \$4.9 million.
- 5) Air navigation, communication and electronic and engineering equipment - \$15.4 million.
- 6) An increase in the war reserve of ammunition from 30 to 60 days - \$29.8 million.
- 7) Other items, falling within the \$200 million credit and discussed in the Military Review Section.

Both the magnitude of these requests (a minimum of \$175 million) and the nature of some of the items (F-111's and Sheridan tanks, still in the development stage) came as something of an initial shock. This is especially true, as the requests are advanced within the first year following the Memorandum. However, some of the things that probably relate to the Shah's decision to advance these requests need to be borne in mind. With regard to the tanks, he has, at the time of and since the Memorandum of September, 1962, consistently expressed the desire for additional tank battalions as soon as he could afford them. His interest in and respect for the Sheridan tank was confirmed during his talk with General Adams in April, 1964 and he conceives of his tank force as a top-priority element in his preparations for the defense of South Iran, especially the Khuzistan area. With regard to the fighter aircraft, he has, of course, been long convinced that he cannot afford to have aircraft inferior in performance to the Soviet-supplied aircraft of his neighbors, Iraq and Afghanistan - and of Nasser. His preoccupation with this problem has continued to sharpen since those countries acquired MIG-21's. We have succeeded, in part, in raising substantially his evaluation of the F-5's and he is, in general, pleased with their performance. Their advent has not, however, shaken his conviction that he cannot afford to be "outgunned" in the air by the Arab countries. He has followed closely press accounts of British and Australian "purchase" of the F-111's, and he is apprehensive that should he fail to get on the list soon he will have no prospect of acquiring this plane for many years. With regard both to the planes and the tanks, it is clear that the Shah is not thinking primarily in terms of his immediate needs; he is looking forward to the state of a Nasserite Arab military posture in the years ahead and to the dilution he expects in the British military presence and capabilities in the area. He has become increasingly conscious of the long lead

times involved in procuring modern weapons systems and in the preparations necessary to utilize them. His eye is on the state of his own defenses in 1970 and he will be watchful for indications that we also have given some thought to his military posture in that period.

Most of the remaining items he associates directly with the immediate state of his southern defenses. His interest in a level of war reserve ammunition sufficient to enable him to deal independently with the early stages of any non-Soviet incursion dates back to the talks prior to the September, 1962 memorandum. At that time he accepted the limitation to a 30-day supply only on the grounds that we could afford no more in a MAP grant program. He has reiterated his desires repeatedly and forcefully in the context of Iranian purchase of the ammunition, a position which, in his mind, removes the only feasible objection to his request. The second Hawk battalion (near Bandar Abbas) and the Aircraft Control and Warning sites in the lower Gulf area he considers integral parts of his military position on the Gulf. After repeated allusions to the need for destroyers for the Gulf fleet, he has apparently accepted our arguments that he could best meet any naval incursion into the Gulf with his Air Force. He views the AC and W sites and the Hawk battalion as improvements necessary to make the Air Defense System effective in that area and he wants to equip his fighter planes with Bull-Pup missiles for that purpose. He is also not unmindful of a possible U.S. interest in the area near Bandar Abbas in connection with prepositioning of U.S. equipment.

Military Review

ARMISH/MAAG has conducted a thorough and extensive review of the current and presently projected military assistance and sales program, of the list of military equipment requested by Iran, and of Iranian performance of her obligations under the Memoranda of 1962 and 1964.

With regard to the military assistance and sales program, as presently understood, ARMISH/MAAG concludes that:

1) Iran has satisfactorily performed its obligation to maintain and utilize equipment that has been delivered and has developed and applied a markedly improved capacity in this regard.

2) The grant aid component is a vital element in the existing military relationship with Iran; scrupulous U.S. adherence to commitments of grant aid in the Memoranda have had and will continue to have an important, positive influence on Iran's determination to meet its commitments; and the grant aid program specified in the 1964 Memorandum and in the MAP programming supporting the Memorandum should, under no circumstances, be diluted or "slipped."

ARMISH/MAAG recommendations with regard to the \$200 million credit-sales program and the Iranian requests for additional equipment were forwarded to CINCPAC on February 29. These recommendations were concurred in by the

Country Team, subject to the findings of the economic review, and have been forwarded to the Department of Defense with CINCSTRIKE approval. (A copy of the ARMISH/MAAG paper, up-dated to include later information, is enclosure 1). The paper included ARMISH/MAAG findings on the military justification of the various items and the following recommendations are based on it:

3) Equipment valued at \$8,829,856 has been approved by State-Defense for inclusion in the \$200 million credit (Defense message 9997, April 29). This equipment consists of one Patrol Frigate, one Patrol Boat Kit for the Caspian, equipment for the AC and W site at Bandar Abbas, the two heavy Ground Control Approach facilities at Dezful and Hamadan, eighteen Command Post Armored Personnel Carriers and radio test equipment.

There is a justified military requirement for the following equipment, valued at \$17,000,000, which should also be approved for inclusion within the \$200 million credit: Additional Communications and Electronic Equipment (Tactical) - \$3.8 million; Communications and Electronic Equipment (Fixed Facilities) - \$9.4 million; Engineering Equipment - \$2 million; Production Equipment for the Armament Department - \$1.8 million.

4) The requirement for a 60-day war reserve of ammunition exists and no valid military arguments can be advanced against it. The Shah has insisted on the need for a 90-day reserve and is most unlikely to be convinced that he should not have at least a 60-day reserve. He is almost certainly aware that we would be unable to give him any kind of meaningful assurance that the United States could and would set down in Iran the additional ammunition in the event he considered a crisis situation to have arisen. Therefore, we should agree to provide this reserve on a phased basis and to assist him to obtain the additional necessary credit on a basis similar to that of the \$200 million credit.

5) The second tranche of the \$200 million credit - expanded to accommodate the 60-day reserve - should be negotiated as early in July, 1965 as possible. This tranche should amount to \$89,076,264 and include the items in Para 3) and 4) above plus four C-130 aircraft, 75 M-60A1 tanks, 163 M113A1 Armored Personnel Carriers and 1610 M1919A6 Machine Guns - items specified in the Memorandum. A recapitulation of the second tranche with anticipated delivery dates is Enclosure 2.

ARMISH/MAAG has carefully inspected and reviewed the preparations of Iranian Armed Force (IIF) facilities, the organization of IIF units, the training of IIF personnel and IIF performance to date in the receipt and use of similar material and considers that the IIF can receive, utilize and maintain this equipment satisfactorily. Furthermore, the anticipated delivery schedules are necessary if the IIF is to meet the planned modernization and improvement programs it has worked out to implement the Memorandum. In the cases of the C-130's, the Armored Personnel Carriers (both standard and command post) the machine guns and the radio test equipment, earliest possible scheduling of their delivery

is an urgent matter, as they have already "slipped" past delivery dates hoped for and anticipated by Iran. Anticipated lead times, indicated in the enclosure, necessitate the inclusion of the other items.

6) There are valid military grounds for postponing discussion of the major items on the Iranian list - higher performance aircraft, reconnaissance tanks, a second Hawk battalion and AC and W equipment for two gap-filler sites between Bandar Abbas and Dezful. The ARMISH/MAAG paper originally had recommended deferral of such discussion until the 1966 annual review. Since February, it has become evident that the Shah is intensely interested in discussing these very items and that he will not accept easily a U.S. position that they should not be talked about until the IIF has demonstrated its capability to absorb equipment it is now scheduled to receive. ARMISH/MAAG does not recommend that Iranian acquisition of these items be discussed in this review - but does consider that we will need to communicate to the Shah some indication that we will be prepared to discuss at a later date Iranian acquisition of similar equipment. A forthcoming exposition of current and projected development (technical and price) and deployment of the aircraft (F-4 and F-111) and of the Sheridan tanks would also be helpful in this regard.

7) The Bull-Pup missile should be disapproved for Iran at this time, as other weapons Iran has or will acquire will serve the purpose of securing the Persian Gulf against hostile naval craft.

8) An increase in the agreed personnel ceiling of the IIF from 160,000 to 172,000 ^{should} be authorized. ARMISH/MAAG points out that the IIF on 1 March 1965 met its commitment under the September, 1962 Memorandum to reduce the overall military force of the IIF to 160,000 within the three years - and that the increased ceiling is not a cover-up for failure to meet that commitment. The entire Table of Organization and Equipment and Table of Distribution of the IIF have been carefully reviewed and existing units scaled down as much as possible to meet the need for additional personnel to man the new equipment to be delivered under the Memorandum of July 1964 but not allowed for in that Memorandum.

The IIF considers that a strength of approximately 180,000 Military Personnel more clearly represents their full TOE/TD requirements. Lacking a manpower survey capability it is impossible to present a valid basis for proposing or requiring additional arbitrary reductions in existing IIF Units to obtain needed manpower to fulfill all modernization requirements. However, on the basis of our experience, and knowledge of the necessary lead time and ability of the IIF to train the manpower required for new equipment, the IIF has accepted an ARMISH/MAAG proposed ceiling of 172,000 military personnel for the IIF. ARMISH/MAAG concludes that modernization requirements cannot be met with fewer than 172,000 personnel. Under an IIF proposed Five Year Personnel Plan, the 172,000 ceiling will be achieved within the time frame 1965 - 1969, inclusive, approximately as follows:

<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>
166,239	169,156	170,886	171,900	172,000

The Economic Review1. Strategy

As part of the annual review we gave to the GOI on February 17 a list of questions (Emb A-443, A-451) on which the GOI might base the economic projections necessary to the review.

It might be useful to outline here the purposes of the economic portion of this exercise and what we think might be achieved by it.

Since the downgrading of the Plan Organization in 1962, the Iranian Government has not made any detailed analysis of its problem of allocation of financial resources among their several competing uses. The Shah, believing that his government would in the future receive ever-increasing oil revenues, saw no need for such an analysis and his economic advisors were reluctant to try to persuade him that he should take a more careful look at the relationship of his military, economic development and social reform programs. Many of Iran's leading economists who had fought and lost a battle on the same ground in 1962 had left Iran. Those that remained were mostly in the Central Bank and hence less strategically placed than they had been previously in the Plan Organization and the Ministry of Finance and were scarred by the battle they had lost three years earlier.

The requirement in the July 4 Memorandum that an economic study be done gave us an opportunity to focus the Shah's attention on his resources allocation problem and in so doing to assist his economic advisors in their efforts to do the same thing. As the Central Bank has a major share of the economic expertise in the government, it was no accident but certainly helpful that the Prime Minister turned to the Bank for assistance in making the projections we had suggested. For the first time since 1962 it thereby became possible to initiate a dialogue between the Shah and his more able economic advisors on some of the fundamental questions affecting the future of the Iranian economy. Already, therefore, the July 4 Understanding has been instrumental in forcing a degree of progress in an area of vital importance to long-term U.S. objectives in Iran.

It is essential, however, not to overstate this point. On the basis of the evidence we have so far, it is too early to say that the kind of dialogue we would like has in fact been established. As can be seen from the Shah's recent remarks to the Secretary (SECTO 26) and to me (Embtel 204), he remains convinced that he has adequate financial resources to meet all his objectives in the military, economic and social fields. It will be necessary for us to nurse the situation along with great care. We will want constantly to attempt on one hand to make the Shah more clearly aware of the magnitude of the resources required to achieve his economic development and social reform programs. On the other hand we will want to avoid giving the Shah the impression that we are trying to insert our presence too far into his internal affairs and to avoid pressing the Central Bankers so far out in front in the battle that their necks get chopped off in the process.

It is helpful to our strategy that the magnitude of the additional military funding being discussed in this first annual review serves to reduce the dimensions of our economic concerns, and it appears that not before the second annual (1966) review will we and the Iranians have to face up to major economic questions related to the Shah's request for new and expensive military equipment. We, therefore, have at least another year of time in which to attempt to focus the attention of the Shah on the economic side of his problem.

2. The Central Bank's Figures

The Central Bank's projections, as was reported in Embtel 1113, consist of 17 detailed tables which were handed to us by Governor Samii on April 10. Before being given to us, they had been discussed with the Shah and the Prime Minister, but there was apparently no coordination in their preparation with other economic agencies of the GOI. Subsequently, the Ministers of Agriculture and of Economy and the Managing Director of the Plan Organization were given copies by the Central Bank.

Of the 17 tables, 11 are strictly germane to the requirements of the July 4 Memorandum, and these 11 are in Enclosure 3. Our comments on these projections are given below and in Enclosure 4.

It must be stressed that these tables are projections which raise problems without suggesting policies to meet the problems. The position of the Central Bank is that policy matters must be decided by the government and that the Central Bank's job is only to show what problems must be addressed by the policy makers.

In the light of this position of the Central Bank, we have not engaged the Central Bankers in any discussion of the policy implications of their projections. After receiving and studying them, however, Embassy and USAID officers had one long meeting with the Bank's economists to clarify some of the figures in the tables. We noted the absence in the tables of certain figures, notably debt repayment figures for the Ministry of War. We, therefore, returned to Governor Samii and requested additional data from him. He, apparently, had some difficulty obtaining the figures and had conversations with the Shah and the Ministry of War during the course of trying to meet our request. He gave us the additional figures on May 5, and we have adjusted the enclosed tables to include the additional information.

The principal policy question which arises from the projections derives from the fact that they show a sizable shortfall in budgetary resources required to meet the targets for public sector investment. The projections are silent with respect to the source of private saving to finance the private sector's investment. It is total investment, of course, which must be geared to meet growth-rate goals for the economy as a whole. On the other hand, the balance of payments projections are unrelated to the macro-economic projections. They do not contain any assumptions with respect to the budgetary shortfall or the possible effects of filling the gap on Iran's balance of payments.

As can be seen from Table 10, the deficit (gap) in the capital budget will, according to the Central Bank's projections rise from 21.6 billion rials (\$288 million) next year to a level of 40-48 billion rials (\$533-640 million) annually for the succeeding eight years. The Central Bank's budgetary projections which build up to this deficit are based upon a number of assumptions, which are listed in Enclosure 4 with our comments.

As is the case with all economic growth models, any indicated deficit in available resources flows directly from the underlying assumptions of the model. An evaluation of these assumptions is not relevant here since the object of the exercise this year is almost entirely to get the GOI to focus on the issue of resources allocation. In a similar manner, no useful purpose is served in discussing in this airgram potential measures for closing the indicated gap in budgetary resources. It is sufficient for our purposes at this time that the exercise was undertaken. We now have a vehicle for further discussions with the GOI and for promoting a dialogue between the economic and military components of the GOI.

With respect to the Balance of Payments projection, a similar situation prevails. While these projections are deficient in the sense that they were derived independently of the resource requirements projected in the macro-economic model, they still serve to point up certain issues and problems that are amenable to policy measures.

It will be recalled that the foreign exchange projections attached to A-661 of May 28, 1964 showed the possibility of a sizable drawdown of Iran's official reserves over the years beginning in 1345 (1966). An important factor in reaching this conclusion was the assumption that Plan Organization imports would have to be greatly increased in order to meet the goals of the development program. The Central Bank's attached projections show an increase in Plan imports substantially below our projections of a year ago, and apparently no effort has been made to relate Plan imports to the required level of the development program as indicated in Table 1.

It follows from these projections that if Plan imports have to be increased at a greater rate than that shown in the projections, so must foreign loan drawings if Iran's reserve position is not to deteriorate too far. Such an increase in foreign loan drawings would also assist in closing the gap in budgetary resources for the development program.

