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PROBABLE DEVELOPMENTS IN IRAN THROUGH 1955

THE PROBLEM

To estimate probable trends in Iran in the light of the oil settlement, with particular respect to: (a) the prospects for continued control by Zahedi or other moderate leaders; (b) the outlook for economic and political stability; (c) the probable extent of Iran's will and ability to contribute to US-backed regional security programs; and (d) the extent to which continuing US assistance and influence will be important factors in the situation.

CONCLUSIONS

1. Since Mossadeq's downfall, political power in Iran has largely reverted to the Shah and the conservative traditional ruling group. The principal new features of the situation are: (a) the extent to which authoritarian means have been used to curtail opposition; (b) the emergence of the US as an acknowledged major influence in the situation; and (c) the re-emergence of British political and economic influence. (Paras. 13-14)

2. Zahedi's chances of survival through 1955 are considerably less than even. We believe that the most likely time for his replacement will be shortly after the Shah's return to Iran in February-March 1955. Iran will probably remain, at least through 1955, in the hands of predominantly conservative governments acceptable to the Shah and Western-oriented. Now that the oil dispute has been resolved, however, there is likely to be a marked increase in political ferment which may weaken the effectiveness of the government and facilitate a

revival of extremist influence. Moreover, even if the conservatives succeed in retaining control beyond 1955, they will remain vulnerable to a Tudeh or nationalist-inspired flareup of popular feeling unless they make some progress in satisfying popular grievances and in reducing popular distrust of the government. (Paras. 21, 22, 24, 27, 41)

3. The Communist Tudeh Party, having suffered a series of setbacks, will be in no position to challenge the government seriously in the next 12 to 14 months. Indeed it may be hard pressed to maintain an effective organization. Nevertheless, it is the only political opposition group in Iran which has some organization and discipline, and it is likely to re-emerge as an active threat unless the government both continues effective suppression and succeeds in allaying popular grievances. (Paras. 15, 21, 35-37)

4. The resumption of oil production, together with interim US aid, will provide Iran with substantial funds for an eco-

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economic development program which could do much to meet popular aspirations. However, the ultimate effectiveness of any such program will depend not only on the money available but also on the way in which the government tackles the managerial and political problems involved, and on the Shah's willingness to provide firm support. This, in turn, is likely to depend on the ability of the US and UK to work together effectively and influence the Shah and other Iranian leaders against allowing the programs to be unduly weakened by corruption, mismanagement, and political maneuvering. (Paras. 29, 38, 42-44)

5. In any event, Iran is likely to remain for a number of years a basically unstable country, plagued with continuing economic and financial difficulties. Its underlying social and economic problems are of a sort which can be solved only over a relatively long period of time and which, in the process, will generate new tensions and strains. The disruptive potential of popular discontent accompanying such tensions and strains will probably be increased unless the ruling group adjusts to a sharing of power with growing middle class elements. (Paras. 27, 30)

6. In time Iran will almost certainly seek increased participation in the management and profits of the oil industry. However, the oil question is unlikely to re-emerge as a burning issue so long as oil company policies pay due heed to Iranian sensitivity and aspirations and Iran remains reasonably stable and pro-Western in outlook. (Paras. 32-34)

7. The Shah and many Iranian leaders are convinced that Iran must maintain close ties with the West if it is to avoid

isolation and eventual Soviet domination. They are probably genuinely interested in eventually participating in a Western-backed regional defense arrangement. However, they are unlikely to make such a commitment until: (a) the Iranian forces have been substantially strengthened, and (b) they are confident that such a move would not encounter serious opposition within Iran. Neither condition is likely to be met within the next year or two. (Paras. 56-57)

8. So long as the Iranian Government continues to expect US economic, financial, and military assistance, it will remain responsive to US influence. As oil revenues are restored and US aid is reduced, however, Iranians may become increasingly determined to manage their own affairs and more resistant to US guidance. (Para. 56)

9. At present the Iranian armed forces have extremely limited capabilities even for a short-term delaying action. Capabilities in this respect could be improved, but this would require outside aid in the form of equipment, training, and financial support for military purposes. To increase Iran's defense capabilities so that Iran could contribute substantially to Middle East defense would be difficult and time consuming. Such a program would require extensive outside aid, a drastic improvement in the professional standards of the officer corps, the development of a will to fight on the part of Iran's conscript forces, and a government resolute to resist aggression. (Para. 52)

10. In the short run, the chief effects of an expanded US military aid program would be political. Such a program would strengthen the self-confidence and pro-US orientation of the Shah, army

leaders, and other key elements in Iran. If accompanied by improved pay and living conditions, such a program would also tend to lessen the vulnerability of the armed forces to Tudeh appeals and thereby to improve their long-term reliability. (Para. 53)

11. The USSR would almost certainly regard it as provocative if Iran joined a Western-backed regional defense organization, and would probably respond with strong diplomatic protests and increased subversive and propaganda efforts. The USSR might also threaten to invoke the 1921 Irano-Soviet Treaty, which it interprets as permitting it to introduce troops into Iran in case of threatened invasion

from Iranian territory. If establishment of Western bases on Iranian soil appeared to be in prospect, the Soviet reaction would be stronger and would probably include shows of force along the border. In this case, the USSR might claim comparable base rights in Iran which would result in the movement of Soviet forces into Iran. (Para. 61)

