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10 January 1969

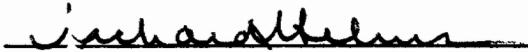
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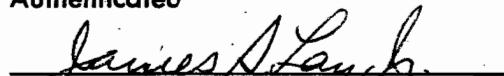
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IRAN

NOTE

Over the past several years, Iran's hostility and suspicion towards the USSR has declined. Iran has purchased some military equipment from Moscow, and economic relations between the two countries continue to expand. In addition, with the impending British withdrawal from the Persian Gulf, Iran is vigorously asserting its own claim to a leading position there, thus running afoul of the aspirations of Saudi Arabia. In this estimate, we examine the implications of these and related developments for US interests in the area.

CONCLUSIONS

A. The initial successes of the Shah's program of social reform—the so-called “White Revolution”—and Iran's notable progress in economic development have given the Shah considerably greater confidence that he is master in his own house and considerably greater assurance in seeking for Iran the position in regional affairs that he deems to be rightfully his. At the same time, he has come to see a lessening in both the threat of direct Soviet aggression and the likelihood of US support in case of threats to Iran from other sources.

B. In consequence, the Shah now feels that Iran can and should be less dependent on the US than in the past, though he will continue to regard the US as the ultimate guarantor of Iran's security and his preferred source of arms. His desire for a position of primacy in the Persian Gulf will involve recurrent frictions with Saudi Arabia, a state of affairs that will pose problems for the US and provide the USSR with opportunities for some expansion of its influence in Teheran.

C. The USSR has established itself as an important factor in Iran's economic development. As relations between the two countries continue to “normalize,” the Shah may become more responsive than in the past to Soviet pressures on particular issues, for example the main-

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tenance of US special facilities on Iranian soil. This would be especially the case if he came to believe that the US was providing insufficient support on matters of particular interest to him.

D. In the domestic field, the Shah's reform program now seems to be entering on a period of consolidation likely to last for some time. Demands for greater political participation by educated groups are likely to grow. If such participation is not permitted and if Iran's economic progress should falter, this could pose serious problems for his still narrowly-based regime, particularly if dissent were to find support within the heretofore loyal military.

E. Iran's remarkable economic progress has been underwritten largely by sharply rising oil revenues. We believe that differences between Western companies and the Shah over production levels will be composed and that continuing high levels of oil receipts will enable Iran's economic growth to continue at a rapid rate and progress to be made on the many intractable problems that hamper modernization of Iran's economy.

DISCUSSION

I. THE DOMESTIC POLITICAL SITUATION

1. The past five years have been marked by political stability and rapid economic growth under the leadership of an increasingly self-assured Shah. During this period he has shaken off his previous insecurity and hesitance, emerging as a confident and purposeful leader. His successes in discomfiting his political enemies and in cutting down possible challengers have left him unrivaled at the center of power. These achievements, often scored in disregard of the advice of his long-term foreign allies, have reinforced his conviction that the country's welfare and progress depend on his continuing rule. The elaborate coronation ceremonies staged in October 1967 symbolized his determination to assert his and Iran's prerogatives against all comers.

2. The Shah has ambitious plans for his country. He sees rapid economic development as a way to acquire the power and prestige he wants for his country internationally. For this he recognizes that some social change and the spread of education are essential. His program of economic and social change, expressed in the so-called "White Revolution,"¹ has propelled some of Iran's semifeudal

¹ The "White Revolution" is the name given in 1962 to the Shah's six-point program of land reform, profit sharing for workers, eradication of illiteracy, electoral reform, nationalization of forests, and the sale of government enterprises. It was subsequently broadened to include the Health Corps, the Development Corps, the village court system, nationalization of water resources, regional development, and a program to increase administrative efficiency in government.

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landowners into the modern world, and has undermined the powers and influence of the more reactionary. While these reforms successfully stole the thunder of the radical opposition, they have greatly increased the role of the government in Iranian life. It has become responsible for such endeavors as providing the peasants credit and assistance formerly supplied by the landlords.

3. The structure of formal changes embodied in the reform program has now been erected; the far more difficult task of carrying out the new governmental functions effectively is not being pursued with the earlier vigor. Nor does the Shah appear to have any dramatic new programs in mind. In short, the White Revolution now seems to be entering on a period of consolidation likely to last for some time. The effort to spread education through the literacy corps of teachers assigned to village schools has enjoyed considerable success, though mere literacy at a bare functional level seems unlikely of itself to produce far-reaching change. Locally elected courts have worked well. Land reform has transformed patterns of peasant ownership. But the overall position of the peasant in the countryside has not yet changed very much, and efforts to alter attitudes, to raise living standards, and to increase production present a continuing challenge that seems destined to absorb the government's energies and attention for many years to come.