Iran can afford to borrow substantial additional funds from foreign sources in order to obtain the resources required for its developmental goals. The Central Bank's projections envisage borrowing at least \$150 million per year for this purpose. A recent IBRD report on the Iranian economic situation, dated March 30, 1965, states that, even taking into consideration the \$200 million U.S.-guaranteed military sales credit, if Iran should borrow an additional \$200 million per year for the next three years, the service on existing foreign debt as a percentage of estimate future gross foreign exchange receipts will rise to a peak of only 14 per cent in 1970. It is possible that the IBRD's figure

of \$200 million as compared with the Central Bank's \$150 million is related to a more favorable outlook on the terms of future loans than is held in the Central Bank. But the conclusion is, in any case, inescapable that Iran can borrow more without real damage to her credit rating.

In his recent conversations with the Secretary and with me, the Shah has referred to his ability to borrow an additional \$680 million even after the establishment and maintenance of the projected growth rates (6% to 1968, 8% thereafter). We have had some difficulty determining where he got that figure. In answer to our inquiries, Governor Samii stated that it is the difference between the projected foreign borrowings shown in Table 11 and the total of at least \$150 million per year which the Central Bank believes Iran can afford to borrow over the next ten years. In other words, it is the total of column 9 of Table 10. But, after taking into consideration the \$200 million U.S.-guaranteed military sales credit, this column adds up to only 30.9 billion rials or \$412 million. Moreover, the figures in this column represent amounts of additional foreign borrowing which are, in view of the Central Bank, desirable in order to attain the desired growth rates, and even after such additional borrowing, the Central Bank figures show a budgetary gap in terms of resources required for the development program.

The essential thing in this discussion is not the figure of additional borrowing which Iran might be able to afford. The key question is what the foreign loans are spent on. If the government intends to attempt to close a substantial portion of its budgetary gap with foreign loans in order to try to achieve its growth-rate goals, it will have to reserve for its development program the preponderant portion of its foreign borrowings. This is a key point which we will be making in future discussions with the Shah and his advisors, in addition to attempting to clarify and, if necessary, to correct the Shah's figures.

As far as the immediate policy questions are concerned, Iran's financial ability to proceed with a second tranche of the \$200 million credit and to undertake an additional debt burden of \$29.8 million to build up additional war reserves of ammunition cannot be questioned.

3. Findings of the Economic Review

A. As it is not clear whether or how the GOI intends to fill the gap in its budgetary resources or that the GOI has given the matter much thought, we believe it necessary to probe further in this area. A key related question, which must be put to the policy level of the government, is what effect measures to close the gap will have on Iran's balance of payments. I will soon be discussing these points with the Prime Minister and, on his return, with the Shah and shall keep the Department informed as the discussion proceeds.

B. As these discussions proceed, we will have to keep in mind two factors in the situation as they affect the relationship between Iran's economic situation and the Shah's request for additional military equipment. These are:

(a) Iran is creditworthy. In the words of the above-mentioned IERD report on Iran's economy: "Because of the rapid increase in oil revenues and because of the limited drawings on foreign sources and the considerable repayments in recent years, Iran's creditworthiness remains unquestionable." In the face of a report such as this, which the Shah and his advisors have read, it is impossible for us to question Iran's ability to borrow more from abroad. All we can do is to ask questions concerning the effect of Iran's borrowing for non-development programs on her economic growth rate.

(b) The Shah is determined to strengthen his security forces even if it becomes necessary to take resources from the economic development program. It would be most difficult for us to dissuade him from this course; apart from economic considerations of resource allocation, there may be non-economic reasons for concurring with the Shah's requests. Hopefully, we can utilize the annual reviews to get him to focus on the relationship of any military build-up to his economic programs and through this and other aspects of the review affect the timing and dimension of his military acquisitions. To enable us to exert a continuing influence in getting him to focus on the economic factor in his military program we will require a continued relationship with the Shah, sufficiently close to permit a useful dialogue - and, for our efforts to succeed, the Shah will have to establish and maintain a corresponding dialogue with his economic advisers.

C. The financial situation permits our proceeding with an amendment to the July 4 1964 Memorandum of Understanding which would increase the \$200 million credit by \$30 million to accommodate the Shah's request for an increase in his war reserve of ammunition to 60 days.

D. The financial situation also permits our proceeding with a second tranche in the amount of \$89.1 million.

Conclusions

The analyses and review set forth in the sections above lead the Country Team to the following conclusions:

1. The only request for additional equipment - above the \$200 million credit -- which is judged valid on military grounds is the increase in the war reserve of ammunition from 30 to 60 days, valued at \$29.8 million. There do not appear valid grounds for rejecting this request, and it would be appropriate to include it in the second tranche.

2. Politico-military considerations make it a matter of considerable urgency that we negotiate the second tranche of \$89,076,264 without delay and the economic review indicates that Iran can finance that tranche without undue financial strain.

3. In addition to the equipment already approved by State-Defense for inclusion within the \$200 million credit, communications and electronic equipment, engineering equipment, and production equipment for the Armament Department - estimated valuation \$17 million - can also be specified as falling within the credit.

4. Our commitment of grant MAP aid, specified in the July 4, 1964 Memorandum and subsequently programmed, should be scrupulously met. Even though Iran's own purchases of military equipment may rise, grant aid is a unique and key element in preserving the existing and valuable military and political relationship we enjoy with Iran.

5. An increase in the IIF personnel ceiling to a level necessary to man the additional equipment contained in the Memorandum was implicit in the decision to provide the equipment - and 12,000 additional spaces will be required to meet that need.

6. Discussion of the major additional items on the Shah's list should be postponed. This postponement will be difficult for the Shah to accept and it would be most useful and advisable for us to spell out in detail the reasons for such postponement and to communicate a willingness to discuss at least some of these items at some future date subject to certain provisos (satisfactory Iranian progress in absorbing currently scheduled equipment, reservations regarding availability of the equipment, and the results of later economic reviews).

7. The annual review procedure has already induced the Shah and the Government of Iran to make an improvement in its management techniques - by having the problem of military acquisitions raised in the context of relatively long-term and overall resource availabilities. This procedure has begun the introduction of GOI financial authorities into the decision-making process regarding military equipment and, for the Shah and the GOI, has sharpened the definition of the policy problems related to long-term resource allocation.

8. There still remains the task of persuading the Shah that this review procedure provides him with a valuable management tool and that only by using it can he be really aware of clearly defined alternatives available to him. This will, of necessity, involve a gradual process and an attempt to force the pace too rapidly would run substantial risk of his abandoning the entire procedure - there has been relevant past experience in this regard. A necessary component of this process will be the continuing dialogue we hope to establish with him concerning application of competent economic analysis to his decisions regarding future acquisitions of military equipment. One objective of our talks with him will be to establish and maintain a corresponding dialogue between him and his economic advisers.

9. Since the increases recommended are being kept relatively small on the basis of military considerations, and since the basic economic questions of resource allocation need not be addressed before next year's annual review, we need not at this point raise any fundamental political question about the size of the Shah's military program. It should be stated, however, that we are not proceeding on the assumption that it is politically wise or necessary to accord the Shah all the military hardware that his country can afford. It is entirely conceivable that at some time in the future we may have to decline, on political grounds, to go along with acquisitions that are both militarily sound and economically feasible.

Recommendations

The Country Team and I recommend:

1. That I be authorized to inform the Shah that

a. We are prepared to assist Iran to obtain an increase in the \$200 million credit to \$230 million in order to accommodate his request for an increase in his war reserve of ammunition to 60 days.

b. We will proceed to help to negotiate the second tranche credit in the amount of \$89.1 million to include the equipment listed in Enclosure 2 and this equipment will be delivered on dates which we then specify to him.

c. We agree to amend the Memorandum to authorize an increase in the personnel ceiling of the Iranian Armed Forces to 172,000.

d. We do not consider that a valid military requirement exists for the Bull-Pup missile.

2. That we be provided all available considerations which justify our reluctance to discuss at this time Iranian acquisition of higher performance aircraft, Sheridan tanks and a second Hawk battalion.

3. That I be authorized to say that we will be prepared to give sympathetic consideration to his request for Sheridan tanks and the second Hawk battalion during the 1966 annual review.

4. That I be authorized to tell him that although it is premature to discuss the matter now, we do not exclude a subsequent possibility of Iran's acquiring higher performance aircraft of some type, if he continues to consider that Iran needs them, and we will keep him informed regarding U.S. developments in this field.

Armin H. Meyer
American Ambassador

~~CONFIDENTIAL~~

Page 1 of Enclosure No. 1
A-590 from Tehran

20 February 1965
(Revised 6 May 1965)

ARMISH/LAAG Recommendations for the First Annual Review
of the Memorandum of Understanding
4 July 1964

1. The following items of equipment are expected to be raised by the GOI during the first annual review of the 4 July 1964 Memorandum of Understanding.

a. High Performance Interceptor Aircraft.

(1) There is a requirement for a MACH 2 all-weather interceptor.

(2) There is considerable doubt concerning the capability of the IIAF to maintain such a weapons system within the time frame of the 4 July Memorandum of Understanding. There is already slippage in the presently approved AC&W program, Hawk program and F-5 program.

(3) Some electronic gear could be eliminated. However, the airborne radar necessary for an all-weather intercept capability must be retained. This type of equipment is notoriously difficult to maintain. At the present time the IIAF is not able to adequately maintain the relatively simple radar ranging system of the A-4 Fire Control System in the F-86F.

(4) The cost of each interceptor squadron based on the available F-4C price inclusive of concurrent spares and ACE would be approximately \$41.25 million or an increase of \$30 million over one F-5 squadron. This does not include the cost of radar guided air-to-air missiles also required.

(5) The Shah is interested in the F-111 rather than the F-4C. Costs, availability date and whether the F-111 will become operational are not known at this time. If the F-111 becomes available a substantial increase in cost over the F-4C can be expected.

(6) Letter of Intent to Purchase and delivery schedule for the two (2) squadrons of F-5s have not been approved by the GOI. Information as to the latest date that Letter of Intent to Purchase can be submitted to the USAF for the production and delivery of the two (2) squadrons of F-5s within the time frame of the 4 July 1964 Memorandum of Understanding has been requested from USAF.

(7) Because of the high expected cost of the F-111 (or other selected aircraft) consideration should be given to replacing the two (2) squadrons of F-5s for one (1) squadron of modern interceptor aircraft.

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RECOMMENDATION: That the consideration of this item be deferred to the second annual review.

b. Second Hawk Squadron (battalion).

(1) A requirement for a second Hawk Squadron (battalion) is recognized.

(2) However, imposition of additional requirement for trainable electronic and mechanic personnel will jeopardize currently approved programs to prepare the IIAF to accept additional F-5 aircraft, C-130E aircraft, the AC&W system and the first Hawk Squadron (battalion).

(3) Insufficient capability currently exists for the IIAF to man new bases being activated in the near future.

(4) The cost of the second Hawk Squadron (battalion) is estimated at \$22.5 million which does not include costs for GSV support material and equipment or annual recurring costs.

RECOMMENDATION: That the United States indicate a willingness to give this item sympathetic consideration during the 1966 annual review should the 1965 economic review reflect an adequately favorable economic outlook; specifically subject to a favorable outlook in the 1966 economic portions of the review, satisfactory progress with the first Hawk unit program, and agreement upon price and availability.

c. Heavy GCA Facilities.

(1) A requirement for heavy GCA facilities is recognized.

(2) Shahrokhi and Vahdati air bases can be expected to operate under high density air traffic which will exceed the operating capability of the AN/TPN-12 GCA sets provided under the MA program.

(3) The one (1) AN/TPN-12 located at Vahdati and one (1) MAP programmed for Shahrokhi are considered adequate to meet GCA requirements at Mashed and Shiraz.

(4) The cost of the GCA facilities is estimated at \$600 thousand per copy or a total of \$1.2 million.

RECOMMENDATION: That the heavy GCA facilities be favorably considered.

d. AC&W System - Southern Iran.

(1) A requirement for an AC&W system for Southern Iran is recognized. This item is consistent with the USSTRICOM AC&W survey for Iran.

(2) Site survey has been approved under MAP for this item. Washington approval has been obtained for the purchase of the equipment by Iran subject to the availability of credits under the \$200 million credit arrangement.

(3) Gap-filler radars, additionally, have been recently introduced as a requirement by the Shah. The survey for gap-filler requirements was included in the approved MAP site survey program.

(4) The following costs are estimated for this project:

AC&W equipment - Bandar Abbas	\$1.64 million
AC&W equipment - gap-fillers	<u>3.28 million</u>
Total	\$4.92 million

Construction by the IIF of facilities,
installation and check-out of equip-
ment and training of personnel
(three sites)

\$12.60 million (50% rial
equiv.)

Total \$17.52 million

RECOMMENDATIONS: That: (a) The purchase of the AC&W equipment and construction of facilities at Bandar Abbas including communications tie-in be favorably considered.

(b) The gap-filler requirements be deferred until successful accomplishment of the initial installation.

e. Air-to-Surface Missile System.

(1) A requirement for an air-to-surface missile system is not recognized.

(2) There is an operational air-to-surface missile (AGM-12B with 250 pound conventional warhead) compatible with the F-5 aircraft in the USAF inventory. The F-5s programmed for Iran, although wired for the installation of the guidance system, do not include the guidance system designed for these missiles.

(3) Employment of in-country available 2.75 and 5.00 inch rockets or conventional bombs is capable of satisfying the expected needs of the IIAF.

(4) Cost of the AGM-12B missile is approximately \$9000 per copy. Cost of the system plus installation charges for the F-5s programmed are not known. Cost of the missile inventory required for WRM is estimated at \$900 thousand.

RECOMMENDATION: That an air-to-surface missile system not be favorably considered for Iran at this time.

f. Armored Reconnaissance Vehicles.

(1) A requirement for a suitable armored reconnaissance vehicle for the seven (7) armored cavalry battalions (126 vehicles plus 4 for training purposes) is recognized.

(2) The seven cavalry battalions are now equipped with the M-47 medium tank (49 tons) which lacks the mobility and operating range required for the performance of Armor Cavalry missions.

(3) The Sheridan tank, desired by the Shah, is expected to be a suitable replacement for the M-47 tank. However, the Sheridan tank is under development and not yet tested. It is not scheduled for issue to U.S. forces until approximately FY 1968. Part of its effectiveness is based on a Shillelagh missile system as the main armament which may not be compatible with the availability of trainable IIGF personnel to man such vehicles.

(4) The M-47 tank is still a good tank. It is considered adequate for the armored cavalry battalions pending availability of a suitable replacement. Sufficient ammunition and parts are available. Substantial 90 mm ammunition, now on hand, will become excess to Iran's needs when the M-47 tank is phased out.

(5) For planning purposes, the cost of the Sheridan tank has been established at \$419 thousand per copy (probably includes substantial R&D charges) inclusive of \$46 thousand CSP or a total cost for planning purposes for 130 tanks of \$54.5 million. A more realistic cost of this item can be determined later upon production.

RECOMMENDATION: That the United States indicate a willingness to give this item sympathetic consideration during the 1966 annual review should the 1966 economic review reflect an adequately favorable economic outlook; specifically subject to a favorable outlook in the 1966 economic portions of the review, satisfactory progress with the M-60 tank program, and agreement upon price and availability.

g. Military Vehicles.

(1) A requirement for additional vehicles to fill TO&E authorizations is recognized.

(2) A study is underway to determine the shortfall in vehicles based on TO&Es prepared and under preparation, vehicles on hand and vehicles to be delivered under the 19 September 1962 and 4 July 1964 Memorandum of Understanding.

(3) The study to date indicates that factors in addition to funding availability will significantly govern the increase of vehicles in IIF inventories over planned deliveries under MAP. These factors include but are not limited to:

(a) Expected inability of the IIF to provide and train the additional drivers in the foreseeable future.

(b) Limitations within the IIF to properly assimilate and maintain the vehicles on hand and those being delivered under MAP.