12. Iran, under any foreseeable leadership, will continue to resist Soviet attempts to interfere in Iranian affairs. At the same time it will be careful to maintain superficially correct relations with the USSR, to avoid giving Moscow solid grounds for intervention. (Para. 62)

DISCUSSION

I. POLITICAL

Present Situation

13. Since the overthrow of Mossadeq in August 1953, political power in Iran has largely reverted to those who controlled the country prior to the oil nationalization crisis of 1951. The Shah has been confirmed in his central role in the governmental power structure; as the most important focus of prestige and political influence in the country; and, through his continuing personal control of the armed forces, as a powerful force in political affairs. The mixture of zealots, demagogues, and reformers who rose to prominence in the Mossadeq era have been forced into the background along with the mobs they led, leaving the traditional landowning, commercial, and military groups once again in control of the offices and perquisites of government. The tribal situation is quiescent, except for the currently strained relations between the Shah and the four principal Qashqai leaders who are powerful in southern Iran.

14. The principal new features of the present power situation are: (a) the extensive use of

authoritarian means — martial law, censorship, and prosecution or repression of opponents — to curtail opposition to the regime and to the government; (b) the emergence of the US, which many Iranians hold responsible for effecting Mossadeq's downfall and which has since been the chief financial backer of the government, as an acknowledged major influence in the situation; and (c) the re-emergence of British political and economic influence.

15. Under General Zahedi, reasonably orderly and stable government has been established in Iran. The Majlis and Senate have been reconstituted, and as yet there has been no resumption of the irresponsible bickering and obstructionism which has marked the legislative process in the past. Zahedi has sought and successfully retained the support of the Shah and has thus been able to stave off various emergent political conspiracies to replace him. The government has recognized its probable inability to appease the extremists and has generally dealt firmly with them. It has made a conscientious effort to crush the

Communist Tudeh Party, and through a lucky break leading to the uncovering of a Tudeh ring in the armed forces has probably given the Communists a serious setback. It has pushed through legislation for reforming the currency, has set up a Planning Council to control the allocation and expenditure of development funds, has presented new anti-Communist legislation, and has promised measures for land reform and reduction of corruption in government.

16. Most important of all, the government pressed ahead with an oil settlement, which was agreed to in principle in August 1954 and finally ratified, with only slight opposition, in late October. While the one-sided vote for ratification was mainly the result of strong pressure by Zahedi and the Shah, the government has apparently succeeded in convincing a considerable part of the public, at least for the present, that some form of oil settlement was necessary and that the present one was the best obtainable under existing circumstances.

17. Despite these achievements, a real basis for lasting stability is still lacking. The events of the last year have not eliminated the strains and discontents which accounted for much of the success of Mossadeq's nationalist appeal (and for much of the appeal of the Tudeh Party). Extreme nationalism itself has been repressed rather than destroyed as a major political force. The government has failed to achieve widespread support and at best appears to be accepted as one which has restored law and order, which may with US support and oil revenues be able to provide some benefits for the country, and which in any event presently has the will and ability to put down opposition. It has not succeeded in checking inflation or in making much tangible progress toward economic and social betterment — two points of particular importance because of their impact on the potentially politically influential urban middle and lower class elements.

18. Because of the traditional practice of using public office for private and family gain, many officials, including Zahedi himself, have been accused of the same graft and corruption

which have long encouraged popular cynicism about the government. The use of authoritarian methods has tended to create some adverse reaction of its own: it has probably generated opposition and may drive some moderate reformists into the arms of Tudeh or other extremist groups.

19. Moreover, despite Zahedi's success to date in retaining the support of the Shah and in obtaining the cooperation of the Majlis and Senate, he has few reliable supporters in either body. His success is largely due to general recognition that an oil settlement was necessary and that the removal of Zahedi would have jeopardized the settlement and incurred the disapproval of the US and the UK. Many legislators probably also reasoned that Zahedi could be made the scapegoat in case the political atmosphere changed and opposition to the oil settlement became active and widespread.

20. Now that the oil settlement has been achieved, it is uncertain as to how long Zahedi himself is likely to remain in office. There is also the more basic question whether, under Zahedi or any likely successor, Iran will develop a basis for political and social stability.

Probable Developments through 1955

21. At least through 1955, we believe the government will remain in the hands of predominantly conservative forces acceptable to the Shah and willing to continue with a Western-oriented policy. Despite the Tudeh Party's continuing long-range potential, it will be in no position to challenge the government seriously during the next 12 to 14 months and may indeed be hard pressed to maintain an effective organization. So long as Zahedi is Prime Minister, the government will almost certainly continue a fairly firm policy of repression. This will inhibit the effectiveness of such violent critics of pro-Western policies as Mullah Kashani, Mozzafer Bagnal of the Toilers Party, and the leaders associated with the pro-Mossadeq National Resistance Movement. Some of these, however, may be able to develop contacts and influence among dissatisfied elements.