4. The Shah has succeeded in presenting himself as a nationalist reformer, but he has concentrated all political power in his own hands and the regime remains narrowly based. In the last analysis it depends on the army and security forces, which as far as we can tell are faithful to the Shah. His efforts to enlist the support of well-educated technocrats in important posts in government have borne fruit and many members of the once politically restive middle class have had their attention diverted to moneymaking. They were attracted by the scope for action they have been allowed in the economic field. Yet their support is not based on any widespread devotion to Iran's political system; an economic recession could quickly reduce their sense of commitment to the regime. This could also take place if the Shah's sense of infallibility should lead him to restrict further their participation in the decisionmaking process. Over the long term, economic development probably will not provide a satisfactory substitute for greater political participation. Hence, in a few years unrest may again begin to reach significant levels among politically aware elements. In time this could pose serious problems for the regime, particularly if dissent were to find support within the military.

5. The Shah has attempted to institutionalize the regime by providing a mechanism for succession. Despite traditional Iranian opposition to women in political life, he has sought to build up the stature of the Queen, who has been designated as regent for their seven-year old son if the Shah should disappear from the scene for any reason. Although the Shah has made some progress in breaking down these prejudices, such a succession arrangement would be basically unstable. Initially at least both the civilian political structure and the military would probably support the monarchy, since both of these groups are essentially interested in political stability. However, the former derives its power from its support by the Shah; after his departure the military would exert proportionately

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more influence. The military would almost certainly be more alert to any possible diminution of their interests and, since they appear to be more conservative than the Shah, might find it more difficult to accept the primacy of the Queen as Regent. But at least in the beginning, a regime which was dominated by these officers would probably continue to follow much the present course.

II. THE IRANIAN ECONOMY

6. During the past three years, economic growth has been proceeding at an annual rate of over 10 percent without incurring inflation, without a major increase in debt, and without serious balance of payments problems. This remarkable performance has been possible mainly because rapidly increasing oil revenues permitted greatly expanded public development expenditures and imports, with only minor strain on Iran's foreign exchange position. The growing oil income coupled with liberal credit policies has restored business confidence, encouraging a rapid rise in private sector investment as well. Per capita income has risen to a point where Iran is in the middle range of less developed countries.

7. Development activity in Iran started in earnest with the resumption of oil revenues in 1954. Since then the Iranian Government has been attempting to direct the expansion of the economy through a series of development plans. These plans at first concentrated on developing a communications network, then after 1962 gave greater emphasis to investment in industry and agriculture. The Third Plan (1962-1968) surpassed its target of six percent average annual growth largely because private sector investment recovered from the doldrums of the early 1960's and was 75 percent higher than forecast. But throughout, the mainstay of the development program has been the rapidly rising oil revenues, most of which have been pledged to public sector investment.² Especially in the early years of the Plan period considerable private investment went into housing; domestic investors have only recently begun putting much money into manufacturing and agriculture. Despite the Plan's overall success, many intractable problems remain that will hamper attempts to expand and modernize the Iranian economy.

8. Agriculture, which is still the most important source of income in Iran, has lagged behind other sectors. While the sweeping land reform program did not bring about the decreased productivity that normally follows such disruptions, agricultural production recently has increased at a rate not far above that of population growth. This modest rise has been attributable more to favorable weather conditions than to improvements in techniques. Even with the completion of the distribution phase of the land reform program, the average Iranian peasant remains a subsistence farmer, working small plots by primitive methods at low yields. Many of the farming units created by land reform are too small to make mechanized cultivation economic. The bureaucracy, short of skilled manpower and more accustomed to ignore than to encourage the peasant, is adapting only slowly to its role in stimulating development. In view of the

² The current Fourth Plan calls for 80 percent of oil revenues to be devoted to this purpose.

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enormity of the problem, it will be some time before the government is able to fill the needs of the new system, particularly requirements for credit and marketing facilities as well as those of water, fertilizer, and seeds.

