



REPORT TO THE CONGRESS

Issues Related To U. S. Military Sales And Assistance To Iran E-133258

Department of Defense
Department of State

*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

770441/087420
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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the Speaker of the House of Representatives
and the President pro tempore of the Senate

This is our report on issues related to U.S. military sales and assistance to Iran.

The review was made in compliance with the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Director, Office of Management and Budget; the President and Chairman of the Export-Import Bank of the United States; the Secretary of Defense; and the Secretary of State.

A handwritten signature in cursive script that reads "Milton J. Acosta".

For the Comptroller General
of the United States

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ABBREVIATIONS

FMS	Foreign Military Sales
GAO	General Accounting Office
MAAG	Military Assistance Advisory Group
MAP	Military Assistance Program
TAFT	Technical Assistance Field Team

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D I G E S T

WHY THE REVIEW WAS MADE

In conjunction with the Middle East situation and the Arab oil embargo, U.S. arms sales and military assistance to Iran-- \$1.5 billion, during fiscal years 1946-69 and \$6.9 billion since fiscal year 1970--have aroused congressional interest and concern.

In 1973 the Congress amended the Foreign Military Sales Act to shift arms sales from Government to commercial channels to the extent practicable. GAO reviewed the nature, purpose, and management of the security assistance program to Iran.

FINDINGS AND CONCLUSIONS

The United States has been and remains Iran's principal arms supplier. Other major suppliers are the United Kingdom, the Soviet Union, Italy, and France. (See p. 4.)

Nature of U.S. arms sales to Iran

U.S. security assistance to Iran has changed as Iran has progressed from grant aid to credit sales to the present program of large-scale cash sales of hardware and management and technical advisory services of Department of Defense personnel. (See p. 5.)

U.S. grant aid to Iran of military equipment stopped in fiscal year 1969 and grant training stopped in 1973.

Foreign Military Sales on credit were made from fiscal years 1965 to 1969 and since then all sales have been cash.

U.S. military assistance and sales through July 31, 1974, included (1) grant aid \$850 million, (2) credit sales \$500 million, (3) cash sales \$7 billion, and (4) ship transfers \$13 million, and totaled \$8.4 billion.

relationship, the United States has sold the following major equipment and services to Iran from fiscal year 1970 through February 1974. (See pp. 8 and 77.)

Classified materials deleted.

Current U.S. sales are responding to Iran's determined needs, but the United States does not participate directly with Iran in developing Iranian force goals.

The U.S. Military Mission with the Iranian Army and the Military Assistance Advisory Group does provide advice which is taken into account by Iranian planners. Under this new

U.S. military assistance has evolved to a new level in Iran with the sale of advisory services of Defense technical and management experts. As of January 1974, 539 such personnel were in Iran--492 uniformed and 47 civilians--to help Iran develop skills to maintain, support, and use its new arms. This service is expected to peak at 640 personnel. (See pp. 10 and 20.)

Purpose of U.S. arms sales to Iran

The United States has important economic and strategic interests in the Persian Gulf area. (See p. 20.)

Classified materials deleted.

--Iran's oil production is the second largest in the Middle East. In 1973 roughly 7.8 percent of its oil exports went to the United States, 37.2 percent to Europe, and 33.6 percent to Japan. Iran has remained nonaligned in the Arab-Israeli conflict.

--U.S. program planners view Iran, in cooperation with its neighbors, as responsible for insuring peace and stability in the Persian Gulf area and as an important factor in the Indian Ocean area.

Management of U.S. sales and assistance programs

A comparison of U.S. arms sales to Iran to the criteria of the Foreign Military Sales Act showed no significant areas of nonconformance. (See p. 38.)

GAO noted that some of the nearly 500 military technical assistance field team personnel in Iran have skills that are in critically short supply in U.S. military units and suggested caution in considering future sales of U.S. advisory services. (See p. 17.)

Although the stated preference of both the legislative and executive branches is for direct commercial arms sales, GAO found that commercial sales were negligible compared with Government sales. (See p. 40.)

The United States is conducting its arms sales program to Iran at considerable cost to the United States, although the law requires recovery of all costs to the maximum extent possible.

The principle of full cost recovery should be implemented in military sales to countries like Iran which are financially capable of paying. To the extent that U.S. costs are not recovered, they become a form of invisible grant aid.