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22. There is likely to be a marked increase in political ferment. The settlement of the oil dispute has removed an important deterrent to resumption of the political maneuvering and intrigue characteristic of the pre-Mossadeq era and has probably increased the desire of deputies and senators, many of whom paid heavily to insure their election, to benefit personally from the oil settlement. The efforts of the government to move ahead with an internal reform and development program are likely to encounter strong opposition from some deputies and senators and indifference from many others. At the same time the government is likely to be confronted with demands, sincere and otherwise, for speedier action to control inflation and improve living standards, for improvements in education, public health, working conditions, and for restoration of freedom of the press and assembly. Personal antagonisms and rivalries are also likely to come to the surface and provincial and tribal resentments against the government may be intensified.

23. Zahedi could probably survive these difficulties if he had the strong support of the Shah, since the various aspirants for his job are likely to remain too weak and divided among themselves to bring effective pressure for his removal without active encouragement from the Palace. The Shah's continued willingness to provide such backing, however, is uncertain. His underlying distrust of any strong personality, his predilection for political intrigue, and his tendency to vacillate all militate against his supporting Zahedi on a sustained basis, particularly now that the oil settlement has been achieved. Moreover, the probable increase in political activity in the months to come is likely to make it easier for Zahedi's rivals to persuade the Shah, who is keenly sensitive to political currents within Iran, that Zahedi no longer is acceptable to the political community and should be replaced. The Shah may be dissuaded from making an early switch by the difficulty of finding a satisfactory replacement, by fear of losing US or UK support, or by concern over the future of the reform and development program. However, his personal inclinations

appear to be in the direction of eventually replacing Zahedi.

24. Zahedi's chances of survival through 1955 are considerably less than even. We believe that the most likely time for his replacement will be shortly after the Shah returns to Iran in February-March 1955. Parliamentary maneuvers to unseat him may develop during the Shah's projected three months trip to Europe and the US beginning in December 1954 but would be unlikely to succeed in view of the Shah's probable desire to have no change of government during his absence. Zahedi's position will be open to further attack if he goes through with his plans to go to Europe for necessary medical attention following the Shah's return. Moreover, the possibility of assassination is always present. Finally, the terms of the entire Majlis and one-third of the Senate will expire in the spring of 1956, and toward the end of 1955 the Shah may take the occasion to remove Zahedi and install a "service" government for the electoral period as has been done frequently in the past. On the other hand, should the Shah still be prepared to back Zahedi as the year ends, the latter's position would be strengthened, since he would presumably have some part in deciding which candidates would obtain the all-important support of the government and the Shah.

25. Zahedi's removal would not necessarily lead to any significant change in the over-all stability and orientation of the government, since the Shah would remain the most influential single figure in the governmental structure and since the present government's major policies are as much his as Zahedi's. However, a successor might not be as willing as Zahedi to use force to maintain order. Furthermore, successful efforts to remove Zahedi would encourage similar attacks on his successor and might accelerate the return of extremist groups to positions of political influence. Such a development would tend to revive the pre-Mossadeq pattern of political instability. In this situation, each prime minister in turn would secure a temporary majority in parliament by promising a redistribution of spoils. Sooner or later, however,

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he would no longer be able to meet the continuing demands of his supporters and would be forced out in favor of someone else who was willing to promise more. If, in the meantime, the Shah had not taken action in the face of a succession of weak governments, a possibility of a coup by a strong military leader would have been created.

26. None of the leading candidates for Zahedi's position has any solid political support and, moreover, none shows any great promise as a national leader. The most prominent current candidate is Senator Manuchehr Efqal, an experienced government official, believed to be particularly well-disposed toward the British and to have the confidence of the Shah. The Shah might also appoint his Minister of Court, Hosein Ala, as an interim prime minister.¹ In any case, the effectiveness of any successor to Zahedi would depend on the willingness and ability of the Shah and the Prime Minister to cooperate.

Long-Range Problems and Prospects

27. The conservative elements now in power will probably be able to retain their control beyond 1955 if they remain prepared to continue the authoritarian methods now in effect. However, unless they make some progress in satisfying popular grievances and reducing popular distrust of the government, they will remain vulnerable to the sort of flareup, under Tudeh or nationalist auspices, which was touched off by Razmara's assassination and the oil issue in 1951. In the long run, moreover, unless the traditional landowning group adjusts to a sharing of political power with growing urban middle class elements, there will probably be an increase in the disruptive potential of popular discontent. While the armed forces will constitute a fairly reliable instrumentality for coping with popular disturbance, they are not immune from grievances common among civilians. A marked decline in popular acceptance of the present

¹ Other aspirants for the prime ministership include: Senator Javad Bushehri; retired general Hassan Arfa; Senator Dr. Mohammed Sajjadi; Ali Soheyli, a former prime minister and now ambassador to the UK; and Abol Qasem Najm, a former minister of finance.

ruling group may therefore have an adverse effect on the reliability of the security forces.