9. The industrial sector has fared considerably better. Industry, including manufacturing and mining, has grown rapidly and now almost equals petroleum in importance as a contributor to gross national product (GNP). Although most manufacturing enterprises thus far have been in the textile or other consumer-oriented fields, the government is undertaking to establish heavy industry. A steel mill is under construction and the development of petrochemical and aluminium industries has begun. This activity is laying the base for continuing industrial growth. Yet it is already beginning to tax Iran's limited resources in managerial talent and skilled labor, which form the principal constraint to the expansion of industry.

10. Oil has been the key to the success of the Iranian economy, and the Shah is determined to increase his revenues from this source as much as he can. He has pressed the Consortium of Western oil companies³ very hard for a commitment to guarantee Iran total payments of \$5.9 billion over the next five years—a sum which would mean an average annual increase in oil revenue of about 16 percent. The companies would prefer to expand production of cheaper oil in other Middle Eastern countries, hence they have resisted his demands. Currently the Consortium seems prepared to make total payments of about \$5.0 billion over the five-year period, an amount which would—under the current tax and royalty structure—require a nearly 8 percent annual increase in oil production. After a hard bargaining session in the spring of 1968, the Shah accepted a compromise proposal by the companies whereby oil revenues accruing to the Iranian Government during 1968/1969 would meet plan goals (\$865 million), but figures for next year's offtake have not yet been agreed. He has since shifted his ground somewhat and is now pressing for rapid expansion of facilities necessary to permit sharp annual increases later in the current five-year period.

11. Both the Shah and the companies find oil production in Iran profitable and neither wishes to precipitate a break. In this situation, the two sides will no doubt explore numerous alternatives in involved negotiations throughout the course of the next five years. The Shah appears to be counting on the domestically owned National Iranian Oil Company to expand its markets, primarily in Eastern Europe, sufficiently to be able to dispose of the additional oil necessary to meet Iran's targeted oil income. This will be a difficult task, particularly if the Suez Canal remains closed, though more rapid progress will probably be recorded after a large Israeli pipeline is completed in 1969. The Shah also hopes for some improvement in the profit split on the operation of the Abadan refinery. No such arrangements are likely to meet Iran's demands in full, but we believe that in the end the Shah will accept a compromise for the five-year period.

³ Forty percent of the Consortium shares are held by US companies, 40 percent by British Petroleum, 14 percent by Royal Dutch/Shell, and 6 percent by a French firm.

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12. In part we reach this conclusion because we believe that Iran will not be able to spend money at quite the rate set in the Fourth Development Plan (1968-1973). This Plan, which calls for investment of \$6.4 billion from the government and \$4.4 billion from the private sector, envisages annual economic growth of 9.4 percent. Already, however, some major projects carried over from the Third Plan are running behind schedule. Administrative and construction delays reflecting unforeseen technical problems probably will hamper investment somewhat in the future as well. Nonetheless, these shortfalls in meeting Plan targets are likely to be modest, and Iran probably will be able to sustain an average annual increase in GNP of about eight percent over the remainder of the Plan period.

13. Presently projected increases in military expenditures probably will not materially slow Iran's economic development. The Shah plans to increase defense outlays at an annual rate of nearly 12 percent; as in the past this target may significantly understate actual expenses. Iran has already obtained from the US arrangements for credit sales of a substantial quantity of military equipment. Repayment will not begin until the goods are delivered and will stretch out over a number of years, however, thus mitigating the immediate economic impact of these purchases. Moreover, only about 10 percent of Iran's foreign exchange earnings are currently committed to foreign economic and military debt repayment. Hence, although Iranian free foreign exchange reserves have recently declined somewhat, the country can afford to borrow from abroad. Indeed, we believe that for some years to come Iran can continue without significant strain to finance both its military and economic programs at currently planned levels.

III. FOREIGN AFFAIRS

14. The Shah's present foreign policy has three major elements. One is his longstanding reliance on the US as the ultimate support for Iran's security. The second, more recently developed, is his belief that Iran can and should seek the advantages of good relations with the USSR and that the political and economic benefits thereof outweigh the risks to Iran. Third is an active concern for asserting Iran's influence in the region, both to enhance access to oil resources and to block the expansion of revolutionary Arab nationalism. Since the UK's announcement of its intention to withdraw its forces by 1971, the Shah has focused particular attention on the Persian Gulf.