Unrecovered costs include at least \$10.5 million in administrative costs and \$24.2 million in unrecovered interest costs on Export-Import Bank loans for arms purchases. The Bank made the loans at lower interest rates than it paid on its borrowings, some of which were from the U.S. Treasury. (See p. 44.)

It seems incongruous that, despite her current great wealth and massive arms purchases, Iran still owes the United States \$36 million in past-due debts incurred mostly right after World War II. (See p. 48.)

GAO found that U.S. personnel in Iran had not accounted for and reported on the location, condition, and use of equipment previously given Iran under the military assistance program as required by law.

GAO believes it would be desirable to sell Iran the U.S. residual rights to such equipment remaining in Iran, thus eliminating the need to closely monitor it. (See p. 53.)

RECOMMENDATIONS

The Secretary of Defense should:

- Explore the possibility of (1) helping Iran establish a mission in the United States for making purchases direct from suppliers or (2) providing procurement advisers rather than continuing foreign military sales to Iran, which absorbs significant numbers of highly trained U.S. military personnel. (See p. 42.)
- Take appropriate action to insure that foreign military sales prices include all pertinent costs. (See p. 46.)

The Secretary of State should:

- Continue efforts to collect past-due debts.
- Reach agreement with Iran on payment of administrative costs incurred for the military sales program in Iran. (See p. 50.)

The Director, Office of Management and Budget, should fix interest rates and charges on long-term capital loans for military purchases at levels sufficient to recover the cost of such financing to the United States. (See p. 46.)

The Secretaries of State and Defense should explore with Iran the desirability of its buying the residual rights to U.S. grant-aid equipment still in Iran. (See p. 59.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

Classified materials deleted.

Classified materials deleted.

MATTERS FOR CONSIDERATION OF
THE CONGRESS

Classified materials deleted.

As the volume of cash sales under the Foreign Military sales Act increases, the foreign policy impact also increases. Even though GAO found no firm contradictions with the requirements of the Foreign Military Sales Act, it questions (1) the impact of such sales on the arms race, (2) the extent and character of the military requirement, (3) the legitimate self-defense needs of the purchasing country, and (4) other criteria set forth in the act.

On July 9, 1974, the Export-Import Bank announced that it was abandoning its fixed interest rates, and that new interest rates would vary between 7 and 8-1/2 percent. On July 17, 1974, the Office of Management and Budget indicated that the Bank's actions should correct the problems noted in our report.

In 1973 and 1974 oil-producing countries, particularly those in the Persian Gulf, accumulated vast amounts of capital from the increased prices for oil. For example, even with the high level of purchases, Iran's international monetary reserves increased from \$992 million to \$5.4 billion in the 9 months ended June 30, 1974. The oil-producing countries, in total, increased their reserves by \$16 billion (or 125 percent)-in the same period.

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These countries are using this

capital to increase arms purchases. For example, Iran agreed to purchase more arms from the United States in 1974 than did the rest of the entire world combined in any other preceding year.

The Congress does not systematically receive timely information on the volume and makeup of such cash sales or on the nature of the military capability they provide the buyer. Although the Congress is provided information on deliveries of arms sales for cash, such de-

liveries often come several years after the sales take place. Estimates of current and future year cash sales are provided, but only in dollar totals by country.

GAO suggests, therefore, that the Congress, as a means of securing timely information for its policy deliberations, may want to require the executive branch to periodically furnish information on the volume and nature of major cash sales that could materially increase the military capability of the purchasing nation.

CHAPTER 1

INTRODUCTION

Recent events have focused world attention on the Middle East to a degree seldom equaled in recorded history. The principal reason for this interest, of course, has been the embargo by the Arab countries on oil shipments to the United States, Europe, and Japan announced in the aftermath of the October 1973 Arab-Israeli War.

While Iran is not a participant in the conflict between Israel and the Arab countries, Iran is the second largest oil-producing country in the Middle East and is a member of the Organization of Petroleum Exporting Countries. This organization has been a major factor in the producing countries' success in recent years in securing majority ownership of production facilities from oil companies and in raising crude oil prices. The December 1973 announcement that the organization was raising prices to record levels and considering tying them to prices of imported manufactured goods was delivered by the Shah personally.