28. The Shah appears to recognize the need to attack these problems before popular disappointment with the government reaches dangerous proportions. However, many difficulties will be encountered before even a modest start can be made. The government's current attempts to curtail corruption and build up public confidence in the bureaucracy will make little progress without the active support of the Shah. Even if government and military salaries are raised sufficiently to provide a decent living, corruption will remain a major characteristic of Iranian political life until such time as a tradition of public service has become established. Efforts to spur social reform will almost certainly encounter strong resistance from vested interests. Moreover, as the government may fail to recognize, the development of greater political stability will probably require, in addition to material advances, greater effort to enlist the support of the opinion-forming intellectual and reformist elements. So long as these elements remain excluded from effective participation in political affairs and prevented by censorship from expressing their views freely, they are likely to maintain an attitude of strong opposition.

29. We believe that progress will be made on the strength of the oil revenues and the impetus provided by US aid. In view of the resistance likely to be encountered, however, the extent of that progress will probably depend on the willingness of the Shah to provide active, continuous, and consistent support. Given the Shah's personal characteristics, this willingness in turn is likely to depend on the ability of the US and UK to convince the Shah of the necessity of such support and to keep his attention focused on the problem.

30. In any event, however, Iran is likely to remain a basically unsteady country for a number of years. Iran's underlying social and economic problems are of a sort which can be solved only over a relatively long period of time and which, in the process, generate new tensions and stresses. With oil revenues in process of being restored and a beneficial relationship with the West established, Iran is

in a better position to attack these problems than it was before. However, they will be successfully solved only through a continuous and sustained effort.

The Succession to the Throne

31. In view of the key role of the Shah in the Iranian political system, the death of the present monarch could be a serious blow to Iranian stability, particularly since he has no male heirs of his own and has refrained from openly designating a successor.³ His death would at least create an opportunity for extensive political bickering over the succession, in which Tudeh and the ultranationalists might revive their demands for a republic. Should the Shah's death take place in the present political environment, the conservative elements now in the ascendancy, with the military high command taking a prominent part, would probably succeed in stabilizing the situation. If the Shah were assassinated, the present leadership's ability to maintain control would probably be enhanced by popular revulsion against the assassins. Even if the succession were quickly established, however, the new Shah would have to establish his authority, and initially, at least, his ability to exercise the positive leadership which Iran needs would be less than that of the present monarch.

The Future of the Oil Issue

32. The recent oil settlement, though not a complete victory in Iranian eyes, involved sufficiently substantial concessions to Iran's aspirations to generate a significant momentum of good will and sense of achievement. Moreover, the oil settlement removes a politi-

³With the recent death of the Shah's only full-brother Ali Reza, the next in line is the Shah's oldest half-brother, Gholam Reza, 31 years old. After Gholam Reza, the next in line is 30-year old Abdor Reza, former head of the Seven Year Plan Organization. Both brothers are western-educated. Although both of these brothers technically can be debarred under the present constitution because their respective mothers are members of the deposed Qajar dynasty, it is probable that the Majlis would interpret the constitution in favor of one of them if he were chosen by the Shah to succeed to the throne.

cal irritant, which for three years has stultified or diverted efforts to solve other urgent social and economic problems, and enables Iranians to hope for improvements both personally and nationally. The settlement will probably also improve relations between Iran and the West. The morale of most Iranian leaders will be improved not only by the revenues in prospect, but also by somewhat greater Iranian participation in the control and operation of the industry and by the apparent elimination of the Anglo-Iranian Oil Company's ability to interfere in internal Iranian matters.

33. With the passing of time and the strengthening effect of oil revenues, however, difficulties may arise over the oil question. Iran will almost certainly share the desire of other Middle East producers for increasing oil revenues and for exercising a growing voice in oil policy and operations at the expense of the oil companies. It will be extremely sensitive about real or apparent slights to its prestige and independence by foreign oil interests, particularly British, and Iranian politicians may attempt to play off the consortium members and interested governments against each other. Finally, the oil settlement may arouse excessive hopes of benefits which cannot be achieved.

34. These dangers do not appear imminent, however, and in any event the risks to the consortium and to the Western Powers in future oil operations are probably not now significantly greater than those involved in Western oil operations in other Middle East countries. If the consortium members and the interested Western nations pursue policies which take into account Iranian sensitivity and aspirations, and if the country maintains a reasonable degree of political stability, prospects for satisfactory oil operations with accompanying benefits to all concerned are good.

The Outlook for the Tudeh Party

35. The Communist Tudeh Party is currently at one of the low points in its history, though it remains the only political opposition group in Iran that has some organization and dis-

discipline.³ Strong popular opposition to Tudeh flared up at the time of Mossadeq's downfall, and since then the party has been subjected to severe governmental restrictions and uninterrupted press and radio attacks. These developments have almost certainly taken a heavy toll among its sympathizers and have probably cut into its membership as well. The uncovering in August 1954 of a Tudeh network in the armed forces and the subsequent arrest of hundreds of persons who were implicated has been a severe blow. The discovery and confiscation of the clandestine printing plants of Tudeh and of its youth organization has been a further setback, as has been the recent intensification of government efforts to root Tudeh members and sympathizers out of the bureaucracy. For the present, in the face of government plans to introduce stringent laws penalizing Communist membership or activities, the party is almost certainly primarily concerned with attempting to maintain an effective organization.