(c) Probability of re-imposing suspension orders on deliveries either under MAP, MAS, or both, were an overly ambitious vehicle program undertaken.

(4) The number of vehicles required to fill all TO&Es and estimated costs will not be known pending completion of the ongoing TO&E program.

RECOMMENDATION: That consideration to purchase additional vehicles under MAS be deferred to the second annual review.

h. M-577 Armored Command Post Vehicles.

(1) A requirement for 16 of these items is recognized.

(2) The greatly increased operating range and cross-country capability of the M-60A1 tank and M-113 armored personnel carrier make it essential that the command and control elements of these units have an equal mobility and operating range.

(3) The M-577 meets the foregoing requirement.

(4) Cost of the eighteen (18) M-577s is estimated at \$40 thousand per copy (includes CSP) or a total of \$720 thousand.

RECOMMENDATION: That the requirement for 18 M-577 Command Post Vehicles be favorably considered.

i. Communications and Electronics Equipment.

(1) A requirement for additional communications and electronic (C&E) equipment is recognized.

(2) "Additional communications and electronic equipment" is included as a commitment item under Annex A.

(3) \$14.75 million in C&E equipment has been provided to date under MAP. \$7.5 million is currently programmed through FY 1970. MAP cannot support additional requirements.

(4) The cost to provide the additional requirements for the tactical forces is estimated at \$4.3 million and fixed C&E facility projects at \$9.9 million or a total estimated cost of \$14.2 million.

RECOMMENDATION: That equipment to meet the communications and electronic requirements of the IIF as later refined be favorably considered in the first annual review, subject to the availability of foreign exchange.

j. Additional Engineer Equipment.

(1) A requirement for additional engineer equipment is recognized.

(2) Although "additional engineer equipment" is included as a commitment item under Annex A, MAP ceilings are not sufficient to cover total modernization requirements.

(3) Sufficient engineer equipment is included in the Fy 1965-1970 MA Program to eliminate all critical existing shortages and to replace obsolete equipment.

(4) A shortfall exists primarily in providing the engineer equipment generated with the activation of the 8th Armored Division.

(5) The cost of the additional equipment is estimated at \$2 million.

RECOMMENDATION: That the requirement for additional engineer equipment be favorably considered in the first annual review, subject to the availability of foreign exchange.

k. Second Security Battalion - IIN.

(1) A requirement for a second security battalion in the IIN is not recognized.

(2) The second battalion has been proposed to provide security guards for the Bandar Abbas base and associated facilities.

(3) The requirement for security of Navy installations under the current five year plan inclusive of Bandar Abbas can be met by increasing the strength of the present battalion (760 personnel) to a planned strength of 1,512, without establishment of an additional battalion headquarters.

(4) The personnel cost of the additional strength requirements is estimated at \$669 thousand (rial equiv) per annum.

RECOMMENDATION: That a second security battalion not be favorably considered.

l. Patrol Boats.

(1) A requirement for a patrolling capability in the Caspian Sea is recognized.

(2) Present planning provides for one PGM (95 foot) from savings that may be generated under the \$200 million credit arrangement. Construction by sections of these boats has been studied by the USN.

(3) Upon successful assembly of the prefabricated sections at the Caspian and successful test operations by the IIN, it is planned to furnish two (2) additional patrol boats under MAP.

(4) The cost of the patrol boat to be purchased is estimated at \$550 thousand.

RECOMMENDATION: That the purchase of one (1) patrol boat be favorably considered.

m. Production Equipment for the Armament Department.

(1) A requirement for increasing the production capability of the Armament Department is recognized.

(2) The requirement to increase WRM from 30 to 60 days applies equally to in-country production of ammunition.

(3) To provide and maintain WRM additional manufacturing equipment is required. A limited portion of this equipment (30 cal) may be available as surplus in U.S. inventories.

(4) The cost of increasing production capacity of the Armament Department to meet projected requirements is estimated at \$1.8 million.

RECOMMENDATION: That equipment to increase the production capacity of the Armament Department to required levels be favorably considered in the first annual review, subject to the availability of foreign exchange.

n. 60-day War Reserve Material (WRM).

(1) The requirement for an additional 30-day War Reserve over the present 30-day MAP committed War Reserve is recognized.

(2) The additional 30-day reserve should be the responsibility of the GOI. The substantial amounts of excess and obsolete ammunition now in-country should be eliminated prior to receipt of new deliveries to Iran.

(3) Introduction of the additional 30-day inventory in-country may be beyond the capacity of present storage facilities and require additional maintenance, tools, inspector and custodian personnel and an increased security capability.

(4) The cost of the 30-day increase exclusive of in-country produced items is estimated below:

Ground Force and Log- istical Command	\$21,059,000
Air Force	8,464,248
Navy	<u>309,000</u>
Total	<u>\$29,832,248</u>

RECOMMENDATION That this item be favorably considered during the first annual review for phased delivery in FY 1966-1969 subject to availability of required facilities, equipment, ordnance personnel and the availability of foreign exchange.

o. Personnel Requirements.

(1) The September 1962 Memorandum of Understanding established the mutually agreed ceiling as 160,000 military personnel in the IIF, the goal to be reached not later than September 1965. Accordingly, total military personnel have been reduced from about 200,000 to 162,471 as of 21 December 1964, and the Chief, SCS is being asked to agree to a program to meet the 160,000 ceiling commitment prior to any negotiations on a new ceiling. In addition, there are 7,500 IIF personnel on duty with other ministries and agencies and acting as Officers' orderlies. The Chief, SCS has agreed to have those non-effectives removed from the payroll of the Ministry of War or absorbed in the 160,000 ceiling.

(2) It was recognized during the negotiations leading to the signing of the 4 July 1964 Memorandum of Understanding that the additional equipment and units involved would require additional personnel. The Shah pointed this out personally and it was repeated to the State Department and Strike Command by the Embassy at the time.

(3) These requirements for additional personnel were generated specifically by the additional airborne battalion, the increased size of the new Armored Division as compared to the previous light infantry division, the augmentation of artillery units, the necessary creation of a Southern Area Command to provide decentralized command and control in that important sector, the Hawk Squadron (battalion), expansion of the air defense system, a special air mission squadron to handle additional command liaison aircraft, two more patrol frigates for the Persian Gulf and three patrol craft for the Caspian Sea, increasing the size of the naval security battalion in the Persian Gulf because of added security requirements, and a reasonable build-up of logistical elements to provide support for this additional equipment and personnel.

(4) ARMISH/MAAG unilateral studies based on the introduction of new organizations in the IIF or augmentation to existing elements set forth in paragraph (3) above, have indicated that the ceiling should be increased from 160,000 to 172,000 to provide the required personnel and that this increase should be phased over a five year period with 6,239 in 1965 (1344), 2,917 in 1966 (1345), 1,730 in 1967 (1346), 1,114 in 1968 (1347), 0 in 1969 (1348). The requirements in the first years are the greatest because of the lead time required to train the personnel before the arrival of the equipment based on anticipated delivery schedules.

(5) IIF unilateral studies have indicated additional requirements which we believe fall in the nice to have but not absolutely necessary category. Additionally, the IIF has great difficulty in obtaining qualified officers and NCOs as illustrated by the fact that even under the present ceiling, the IIF is short 2,000 officers and 20,000 NCOs. The NCO shortages are filled by conscripts who hinder rather than help in the modernization process.

(6) The in-country personnel cost over the present authorized ceiling of the IIF for the 1344 of 6,239 is estimated at \$889 per person or \$5.5 million.

RECOMMENDATIONS: (a) That the U.S. negotiating position be that 12,000 additional spaces can be justified over the next five years with 6,239 military spaces to be added in 1965 (1344).

(b) That these spaces be filled only by qualified officers and NCOs and that the requirement for conscripts be reduced accordingly.

(c) That the matter of personnel requirements be included in each of the annual reviews required by the 4 July 1964 Memorandum of Understanding and the yearly ceiling adjusted in accordance with demonstrated ability of the IIF to procure and train additional qualified officers and NCOs and the actual needs of the services.

2. Estimated known costs of the foregoing items, recommended for consideration and recommended to be deferred separately, keyed to the foregoing paragraph numbers, are recapitulated below:

<u>Recommended for Consideration</u> <u>During First Annual Review</u>	<u>Total</u> <u>Foreign Exchange</u>	<u>In-country Rial</u> <u>Costs (in dollars)</u>
c. 2 Heavy GCA Facilities	\$ 1,200,000	
d. AC&W System - Southern Iran	1,640,000	\$ 4,200,000
h. M-577 Armored Command Post Vehicles	720,000	
i. Additional Communications and Electronics Equipment (Tactical)	3,800,000	

	<u>Total Foreign Exchange</u>	<u>In-Country Rial Costs (in dollars)</u>
Communications and Electronics Equipment (Fixed Facility Projects)	\$ 9,400,000	
j. Additional Engineer Equipment	2,000,000	
k. Personnel Augmentation of IIN Security Battalion		669,000
l. PGM Kit (Caspian)	550,000	
m. Production Equipment for the Armament Department	1,800,000	
n. 60-day War Reserve Material (WEM)	29,832,248	
o. Personnel Costs (Ceiling Increase)		5,500,000 (1344 FY65)
Total	<u>\$50,942,248</u>	<u>\$10,369,000</u>
<u>Recommended for Deferral to Second Annual Review</u>		
a. High Performance Aircraft (One Squadron)	\$41,250,000	
b. Second Hawk Squadron (battalion)	22,500,000	
d. AC&W System - Gap-fillers Southern Iran	7,480,000	\$4,200,000
e. Air-to-Surface Missile System (missiles only)	900,000	
f. Armored Reconnaissance Vehicles	54,500,000	
g. Military Vehicles	<u>Unknown</u>	<u> </u>
TOTAL	<u>\$126,630,000</u>	<u>\$4,200,000</u>
Total Estimated Known Cost of all Foregoing Items	<u>\$177,572,248</u>	<u>\$12,469,000</u>

\$200 MILLION CREDIT ARRANGEMENT STATUS

6 May 1965

Total Credit Arrangement	<u>\$200,000,000</u>
Line <u>No.</u>	
1. 176 M-60A1 Tanks with 4 Tank Transporters	\$ 35,462,200
2. 4 C-130E Aircraft	10,325,316
3. M-60A1 Tank Ammo, Tools and Training Devices	985,631
4. M-60A1 Tank Ammo, Tools and Training Devices	2,161,590
5. M-60A1 Tank Tools	15,938
6. Total First Package	<u>(\$ 48,950,675)</u>
<u>Actions Pending</u>	
7. 4 C-130E Aircraft	10,753,416
8. 163 APCs	7,170,978
9. 1610 M-1919A6 MGs	489,766
10. Radio Test Equipment	219,856
11. 284 M-60A1 Tanks	56,849,579
12. 1 Patrol Frigate	4,500,000
13. 1 Hawk Squadron (battalion)	22,450,611
14. 1 PCM (Patrol Boat)	550,000
15. 26 F-5 Aircraft	27,107,000
16. AC&W System - Bandar Abbas	1,640,000
17. 2 Heavy GCA Radars	1,200,000
18. 18 APC (Command Post)	720,000
19. Additional Communications and Electronic Equipment (Tactical)	3,800,000
20. Communications and Electronics Equipment (Fixed Facility Projects)	9,400,000
21. Additional Engineering Equipment	2,000,000
22. Production Equipment for the Armament Department	<u>1,800,000</u>
Total Actions Pending	\$150,651,206
Total List within the \$200 Million Credit	\$199,601,881
23. Not included within the \$200 million credit and necessitating additional credit: Increase to 60 days War Reserve of Ammunition	\$ 29,832,248

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PROPOSED SECOND TRANCHE
4 July 1964 Memorandum of Understanding
\$200 Million Credit Arrangement

Page 1 of Enclosure No. 2
A-590 from Tehran

6 May 1965

	FY 1966		FY 1967		FY 1968		TOTAL		
	<u>No.</u>	<u>Del Date</u>	<u>Amount</u>	<u>No.</u>	<u>Del Date</u>	<u>Amount</u>	<u>No.</u>	<u>Amount</u>	<u>REMARKS</u>
1. 4 C-130E Aircraft				(1Jul66) (1Aug66) (1Sep66) 4 (1Oct66)		\$10,753,416	4	\$10,753,416	12-15 mos. lead time
2. M-60A1 Radio Test Equipment	(Jul65)		\$219,856					219,856	
3. 75 M60A1 Tanks				75 (39Jan67) (36Jun67)		15,000,000	75	15,000,000	12 mos. lead time
4. 163 Armored Personnel Carriers	163(Aug & Sep65)		7,170,978				163	7,170,978	Delivery dates indicated reflect delivery schedule of Letter of Intent
5. 18 APC (Cmd Post)	18(18Sep65)		720,000				18	720,000	
6. 1610 M1919A6 MG	1610(1610Sep65)		489,766				1610	489,766	
7. AC&W System-So Iran				(May67)		1,640,000		1,640,000	24 mos. lead time
8. 2 Heavy GCA Facilities				2(May67)		1,200,000	2	1,200,000	24 mos. lead time
9. 1 Patrol Frigate					1 (Oct67)	\$4,500,000	1	4,500,000	36 mos. lead time
10. 1 PGM (Prefab Patrol Craft)	1(Dec65)		550,000				1	550,000	8 mos. lead time
11. Additional Communications & Electronic Eqp. (Tactical)	(Jun66)		2,150,000	(Jun67)		2,150,000		4,300,000	12-24 mos. lead time
12. C&E Eqp (Fixed facility Projects)	(Jun 66)		4,950,000	(Jun67)		4,950,000		9,900,000	12-24 mos. lead time

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Page 2 of Enclosure No. 2
A-590 from Tehran

	FY 1966		FY 1967		FY 1968		TOTAL		REMARKS
	<u>No.</u>	<u>Del Date</u>	<u>Amount</u>	<u>No.</u>	<u>Del Date</u>	<u>Amount</u>	<u>No.</u>	<u>Amount</u>	
13. Add									
Additional Engineer									
Equipment	(Jun66)		\$1,000,000	(Jun67)		\$1,000,000		\$2,000,000	12-24 mos. lead time
14. War Reserve Ammo	(Jun 66)		10,000,000	(Jun67)		19,832,248		29,832,248	12-24 mos. lead time
15. Production Equipment									
for the Armament Dept.(Aug65)			1,800,000					1,800,000	
TOTAL			\$28,550,600			\$56,025,664		\$4,500,000	\$89,076,264

NOTE:

Line 2. Radio test equipment included owing to late identification of this item for inclusion within the present \$49 million credit ceiling (First Tranche) and essentially of prompt delivery of this equipment for use in connection with initial increment of M-60A1 tank radios.

Lines 5, 7 and 8. Items required on a priority basis. Items approved by DOD and USSTRICOM subject to availability of credits under the \$200 million credit arrangement.

Lines 11, 12, 13, 14 and 15. Represent additional items recommended for consideration during the First Annual Review.

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Economic Projections of the Central Bank of Iran April, 1965
Summary Notes

1. The figures which appear in the attached tables are based on a number of assumptions which are given as footnotes to respective tables.
2. All projections are shown at constant prices (1343=100).
3. All projections (except those relating to public investment, balance of payments and the proceeds of the internal sale of petroleum products) are based on 1344 budget estimates.
4. In computing the "resource gap," the "Special Accounts" and the receipts and payments of Government Agencies (except as they are reflected in the General Treasury Account) are assumed to have no net budgetary effect. It should be noted, however, that any investment expenditure other than those financed out of development budget by these agencies will undoubtedly increase, albeit not significantly, the projected rate of economic growth. This is also valid in the case of the oil sector.
5. In view of the assumption of price stability (1965-74), the projected rate of increase in credit and money supply is related to the assumed rate of growth of Gross National Product. Since the expansion of the bank credit will have to be modest (averaging around 7.5 per cent per year) and the need of private sector for bank credit very great, it seems reasonable to allocate the whole increase in bank credit to the private sector.
6. No attempt is made to examine the effects of alternative methods of financing the "resource gap" (Cf. Table 10) on the level of prices, balance of payments and the activity of the private sector. Nor is there any attempt to examine the merits of the alternative methods of financing the "resource gap."

