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22 MAY 1967

MEMORANDUM FOR: Mr. Harold H. Saunders
National Security Council Staff
Room 372-A
Executive Office Building

SUBJECT : Iran's Economic Relations with Communist Countries

1. Attached is the paper which Mr. Eliot at State requested of us, and which I discussed with you on 26 April. The original has been dispatched to Mr. Eliot.

2. Because the paper was intended for use at the highest levels, we have included, on page 2, some intelligence which would have been omitted from a paper for general circulation. As you will note, we have asked Mr. Eliot to omit this material if the paper is seen by any but senior policy officials.

Director
Research and Reports

Attachment:
As stated.

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NOTE: On page 2, paragraph 3, 5th line: the following was blocked out "at about one-third the going selling price*" on copies forwarded to: ONE; OCI;

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22 MAY 1967

MEMORANDUM FOR: Mr. Theodore L. Eliot, Jr.
Country Director for Iran
Bureau of Near Eastern and
South Asian Affairs
Department of State; Room 5252

SUBJECT : Iran's Economic Relations with Communist Countries

1. Attached is the paper you requested on which action was assigned to this Office. A copy is being sent to Hal Saunders.

2. Because we were aware that the paper was intended for use at the highest levels, we have included a piece of information which would have been omitted from a paper for general circulation. I refer to the footnoted material on page 2, dealing with the price at which the Consortium is furnishing oil to the Shah. If the paper is shown to any but senior policy officials of the Government, this information should be deleted. With the deletion, the paper can be freely used within the limits imposed by its classification.

3. Please let us know if we can be of further assistance.

Director
Research and Reports

Attachment:
As stated.

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~~GROUP 1 Excluded from automatic downgrading and declassification~~

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
20 May 1967

MEMORANDUM

## Iran's Economic Relations with Communist Countries

Although Soviet motives are in part political, Iran's economic relations with the USSR and the Eastern European Communist countries reflect mutual economic interests, and are unlikely to threaten seriously Iran's predominately Western orientation.

In late 1962, the USSR abandoned its efforts to weaken Iran's ties with the West through propaganda and subversion, and began wooing Iran with offers of economic assistance. Since then, the USSR has extended economic credits to Iran totalling nearly $350 million, and the Eastern European Communist countries have extended another $150 million (see the table). The two principal credits have been:

(1) A Soviet credit for $289 million, extended in January 1966. It helps finance a steel mill, a gas pipeline to the Soviet border, iron ore mines, coal mines, a heavy machinery plant, and water control projects. Repayment is to be in natural gas which is now flared and wasted; the gas will be carried by the proposed pipeline.

(2) A Rumanian credit for $100 million extended in October 1965, which finances the shipment of Rumanian tractors and machinery. Repayment is to be in oil.

In April 1967, the USSR suggested to Iran that the delivery of gas in 1970 be at the rate originally planned for 1974 (10 billion cubic meters). The USSR also suggested that gas deliveries eventually be doubled; this would require an additional pipeline. No agreement has yet been reached on these suggestions.

Iran stands to gain considerably from the agreement with the USSR. The projects covered will contribute to Iran's economic development, and the pipeline will carry gas not only to the USSR but to localities in Iran as well. By 1985, Iran will have

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accumulated from gas sales to the USSR some $500 million more than the amount needed to pay off the Soviet credit. The steel mill, though a relatively high cost producer, will save Iran up to $100 million a year in foreign exchange. At the same time, the Soviet credit does not cover the entire cost of the various projects. In addition to meeting local currency costs, Iran will have to borrow some $300-400 million to meet foreign exchange costs.

The USSR will also benefit economically. Growing demand and dwindling local supplies in the Transcaucasus area make the import of 10 billion cubic meters per year from Iran attractive and convenient (under analogous circumstances, the US imports Canadian gas into the Pacific northwest). Most of the gas would be used locally, and any surplus would add only marginally to the overall Soviet supply. The suggestion that Iranian deliveries be doubled to 20 billion cubic meters is less easy to understand in terms of domestic Soviet requirements. Possibly the Soviets have in mind freeing some of their own gas for export.