A. The Persian Gulf

15. The Shah is determined to discourage any outside power from playing an influential role in the Gulf after the British leave. UAR withdrawal from Yemen and the resounding Egyptian defeat in the six-day war with Israel have to some extent eased the Shah's fears of Nasser's ability to foment troubles in the Gulf. Nonetheless, he still regards radical Arab nationalism as a threat to

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his position and an especial danger to his province of Khuzistan, where the main Iranian oil fields are located and which has a large Arab population. He therefore feels impelled to expand his influence, particularly over the weak feudal states on the Gulf, an aspiration encouraged by his confidence that no country in the region can match Iran's power.

16. Iran's territorial claims in the Gulf are a major irritant in its relations with the Arab states of the area. The Shah finds it hard to abandon recently revived pretensions to Bahrein, though these undoubtedly run counter to the desires of the overwhelming majority of its population. While he evidently has no intention of asserting these claims by force—and indeed would perhaps be willing to drop them if a face-saving arrangement could be worked out—he opposes the nascent Federation of Arab Emirates (FAA). This tenuous venture at combining the seven trucial sheikhdoms with Bahrein and Qatar seems unlikely to achieve any significant unity; it may even fall of its own weight before the British depart. Despite the Shah's efforts to woo the sheikhs individually, his continuing opposition to the inclusion of Bahrein in this grouping may further encourage the federation's tendency to look to Saudi Arabia as its main source of support. If the FAA should collapse, the Shah probably hopes to establish close ties with some of the sheikhdoms—a relationship that they might welcome as an alternative to the prospect of domination by Saudi Arabia.

17. Iran also has claims to islands in the lower Gulf. The Shah fears the possibility that hostile forces might gain control of the Strait of Hormuz and close access to the Persian Gulf. However remote this contingency may be, it nonetheless reinforces his desire to control Abu Musa and the Tunb islands which are held by two of the small Gulf sheikhdoms. In conversations with the British the Shah has asserted his right to jurisdiction over these islands, but he may be willing to settle for arrangements which would allow him to use them for defense purposes.

18. An even more important consideration in determining the Shah's success in influencing developments in the Persian Gulf will be his ability to maintain cordial relations with Saudi Arabia. Both countries share concern lest radical Arab nationalism gain a foothold in this area. Furthermore, each is interested in deriving maximum benefits from undersea oil deposits. An agreement to resolve the most pressing dispute—the location of the Saudi-Iranian portion of the median line in the Persian Gulf—was reached in November 1968, although ratifications have not yet been exchanged. But other stumbling blocks to cooperation remain. Neither monarch wishes to admit the primacy of the other in the Gulf; more importantly, the two have not been able to devise any common approach to the FAA. These factors will probably increase frictions in the relationship of the two countries already strained by centuries-old rivalries between Sunni Arabs and Shia Iranians. Particularly unless both feel threatened by some external force in the Gulf, enduring cooperation between the two rulers appears unlikely.

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B. Other Regional Relations

19. Iran views its other regional concerns as less immediate. The Shah is not as afraid of Iraq as in times past. Yet he would be reluctant to abandon his intrigues with the Kurds in northern Iraq whose dissidence he sees as insurance in the event a more dangerous and purposeful regime should come to power in Baghdad. Iran's interest in CENTO has declined considerably in recent years, though the Shah has no desire to see it disappear entirely. Iran never set much store by the Regional Cooperation for Development arrangement;⁴ its prospects have been further dimmed by coolness in Iran's relations with Pakistan. In response to Pakistani support for Nasser, the Shah is encouraging more intimate ties with India which he visited early in 1969.

C. Relations with the US

20. As a sign of his increased independence the Shah in recent years has sought publicly to appear less aligned with the West. Nonetheless, he considers a relationship with the US as the cornerstone of his policy and he looks to the US as the principal source of the weapons which he feels he needs. He believes that he must have the capability not merely to defend Persian shores and airspace, but to keep open the Strait of Hormuz and perhaps to intervene on the Arab littoral as well. These desires have led him to seek F-4 Phantom fighter-bombers, patrol craft, C-130 air transports, Sheridan tanks, and other equipment from the US. While he is basically content with the May 1968 military credit sales program that could provide up to \$600 million in such equipment over a six-year period, he will continue to press for accelerated delivery of the major items. If significant revolutionary activity were to erupt in the Gulf, we would expect the Shah to request major additional arms from the US; if he could not get some satisfaction from these efforts, he would almost certainly seek weapons from other Western sources and from the Soviet Union. At the same time, he may calculate that if he were to pursue an overly aggressive policy in the Gulf, American arms might be denied him.