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I. Basic Economic Data (Estimated)

Table 1
Constant Prices (1343)

Description	1964 (1343)	1965 (1344)	1966 (1345)	1967 (1346)	1968 (1347)	1969 (1348)	1970 (1349)	1971 (1350)	1972 (1351)	1973 (1352)	1974 (1353)
GNP (Billion Rls.) ⁽¹⁾	383.2	406.2	430.6	456.4	492.9	532.3	574.9	620.9	670.6	724.2	782.1
Population (Thousand persons) ⁽²⁾	23,095	23,673	24,264	24,871	25,493	26,130	26,783	27,453	28,139	28,843	29,564
Per capita Gross National Product	16,592	17,159	17,746	18,351	19,335	20,371	21,465	22,617	23,832	25,108	26,454
Total fixed investment ⁽³⁾ (Billion Rls.)	80.5	85.4	90.3	127.7	137.9	149.1	161.0	173.9	187.6	203.0	218.7
Public fixed investment ⁽⁴⁾ (Billion Rls.)	44.7	47.4	50.1	70.9	76.6	82.8	89.4	96.5	104.2	112.7	121.5
Current expenditures to maintain ⁽⁵⁾ fixed public investment (Billion Rls.)	8.9	9.5	10.0	14.2	15.3	16.5	17.9	19.3	20.8	22.5	24.3
Other capital expenditures ⁽⁶⁾ (Security, etc. - cf. Part II)	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Total public investment	55.3	58.6	61.8	86.8	93.6	101.1	109.0	117.6	126.7	136.9	147.5
Private fixed investment (Billion Rls.)	35.8	38.0	40.2	56.8	61.3	66.3	71.6	77.3	83.4	90.3	97.2

- (1) The annual rate of growth of GNP is assumed to be 6 per cent for 1965-67 (1344-46) and 3 per cent for 1968-74 (1347-53) in constant prices.
- (2) The annual rate of growth of population is assumed to be 2.5 per cent.
- (3) The capital-output ratio is assumed to be 3.5 to 1. Also the time lag between investment and output is assumed to be one year.
- (4) The breakdown of total investment into public and private sector is according to the ratio of Rls. 160 billion private or 44.5% for the private sector and 55.5% for the public sector - a ratio assumed in the Third Plan.
- (5) Current development expenditures to maintain new fixed public investment are assumed to be 20 per cent of the public fixed investment.

Table 1 (continued)

- (6) Capital outlay for defense and other miscellaneous items are assumed constant throughout 1964-73.

Note:

Accounts of the Public Agencies except for that part of their revenues and expenditures which are reflected in the General Treasury accounts, and the accounts of the Plan Organization are assumed to have no net budgetary effect. Therefore, any development expenditure out of the fund of these Public Agencies would be in addition to the total public investment estimated in the above table.

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II. Estimated Budgetary Data

Table 2
Revenues
(Millions of Rials)
Constant Prices (1343)

	1965 (1344)	1966 (1345)	1967 (1346)	1968 (1347)	1969 (1348)	1970 (1349)	1971 (1350)	1972 (1351)	1973 (1352)	1974 (1353)
1 - Direct Taxes ⁽¹⁾	6,665	7,064	7,487	8,086	8,733	9,431	10,185	11,000	11,880	12,830
2 - Indirect Taxes:-										
A) Customs ⁽²⁾	12,940	15,434	16,536	17,480	18,948	19,878	21,710	23,772	27,810	28,579
B) Petroleum ⁽³⁾	5,346	5,768	6,212	6,744	7,316	7,949	8,623	9,365	10,182	11,071
C) Others ⁽⁴⁾	2,542	2,695	2,856	3,085	3,331	3,598	3,886	4,197	4,532	4,895
3 - Monopolies:-										
A) Tobacco ⁽⁵⁾	2,963	3,037	3,113	3,207	3,302	3,401	3,504	3,609	3,717	3,829
B) Sugar ⁽⁶⁾	1,658	1,691	1,725	1,768	1,812	1,857	1,904	1,952	2,000	2,051
C) Tea ⁽⁷⁾	510	525	541	562	585	609	633	658	685	712
D) P.T.T. ⁽⁸⁾	1,203	1,299	1,403	1,543	1,698	1,868	2,054	2,260	2,486	2,734
E) Others ⁽⁹⁾	1,667	1,750	1,838	1,930	2,026	2,128	2,234	2,346	2,463	2,586
4 - Public services ⁽¹⁰⁾	1,606	1,702	1,805	1,949	2,105	2,273	2,455	2,652	2,864	3,094
5 - Miscellaneous ⁽¹¹⁾	1,094	1,148	1,205	1,255	1,328	1,394	1,464	1,537	1,613	1,694
6 - Oil Revenue ⁽¹²⁾	41,400	48,375	52,875	58,500	64,125	71,625	80,250	89,100	98,250	108,000
A) Treasury	12,787	12,787	10,575	8,775	6,412	3,585	-	-	-	-
B) Plan Organization	28,613	36,285	42,300	49,725	57,713	68,040	80,250	89,100	98,250	108,000
Total (excluding oil revenue)	38,194	42,113	44,721	47,617	51,184	54,295	58,652	63,348	70,232	74,074
7 - Miscellaneous income of Plan Organization ⁽¹³⁾	3.5	3.7	3.8	4.0	4.2	4.5	4.7	4.9	5.1	5.4

Table 2 (continued)

- (1) Estimated on the basis of the ratio of $\frac{(\text{direct taxes})}{\text{GNP}}$ in 1344 and 6 per cent annual increase throughout 1966-67 (1345-46) and 8 per cent throughout 1968-74 (1346-53).
- (2) Revenues from customs are estimated on the basis of the ratio of $\frac{(\text{customs})}{(\text{imports})}$ in 1344 and the application of this ratio to the estimated amount of imports (of Part III) throughout 1966-74 (1345-53).
- (3) cf. Table 4
- (4) Estimated on the assumption of 6 per cent annual increase for 1966-67 (1345-46) and 8 per cent annual increase for 1968-74 (1347-53).
- (5) Estimated on the basis of the 1344 Budget and increasing 2.5 per cent (calculated on the basis of the income coefficient for tobacco) annually for 1965-68 (1344-46) and 3 per cent annual increase for 1968-74 (1347-53).
- (6) Estimated on the basis of the 1344 Budget and increasing 2 per cent (calculated on the basis of the income coefficient for sugar) annually for 1966-67 (1345-46) and 2.5 per cent annual increase for 1968-74 (1347-53).
- (7) Estimated on the basis of the 1344 Budget and increasing 3 per cent (calculated on the basis of the income coefficient for tea) annually for 1966-67 (1345-46) and 4 per cent annual increase for 1968-74 (1347-53).
- (8) The figure in the 1344 Budget is assumed to increase at 8 per cent annually for 1966-67 (1345-46) and to rise 10 per cent annually for 1968-74 (1347-53).
- (9) The 1344 Budget figure is assumed to increase 5 per cent annually throughout 1966-74 (1345-53).
- (10) Government services are assumed to increase 6 per cent annually for 1966-67 (1345-46) and 8 per cent annually for 1968-74 (1347-53).
- (11) The figure in the 1344 Budget is assumed to increase 5 per cent annually throughout 1965-74 (1345-53).
- (12) cf. Table 3
- (13) It includes the share of Plan Organization in the surtax on gasoline (cf. Table 4). Other incomes are assumed to rise 5 per cent annually.

II. Estimated Budgetary Data (continued)

Table 3
Oil Revenue
(Million Dollars)
(Million Rials)

	1964 (1343)	1965 (1344)	1966 (1345)	1967 (1346)	1968 (1347)	1969 (1348)	1970 (1349)	1971 (1350)	1972 (1351)	1973 (1352)	1974 (1353)
Oil Revenue M.D.	488	540	595	655	720	785	855	920	988	1,060	1,140
(Consortium) M.R.	36,600	40,500	44,625	59,125	54,000	58,875	64,125	69,000	74,100	79,500	85,500
Oil Revenue M.D.	5	12	50	50	60	70	100	150	200	250	300
(Other Companies) M.R.	375	900	3,750	3,750	4,500	5,250	7,500	11,250	15,000	16,750	22,500
Bonuses ⁽¹⁾ M.D.	185	-	-	-	-	-	-	-	-	-	-
M.R.	13,875	-	-	-	-	-	-	-	-	-	-
Total ⁽²⁾ M.D.	678	552	645	705	780	855	955	1,070	1,188	1,310	1,440
M.R.	50,850	41,400	48,375	52,875	58,500	64,125	71,625	80,250	89,100	98,250	108,000
Treasury ⁽³⁾ M.D.	1,528	170.5	161.2	141	117	85.5	47.8	-	-	-	-
M.R.	11,460	12,787	12,090	10,575	8,775	6,412	3,585	-	-	-	-
Plan Organization M.D.	525.2	381.5	483.8	564	663	769.5	907.2	1,070	1,188	1,310	1,440
M.R.	39,390	28,613	36,285	42,300	49,725	57,713	68,040	80,250	89,100	98,250	108,000

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- (1) All bonus payments are allocated to Plan Organization.
- (2) Assumptions with respect to oil revenue (cf. Table 11).
- (3) Division of oil revenue between Treasury and Plan Organization is assumed to continue at the rate reflected in the Third Plan Law. However, through 1965 (1344) share of Plan Organization is calculated after deducting \$7 million (Rls. 525 million) on account of B.P.C. compensation. The respective shares of Treasury and Plan Organization are given below:-

	1343-44	1345	1346	1347	1348	1349	1350-53
Treasury	30%	25%	20%	15%	10%	5%	0%
Plan Organization	70%	75%	80%	85%	90%	95%	100%

Notes: M.D. = Million dollars; M.R. = Million rials

II. Estimated Budgetary Data (continued)

Table 4

Oil Revenue (share of the Treasury from the domestic sale proceeds of National Iranian Oil Company)⁽¹⁾
(Million Rials)
Constant Prices (1343)

	1965 (1344)	1966 (1345)	1967 (1346)	1968 (1347)	1969 (1348)	1970 (1349)	1971 (1350)	1972 (1351)	1973 (1352)	1974 (1353)
Gasoline	4,030	4,294	4,569	4,873	5,189	5,528	5,885	6,265	6,675	7,107
Kerosene	1,255	1,358	1,465	1,582	1,708	1,845	1,992	2,151	2,323	2,509
Gasoil ⁽²⁾	1,470	1,617	1,779	1,992	2,231	2,499	2,799	3,135	3,511	3,932
Fuel ⁽³⁾	38	40	43	47	50	54	59	64	69	74
Total	6,793	7,309	7,856	8,494	9,178	9,934	10,735	11,615	12,578	13,622
Treasury	5,346	5,768	6,216	6,744	7,316	7,949	8,623	9,365	10,182	11,071
Plan Organization ⁽⁴⁾	1,447	1,541	1,640	1,750	1,862	1,985	2,112	2,250	2,396	2,551

(1) The above figures are estimated before price changes in Azar 1343 (NIOC estimates).

(2) The Gasoil price is assumed to be uniform throughout the country.

(3) Increased tax on fuel has not been allocated to Plan Organization.

(4) The share of Plan Organization is calculated on the basis of 70% of Rle. 3 increase in tax on Gasoline. This percentage will be 70, 75, 80, 85 and 90 in 1965-66, 1967, 1968, 1969 and 1970-74 respectively.

II. Estimated Budgetary Data (continued)

Table 5

Oil Revenue (from Internal Sales and Export Proceeds - Table 3 and 4)
(Millions of Rials)

	1964 (1343) ⁽¹⁾	1965 (1344)	1966 (1345)	1967 (1346)	1968 (1347)	1969 (1348)	1970 (1349)	1971 (1350)	1972 (1351)	1973 (1352)	1974 (1353)
Treasury	11,460	18,133	17,858	16,791	15,519	13,728	11,534	8,623	9,365	10,182	11,071
Plan Organization	39,390	30,060	37,826	43,940	51,475	59,575	70,025	82,362	91,350	100,646	110,551
Total	50,850	48,193	55,684	60,731	66,994	73,303	81,559	90,985	100,715	110,828	121,622

(1) Figures for 1343 do not include internal sales. Bonus payment is, however, included.

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II. Estimated Budgetary Data (continued)

Table 6

Total Receipts of the Treasury and the Plan Organization
(Billion Rials)

Constant Prices (1343)

	Treasury Income (Other than oil) (1)	Oil (2) Revenue	Miscellaneous (3) Income of Plan Organization	Foreign (4) Loans	Total
1965 (1344)	38.2	41.4	3.5	8.8	91.9
1966 (1345)	42.1	48.4	3.7	10.4	104.6
1967 (1346)	44.7	52.9	3.8	14.0	115.4
1968 (1347)	47.6	58.5	4.0	14.9	125.0
1969 (1348)	51.2	64.1	4.2	9.7	129.2
1970 (1349)	54.2	71.6	4.5	6.0	136.3
1971 (1350)	58.6	80.2	4.7	6.0	149.5
1972 (1351)	63.3	89.1	4.9	6.0	163.3
1973 (1352)	70.2	98.2	5.1	6.0	179.5
1974 (1353)	74.1	108.0	5.4	6.0	194.0

(1) of. Table 2

(2) of. Table 3

(3) of. Table 2

(4) of. Table 11

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II. Estimated Budgetary Data (continued)

(2) Security Expenditures

(a) Ministry of War

Table 7
(Million Rials)

	1965 (1344)	1966 (1345)	1967 (1346)	1968 (1347)	1969 (1348)	1970 (1349)	1971 (1350)	1972 (1351)	1973 (1352)	1974 (1353)
Current expenditures ⁽¹⁾	17,437	18,616	19,883	21,245	22,710	24,284	25,976	27,795	29,751	31,853
Foreign loan repayments ⁽²⁾	870	1,755	1,830	1,875	1,583	1,583	1,583	1,583	1,583	1,580
Capital expenditures ⁽³⁾	1,350	1,350	1,350	1,350	1,350	1,350	1,350	1,350	1,350	1,350
Total	19,657	21,721	23,063	24,470	25,643	27,217	28,909	30,728	32,684	34,783

(b) Other

Table 8
(Million Rials)

Current expenditures ⁽⁴⁾	5,860	6,212	6,585	6,980	7,399	7,843	8,314	8,813	9,342	9,903
Capital expenditures ⁽⁵⁾	204	204	204	204	204	204	204	204	204	204
Total	6,064	6,416	6,789	7,184	7,603	8,047	8,518	9,017	9,546	10,107
Total (Tables 7 and 8)	25,721	28,137	29,852	31,654	33,246	35,264	37,427	39,745	42,230	44,890

(1) Except for Rls. 1,720 million expenditures for parts and other miscellaneous items (which are assumed constant throughout 1965-74), other current expenditures are assumed to increase 7.5 per cent annually.

(2) Repayment of the principal of the \$200 million U.S.-guaranteed credit is estimated as follows:

(a) Repayment (advance repayment) of \$3 million in 1343.

(b) Repayment of \$7.5 million (including 0.5 million dollars interest) in 1344.

(c) The repayment of the remaining \$190 million is equally divided over 1966-74.