36. The recent spy ring discoveries have not yet established the extent of Tudeh penetration of the Iranian armed forces, and Tudeh strength in the bureaucracy remains unknown. Even at a minimum, however, indications are that Tudeh penetration of the armed forces was sufficient to carry on an effective intelligence collection effort, to develop a capability for strategic sabotage and political assassination, to acquire weapons and equipment, to protect Tudeh members from the police, and to facilitate clandestine transit across Iran's borders of Soviet and Iranian Communists. The extent of this Tudeh penetration of the armed forces reinforces previous indications that various ministries, notably Justice and Education, also have been infiltrated. It also points up both the weakness of Iranian security against espionage and the success of the Communists in recruiting Iranian personnel for their covert operations. The fact that the Tudeh ring in the armed forces apparently confined its efforts to espionage and the development of

a sabotage potential suggests that in present circumstances the USSR recognizes that its program must be confined to developing assets rather than fostering an early attempt to seize control of the armed forces.

37. At least for the short run, recent stringent measures against the Tudeh Party have reduced its ability to promote overt opposition to the oil agreement and the Western position in Iran and have stimulated public and official awareness of the Tudeh threat. If these measures are continued against Tudeh adherents and not used to harass political opponents, the dependability of the armed forces and the bureaucracy will increase. On the other hand, the severity of official action against Tudeh members may adversely affect popular attitudes toward the government, which is already condemned in many quarters for oppressive measures, and as a result may enable the Tudeh Party to share in popular sympathy for other opposition elements which also have been targets of the government crackdown. The government's long-range chances of success in its anti-Tudeh measures will depend both on its readiness to remain consistently firm and alert, and on its ability to make some progress in allaying social, political, and economic grievances which make Iranians vulnerable to Tudeh exploitation. The government's effectiveness, in both of these respects, will in turn depend on firm backing from the Shah.

II. ECONOMIC

Present Situation

38. The chief economic accomplishment of the Zahedi government has been the agreement between Iran and a consortium of eight Western firms for restoration of Iran's oil industry.⁴ This agreement, which calls for development of Iranian oil production by the end of the third full year of operation to a level yielding the Iranian Government revenues of approximately \$175 million a year, will provide Iran with substantial funds for a program of economic rehabilitation and de-

³ During the last year of Dr. Mossadeq's regime (1953) Tudeh membership probably reached a peak of about 35,000. Present active membership probably numbers about 7 to 8 thousand.

⁴ Major provisions of the settlement are summarized in an appendix.

velopment.³ Although the oil companies have made no further specific commitments, they have formally indicated that they expect Iran's revenues to average out at least that level for the remainder of the 40-year contract period. In addition, Operating Company purchases of rials for local operating expenses will add approximately \$34 million annually to Iran's foreign exchange income. The resumption of oil production has relieved the government of the cost of meeting the NIOC payroll and will also have various indirect economic benefits in the southern oil areas.

39. In other respects, the Iranian economy has done little more than mark time in the period since Zahedi's advent to power. The provision of \$70 million in US emergency assistance has enabled Zahedi to pay the government's running expenses, and the oil settlement has bolstered general business confidence and Iran's foreign credit standing. On the other hand, there has been little development activity other than that undertaken in connection with the \$23.9 million US technical assistance program. Moreover, during the past year the urban cost of living has continued to rise sharply, thus increasing the already heavy economic pressure on government employees, factory workers, and others in the fixed income groups. In addition, the government's financial position has been weakened by a wave of uncoordinated credit purchases this summer from foreign suppliers eager to cash in on the expected resumption of oil revenues. These credit deals, involving rails, buses, and other items, are estimated to total up to \$100 million.

40. The government has obtained US pledges of an additional \$127.3 million in grant aid and loans during fiscal 1955 including \$52.8 million for direct budgetary support. In addition it has taken some steps, in part at US urging, to improve its future financial management. Currency reform legislation was pushed through in July 1954, providing the government with increased flexibility in

³ Consortium payments to Iran will be in sterling. Under a secret UK-Iranian convertibility agreement, 40 percent of these sterling payments will be convertible into dollars.

monetary matters. Following the wave of profligate government buying this summer, an Economic Council, made up of the director of the Plan Organization, the governor of the Bank Melli, the Ministers of Finance and National Economy, and the Prime Minister, was established to plan, coordinate, and control government finances and developmental expenditures. The government's program also calls for prompt reorganization of the government tobacco monopoly and of the customs and income tax administration.

Probable Developments

41. With the achievement of an oil settlement the government is now faced with the task of setting up and carrying out an economic rehabilitation and development program which will be effective in raising general living standards. Promises of economic development have been bandied about ever since World War II, but no substantial progress has been made. Moreover, continuing inflation has worsened the economic position of the politically most volatile and articulate elements of the population, while at the same time hopes have been raised, first by oil nationalization and more recently by the solution of the oil dispute. While economic grievances are not the only factors affecting popular attitudes toward the government, there will almost certainly be a serious rise in unwillingness to accept the regime unless some tangible progress in economic development is made.