The economic agreement with Rumania also promises to benefit both sides. The Shah has the right, under his agreement with the Western Consortium, to take crude oil at a discounted price in lieu of royalties. In December 1966, the Consortium agreed to furnish up to 20 million tons through 1971 [at about one-third the going selling price*] for sale only to Eastern European countries. Iran has agreed to ship Rumania 3.5 million tons of this oil over a three-year period. The price, though unknown, is almost certainly well above the discounted price to Iran. The goods to be procured with the oil are of acceptable quality, and, although we lack information, are presumably of greater value than those which could have been purchased elsewhere with the royalties foregone. For its part, Rumania has excess refining capacity, can export the additional refined products to Western and Eastern Europe, and has been trying to diversify its sources of supply for crude oil and other goods to strengthen its independence from the USSR.

To impress Americans, the Shah sometimes claims that he is "building bridges" to Eastern Europe. His motives, however, are primarily economic, leavened with a desire to show his independence. Nonetheless, his dealings with the Eastern European countries will help these countries at least marginally in efforts they may make to move away from Moscow.

In principle, any sales of Iranian oil in Eastern Europe would release equivalent amounts of Soviet oil for sale in the West, since the USSR has up to now been Eastern Europe's principal supplier. But the matter of displacement cannot be viewed so simply. The market for oil is complex and dynamic, and the effect of displacement could be swamped by a host of other influences. The USSR itself has been showing some uneasiness about its future supply position, and its ability to meet the rapidly growing requirements of Eastern Europe for oil. Thus, the Soviet oil theoretically made available by Iranian sales to Eastern Europe would not necessarily displace Western oil in Western markets in a simple one-to-one fashion. Even if one-to-one displacement occurred, there would still be a net gain from the Shah's point of view, because Soviet sales in the West would be at the expense of <u>all</u> sellers and not of the Consortium alone.

The credits have had little effect as yet on Iran's trade with Communist countries, which has accounted for only 4 to 5 percent of Iran's total trade. (However, the Communist countries have been taking about one-fourth of Iran's non-oil exports). As the recent agreements are implemented, Iran's trade with Communist countries will increase very substantially. Shipments of natural gas to the USSR will begin at about $40 million in 1970 and rise to some $65 million by 1974. Deliveries of equipment under Soviet credits alone will probably average around $100 million a year during 1968-70. Iran should have no difficulty in obtaining satisfactory imports from the USSR and from Eastern Europe.

Iran has not accepted Communist aid because of any pressing short-term need. While it is true that Iran now requires additional outside assistance to sustain its present rapid growth, it can obtain large credits from Western countries and financial institutions. The deals with the Communist countries, however, enable Iran to make additional investments while repaying in goods not saleable on Western markets.

The USSR is acquiring some influence and good will as a result of its economic agreements with Iran, but not decisive economic leverage. Over the longer term, Soviet-Iranian economic relations may grow, and this growth may bring greater influence. For example, the USSR is prospecting for offshore oil in the Caspian Sea under contract with Iran. If oil is found, it could most easily be shipped to the USSR, and Eastern Europe would be a possible market. But the bulk of Iran's oil must continue to be marketed in the West, and it is difficult to foresee a situation in which the USSR could acquire an economic stranglehold over Iran.

In one sense, the agreement between the USSR and Iran is a force for stability, because it results in interlocking mutual interests. The USSR knows that the successful completion of the capital projects to which it is a party will require that Iran spend a large amount of foreign exchange. Both the USSR and Iran know that the continued delivery of gas depends on the uninterrupted production of the oil with which the gas is associated. Finally, Iran knows that its balance of payments position, its access to Western credit, and its future economic health depend on its ability to market oil in the West.

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Table 1

Soviet and East European Economic Aid Extended to Iran
1958-1967

Million US $

| | Total 1958-1967 | 1958-1962 | 1963 | 1964 | 1965 | 1966 | 1967 |
|---|---|---|---|---|---|---|---|
| Total | 503.6 | 6.6 | 39.8 | 16.7 | 125.0 | 305.5 | 10.0 |
| USSR | 346.6 | 0.5 | 38.9 | 1.7 | 0.0 | 305.5 | 0.0 |
| Eastern Europe | 157.0 | 6.1 | 0.9 | 15.0 | 125.0 | 0.0 | 10.0 |
| Bulgaria | 10.0 | | | | | | 10.0 |
| Czechoslovakia | 15.0 | | | | 15.0 | | |
| Hungary | 10.0 | | | | 10.0 | | |
| Poland | 22.0 | 6.1 | 0.9 | 15.0 | | | |
| Rumania | 100.0 | | | | 100.0 | | |

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