Tables 7 and 8 (continued)

Repayment of the interest on the \$200 million U.S.-guaranteed credit at 5 per cent is calculated on the respective amount utilized each year. The amount of the utilization of the above credit is as follows:

- (a) 1965 - \$67 million
- (b) 1966 - \$8 million
- (c) 1967 - \$46 million
- (d) 1968 - \$79 million

However, the repayment of \$3.4 million interest on \$67 million to be utilized in 1965 is divided as follows:

- (a) 1965 - \$0.5 million
- (b) 1966 - \$1.9 million
- (c) 1967 - \$1.0 million.

- (3) Capital expenditures are assumed to remain constant throughout 1965-74.
- (4) Current expenditures are assumed to increase 6.0 per cent annually.
- (5) Capital expenditures are assumed to remain constant throughout 1965-74.

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II. Estimated Budgetary Data (continued)

Table 9

Total Current Expenditure and Foreign Debt Repayment
of the Treasury and Plan Organization in 1965-1974
(1344-1353)

(Billion Rials)
Constant Prices (1343)

	TREASURY						PLAN ORGANIZATION		
	General ⁽¹⁾ Administrative Expenditure of Treasury	Expenditure ⁽²⁾ on Security	Outlay ⁽³⁾ on Social Affairs	Outlay ⁽⁴⁾ on Economic Affairs	Other ⁽⁵⁾ Disbursements	Total	Current ⁽⁶⁾ Administrative Outlay	Repayment ⁽⁷⁾ of Foreign Loans (principal and interest)	Total
1965 (1344)	7.4	25.7	17.8	5.7	2.2	58.8	0.5	4.6	63.9
1966 (1345)	8.0	28.1	18.2	5.9	2.3	62.5	0.6	4.9	68.0
1967 (1346)	8.6	29.9	18.5	6.0	2.5	65.5	0.6	5.4	71.5
1968 (1347)	9.2	31.7	18.9	6.9	2.7	69.4	0.6	6.4	76.4
1969 (1348)	9.9	33.2	19.3	6.2	2.9	71.5	0.6	6.6	78
1970 (1349)	10.7	35.3	19.7	6.3	3.1	75.1	0.6	8.1	83.8
1971 (1350)	11.5	37.4	20.0	6.5	3.3	78.7	0.6	8.7	88.0
1972 (1351)	12.3	39.7	20.5	6.6	3.6	82.7	0.6	9.3	92.6
1973 (1352)	13.3	42.2	20.9	6.7	3.8	86.9	0.6	9.6	97.1
1974 (1353)	14.3	44.9	21.3	6.9	4.1	91.5	0.6	9.7	101.8

- (1) It is assumed to increase 7.5 per cent annually throughout 1966-74 (1345-53).
- (2) cf. Tables 7 and 8. It includes capital outlay and debt repayments.
- (3) It is assumed to increase 2 per cent annually throughout 1966-74 (1345-53).

Table 9 (continued)

- (4) It is assumed to increase 2 per cent annually throughout 1966-74 (1345-53).
- (5) It is assumed to increase 7.5 per cent annually throughout 1966-74 (1345-53).
- (6) It is assumed to increase by 2 per cent annually throughout 1966-74 (1345-53).
- (7) of Table 11.

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II. Estimated Budgetary Data (continued)

Table 10

Deficit in the Capital Budget and the Way to Finance It.
(Billion Rials)

	Total Saving						Financing of the Resources Gap ⁽⁶⁾			
	Fixed ⁽¹⁾	Current ⁽²⁾	Total	Receipts ⁽³⁾	Current ⁽⁴⁾	Difference ⁽⁴⁻⁵⁾	Deficit ⁽⁵⁾ (3-6)	Net Increase in	Additional	Remaining
	Investment	Development Outlay			Expenditure			Treasury Bills and Bonds (a)	Foreign Loans (b)	
	1	2	3	4	5	6	7	8	9	10
1965 (1344)	47.4	(-)	47.4	91.9	63.9	28.0	19.4 ⁽⁷⁾	1.0	2.5	15.9
1966 (1345)	50.1	10.0	60.1	104.6	68.0	36.6	23.5	1.0	0.9	21.6
1967 (1346)	70.9	14.2	85.1	115.4	71.5	43.9	41.2	1.0	-	40.2
1968 (1347)	76.6	15.3	91.9	125.0	76.4	48.6	43.3	1.0	-	42.3
1969 (1348)	82.8	16.6	99.4	129.2	78.7	50.5	48.9	1.5	1.5	45.9
1970 (1349)	89.4	17.9	107.3	136.3	83.8	52.5	54.8	1.5	5.2	48.1
1971 (1350)	96.6	19.3	115.9	149.5	88.0	61.5	54.4	2.0	5.2	47.2
1972 (1351)	104.2	20.8	125.0	163.3	92.6	70.7	54.3	2.0	5.2	47.1
1973 (1352)	112.7	22.5	135.2	179.5	97.1	82.4	52.8	2.0	5.2	45.6
1974 (1353)	121.5	24.3	145.8	194.0	101.8	92.2	53.6	2.0	5.2	46.4
Totals:									30.9	400.3

(1) cf. Table 1

(2) cf. Table 1. Rls. 7 billion current development outlay is budgeted for in the Treasury expenditure budget for 1965 (1344).

(3) cf. Table 6

(4) cf. Table 9

(5) Deficit given in column 7 is the difference between the total development expenditure presented in column 3 and total public saving at the existing level of taxes and foreign borrowing at a modest scale (cf. column 6 of the above table).

Table 10 (continued)

- (6) Financing of the Resource Gap:
- (a) Net increase in Treasury Bills and Bonds (totaling Rls. 15 billion during 1965-74 (1344-53) (cf. column 8).
 - (b) Additional foreign borrowing. This item is calculated on the bases of principal and amortization payment of Iran's foreign debt which is to be within the limit of 8 per cent of foreign exchange earning (cf. Table 11). (Embassy Note: This column anticipates annual foreign borrowing of at least \$150 million.)
 - (c) The last column presents the extent of the remaining deficit. It should be noted, however, that the above table assumes no increase in advances of the Bank Markazi Iran to the Treasury and the Plan Organization. Exception to this is the finance provided for Tehran Refinery and the pipeline by the Bank Markazi Iran.
- (7) The reconciliation of this figure with the budget figure for 1344 can be summarized as follows:
- | | |
|--|------------------|
| (1) Drawings on oil bonus deposit (given in the budget) | Rls. 7.1 billion |
| (2) Bank Markazi Loan for Tehran Refinery | 4.7 |
| (3) Additional foreign borrowing and Treasury Bills given in 1344 Development Budget | 6.7 |
| (4) The difference between the development outlay presented here and the actual budget | 3.9 |
| (5) Budgetary Deficit in the General Treasury Account as adjusted for Ministry of War foreign loan drawings and repayments | -3.0 |
| Total | 19.4 |

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III. Balance of Payments Data

Table 11

PROJECTION OF FOREIGN EXCHANGE RECEIPTS AND PAYMENTS *
Years 1344 - 1353 (years ending March 1966 - 1975)
(In Million Dollars)

	1343 (latest estimate)	1344	1345	1346	1347	1348	1349	1350	1351	1352	1353
A. Imports of goods and services											
1. Private, (goods only)	-540	-560	- 600	- 640	- 690	- 745	- 805	- 870	- 940	-1015	-1100
2. Plan Organization	- 26	- 50	- 70	- 80	- 90	- 100	- 120	- 145	- 175	- 210	- 250
3. NIOC	- 26	- 30	- 33	- 36	- 40	- 44	- 47	- 52	- 55	- 60	- 65
4. Other government ⁽¹⁾	- 88	-100	- 180	- 190	- 180	- 195	- 160	- 175	- 190	- 210	- 230
(a) Including military imports except from \$200 million credit	(?)	(-31)	(-34)	(-38)	(-41)	(-45)	(-50)	(-55)	(-60)	(-66)	(-73)
5. Imports under \$200 million credit	-	- 67	- 8	- 46	- 79	-	-	-	-	-	-
B. Other current payments (private services)	- 45	- 45	- 50	- 55	- 60	- 66	- 72	- 79	- 87	- 96	- 105
C. Receipts from commercial exports	90	95	105	115	126	139	153	168	185	200	220
D. Oil Sector:											
1. Income from the Oil Consortium	488	540	595	655	720	785	855	920	988	1060	1140
2. Rial purchases by the Oil Consortium	80	67	70	75	77	81	85	89	93	98	103
3. Income from other oil companies ⁽²⁾	190	12	50	50	60	70	100	150	200	250	300
4. Rial purchases from other oil companies	12	10	20	20	25	25	25	30	30	30	35
5. NIOC investment expenditure	-	- 6	- 6	- 6	- 6	-	-	-	-	-	-
E. Other current receipts (services)	45	47	50	52	55	57	60	63	66	69	72
F. Drawings of official foreign loans											
1. Steel mill	-	-	70	70	50	50	-	-	-	-	-
2. \$200 Million Military Sales Credit	-	67	8	46	79	-	-	-	-	-	-
3. Other	8	50	60	70	70	80	80	80	80	80	80
G. Principal and interest payments on official loans:											
1. Old loans	- 85	- 57	- 49	- 40	- 38	- 36	- 35	- 35	- 32	- 30	- 28

CONFIDENTIAL

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Table 11 (continued)

	1343 (latest estimate)	1344	1345	1346	1347	1348	1349	1350	1351	1352	1353
2. \$200 Million Military Sales Credit	-	12	23	24	25	21	21	21	21	21	21
3. New loans	-	-	14	30	46	51	70	79	90	95	100
H. Note issue requirements	0	14	15	16	18	19	20	22	23	25	26
I. Movement of gold and foreign exchange reserves (increase +)	103	53	20	12	10	10	8	22	29	25	25

(1) Includes steel mill project

(2) Includes 3185 million bonus in 1343

* Figures for the year 1343 are nearly actual and based on latest information. Figures for 1344-53 have been projected as described below. It has been assumed that the country will enjoy monetary stability over the period and that development plans will be carried out without disturbing the balance of payments.

A. Imports of goods and services

1. Private import of goods in 1344 have been estimated at the level of 1343. A 6 per cent rise for 1345 and 1346 and an 8 per cent increase for 1347-1353 have been allowed which corresponds to an import elasticity of one with respect to income.

2. Imports by the Plan Organization which were quite small in 1343, have been assumed to grow more rapidly in the remaining years of the Third Plan, and to rise by almost 10 per cent in the earlier years of the Fourth Plan and then grow by 20 per cent in 1349-1353.

3. NIOC imports are assumed to rise by 10 per cent annually.

4. Imports of other government agencies including expenditure of Ministry of War are assumed to grow by 10 per cent annually as from 1345. Expenditure for the construction of a steel mill (see F, 1) have been separately added to the 1345-48 figures.

B. Other current payments (invisibles) show a rise of 10 per cent as from 1345. The 1344 figure has been assumed to equal that for 1343.

C. Commercial exports which have so far enjoyed a modest increase (3 per cent annually over the last 7 years), are assumed to rise by 10 per cent as from 1345. The assumption takes into account potential export possibilities such as those for the products of petrochemical and other manufacturing industries which would be brought about by the rapid industrialization and diversification of Iran's economy during the next decade.

D. Oil Sector:

1. Income from the Consortium has been estimated to increase by 10 per cent in 1344-47, by 9 per cent in 1348-49 and 7.5 per cent in 1350-53.

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Table 11 (continued)

2. Rial purchases by the Consortium are assumed to increase by 5 per cent annually.
 3. Income from other oil companies are difficult to estimate at the present time when no basis for projection is available. This income is, however, estimated to grow more rapidly when exports from No. 1 Zone will start as from about 1349. Direct information on present SIRIP and IPAC activities have helped to make estimates for 1344-48.
- E. Other current receipts (invisibles) show an annual increase of 5 per cent.
- F. Apart from the loan for the steel mill project, the utilization of foreign official borrowings is a residual item. The figure for 1344 is estimated on the basis of recent trend as well as on the basis of other information. The country's capacity to absorb and repay foreign loans, which has been computed separately is higher than the figures inserted in the Table. However, the resource gap as presented at the concluding part of this report takes this factor into account while the additional foreign loan is not reflected in the balance of payments Table.
- G. Capital and interest repayments on old loans are shown as scheduled in the related loan agreements while those for new ones have been computed on the assumption that new loans will have average terms of 17 years at 3.9%.
- H. Under the present regulations, an issue of Rls. 1 billion notes requires almost \$5.5 million gold or foreign exchange cover. The figures shown in the Table are based on this requirement as well as on the need for new issue in each year.
- I. Foreign assets have risen by \$103 million in 1343 although the \$185 million oil bonus was received late in the year. It is estimated that free reserves will decline by \$53 million in 1344 should imports remain at the level of 1343. For the remaining years of the period a moderate rise in foreign holdings has been allowed which will strengthen national reserves to some extent. Free foreign assets (gold and exchange holdings) will presumably amount to \$236 million at the end of 1353 (compared with \$73 million at the beginning of 1343) while total foreign assets including note cover will amount to \$569 million.

Note: Transactions with the IIF are not included

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Country Team Comments on Central Bank Projections

1. General Comment

In almost every case, there is no statistical basis for the figures given in the base years. To the extent base figures are incorrectly estimated, all figures which follow from them are inaccurate.

2. Table 1

a. The assumptions of Table 1 include a GNP growth rate of 6 per cent for the remainder of the Third Plan (to March, 1968) and of 8 per cent for the Fourth Plan. The assumed rate for the Third Plan represents the announced goal for the plan. The assumed rate for the Fourth Plan is one the Central Bankers would like to see as a policy goal.

b. The assumption of a 2.5 per cent per year growth in population may be slightly low.

c. A capital-output ratio (the ratio of new fixed investment to the additional product it produces) of 3.5 to 1 appears reasonable but may also be somewhat low. It should be noted that the previously used ratio, in Third Plan documents, was 3 to 1, but in the light of subsequent experience a higher ratio appears more reasonable to the same economists who devised the Third Plan.

d. The amount of total fixed investment given in Table 1 is that required to maintain the desired growth rates of GNP. The starting GNP figure (383.2 billion rials for 1343) is in the upper range of current estimates.

e. The division of total fixed investment between public and private is on the same basis as in the original Third Plan Outline, namely on the ratio of 55.5/45.5. In the light of the low level of private investment in recent years, the ratio may understate the portion that has been and may in the future have to be borne by the public sector if the projected growth rates are to be achieved.

3. Tables 2 - 9

a. The assumptions concerning the revenue figures in Table 2 all seem reasonable to us with the possible exception of oil revenues which are discussed below. The starting points for most of the revenue figures are the estimates in the 1344 budget, and, again with the possible exception of oil, those estimates appear reasonable.

b. The oil revenue estimates in Tables 3, 4 and 5 are again "best judgments" of the Central Bank. Income from the Consortium is expected to increase annually by 10 per cent in 1344-47, by 9 per cent in 1348-9 and by 7.5 per cent in 1350-3.