These events have taken place against the backdrop of Iran's previously stated intentions of purchasing large amounts of military equipment, primarily from the United States, in order to play a major protective role in the Persian Gulf area.

These developments have generated much interest and concern on the part of the Congress. Articles in the U.S. press have also expressed concern that Iran's military buildup may not be in the best interests of all concerned in the Gulf area and that U.S. sales to Iran may not be to the best interests of the United States. Members of the Congress have also expressed concern over these sales--particularly the magnitude--and in December 1973 amended the Foreign Military Sales Act to stipulate that arms sales be shifted from Government to commercial channels to the maximum extent practicable.

Among the most common fears expressed have been that (1) Iran's military development will cause an arms race in the area and (2) Iran is buying arms at the expense of her economic development.

SCOPE OF REVIEW

Our examination was made largely in Iran, with supporting work done at cognizant military commands in Germany and Washington, D.C. and at the Department of State. We concentrated primarily on the question of justification for these sales, their management, and the U.S. military role in Iran with respect to Foreign Military Sales (FMS), rather than on the purely advisory activities of the U.S. Military Assistance Advisory Group.

We did not have discussions with Iranian officials during the course of our examination.

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CHAPTER 2

NATURE AND MAGNITUDE OF

ARMS SALES TO IRAN

Iran is buying arms and military advisory services on a massive scale. U.S. Government commercial sales to Iran exceeded 1974--nearly; Classified materials deleted. by the end of fiscal year in 1973 and 1974 alone. Total U.S. military assistance and sales to Iran is shown in the following table.

3.5. Military Assistance and Sales

and Commercial Sales to Iran

Fiscal year	MAP grant aid (note a)	Transfers of excess stock	Ship trans- fers	FMS		Total Government sales and assist	Comer- cial sales
				Credit	Cash		
(million)							
1946-48	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
1949-52	15.6	0.2	-	-	-	15.9	-
1953-61	436.1	15.3	-	-	-	451.4	-
1962-65	234.9	3.4	-	48.8	11.9	299.0	-
1966	62.6	0.8	-	90.0	34.1	187.5	5.1
1967	34.7	0.6	-	161.0	12.7	209.0	2.0
1963	22.1	-	-	100.0	40.9	163.0	5.1
1969	23.3	0.2	-	104.2	107.0	234.7	10.1
1970	2.6	-	-	-	89.1	91.7	9.8
1971	2.1	-	-	-	412.8	414.9	27.1
1972	0.5	-	12.7	-	520.8	534.4	37.0
1373	-	-	-	-	2,054.3	2,054.3	19.4
1574	-	-	-	-	-	-	-
TOTAL	<u>\$835.9</u>	<u>\$20.5</u>	<u>\$12.7</u>	<u>\$504.0</u>			

Classified materials deleted.

a/ Military assistance program (1951 to 1972)

b/ COD projection

See appendix IV for a listing of major U.S. arms sold to Iran from fiscal year 1970 through February 1974.

EXTENT OF IRAN'S MILITARY BUILDUP

While the United States has been and remains Iran's principal arms supplier, it is by no means the only one.

Following is a list of major items obtained from the United States and other countries. We do not have complete figures on quantities and costs of these purchases.

Major Iranian Arms By Source
Both on Hand and Ordered

<u>Item</u>	<u>Supplying country</u>
Imperial Iranian Air Force:	
Combat aircraft	USA
Refueling tanker aircraft	USA
Transport aircraft	USA
Missiles, air-to-air and air-to-ground	USA
Missiles, surface-to-air	USA, ^a /UK
Radar	USA
Helicopters	Italy, France
Light aircraft	USA, Canada
Imperial Iranian Ground Forces:	
Small arms	Iran
Antitank missiles	USA, France
Tanks	USA, UH
Armored personnel carriers	Soviet, USA
Artillery, towed	Soviet, USA
Artillery, self-propelled	USA
Helicopters	Italy, USA
Light aircraft	USA
Trucks and trailers	Soviet'
Rockets (artillery)	Soviet
Imperial Iranian Navy:	
Destroyers	USA, UK
Fast frigates	UK
Corvettes	USA
Minesweepers	USA
Utility craft	USA
Patrol boats	USA, France
Hovercraft	UK
Logistic landing ships	UK
Patrol aircraft	USA
Helicopters	Italy