21. Beyond the give and take of these arms negotiations, US-Iranian relations are likely to be subjected to relatively little strain for the next few years. Some longstanding irritants—such as litigation by a former Iranian national attaching the assets of the Shah's brother and sister—have disappeared in recent years. Despite the mounting nationalist fervor that animates the Shah's actions, he continues to value his association with the US. Hence the Shah has accepted with equanimity the end of the AID program in 1967; he is prepared to view his rapidly rising oil income as an acceptable substitute. He also encourages private American investment in Iran. The presence of our special facilities in Iran has not been a point of contention.

⁴ The members of the Regional Cooperation for Development are Iran, Turkey, and Pakistan.

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22. How long these facilities remain available and whether any expansion would be possible will depend on a complex interplay of Iranian, American, and Russian attitudes and actions. The Shah is aware of the relationship between these facilities and Iran's own security. On the other hand, one aspect of the Shah's increasing self-confidence and independence is his willingness to adopt a more "normal" attitude toward the Soviet Union. At some stage the Soviets may elect to urge that the maintenance of US special facilities on Iranian soil is incompatible with correct relations between Iran and the USSR. Such a line of argument might seem persuasive to the Shah, especially if pressed at a time when he felt that the US was not sufficiently forthcoming on matters of particular interest to him, such as supply of military equipment or support of Iran's desire for a position of primacy in the Gulf.

D. Relations with the USSR

23. The Shah is interested in fostering Moscow's "good neighbor" policy. It offers him useful economic relationships, in the fields both of trade and of development. It provides an additional source of military equipment. It has attractive political aspects as well; the Shah may calculate that a more cordial relationship between Teheran and Moscow will serve to temper the ambitions of Moscow's Arab clients—those radical states which the Shah sees as the most immediate threat to his own aspirations in the Gulf. At the same time the Shah undoubtedly finds it useful within Iran. It serves to undercut the criticisms of the left, while the economic deals can be held up as hard bargains much beloved by Iranians of any class. Considerations such as these probably underlay the Iranian decision to purchase over \$110 million of arms—not including advanced weaponry—from the USSR, though the immediate occasion was the withholding of US credits. At the same time, the Shah recognizes that to procure surface-to-surface missiles and other advanced weapon systems from the Soviet Union would call into question continuation of military deliveries from the US. Hence, we believe that the Shah will not turn to the Soviets for major items of sophisticated equipment as long as he is reasonably satisfied by Western supply.

24. In the economic field, Iran continues to expand its relations with the Soviet Union. The principal deal thus far involves an exchange of natural gas for a steel mill and other items. While Iran will have to make substantial investments of its own in connection with these projects, the Shah is particularly pleased by this arrangement, which brings him a substantial return for gas that had previously been flared in the process of oil production. The pipeline essential for delivery of this gas is somewhat behind schedule, however, mainly because of construction delays, occasioning some friction between the two parties.

25. In June 1968 the USSR extended a credit of about \$200 million for development projects under the Fourth Plan also to be repaid by natural gas deliveries. Present economic deals will use about \$545 million of Iran's expected \$900 million in Soviet barter credits for the period 1970-1985. The uncommitted credit balance could rise further if the gas pipeline capacity should be enlarged,

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a project perennially under consideration. In any event, though dwarfed by comparison with the activities of the Western oil companies, the USSR has established itself as a major factor in Iranian economic development.

26. The Iranian Government is careful to restrict the flow of Soviet technical aid personnel into Iran, and the omnipresent security force keeps them under surveillance. The Shah has been particularly sensitive about permitting Soviet contact with Iranian military personnel. Only a few have been sent to the Soviet Union for specialized training—and these for short periods. Some Soviet technicians were permitted to accompany military equipment sent from the USSR, but they remained only a few months; there do not appear to be any Soviet military advisers in Iran at present. Moreover, the USSR's interest in the Indian Ocean and the Persian Gulf may give rise to new strains in Soviet-Iranian relations. Although the Shah felt constrained to permit a visit by three Soviet naval vessels to the Persian Gulf port of Bandar Abbas in June, he clearly does not want to see the Soviets become more active in this area—a possibility that will become more immediate when and if the Suez Canal is opened. Indeed, there are limits beyond which the Shah is not likely to go in deemphasizing his ties to the West and in improving relations with the Communist countries. At bottom, the Shah remains wary of the Soviet Union and suspicious of the revolutionary potential of its Arab clients.

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