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The Central Bank's figures are therefore somewhat lower in the later years than estimates earlier provided to Ambassador Holmes by the Prime Minister which showed a steady 10 per cent annual increase throughout the period under review. The Central Bank's projections may, however, be more realistic as other sources of supply than Iran may become available or be tapped far more within the next few years. The Central Bank's figures on income from companies other than the Consortium do not include future bonuses, which we expect will be paid. They do, however, suggest a significantly higher rate of increase in offtake from non-Consortium fields than we have seen projected elsewhere. On balance, therefore, the Central Bank's oil revenue projections appear to be well within the range of possibility.

c. The division of oil revenues between the Plan and the Treasury is projected by the Central Bank on the basis that the Plan will receive five per cent more of the total each year until it receives 100 per cent. This projection again reflects the hopes of the Bank's economists.

d. The projections of receipts from foreign loans to Iran given in Table 6 are based on the estimates given in Table 11 which in turn are based on recent trends.

e. The projections of increases in current expenditures of the security forces in Tables 7 and 8 have been provided by the security agencies themselves and are based on recent trends. The assumptions concerning repayment of the \$200 million U.S.-guaranteed military sales credit appear reasonable to us. The assumed rate of drawings of the \$200 million credit, however, differ from our estimates as follows: (\$ Million)

	<u>1343</u>	<u>1344</u>	<u>1345</u>	<u>1346</u>	<u>1347</u>
Central Bank	0	67.0	8.0	46.0	79.0
Country Team	5.0	57.7	41.4	48.6	47.3

These differences, while they affect the figures for foreign loan drawings (Tables 6, 10 and 11) in individual years, especially 1345 and 1347, do not affect our over-all conclusions as the total is in both cases \$200 million.

f. The projected 7.5 per cent increases of current expenditures in Tables 7 and 8 are based on current prices. As the price assumption throughout the other projections is constant prices, these expenditure projections are somewhat inflated, but not so inflated as to make a significant dent in the resources gap shown in Table 10.

g. The 2 per cent (instead of 7.5 per cent) annual increase shown for some expenditure accounts in Table 9 is based on the assumption that the activities covered by these accounts will benefit from the "current development outlay"

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given in column 2 of Table 10 which is for recurring expenditures on development projects and is estimated (see Table 1) at 20 per cent of total public-sector fixed investment. The 7.5 per cent annual increases stated in Table 9 are based on the clause in the Third Plan law which permits increases of 7.5 per cent per year in non-Plan expenditures. These projections roughly accord with recent trends.

4. Table 10

a. This table shows the projected resources gap and is largely self-explanatory except for column 9. The table assumes that Iran can afford to borrow from abroad up to the point where annual debt service payments reach 8 percent of annual foreign exchange earnings. According to the Central Bank, this permits borrowing of about \$150 million per year. When, on the basis of current trends, foreign borrowings in the balance of payments projections (Table 11) do not reach \$150 million per year, the Central Bank has added foreign borrowings to column 9 of Table 10 up to \$150 million per year as a means of closing the gap.

b. The size of the gap deserves some comment.

In the first place, unless the Shah and his governments attach much higher priority than they do now to economic development and unless administrative bottlenecks are removed, the projected public investment outlays are unrealistically high. The resources gap is of course reduced by the amount of shortfall in these outlays. So may be the projected growth rates.

Secondly, private savings and investment are not analyzed in the Central Bank's studies. Until they are, it is impossible to make judgments about the ratio between private and public investment or about the amount of the resources gap that may or may not be filled by private savings.

Thirdly, to the extent that some of the assumptions in the projections may be incorrect, the size of the gap will be affected. For example, as can be noted from the footnote on the bottom of Table 1, capital outlays of "other public agencies" have been eliminated from the budgetary projections. As these outlays amounted to almost 4 billion rials in 1343 and are budgeted at over 8 billion rials in 1344, it can be seen that they might significantly reduce the budgetary shortfall shown in Table 10. Other assumptions may have an opposite effect if proved wrong. For example, it is not at all certain that the Plan Organization will receive for use on development programs the assumed percentages of total oil revenues.

Finally, there are of course a number of policy decisions which the government might take to reduce the gap. These include increasing taxes, making available more Central Bank credit to the government, additional Treasury borrowing from the public and reductions in current expenditures.

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5. Table 11

a. The principal question about the balance of payments projections in their relationship to the budgetary projections. No attempt has been made by the Central Bank to analyze what effects various alternative measures to close the budgetary gap might have on the balance of payments.

b. The balance of payments projections have been made on the basis of recent trends. It appears an acceptable assumption that private imports in 1344 will be held reasonably close to the 1343 level in view of recent additional restrictions and the current prospects for a good crop year. Thereafter, the increase is projected at the same rate as the increase in GNP. The projections show rapid increases in export proceeds which may be overly optimistic but take into account the possibility, which was mentioned by the Shah to the Secretary, of new export industries. The oil revenue estimates are discussed above. Projected repayments of official foreign debt are in line with our projections. The projections take into account an energetic NIOC investment program and the construction of a steel mill.

c. The projections conclude that there will be a substantial increase in total Iranian gold and foreign exchange reserves over the eleven-year period beginning with 1343. The total increase will be \$337 million whereas, after the blocking of a portion of the additional reserves for note cover, the net increase or the increase in free reserves will be \$163 million. The following is a summary table of the Central Bank's foreign exchange projections which take into account repayments of the \$200 million U.S.-guaranteed military sales credit (figures in \$ millions);

<u>Year</u>	<u>Total Increase or Decrease in Official Reserves</u>	<u>Total Official Reserves at End of Year</u>	<u>Note Cover at End of Year</u>	<u>Net (Free) Reserves at End of Year</u>
1342 (actual)	25	232	159	73
1343	115*	347	125**	222
1344	-39	308	139	169
1345	- 5	303	154	149
1346	4	307	170	137
1347	8	315	188	127
1348	29	344	207	137
1349	28	372	237	135
1350	44	416	259	157
1351	52	468	282	186
1352	50	518	307	211
1353	51	569	333	236

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- * The increase in reserves shown here is \$115 million, which is the figure reported to the IMF. It differs with the figure in Table 11, Enclosure 3 which shows \$103 million because the table does not include an \$18 million drawing from the IMF and because some of the figures for some items in the table are estimates.
- ** The percentage of the note issue which must be covered by reserves was reduced in 1343 to 40 per cent from about 50 per cent.

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TO RUQPIN/CARMISH MAAG TEHERAN
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RUEPWW/WHITE HOUSE
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~~SECRET~~ DEF009997 SECTION 1 OF 2 FROM OASD/ISA

- REFS: A. ARMISH MAAG MSG ARKAT 7196, 071845Z
B. ARMISH MAAG MSG ARJ5 8025, 071730Z
C. AIRGRAM A-75, 9 FEB 65
D. AF MSG 89187, DTD 25 FEB 65

WE HAVE REVIEWED HERE THE VARIOUS PROBLEMS ARISING IN CONNECTION WITH YOUR SALES PROGRAM AND THIS IS TO ASSURE YOU THAT ALL OF THE ITEMS FOR WHICH LETTERS OF OFFER HAVE BEEN EXECUTED BETWEEN THE USG AND GOI (AGGREGATING ABOUT \$59 MILLION) WILL BE DELIVERED PER THE SCHEDULES SET FORTH IN THE LETTERS OF OFFER UNLESS THERE ARE

PAGE 2 RUEKDA 105 ~~SECRET~~

UNFORESEEN SLIPPAGES. (THE ONLY IMMEDIATE EXCEPTION TO THIS IS THE 2ND INCREMENT OF 4 C-130'S.)

TO RECAPITULATE, THE ITEMS SCHEDULED FOR DELIVERY IN THE FIRST TRANCHE ARE AS FOLLOWS:

FIRST TRANCHE

QTY	ITEMS	COST	ORIGINAL DELIVERY PROPOSED	DELIVERY DATE	ACTUAL OR CURRENT EST. DEL
			8 OCT 64	IN L/O	
176	M-60A1 TANKS	\$35.2	19	FEB 1965	FEB 65
			53	AUG 1965	AUG 65
			53	FEB 1966	FEB 66
			51	AUG 1966	AUG 66
					19 SHIPPED
					7 JUN 65
					25 JUL 65
					21 AUG 65
					13 DEC 65
					23 JAN 66
					20 FEB 66
					25 JUL 66
					26 AUG 66
					4 SEP 65
4	TANK	0.3	NOT SPECIFIED	JAN 65	(NOT FIRM)
	TRANSPORTERS				WQ DEC 65
4	C-130E	10.3	1	JAN 1966	1 DEC 65
	AIRCRAFT		1	FEB 1966	7 JAN 66
					1 JAN 66

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By ag/bm, NARA, Date 7-10-07

	1	MAR 1966	1 FEB 66	1 FEB 65
	1	APR 1966	7 MAR 66	1 MAR 66
TANK	2.5	NOT SPECIFIED	12/15 MOS	46 PCT SHIPPED
AMMUNITION				38 PCT DEC 65
				16 PCT FEB 66
TANK TOOLS	0.8	NOT SPECIFIED	4/24 MOS	50 PCT SHIPPED
& TRAINING				45 PCT JUL 65
				5 PCT DEC 65

ALL ITEMS FOR WHICH LETTERS OF OFFER HAVE BEEN EXECUTED HAVE BEEN FUNDED EXCEPT FOR THE SECOND FOUR C-130'S. THESE C-130'S WILL BE PLACED ON ORDER BY 15 JULY 1965 AND WILL BE DELIVERED JANUARY-FEBRUARY 1967, AT A TOTAL PRICE OF \$12.78 MILLION AS STATED BY REF D. THE MECHANICS OF PLACING THE ORDER BY 15 JULY WILL BE THE SUBJECT OF A SEPARATE MESSAGE; THESE WILL, HOWEVER, END UP AS PART OF THE SECOND TRANCHE.

YOU INDICATED (REF 9) THAT ABOUT \$16.7 MILLION OF ADDITIONAL ITEMS SHOULD BE PUT ON ORDER SOON BECAUSE OF THE LONG LEAD-TIMES INVOLVED. WE RECOMMEND THAT THESE ITEMS PLUS THE SECOND 4 C-130'S BE INCLUDED IN A SECOND TRANCHE WHICH WOULD BE FUNDED IN FY-1966. (WE WILL UNDOUBTEDLY HAVE COMPLETED OUR JOINT ANNUAL REVIEW BEFORE

FY-1966). THIS WILL NOT RESULT IN ANY ORIGINALLY SCHEDULED DELIVERY DATES BEING SLIPPED EXCEPT THE APC'S AND SOME RADIO TEST SETS. UNDERSTAND YOU ARE IN COMMUNICATION WITH DA TO SECURE EXPEDITIOUS DELIVERY OF LATTER. SET FORTH BELOW IS A LIST OF MAJOR UNPROGRAMMED ITEMS, SOME OF WHICH WILL BE INCLUDED IN A SECOND TRANCHE FOR FUNDING FY -1966:

QTY	ITEMS	COST	ORIGINAL DELIVERY PROPOSED 8 OCT 64	CURRENT ESTIMATED LEADTIME REQUIRED AFTER ORDER
4	C-130E AIRCRAFT	\$10.8	1 JUL 1966 1 AUG 1966 1 SEP 1966 1 OCT 1966	1 JAN 1967 3 FEB 1967
163	APC M-113A'S	7.2	52 EUG 1965 52 FEB 1966 59 AUG 1966	16 MONTHS
1	PATROL FRIGATE	W RMT	36 MONTHS AFTER ORDER	28 MONTHS
1610	M-1919 A6MG GUNS	3.5	SEPT 1965	60 DAYS
--	M-60A1 RADIO TEST	0.2	NOT SPECIFIED	2 TO 24 MONTHS

EQUIPMENT

--	AC&W SYSTEM -SO.	3.8	NOT SPECIFIED	DETAILS NEEDED
	IRAN			
2	GCA FACILITIES	1.2	NOT SPECIFIED	DETAILS NEEDED
18	APC COMMAND POSTS	0.7	NOT SPECIFIED	16 MONTHS
1	PGM PATROL CRAFT	0.4	NOT SPECIFIED	2 14 MONTHS
123	M-60A1 TANKS	24.6	36 FEB 1967	
161	M-60A1 TANKS	32.2	36 JUN 1967	
			36 OCT 1967	AS PROPOSED,
			36 FEB 1968	PROVIDED
			36 JUN 1968	AUTHORIZED 16
			36 OCT 1968	MOS. PRIOR TO
			53 FEB 1969	DELIVERY TIME
			15 JUN 1969	BECAUSE OF LEAD-
				TIME FOR RADIOS.
1	HAWK BATTALION	22.5	1 JAN 1968	18 MONTHS
26	F-5 A/B AIRCRAFT	27.1	13 MAY 1969	18 MONTHS
			13 MAY 1970	18 MONTHS

WE HAVE NO OBJECTION FROM A POLICY STANDPOINT TO INCLUSION IN THE CREDIT PROGRAM OF THE AC&W SYSTEM, THE GCA FACILITIES, THE ABC BT

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~~SECRET~~ DEF009997 SECTION 2 OF 2
FROM OASD/ISA

COMMAND POST, AND THE PGM. PLEASE PROVIDE THE MILITARY DEPARTMENTS WITH DETAILED SPECIFICATIONS WHERE NECESSARY SO THAT LETTERS OF OFFER CAN BE PREPARED ON THESE ITEMS.

SINCE THE CREDIT GUARANTEE AUTHORITY HAS BEEN ENACTED AS LAW, IT IS NO LONGER NECESSARY FOR YOU TO OBTAIN LETTERS OF INTENT FROM THE GOI.

YOU NOW HOLD SEVERAL LETTERS OF OFFER FOR ITEMS FOR SUBSEQUENT TRANCHES WHICH WERE PREPARED AND FORWARDED TO YOU SO AS TO MINIMIZE DELAYS IN THEIR EXECUTION. EXECUTION OF THESE SHOULD CONTINUE TO BE DELAYED UNTIL COMPLETION OF THE FINANCIAL REVIEW

PAGE 2 RUEKDA 106B UNCLAS
AND DETERMINATION OF TOTAL ITEMS FOR SECOND TRANCHE FINANCING. WE WISH TO CAUTION THAT PRICE AND DELIVERY DATES QUOTED IN ANY LETTER OF OFFER IS SUBJECT TO CHANGE AND YOU SHOULD VERIFY THOSE BEING HELD BY YOU WITH THE ORIGINATING MILITARY DEPARTMENT BEFORE YOU FINALLY SUBMIT THEM TO THE GOI FOR ACCEPTANCE.

WE WOULD HOPE TO INCLUDE IN THE SECOND TRANCHE ALL ITEMS WHICH MUST BE FUNDED IN FY 1966, WITH THE THIRD TRANCHE NOT BEING REQUIRED BEFORE FY 1967. WE DO NOT WISH TO BE INFLEXIBLE ON THIS POINT, HOWEVER, AND WOULD APPRECIATE YOUR COMMENTS ON FEASIBILITY THIS APPROACH, TOGETHER WITH RECOMMENDED SECOND TRANCHE ITEMS. WE WOULD NOT EXPECT YOUR COMMENTS UNTIL AFTER YOUR ANALYSIS IRAN ECONOMY.

COPY THIS MESSAGE BEING AIRMAILED. STATE CONCURS.

GRP-4
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HANDLING INDICATOR

1965 FEB 23 PM 4 45

ANALYSIS & DISTRIBUTION
BRANCH

DATE:

REF : Embotel 854. February 15

SUMMARY AND CONCLUSION

As indicated in the telegram under reference, the Shah and his military advisors have indicated a desire to consider the purchase of additional military equipment beyond that listed in the U.S.-Iranian Memorandum of Understanding of July 4, 1964. The Shah has invoked the annual review procedure provided for in the Memorandum in order to examine the feasibility of such purchases. Ambassador Holmes has suggested that the first step of the review should be a comprehensive assessment by economic officials of the Iranian Government of Iran's projected revenues and outlays, especially of foreign exchange, over the next several years. It was agreed that this review would take place in consultation with Embassy-USAID economic officers. Accordingly, the Embassy and USAID have prepared a lengthy questionnaire of items to be covered by the assessment and the Ambassador passed this questionnaire to Prime Minister Hoveyda on February 17. ARMISH/MAAG is preparing studies on the equipment involved to include military utility of the equipment and its cost, but discussion with Iranian military officials will be deferred until the economic assessments can be completed and recommended U.S. position is approved.