^a/ United Kingdom

In addition to purchasing arms, Iran has awarded major defense-related contracts to United States, United Kingdom, French, Danish, and Swedish firms. Iran's military buildup is not limited to arms acquisitions but includes modernizing

its military organization, management, and planning (primarily under U.S. advice). It has built, or is planning to develop, major logistics and maintenance facilities to:

- Manufacture spare parts for most major items and systems in Iran's inventory, including armored vehicles, naval vessels, and combat aircraft.
- Manufacture ammunition and munitions used by Iran, including laser-guided tank sights.
- Maintain and overhaul major items, such as tanks, F-4 and F-5 aircraft, and all electro-optical systems in Iran's inventory.
- Establish and maintain logistical supply systems complete with computerized management and information systems.

Iran already manufactures its own small arms (rifles and machine guns) and much of its ammunition, including artillery and mortar rounds. Large-scale military advisory services on a government-to-government basis, however, have been obtained from only one country--the United States. (See ch. 3.)

NATURE OF U.S. ARMS SALES TO IRAN

As illustrated by the table on page 3, Iran has received the full range of U.S. military assistance--from grant assistance under the Military Assistance Program (MAP) of the Mutual Security Act of 1951 and the Foreign Assistance Act of 1961, to credit FMS, to cash FMS, to direct commercial sales.

Most U.S. military assistance was provided under MAP, which provided grants of equipment and training from fiscal year 1950 to 1972. Grants of equipment were terminated in 1969 by the United States, and grant training was terminated in 1973 at Iran's request. During that period the United States gave Iran over \$800 million in equipment and training. Administration and management of MAP in Iran is discussed further in chapter 8.

From fiscal year 1962 to 1969, nearly half of the U.S. military assistance to Iran was provided in the form of credit sales of equipment under the Foreign Military Sales Program. From 1970 to the present, most sales have been for cash with some financing received through the Export-Import Bank of the United States. At present Iran is receiving no

assistance from the United States in the sense of grants or loans of resources but is purchasing military equipment, training for Iranian personnel in U.S. military schools and courses, and advice and assistance from U.S. Technical Assistance Field Teams, (TAFTs) in Iran.

FMS cash sales

Current U.S. equipment transfers to Iran are being made for cash under authority of the Foreign Military Sales Act, as amended.

Recent military equipment cash sales to Iran have been larger than to any other country in the world. Total sales, both cash and credit, to Iran through fiscal year 1974 was over \$7.5 billion. Cash sales for fiscal years 1973 and 1974 alone were nearly \$6 billion.

The term "cash sales" as used by the Department of Defense does not mean that credit financing is not involved in the sale, nor does it even mean that the credit is not provided by the U.S. Government. It means only that Defense does not provide the credit. Actually some \$620 million of Defense "cash" sales to Iran were financed through the Export-Import Bank of the United States via six loans made from fiscal year 1971 through fiscal year 1974. Four of these six loans were at interest rates less than that then being paid by the U.S. Government on its current borrowings--a matter discussed further in chapter 6 of this report.

FMS credit sales

There are three basic types of credit using U.S. Government resources available for FMS: Export-Import Bank credit, private credit guaranteed by the Department of Defense, and FMS credit. The first appears in Defense reports as cash sales.

FMS credit sales (sales financed by Defense) to Iran have totaled over \$500 million. Defense records indicate that as of September 30, 1973, \$140 million of the above remained outstanding. In fiscal year 1970, Iran converted to cash sales.

Commercial sales

Commercial sales of military articles are those entered into directly between private U.S. firms and foreign governments, subject to State Department approval. Total

commercial sales'from 1966 to 1973 were about \$116 million.
(See also ch. 5.)

MAP grant aid

Total U.S. grant aid to Iran, including ship loans and supporting assistance, has amounted to about \$870 million since 1949. No major grant aid has been programmed since 1969; all grant aid was terminated after 1972, although some grant aid previously programmed has been delivered since that time. Chapter 8 discusses management of the current program.

MAKEUP OF U.S. SALES

Major U.S. equipment items purchased by Iran include

Classified materials deleted.