42. Over the long run, Iran will have substantial oil revenues which could be devoted to financing a development program. In the first full year of operation, however, Iran will obtain only about \$60 million in oil revenues, and much if not all of this may be used up in meeting current operating expenses. Although projected US aid for 1955 includes \$52.8 million for direct budgetary support — enough to cover the current rate of deficit — pressures for an increase in salaries of government workers, who have been particularly hard hit by inflation, will almost certainly become stronger. After the first year of operation, however, oil revenues will rise, levelling off at about \$175 million in the third year, and by then the government's

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efforts to curtail waste and corruption and to increase other revenues may be bringing in some return. Plan Director Ebtahaj hopes, probably somewhat optimistically, that these latter measures will enable the government to support itself out of ordinary revenues by March 1956, thereby freeing the entire oil income for developmental use.

43. In any event, the ultimate effectiveness of any development program will depend not only on the amount of money available but also on the manner in which the government tackles the managerial and political problems connected with it. Since most economic development projects are slow in getting under way and even slower in producing their full economic effects, there is a danger that without programs which have an immediate social or economic impact public confidence in the over-all program may be dissipated. These difficulties will be compounded if lethargy, corruption, and mismanagement are allowed to delay the program or to divert its funds to private pockets or unproductive ventures. Moreover, the desired political effect will not be obtained unless special care is taken to assure sufficiently broad participation in the benefits of these projects.

44. The Shah and Zahedi appear convinced of the need for an effective development program and have some capable men associated with them in this effort. However, the problems ahead cannot be solved without effective US and UK guidance and support. Given such guidance and support, the Economic Planning Council may be able to commit the government to worthwhile projects which, though unpopular with certain vested interests, would be difficult for subsequent governments to repudiate. Iran will also have continuing need for technical assistance in carrying out projects in the field.

45. Finally, while the economic development programs currently envisaged should eventually result in a significant increase in over-all output and a rise in the general standard of living, Iran will continue to be plagued by recurrent economic and financial problems which will require firm government action.

Unless carefully managed, the development programs may themselves contribute seriously to inflationary pressures.

46. In general, however, Iran will probably make some gradual and uneven progress in improving its economic position. Both public and private foreign trade is likely to increase, particularly in view of the strong and growing desire of Japan, Germany, and Italy to participate in the Iranian market. Barter trade with the USSR may increase in absolute terms, though its relative importance is likely to decline in view of Iran's expanding relations with the Western world.

III. MILITARY

47. Iran's present armed forces, numbering over 150,000, are organized primarily for control of the tribes and other internal security duties.* Their traditional loyalty is to the Palace rather than to the government as a whole, and all but the gendarmerie report directly to the Shah as Commander-in-Chief rather than through any civilian minister. The recent uncovering of a widespread Tudeh ring within the armed forces indicates that they have been vulnerable to subversive influences. However, most of the currently disloyal elements appear to have been eliminated or identified and we believe that the armed forces can be presently considered fairly reliable.

48. Since 1950 the US has assisted in efforts to modernize and improve the armed forces through maintenance of military missions to the army and the gendarmerie, and through provision of military equipment. Of the \$110 million in such equipment aid allocated thus far, about \$76 million had been shipped by mid-1954. The mission to the army is to be augmented by five US training teams at brigade or division level in early 1955.

*The Iranian armed forces consist of a conscript army of 120,000; a gendarmerie or rural police force of 20,000; and a small air force, navy, and frontier guard, the latter for border patrol and customs duties. The Air Force, Navy, and Frontier Guard are subordinate units of the Army. The Gendarmerie is under the control of the Ministry of the Interior, except in time of war, when it comes under army command.

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49. While some improvements have been effected through these programs, the Iranian military establishment is still of generally poor quality. Although it is generally capable of fulfilling its primary mission of maintaining internal security, it would be unable to offer significant resistance to a Soviet attack. Only a start has been made at developing adequate standards of leadership and tactical proficiency. Because of a general lack of technical skills and experience and a poor logistic system, Iran has had difficulty in absorbing even the limited amounts of US equipment thus far made available. Low pay and the general atmosphere of slackness, graft, and favoritism have weakened morale, particularly among the junior officers; these factors were probably in large measure responsible for Tudeh's success in winning supporters among the armed forces. Finally, Iran's potential for defense against a Soviet attack is weakened by its lack of a modern martial tradition and of any strong popular sense of national loyalty.

50. The development of the "northern tier" concept of a regional defense system based on the Turk-Pakistani agreement has emphasized the potential importance of the Zagros Mountain chain in Iran as a major barrier to any Soviet military advance into the Middle East. If an Iranian military force could be developed which was capable of effecting substantial delay in the Zagros passes, it would constitute an important asset in defense of the area.

51. An effort to create such an Iranian military capability would require a long-term program involving US expenditures very substantially in excess of present levels. The first and basic requirement would be to provide Iranian combat units with sufficient modern equipment and technical and tactical training to bring them up to adequate standards of combat effectiveness. Moreover, for such a force to function effectively additional outlays would be required for redeployment of troops and military installations from their present exposed positions to more defensible points in the Zagros Mountains area; the relocation or new construction of military stores,

arsenals, and factories; and the construction of a number of military roads linking strategic defensive points. Increased pay for the armed forces would almost certainly be required if morale were not to remain a major problem. A program on this scale would also require collateral economic aid since, even with the oil revenues anticipated in the next three years, Iran will be unable to afford the construction and development involved, for example, in moving military facilities and industries or in building military roads.