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The following is a chronology of significant related developments:

In the Washington conversations preceding the July 4 Memorandum, the Shah indicated an interest in certain military equipment which was

Group 4

Downgraded at 3-year intervals.
Declassified after 12 years.

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☐ In ☐ Out

Drafted by:

SA: JAArmitage: ap 2/20/65

Contents and Classification Approved by:

SwRockwell

Clearance: ECON: Mr. Eliot

ARMISH/MAAG: Maj. Gen. Eckhardt

BUNDY/SMITH
BATOR
BELK
BOWMAN
COOPER
JESSUP
JOHNSON
KLEIN
KUMER
SAUNDERS
SAYRE
THOMSON

~~SAUNDERS~~
SAYRE
THOMSON

1965 FEB 23

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E.O. 13292, Sec. 3.4

By 6/10/07, NARA, Date 7-10-07

not to be included in the July 4 Memorandum. He raised the question of light tanks or armored carriers for Iranian armored cavalry battalions, stated that Iran would have a need for a second Hawk battalion near Bandar Abbas and remarked on his interest in an interceptor aircraft with higher performance characteristics than the F-5.

During the Shah's conversations with the Ambassador prior to the signing of the July 4 Memorandum, the Shah agreed that the military equipment program in the Agreement reflected the maximum which Iran should spend on military equipment in the light of existing revenue and foreign exchange projections. However, he stated that he wished to bring up the possibility of purchasing additional equipment if revenues should rise faster than was currently anticipated. He mentioned again the second Hawk battalion, one or two squadrons of F-4C jet fighter aircraft or other high performance aircraft and a radar site near Bandar Abbas.

Following the signature of the Memorandum, General Hejazi addressed a letter to General Eckhardt, citing Paragraph IV of the Memorandum. The letter then expressed Iranian interest in acquiring certain military equipment, including, among other items, a second Hawk battalion, one squadron of higher performance interceptor aircraft and 126 light tanks for the armored cavalry battalions. The letter asked that consideration be given to the purchase of this equipment "when it can be demonstrated that the IIF has the capability properly to maintain and utilize its present and new equipment and facilities and when our two Governments have agreed that the economic situation has sufficiently improved to permit the expenditure of additional foreign exchange." In ARMISH/MAAG's correspondence with General Hejazi regarding this letter, General Eckhardt consistently emphasized the provisions of the Memorandum requiring that any discussion of additional military purchases should include the projected assessment of Iran's economic resources. More specifically, General Eckhardt has confined exchanges of views regarding additional military equipment to those items which could be covered within the \$200 million credit. With regard to the major and additional items (Hawk battalion, fighter aircraft, light tanks), General Eckhardt formally informed General Hejazi that these items should be given consideration during the annual review of the Memorandum of Understanding.

Toward the close of the year there were intimations that the Iranians wanted the possibility of additional military acquisitions examined. Then, on January 28 in audiences with both Ambassador Holmes and General Eckhardt the Shah spoke of the prospect of marked increases

in Iranian oil revenues and expressed his interest in one or two squadrons of higher performance aircraft instead of the two F-5 squadrons scheduled for Iranian purchase and delivery in FY 69-70, 126 Sheridan tanks to replace the M-47 tanks with which the armored cavalry battalions are now equipped, the second Hawk battalion for Bandar Abbas and an increase in the war reserve of ammunition from 30 to 60 days. (The increase in the ammunition reserve had previously been broached to General Eckhardt who had persuaded the Shah that the 90-day reserve which he desired was unnecessary and would be extremely expensive.) Later the Shah requested that General Eckhardt consider gap-filler radar (s) between Bandar Abbas and Dezful and Bull Pup air-to surface missiles for the IIAF. In the conversation with the Ambassador, the Shah specifically invoked the annual review provision of the Memorandum and asked the Ambassador to have General Eckhardt produce an estimate of the cost of the desired equipment and the Embassy-USAID staff to examine the probable state of the Iranian economy and foreign exchange availabilities. The Ambassador noted that the present Iranian budget was in the process of preparation and suggested that the Shah ask his economists and finance officials to make projections of anticipated revenues and expenditures over the next several years. The Ambassador offered to make the Embassy--USAID staff available for consultation and the Shah agreed that he would have Iranian officials make the suggested study.

The Shah promptly acted on his decision. When the Prime Minister summoned the Ambassador on February 11, he communicated to the Ambassador the Iranian estimate of future oil revenues which he said had been prepared in response to the Shah's direction. The Ambassador remarked that the economic assessment would, of course, need also to cover other sources of revenues and anticipated allocations including the administrative^{and}/development budget. The Ambassador said that the economic staff of the Embassy-USAID would be glad to assist by drafting the economic questions which would need to be covered in the projections. The Prime Minister welcomed and accepted this suggestion.

Last week the Country Team held extended discussions of the Iranian request. It was agreed that a number of the military items might be accommodated within the \$200 million credit if "savings" on other items permitted and that they should be so included if there was a valid military need for them. With regard to the more costly items (fighter aircraft, light tanks, war reserve ammunition, second Hawk battalion), it was agreed that ARMISH/MAAG would proceed to obtain the latest relevant price and availability data and incorporate in its studies the military requirement for and the Iranian capability to absorb and utilize the equipment. The next step in dealing with the

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Page 4, A-443 from Tehran

Iranians, however, would be confined to the consultation with Iranian economic officials on the projected financial situation.

On February 17, the Ambassador handed to the Prime Minister a four-page questionnaire asking for projections of basic elements of the Iranian economy for the years 1965-74. It was explained to the Prime Minister that the projections would be useful not only for the annual review but also in determining the repayment schedule for the second tranche of the \$200 million military sales credit.

The Prime Minister told the Ambassador that he would ask the Central Bank to take the lead in preparing the economic projections. The Plan Organization would assist the Central Bank. He said that before purchasing additional military equipment such as airplanes, it was necessary to determine whether Iran could afford to make such purchases.

For the Ambassador:

Stuart W. Rockwell

Stuart W. Rockwell
Minister-Counselor

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32

KOREA

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MEMORANDUM FOR

January 22, 1964

THE PRESIDENT

This is for background, because Rusk and McNamara plan to take up with you shortly force cuts in Korea.

They met yesterday and reportedly agreed that rather than cut both ROK and US forces we should cut neither now! McNamara does favor both a 70,000 man cut in the 580,000 man ROK army (phased over two years) and a 12,000 man cut in US forces by the end of 1964. This is a big step forward from the military's previous adamant position.

Rusk was perfectly willing to buy the ROK cut; State feels that such a small reduction probably would have little adverse political implication. But Rusk is strongly opposed to a simultaneous US cut, announced now. He fears it would upset the Japs and Koreans, and even worry all our Asian allies that we're disengaging from Asia.

So McNamara then said that if we didn't cut US forces he didn't want to cut ROK forces either; this would be hard to defend on the Hill because it ran counter to our MAP theory of buying cheap infantry (i. e. why cut local forces instead of bringing our boys home?).

It would be a pity to postpone entirely once again a long-needed shift which would also save some money. There is never a good time to cut, but the plain fact of the matter--no longer denied by anyone--is that we're overinsured militarily in Korea at a time when we need strength much more elsewhere. The big danger area is in Southeast Asia not Northeast Asia, and has been ever since the Korean War.

Since the issue seems to be more one of timing than of substance, why can't we take a decision in principle now, while allowing ourselves tactical flexibility in execution? We ought to be able to devise some way of fuzzing up our action enough to forestall the adverse reactions State fears. For example, we could:

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E.O. 13292, Sec. 3.4

NSC Memo, 1/30/95, State Guidelines

By sp/bs, NARA, Date 7-10-07~~SECRET~~

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1. Decide now to go ahead with the ROK cut, but play it in low key so as to avoid the problem bethering McNamara. Rusk could tell the ROK when in Seoul that we desire a gradual streamlining of their forces, but feel that they and we should handle it in such a way as to minimize any political splash. The ROKs have as much incentive as we to avoid publicity. And a cut of only 35,000 per year out of 560,000 could be presented here if necessary as revamping, not a main cut.

2. Decide now within the USG, at least tentatively, on a substantial cut in US forces by the end of 1965, if not 1964. Planning should begin, but no announcement of any kind would be made until State and DOD present a final plan to you for decision by 30 June 1964.

3. State and Defense should work out together the optimum timing for such a cut, with an eye to mitigating any adverse political impact in the area. Perhaps doing it in several bites over an 18-month period would help. We could also begin to lay the public relations groundwork by pointing out the erosion of Chicom military capabilities as a result of the Sino-Soviet split, and how we're over-insured in Northeast Asia so may need some redeployment to increase the forces available for Southeast Asia.

- - - - -

While any force cuts will always entail some pain, and I don't wish to play down State's concerns, we cannot always let this be an excuse for no action at all. So I urge you keep the pressure on State and Defense via some such proposal as that described above.

R. W. Komer

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DEPARTMENT OF STATE
ASSISTANT SECRETARY

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November 4, 1964

Mr. Komer

Bob,

I still stand by the argument here, and do not consider it inconsistent to consider the force levels in Korea and Taiwan too high.

Where is your draft on MAP Navy for Korea?

Please take a minute to read Department's 1228 to Tokyo. It is really about the problem of "negotiation" per se.

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E.O. 13292, Sec. 3.4
By *sp/klm*, NARA, Date *1-10-07*

Rob.

Robert W. Barnett
Deputy Assistant Secretary
for Far Eastern Affairs

Attachment:

Memo to Kitchen, 10/16/64, from Barnett and Handley, "Def. Approved FY 65 MAP Reductions".

NOV 6 1964

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OCT 16 1964

TO: G/PM - Mr. Kitchen

FROM: FE - Robert W. Barnett
NEA - William J. Handley

SUBJECT: Defense Approved FY 1965 MAP Reductions

To meet MAP requirements for the Congo, Guinea, Vietnam, Laos, and other program changes, ISA placed before the Secretary of Defense a recommendation that \$123 million MAP be taken from certain other recipients for these countries, and justified it within the following assumptions:

- a. That the MAP appropriation will be \$1.055 billion;
- b. That the Section 510 Authority of the Foreign Assistance Act will not be used;
- c. That no supplemental appropriation will be sought; and
- d. That no funds will be transferred from AID sources.

We feel that these assumptions must be challenged by the State Department.

If the contemplated reductions occur, as now approved by Secretary McNamara, the military/political consequences would be unacceptable. We make this statement in light of the harsh reality that the FY 1963 and 1964 MAP levels for the Forward Defense Countries fell far below the optimum level, the original FY 1965 budgetary request was barely adequate to meet minimal requirements, and the proposed FY 1966 budgetary planning level would be even more restrictive. The net effect of this trend has been a mounting level of deferrals on a steadily declining level of MAP availabilities. This leads inexorably to military obsolescence and force goal bankruptcy.

In addition to the direct country impacts, the proposed reductions could be expected to have serious consequences in Congress. The AID MAP program for FY 1965 was justified to the Congress as a hard program, needed for the national interest, and intended to preserve stability, safety, and strength of the Free World. Uncertainties about future changes in Vietnam and Laos and other situations were admitted. In view of this and the heavy emphasis of Administration spokesmen on the dangerous decline in the relative defensive capacity of key Forward Defense Countries, there was considerable concern

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By ag/cbm NARA, Date 7-10-07

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expressed by important members of Congress about the adequacy of the FY 1965 Budget request. If the Congress and the public now learn that the Administration plans to transfer from "minimum programs" \$123 million of MAP for emergency requirements in Vietnam and Laos in the Far East as well as the Congo and Guinea in Africa, they can conclude only (a) that the Administration is recklessly risking greater vulnerability to external attack and internal instability in deprived countries, or (b) that the Administration claim of "minimum" requirement was seriously misleading.

The regional bureaus are aware that MAP programs may, in some cases, prove to be larger than our national interest, ultimately, requires. By way of example, NATO has under study at the present time force goals for all NATO countries. DOD has separate studies under way of force goals for Greece and Turkey. In addition, Embassy Seoul, Commander U.S. Forces Korea, CINCPAC, DOD, the JCS, and the Department have accepted in principle the desirability of phased reductions in Korean forces. The Administration was on the threshold of important decisions on this matter when the French Government recognized Peking last January, and plans were set aside. Similar analysis has gone into study of possible reduction of military expenditures, both US and GRC, on Taiwan, but the obvious delicacy of the GRC's current external and internal environment delays decision. Cuts found to be undesirable after exacting and calm analysis of all consequences should not subsequently take place by default. This matter should be brought directly to the attention of the Secretary so that he can participate fully in the final decision.

We recognize the difficulties inherent in resort to a supplementary budget, to Section 510, and to a transfer of AID funds. We are convinced, however, that our national interest requires that the requisite funds to meet our MAP requirements be made available from one or more of these sources.

With specific reference to Section 510, we wish to point out that Congress by means of this provision enables the Department of Defense to meet unexpected emergency situations affecting the national security out of the resources of the Department of Defense, "subject to subsequent reimbursement therefore, from subsequent appropriations available for military assistance." This authority permits segregation of MAP for countries whose long-term on-going safety and stability is in the interest of the United States from that of countries confronting unexpected dangers of vital current concern to the United States. The availability of Section 510 resources to meet unanticipated requirements was specifically noted by individual Congressmen in the course of the FY 1965 MAP hearings.

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A drawing under Section 510 authority would be clearly practical and also clearly consistent with the intent of the Congress.

The impact of the course of action approved within Defense by the Secretary of Defense upon specific countries are noted in Tab A for the Far East, in Tab B for the Near East and South Asia, and in Tab C for Europe (NATO).

Attachments:

Tab A - Far East
Tab B - Near East and South Asia
Tab C - Europe (NATO)

cc: ARA/RPA - Capt. Sharp
NEA/NR - Mr. Walsh
EUR/RPM - Mr. Conroy
FE - Mr. Sandri

FE:RWEarnett/
NEA/NR:JPWalsh:mgr/aws
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FAR EAST~~SECRET~~Republic of China

The proposed 30 per cent cut would be a heavy blow to the GRC at a time when both the GRC and the U.S. face an unprecedentedly grave challenge on Chinese representation in the United Nations. President Chiang would almost certainly sacrifice the economic development of Taiwan, just now successfully adjusting to the termination of our AID program, to prevent further deterioration in the equipment, morale, and discipline of his armed forces. The military, resentful and disillusioned, would probably spend a substantial proportion of these compensating funds in Japan, Germany and other non-United States sources to purchase offensive rather than defensive equipment. Leaders oriented toward military operations against the mainland would gain influence at the expense of economic leaders oriented toward the peaceful development of Taiwan. Pressures upon internal political stability would increase; some Taiwanese would be likely to interpret the apparent withdrawal of U.S. support for the Government as an opportunity to challenge mainlander rule. The current trend toward harsher internal security measures would be accelerated, and U.S. ability to influence the Government's policies and practices reduced. The difficulties which the GRC will in the best of circumstances face in the next year or two in moving toward a new and enduring status would be seriously and possibly critically increased.

Korea

The contemplated cut of \$20 million in the Korean FY 1965 MAP, already at an unprecedented low level, would necessitate cancellation of all force improvement and modernization programs, except for the long delayed introduction of F-5 aircraft. There would be no alternative, since funds for maintenance and operations are already seriously inadequate, with essential training programs jeopardized by grave ammunition and supplies shortages. There is no prospect of shifting a larger share of defense costs to the Korean Government, which because of severe budgetary pressures remains unable to carry out even badly needed military pay and allowance increases. The proposed large reduction in MAP, together with recent cuts in economic aid, would be regarded in Korea as a rebuff to the Pak Administration and as a major step toward U.S. withdrawal from Korea. The Korean military, heretofore a principal support of U.S. policy and of the Pak Government, would be gravely demoralized over the prospect of further deterioration of the Korean forces, as would those now bending every effort for economic stabilization and development. Political stability would be seriously endangered, with the possibility of a violent shift of power to elements far less friendly to U.S. policy than the present Government.