EVOLUTION OF U.S. MILITARY ROLE IN IRAN

The first U.S. military presence of significance in Iran was a joint effort with Great Britain and the Soviet Union during World War II from the ports of the Persian Gulf across Iran into the Soviet Union. These troops, the Persian Gulf Command, were withdrawn in 1945.

Advisory mission

Throughout the 1940s U.S. military assistance to Iran was limited to advisory missions to help improve the organization, management, and administration of the Iranian Gendarmerie and Army.

United States Military Mission with the Imperial Iranian Gendarmerie

On November 27, 1943, the United States and Iran signed an agreement, at Iran's request, whereby the United States agreed to provide a small mission of Army officers, non-commissioned officers, and experts to advise and assist Iran in reorganizing the Imperial Iranian Gendarmerie. The Gendarmerie is a military force of 71,000 under the direction of the Ministry of the Interior. Its major missions are to provide police protection, maintain internal security, enforce judicial decrees in rural areas, act as a supplement to the army in time of national emergency, and suppress smuggling and traffic in narcotics. Since 1963 it has provided the border guard, formerly an army responsibility. One of its major activities is controlling narcotics smuggling, primarily from Afghanistan and Pakistan into Iran.

The first head of the mission also was appointed and functioned as commander of the Gendarmerie. Since 1948, however, U.S. personnel have not filled operative positions but have served purely as advisers. The mission presently includes 16 officers and enlisted men and is commanded by a U.S. Army colonel.

Its annual cost to the United States is about \$659,000, and assistance-in-kind provided by Iran is \$309,000.

United States Military Mission with the Iranian Army and the Military Assistance Advisory Group (MAAG)

By agreement of October 6, 1947, the United States provided a mission of U.S. Army officers and enlisted men to advise and assist in improving the efficiency of the Iranian Army. This agreement was amended in 1950 to include U.S. Air Force officers and enlisted men.

The Mutual Defense Assistance Agreement signed on May 23, 1950, established the Military Assistance Advisory

Group (MAAG). The United States agreed, under authority of the Mutual Defense Assistance Act of 1949, to provide to Iran on a grant basis military equipment, materials, and services. MAAG was established to administer this program.

In 1958 the separate organizations for the mission and MAAG were consolidated into a single organization known as the MAAG. Its principal responsibilities are (1) providing advice and assistance on military matters to the Government of Iran and (2) administering the U.S. security assistance activities (FMS and MAP) in Iran. Adjustments have been made in its internal organization since 1958. In 1965 MAAG was reorganized to include separate Army, Air Force, and Navy advisory sections and a headquarters with a joint command staff and a consolidated support and administrative element.

The MAAG workload in December 1973 was divided about equally between advisory activities and FMS administration with only minimal time spent on MAP administration. At that time MAAG had on its records 784 active and 150 pending FMS cases.

Although FMS administration in Iran requires a considerable U.S. effort, the State Department in Washington, MAAG, and Embassy officials said they considered the advisory role to be the more important of the two roles to U.S. interests. They stressed that, through this function, the United States can have an effect on Iranian decision-making that is valuable and beneficial to both countries.

We were told that the Shah makes all final decisions on major military purchases. U.S. officials seemed quite impressed with the Shah's expertise and ability. Before decisions are made, however, much consultation, questioning, and advising takes place between Iranian officials and MAAG personnel. During the 2-month span of our visits to Tehran, the MAAG chief met with the Shah three times.

In recent years MAAG has moved from merely advising Iranians on the technical aspects of particular weapons into advising on managerial matters.

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Technical Assistance Field Team

In 1968 TAFT, a new type of U.S. military assistance, was pioneered in Iran to help Iran develop the expertise to use and support all the equipment it is buying. Actually, TAFTs are not a form of assistance in the traditional sense of the word because Iran is buying the services of these teams through FMS. The teams have very specific advisory missions and, according to Defense spokesmen, will leave when those missions have been completed. The length of time estimated for mission achievement for the teams in the current agreement varies up to 6 years.

As of February 1973 about 610 personnel comprising 19 separate TAFTs and support elements had been programed but only 539 were in Iran by February 1974 because of schedule slippages and changes. The fiscal year 1975 program calls for a peak level of 640 TAFT personnel in-country.