52. At present the Iranian armed forces have extremely limited capabilities even for a short term delaying action. Capabilities in this respect could be improved, but this would require outside aid in the form of equipment, training, and financial support for military purposes. To increase Iran's defense capabilities so that Iran could contribute substantially to Middle East defense would be difficult and time consuming. Such a program would require extensive outside aid, a drastic improvement in the professional standards of the officers corps, the development of a will to fight on the part of Iran's conscript forces (which would in turn depend largely on the over-all state of national morale), and a government resolute to resist aggression.

53. At least in the short run, therefore, the chief effects of an expanded US military aid program would be political. Such a program would strengthen the self-confidence and pro-US orientation of the Shah, army leaders, and other key elements in Iran and would demonstrate to them that the US has not written Iran off militarily. If accompanied by improved pay and living conditions, such a program would also tend to lessen the vulnerability of the armed forces to Tudeh appeals and thereby to improve their long-term reliability.

IV. FOREIGN AFFAIRS

Relations with the US

54. Under the Zahedi government, and with the strong support of the Shah, Iran has moved toward alignment with the West, particularly the US. The timely extension of US support and guidance has made the US the

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dominant western influence in the Iranian Government. The present leaders of Iran appear to welcome this relationship.

55. The Shah and other important leaders have shown themselves generally responsive to US advice over settlement of the oil issue, resumption of relations with the UK, methods of improving the armed forces, and certain internal matters such as economic planning and administration. Iran has generally supported the US in issues before the UN and tends to follow US advice in its relations with other Asian states. Moreover, since the signing of the Turk-Pakistani agreement and the start of US military aid to Pakistan and Iraq, Iranian leaders, particularly the Shah as Commander-in-Chief, have expressed growing interest in eventual participation in US-backed regional defense preparations. Iran has maintained a firm position in the face of Soviet protests over the prospects for its defense cooperation with the West, and the government has risked Soviet displeasure by firm measures against the Tudeh Party and Communist subversion.

56. So long as the Iranian Government continues to expect US economic, financial, and military assistance, it will remain responsive to US influence. As oil revenues are restored and US aid is reduced Iranians may become increasingly determined to manage their own affairs and more resistant to US guidance. We do not believe, however, that developing Iranian self-reliance is likely to alter significantly the conviction of the government, and of the Shah in particular, that Iran requires Western support and friendly relations if it is to avoid isolation and eventual Soviet domination. The Shah is especially desirous of building up the army and regards the US as the only feasible source of the military assistance required to do so. He may also believe that obvious US concern about Iran gives him a favorable bargaining position. Even if he is unsuccessful in obtaining assistance on the scale he believes necessary to give Iran effective forces, his urgent desire for such assistance as he can get will continue to give the US bargaining power with him. The willingness of Iranian Government lead-

ers, including the Shah, to make firm commitments to the West is likely to be limited, not by indifference to the Soviet danger but rather by the proximity of Soviet power, by public distrust and dislike of undue foreign influence, and by uncertainty as to the effectiveness of Western military support in the event of war.

Iran and Regional Defense

57. The Shah and many Iranian leaders would like to participate in a regional defense arrangement backed by the West, and they will probably continue to advance the idea both for motives of prestige and as a means of securing maximum US military aid and defense support. Under present circumstances, however, they would probably be reluctant to join any regional grouping until: (a) the Iranian military establishment had been substantially strengthened, and (b) they were confident that such a move would not encounter serious opposition within Iran. Neither condition is likely to be met within the next year or two at least. However, Iran might engage in informal staff talks with Iraq and possibly Turkey or Pakistan within this period.

Relations with the UK

58. Iranian-UK diplomatic relations have been resumed and, with the oil settlement, tension between the two governments has subsided. However, widespread suspicions of the British persist. Because of the fact that most Iranian leaders now tend to look more to the US than to the UK for support and guidance, the expansion of UK diplomatic influence is likely to be slow, and the UK will not, in the foreseeable future, regain its former position as the dominant western power in Iranian affairs. Nevertheless, many prominent Iranians have long-standing British ties, and their responsiveness to British influence is likely to increase with the revival of British commercial activity. At least some restoration of former British commercial and banking connections with Iran, which were close and mutually profitable, will almost certainly take place, particularly since more than half of Iran's oil revenues will not be transferrable into dollars. The British are also likely to make a comeback

in construction and engineering, although they will probably encounter increasing competition from the West Germans in this and other business fields.

59. The UK currently agrees with the US on the desirability of Zahedi's remaining in office. However, various differences are likely to arise between the US and UK. The most likely source of major US-UK differences concerns Iran's role in Middle East defense. The UK not only has a low opinion of Iran's military potential and reliability, and looks with considerable reserve on the Shah's military aspirations, but also appears to believe that Iranian participation in a defense arrangement would unnecessarily provoke the USSR without adequate compensating benefits to the West. Moreover, the UK is apparently less convinced than is the US of the urgency of the need to allay widespread social and economic grievances in Iran. Other US-UK differences will probably arise over commercial and financial conflicts of interest.