Japan

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Japan

The funds included in the Military Assistance Program for Japan in FY 1965 (\$19.2 million) are for the fulfillment of firm commitments made to the Japanese Government before July 1, 1964. The principal increment is \$14 million for the U.S. share of the cost of the semi-automatic air weapons control system (commonly called BADGE) which Japan has decided to build in Japan. The remainder of the FY 1965 program provides for ASW and other activities. Since the funds contained in this last year's program are for commitments previously made to the Japanese Government, and since these committed programs will benefit our own forces in the theater, no reduction in the present program can be contemplated.

Philippines

Any reduction in the Philippine FY 1965 MAP would be particularly ill-advised, closely following President Macapagal's State Visit during which the United States Government agreed to study with the Government of the Philippines its proposal to shift emphasis of its military defense to the southern Philippines to counter the potential threat from Indonesia and to consider an augmentation to our MAP contingent upon actual increases in the Philippine military budget.

Nothing was said during Macapagal's visit to lead him to conclude that we were seriously contemplating a reduction in our support of the Philippine Armed Forces. Under the circumstances, such action would be misunderstood in the Philippines and would be exploited there by political enemies and anti-American elements as exemplifying our alleged small esteem for both Macapagal and the Philippines.

Burma

In fulfilling our \$43 million MAP commitment to the RGUB, we have offered the Burmese a three-year program after FY 1965 which would reduce the cost of the MAP to a minimum consistent with our obligation and with the achievement of our objectives. Any further reduction in the FY 1965 and following MAP would be interpreted by Ne Win as indicating a change, adverse to him, in U.S. policy toward his government. More generally, it would in Burmese minds call into question U.S. willingness to support their independence and internal security and would reduce our influence in the Burmese armed forces, which by and large are the only organized and

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unified anti-communist force in Burma today. It would also encourage those leftist elements in the Government who have been urging that the RGUB accept military aid offers from the Communist Bloc, something the Government has been loathe to do hitherto. As one of the few continuing and successful U.S. programs in Burma, the MAP has an importance beyond the modest size of the program and this influence would be severely curtailed if we cut the program back any further.

Thailand

The proposed cut of \$800,000 will probably have no adverse political impact. To avoid possible misunderstanding, however, it should be pointed out that the already low Thai MAP for FY 1965 cannot be cut much further without having a palpable effect on deliveries which would in turn have serious repercussions. While they recognize their stake in our effort in Vietnam, the Thai would be rightly concerned if it appeared that our effort there (and in other crisis areas) was being increased at the expense of U.S. programs in Thailand which they (and we) regard as essential to Thailand's security and to its ability to play its very important role in our mutual effort in Southeast Asia. Furthermore, Ambassador Martin has made it clear that our military assistance program in Thailand can be a major tool with which we can influence, in directions desired by the U.S., the level and emphasis of Thai efforts, for example to encourage the Thai to emphasize those armed forces of greatest use in internal security matters and to make more use of their armed forces in economic and social development programs. Any significant reduction of the FY 1965 MAP level would vitiate the usefulness of the MAP for this purpose.

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~~SECRET~~NEAR EAST AND SOUTH ASIA11.5. for
HatzingerTurkey

Defense has proposed that the Turkish FY 1965 MAP be cut by \$23 million to a level of \$106.4 million. This is \$35.7 million below the very austere FY 1964 level of \$144.1 million and approximately \$72 million below the level which General Lemnitzer categorically states is required to reach effective force goals by 1970.

The deletion of \$23 million from the Turkish program would result in a further declining materiel readiness and mission capability in the face of increasing Bulgarian threat and an increasing Russian interest in the Mediterranean, as evidenced by increased naval deployment therein, and Soviet-Egyptian attitude toward the Cyprus crisis. It is noted that more than one-half of the army mobility in Turkey today is over twenty years old. On the political side, our relations with Turkey are currently undergoing subtle changes. As a result of Turkey's exaggerated idea of what the United States, a NATO ally, was bound to deliver to it in a Cyprus settlement and disillusionment over U.S. inability to achieve what Turkey considers its just claims on the island, Turkish Government agencies are undertaking a thorough review of the immunities and privileges granted to American personnel in Turkey, both diplomatically and under the Status of Forces Agreement. The review is accompanied by a renegotiation of privileges granted so far. Should the Turks learn of any significant cuts or deferrals of deliveries for the FY 1965 MAP program, they could quickly extend the review to include the status of our vital bases and facilities which we now have in Turkey or contemplate requesting in the future. Attention must also be invited to the relevance of any cuts to the Cyprus question. Suspicion on the part of the Greeks or Turks that we contemplate significant cuts in MAP would cause misunderstanding of our motives and could defeat our efforts to bring about a settlement on Cyprus. Assuming that the Cyprus problem is susceptible to resolution in the near future, we must anticipate that some indication of U.S. intentions with respect to the parties may figure, at least implicitly, in the settlement. Following settlement, abrupt or substantial aid cuts would reduce critically our capability to heal the wounds already sustained by the parties and to reestablish a stable and satisfactory pattern of relationships with and among our allies.

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Greece

Defense has proposed that the FY 1965 Greek MAP be cut by \$19.1 million to a level of \$61.4 million. As in Turkey, it is noted that the revised program is approximately 60 per cent of that level estimated by General Lemnitzer as essential to maintain and improve force effectiveness to an acceptable standard by 1970. Deferral of combat and general purpose vehicles and other supporting items as envisaged in the \$19.1 million cut for FY 1965 would result in a further declining materiel readiness (\$9.5 million below the austere FY 1964 program) and mission capability in the face of an increasing Bulgarian air and armored threat. This adverse impact on force effectiveness can only be offset by restoration of funds in the FY 1966 program. The FY 1966-70 MAP plan for Greece is an austere plan and it will be difficult to absorb deferrals and reapportion the funds available in FY 1966. The comments previously made in respect to the effect in Turkey of MAP cuts in respect to the Cyprus issue apply fully to Greece.

Iran

In Iran, Defense has indicated certain materiel which could be deferred and still retain sufficient quantities to apply toward commitment totals. Defense believes these deferrals, totaling \$5.8 million (primarily wheeled vehicles), are acceptable within the overall context of the commitment agreements. Although the vehicles mentioned are not commitment items in terms of specific quantities, we believe that they represent equipment for the IIF TO&E units that ARMISH/MAAG has approved. Deletion of these items reduces mobility, command and control, and support capability of the armed forces. In fact, we believe that the \$5.8 million deferral to the FY 1965 MAP will result in a failure of the United States to meet its commitments. The adverse impact on the combat capability of the IIF can only be offset by restoration of these funds in FY 1966. The FY 1966-70 MAP plan for Iran is an austere plan which includes commitment items only, and the inclusion of the FY 1965 deferral items would necessitate a completely new reapportionment of the funds available.

In view of the considerable political benefits that we are deriving from our MAP program in Iran and the critical importance of maintaining the credibility of our commitments to the Shah, we consider the proposed reduction in MAP levels to be politically unacceptable.

Pakistan

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Pakistan

Although the cut of \$1.8 million in the Pakistan program would appear to be manageable from a dollar point of view, the cost will require deferral of APC's and M-48 tanks, areas of particular sensitivity to the GOP at this time. General Musa was promised during his trip here this spring that APC's would be forthcoming in FY 1965 and that a better effort would be made on tank deliveries which are already behind schedule. In view of the tanks included in the recent Soviet-Indian arms agreement, to which Pakistan has reacted sharply, any actions now that deferred U.S. tank deliveries to Pakistan could also cause strong criticism of us. Indeed, any actions now that would suggest deferrals of deliveries of combat vehicles or signal any cuts for the FY 1965 program could set off serious repercussions from which we cannot exclude a Pak break with SEATO or actions prejudicial to our vital facilities in Pakistan. This must be seen against the fact that our relations with Pakistan are currently undergoing critical strains. This arises out of Pakistan's reaction to U.S. arms aid to India and our view of developments in Pak-Chicom relations. In dealing with these strains, our MAP program is of crucial importance, particularly in maintaining the confidence of President Ayub and of the military leadership upon whom he continues to rely heavily for support. In the aftermath of our June 1964 announcement on arms aid to India and the more recent Soviet-Indian arms deal, our MAP program in Pakistan will be watched even more closely by the Pakistanis as an important indicator of our support.

India

We note that it is not now proposed by DOD to reduce the program for India below the commitment level. In view of the many months of intricate negotiation which produced a substantial measure of agreement with the Indians in June 1964 on the future of our military relationship, we must avoid at this time any cuts. A reduction in the India MAP, eliminating from the FY 1965 program important items or categories which Chavan has already been informed of, would seriously undermine Indian confidence in our willingness to make good on our commitments. This in turn would cause erosion of whatever influence we have been able to build up over Indian military policy and Indian defense planning. There has been no significant change in the climate of Sino-Indian relations since the Chinese withdrawal in 1962. Now that the Chinese have detonated a nuclear device, tensions are bound to increase and this is the time to bolster India's confidence in its ability to defend itself.

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Europe (NATO)

According to the latest information we have been able to obtain, the reductions proposed by DOD (to \$2.6 million) for Portugal will leave only programs for PCH & T and Training, leaving practically no contribution to Portugal's capability to meet its NATO obligations. There is, therefore, virtually no quid pro quo for continuing U. S. base rights in the Azores. We understand that the reductions were made in light of the fact that there is approximately \$9 million being held in reserve from the suspended FY 1963 program. Nevertheless, negotiations for the Azores and LORAN-C may require an additional amount as quid pro quo.

General Lemnitzer has judged the Greek and Turkish forces to be of limited effectiveness to perform their NATO missions. The proposed drastic reductions would seriously aggravate the status of their forces in the NATO General War Context.

Revised estimates for the NATO Infrastructure Program from \$60 million to \$50 million are acceptable provided we obtain a DOD assurance that the cost of the program for FY 1965 will be met, through readjustments in other programs if required, even if it exceeds the latter amount.

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ASSISTANT SECRETARY OF STATE
WASHINGTON

JUL 6 1964

Mr. K. Kim
Korea

OFFICIAL-INFORMAL

~~SECRET~~

Dear Sam:

I appreciated your frank letter of May 13 expressing concern about the heavy cuts planned over the next five years in MAP support for the Korean forces.

The cuts in the MAP, particularly in Korea, have also greatly worried those of us in the Department and in the Pentagon responsible for MAP matters. I assure you that everyone involved, including the Joint Chiefs of Staff, shares your concern over the prospect of reduced levels of assistance for Korea. We recognize the importance of not permitting our current concentration on Southeast Asia from resulting in a weakening of our defenses in Northeast Asia. With a worldwide annual MAP of only about \$1 billion, and with critical and unforeseen situations constantly arising, notably in Viet-Nam, however, we have had no alternative but to cut drastically programs in less immediately critical areas. Although mindful of the seriously harmful effects in Korea, we have been unable to exempt it from these cuts, since it is one of the largest programs. During the recent hearings before the House Foreign Affairs and Appropriations Committees, Secretary McNamara, Admiral Felt, and other Defense witnesses used Korea as one of the prime examples of the regrettable reductions necessitated in key country programs during FY 1964 to meet emergency needs in Southeast Asia. They also, as you know, strongly emphasized the seriousness of reduced MAP appropriations for FY 1965.

When I testified before the same Committees during April and May, I spoke very frankly about Korea. I said there was serious question in my mind whether the military assistance proposed for Korea (\$145.8 million, including packing, crating, handling, and transportation charges) would be sufficient at a time when the ROK is confronted by North Korean forces of over 350,000 men, well equipped and intensively trained, and by North Korea's enormous economic advantages. I pointed out that although we

The Honorable
Samuel D. Berger,
American Ambassador,
Seoul.

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intervals; not
automatically declassified

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have been exploring the concept of force reductions (both U.S. and Korean) with the Department of Defense, the military and political implications of such a reduction seemed at the moment to argue against it. I also said that if a reduction were decided, additional amounts of modern equipment would probably be required to maintain the necessary capabilities.

We are making every effort to mitigate the effects of the FY 1964 MAP cuts. Additional FY 1964 funds have been made available for Korea, restoring part of the amount previously taken from Korea. We and AID intend that the savings resulting from the MAP transfer program will be used for military hardware and other force-improvement expenditures, providing at least some small relief in future years.

In brief, the dangers of an inadequate Korean MAP are, I believe, well understood by the Administration, and every effort will continue to be made to impress those dangers on the Congress. Your further warning is nevertheless timely, and I am taking the liberty of providing copies of our exchange to interested key officials in State, Defense, AID, and the White House.

We understand that General Howze has written to General Taylor on the lines of your summary of his views in the third paragraph of your letter. I would like to suggest that you bring the problem before the Country Team and communicate the Country Team's views to us as a basis for inter-agency consideration in Washington. While fully appreciating the serious political consequences of a deterioration of the Korean forces, I suggest that in any Country Team message you put special emphasis on military factors: the justification for military assistance should be based primarily upon military considerations.

Sincerely yours,

William P. Bundy

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UNITED STATES OF AMERICA

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Number 1 of 4 copies

American Embassy,
Seoul, Korea,
May 13, 1964.

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OFFICIAL-INFORMAL

Dear Bill:

I must confess to you that I am greatly worried by the heavy cuts in MAP support for the Korean armed forces planned for the next five years.

To give you some idea of the size of the cut, the yearly MAP figures to which we had been working until last year ranged from \$190 million to \$230 million not including packing, handling and transportation charges. The new planning figures provide for around \$130 million a year.

This reduction will begin to be felt in a major way in about a year. General Howze states flatly that the ROK forces, especially the army, already short of equipment and supplies, will then be faced with even graver shortages, and he predicts a serious impairment of the army's defense capability. He has so informed CINCPAC and I share his concern.

There is, however, another aspect of this reduction that I want to point out. For the past ten years the Korean army has been built and improved year by year until it has become a fine fighting force -- proud, well-trained, disciplined, and on the whole, well led. This has been achieved at a comparatively low cost. If we adhere to these reduced MAP figures, there is not only

The Honorable
William P. Bundy,
Assistant Secretary for Far Eastern Affairs,
Department of State,
Washington.

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going to be a rapid running down of this force in terms of equipment and capability, but more important, I foresee a danger to morale and a change in attitude in military circles toward the United States. There will be invidious comparisons between the way we equip and supply U.S. forces in Korea and starve the Korean forces, which have -- or should have -- the main responsibility for defending their own soil.

The fine relations between our two forces and between our military leaders, and the friendly attitude of the Korean military leaders toward the United States, represent one of the few important stabilizing elements in Korea. If this relationship and attitude give way to bitterness and frustration, we are going to have some really serious problems on our hands with far-reaching implications.

Reducing the ROK army by some tens of thousands so as to spread our MAP support thicker for the remainder is not the answer to the problem, for the MAP cuts are far too deep and the program will not suffice even for a somewhat smaller force. Since we plan to reduce the U.S. forces for economy and other reasons, we should not at the same time be thinking of cutting the MAP program, but of increasing it.

I am aware of all the reasons for the MAP cuts; nonetheless, I must warn the Department, and I believe the Congress and the Department of Defense should be warned, that as matters now stand we can expect a pack of troubles.

Sincerely,



Samuel D. Berger
Ambassador

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