Operational military units

In addition to the advisory missions, about 13 other U.S. military organizations or units are performing various administrative, communications, and other supporting tasks. Foremost among these is the European Command Support Activity (ESA), which provides logistical and housekeeping support for the other units.

The activity has a staff of 41 officers, 62 enlisted men, and 13 civilians. It provides administrative services; operates a hospital; provides comptroller services for the TAFT units, materiel control, a staff judge advocate, security and law enforcement services, and a public affairs office; and manages a special services office and a central post fund. It also manages six non-appropriated-fund activities-- an officers' open mess, an enlisted open mess, a purchase order activity, a hunting and fishing club, and a central welfare fund. The activity is augmented with a TAFT element, funded by Iran, which supports TAFT teams and personnel.

The approximate total of U.S. military personnel (excluding dependents and personnel on temporary duty) in Iran is shown in the following table.

<u>Type of unit</u>	<u>Officer</u>	<u>Enlisted</u>	<u>Civilian</u>	<u>Total</u>
Long term:				
MAAG	135	47	16	198
Gendarmerie mission	11	5	-	16
Operational units	<u>56</u>	<u>251</u>	<u>99</u>	<u>406</u>
Total	<u>202</u>	<u>303</u>	<u>115</u>	<u>620</u>
Short term:				
TAFT units	<u>88</u>	<u>404</u>	<u>47</u>	<u>539</u>
Total	<u>290</u>	<u>707</u>	<u>162</u>	<u>1,159</u>

U.S. ECONOMIC ASSISTANCE TO IRAN

The United States sent economic administration advisory missions to Iran in the 1920s, but for all practical purposes U.S. assistance to Iran started after World War II. Some \$25.8 million was loaned to Iran from 1946 to 1948, and another \$16.5 million in grants was given from 1949 to 1952. From 1953 through 1968, however, most economic assistance was supplied under the Mutual Security Act and the Foreign Assistance Act.

The United States continues to grant economic assistance to Iran in the form of Peace Corps services and one nearly completed Food for Peace program. Iran has also borrowed from the Export-Import Bank.

Total U.S. economic assistance to Iran through fiscal year 1972 was \$1.2 billion, of which \$401 million in loans had been repaid.

Current social and economic programs

Major U.S. programs affecting the Iranian civil sector are the United States Information Service, the Peace Corps, and an almost completed Public Law-480 program administered by the Embassy's agricultural attache.

CHAPTER 3

SALE OF TECHNICAL ADVISORY SERVICES TO IRAN

U.S. military assistance has evolved to a new phase in Iran with the large-volume sale of technical advisory services of military personnel and Defense civilians. As mentioned in chapter 2, 539 TAFT personnel were in Iran in February 1974, although 610 personnel in 19 teams and a support element had been programed.

<u>TAFT</u>	<u>Number of personnel</u>	<u>team duration</u>
Army:		
Engineer	2	6-73 to 6-75
Aviation	50	3-73 to 6-75
Logistics and maintenance	42	6-73 to 6-78
Data processors	16	6-73 to 9-79
Signal	18	6-73 to 6-78
TOW missile	3	6-73 to 6-74
Personnel services	15	5-73 to 6-75
Air defense	a/61	12-73 to 11-79
Navy:		
Communications/supply/ materiel management/ financial management/ contract consultant and administration	8	6-73 to 6-75
Ship repair/supply depot management	2	6-73 to 6-74
Personnel training/training aids specialist	2	6-73 to 10-74
Helicopter operations and maintenance	8	6-73 to 10-74

a/Includes 59 personnel not funded for calendar year 1973.

<u>TAFT</u>	<u>Number of personnel</u>	<u>Team duration</u>
Air Force:		
Communications/electronics	64	4-73 to 8-75
F-4 maintenance	68	6-73 to 9-75
F-5 maintenance	53	6-73 to 7-75
Aircraft control and warning	12	4-74 to 4-76
Logistics	36	5-73 to 9-75
C-130	b/15	1-73 to 1-75
F-4	b/43	6-72 to 6-74
European Support Activity:		
Army	75	1-73 to 4-79
Air Force	<u>17</u>	
Total	<u>610</u>	

b/These two teams were in existence before the major program started in February 1973.