Relations with the USSR

60. The Zahedi government's actions and policies with respect to the oil dispute, resumption of relations with the UK, desire for increased US military aid, the uncovering of Tudeh sabotage and espionage rings, and firm action against the Tudeh Party have almost certainly appeared to Soviet leaders as a setback to their interests in Iran. Nevertheless, the USSR is unlikely to respond with force, estimating that such action would almost certainly provoke a violent Western reaction.

The USSR will probably continue its propaganda efforts to discredit the oil consortium and US influence in Iran, and will be alert to exploit any opportunities for subversion and internal disunity in Iran. At the same time, it will probably continue its trade with Iran so long as commercial and political advantages seem to warrant it, and may make further conciliatory gestures toward Iran. It has, for example, now initiated an agreement with Iran on boundary disputes and on the restoration of gold and foreign exchange which the USSR has owed Iran.

61. The USSR would almost certainly regard it as provocative if Iran joined a Western-backed regional defense organization, and would probably respond with strong diplomatic protests and increased subversive and propaganda efforts. The USSR might also threaten to invoke the 1921 Irano-Soviet Treaty, which it interprets as permitting it to introduce troops into Iran in case of threatened invasion from Iranian territory. If establishment of Western bases on Iranian soil appeared to be in prospect, the Soviet reaction would be stronger and would probably include shows of force along the border. In this case, the USSR might claim comparable base rights which would result in the movement of Soviet forces into Iran.

62. Iran, under any foreseeable leadership, will continue to resist Soviet attempts to interfere in Iranian affairs. At the same time it will be careful to maintain superficially correct relations with the USSR, to avoid giving Moscow solid grounds for intervention.

APPENDIX

Summary of the Terms of the Oil Agreement between the
International Oil Consortium and the Government of Iran,
Signed 30 October 1954

OPERATION OF THE OIL INDUSTRY

The operation of the Iranian oil industry, including production and exploration as well as operation of the refinery at Abadan, will be conducted by two Dutch-registered companies formed by the International Oil Consortium.¹ Each of the operating companies, one of which will be responsible for production and exploration, and the other for refining, will have seven directors, two of them nominated by Iran. The companies will enjoy "beneficial use" of the former Anglo-Iranian installations and properties in Iran, with the exception of the Kermanshah refinery, the Naft-i-shah field, and internal distribution facilities which will be operated exclusively by the National Iranian Oil Company. Legal title to all former Anglo-Iranian Oil properties is transferred immediately to the government of Iran.

SCOPE OF CONCESSION RIGHTS

The exclusive exploitation rights of the Consortium over an area of 100,000 square miles will run for twenty-five years, with provisions for three five-year extensions. After the initial twenty-five year period, the Consortium must surrender 20 percent of its total

¹Members of the Consortium (and their respective shares of participation) are: Anglo-Iranian Oil Company (40%); Gulf-International Company (8%); Socony-Vacuum Overseas Supply Company (8%); Standard Oil Company (New Jersey) (8%); Standard Oil Company of California (8%); Texas Company (8%); Royal Dutch Shell (14%); and Compagnie Francaise des Petroles (6%).

area with each five-year extension of the concession term.

SATISFACTION OF CLAIMS

To compensate the Anglo-Iranian Oil Company for the Kermanshah, Naft-i-shah, and internal distribution facilities, and for the losses and damages arising from nationalization, Iran will pay the Company the equivalent of \$70 million in 10 equal annual installments, without interest, beginning 1 January 1957. (By a collateral agreement, the Anglo-Iranian Oil Company will receive the equivalent of \$600 million from the other Consortium members as payment for their participating interests.)

GUARANTEED AND TARGET LEVELS OF
PRODUCTION AND REFINING

The Exploration and Producing Company guarantees to produce during the first three years of the agreement the following:

- 1955 — 17,500,000 cubic meters of crude oil
- 1956 — 27,500,000 cubic meters of crude oil
- 1957 — 35,000,000 cubic meters of crude oil

The Refining Company will strive, but does not guarantee to refine the following:

- 1955 — 7,500,000 cubic meters
- 1956 — 12,000,000 cubic meters
- 1957 — 15,000,000 cubic meters

ANTICIPATED REVENUES

Iran will receive 50 percent of the net profits of the Consortium and will receive its payments in sterling, 40 percent of which, under a separate and secret UK-Iranian converti-

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ability agreement, will be convertible to dollars. It is estimated that after the initial starting period of three months, oil revenue for Iran during the first three years will total the equivalent of \$385 million at present prices and costs: \$60 million in the first full operat-

ing year, \$150 million in the second, and \$175 million in the third. In a supplementary note the Consortium stated that it expected oil revenues thereafter to remain at or above the third year level, though it could make no firm commitment to that effect.

FINANCIAL BENEFIT TO IRAN OF PRESENT
AGREEMENT AS COMPARED WITH
PAST AGREEMENT

The highest level of oil production, and of direct oil revenue to Iran, was reached in 1950; AIOC then produced about 35 million cubic meters of oil and paid to Iran in taxes and royalties about \$44.7 million. Iran's receipts for the same level of production, which is guaranteed for 1957, will amount to an estimated \$175 million.

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