EVOLUTION OF TAFT

Late in 1968 the first TAFT was contracted to Iran to support the procurement of F-4 aircraft. Iran desired greater technical assistance for newly purchased **F-4s** than could be provided by **MAAG**. Iran agreed to purchase the assistance as FMS, and a 54-man TAFT was provided, which operated under the control of MAAG.

Classified materials deleted.

During a visit to Iran in May 1972, the President committed the United States to providing the number of technical personnel necessary to assist Iranian military advancement. The Prime Minister of Iran advised the American Embassy in July 1972 that many skilled U.S. personnel were needed to support acquisitions of U.S. equipment until in-house capability could be developed. The Embassy advised the Prime Minister that the thrust of advisory support would be to teach Iranians to do the job, not for U.S. personnel to do the job. The State Department supported the Embassy

position, stating that the United States had no intention of providing operational personnel to Iran but would be as responsive as possible to requests for training personnel.

In August 1972 MAAG advised the Secretary of Defense that Iran had requested 1,297 technical advisers to assist in various programs and functional areas within the Iranian Armed Forces. The request included personnel to fill operational positions. It did not include any personnel to provide TAFT logistical support.

Requirements were refined by MAAG in consultation with Iran and submitted to Defense in late September 1972. MAAG proposed 745 technical advisors, 47 logistical and clerical personnel, and a support activity element of 217 personnel not previously included in the Iranian request.

Also, during August 1972 the Secretary of State stated that the TAFT approach was probably the most suitable method of meeting Iran's needs. In January 1973 MAAG received guidance from Defense indicating that a directive on TAFT was being prepared. The guidance stated TAFT personnel would not perform MAAG functions nor be used to augment MAAG. TAFTs were to provide in-country technical instruction on specific equipment, weapons, or support systems for a duration and purpose which could not be satisfied by other means. Also, interim assistance was planned, pending development of self-sufficiency of in-country forces in management, maintenance, and use of equipment, weapons, or support systems.

In addition to the guidance, Defense in January 1973 set a TAFT personnel ceiling of 600, to include only 500 U.S. military. The ceiling was not to include the F-4 and C-130 TAFTs.

TAFT requirements were further refined by MAAG to get below the ceiling. In February 1973 an FMS was signed for the 17 teams. Each adviser was to provide 1 to 2 years of technical assistance with personnel phased in as equipment systems arrived. All personnel were to be in-country by December 31, 1974.

During 1973 there was some slippage in the program and only about 400 advisers had arrived by January 1974. Because of slippage in the arrival dates for two teams-- Improved Hawk (59 advisers) and Aircraft Warning and

Control (12 advisers) -- these teams were added to a proposed follow-on TAFT program.

There were other significant developments during 1973.

--The initial TAFT policy guidance was published as Department of Defense Directive 5132.10 on December 14, 1973.

--Command and control elements were established for administrative control of the Army and Air Force TAFTs. The senior Navy TAFT member was designated the Navy TAFT command element. Also U.S. Army and Air Force liaison officers now operate at headquarters in Europe to provide guidance to command element.

Under guidance of the Secretary of Defense, MAAG prepared a proposal to continue TAFT. This proposal, completed in December 1973, recommended extending the existing program to June 1974 and starting a follow-on program for fiscal year 1975. The Secretary's guidance directed adding the original F-4 and C-130 teams plus the command elements to the program. The fiscal year 1975 program is projected to exceed the ceiling by approximately 40 personnel.

TAFT RELATIONSHIP TO MAAG

The first TAFT (F-4) established in Iran was under the command and supervision of MAAG. In 1971 the Congress added section 512 to the Foreign Assistance Act, which required that:

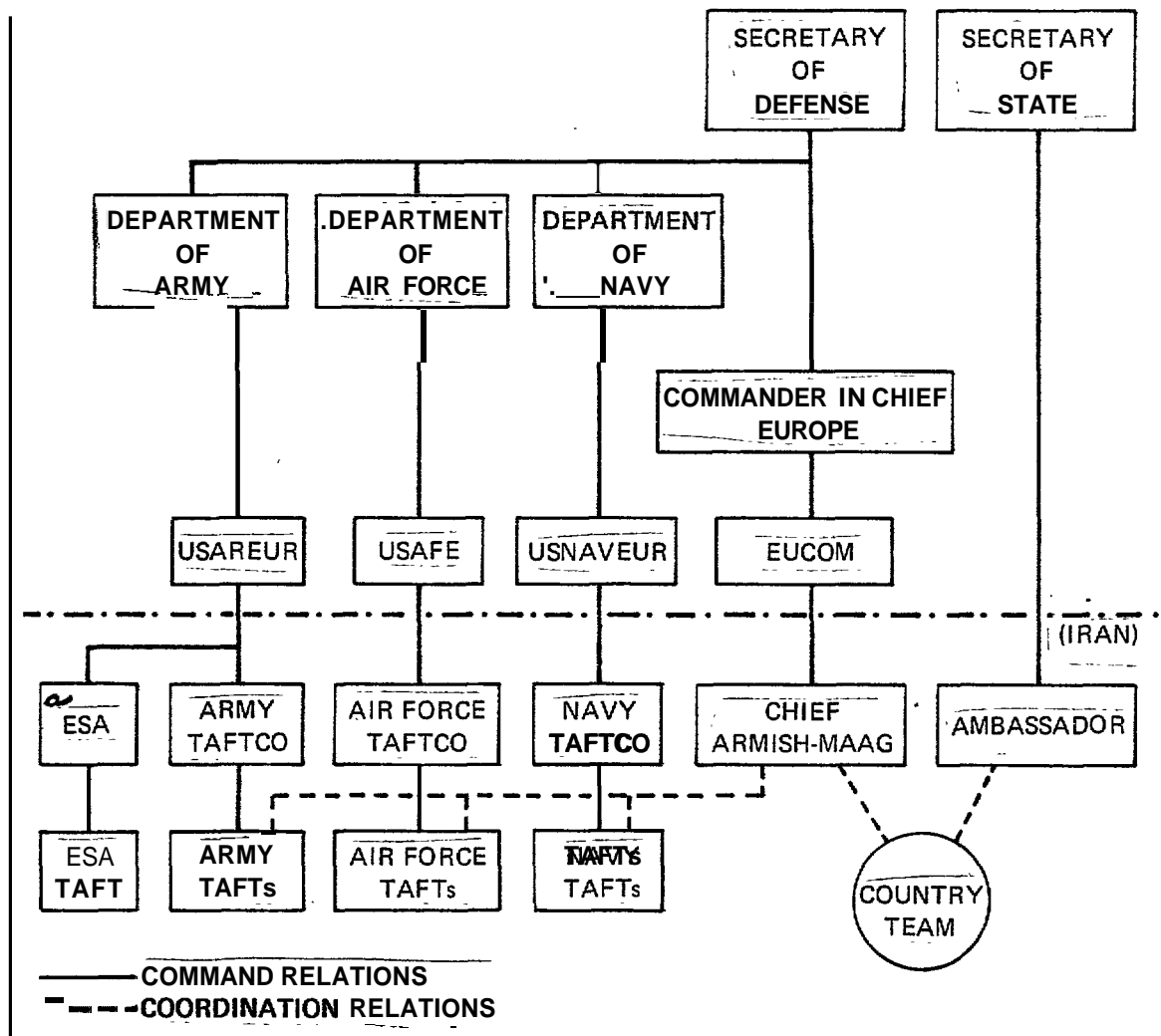
" . . . the total number of United States military personnel assigned and detailed, as of September 30, 1971, to United States military assistance advisory groups, military missions, and other organizations of the United States performing activities similar to such groups and missions, shall be reduced by at least 15 per centum by September 30, 1972, but every effort should be made to effect an aggregate reduction of 25 per centum by September 30, 1972."

In effect, this amendment placed a ceiling upon MAAG size.

Defense response to section 512 has brought about some rather unwieldy command structures and management relationships and has resulted in extra cost to the United States (see ch. 6).

Unwieldy organizational structure
to avoid section 512 ceiling

Defense has now taken the position that TAFTs cannot legally be part of MAAG because of the section 512 ceiling. (Although section 512 was repealed in December 1973, officials considered the intent of this legislation still binding.) Separate command channels to Europe-based commands have been established with in-country TAFT command elements of five men each over the TAFTs, producing an organization roughly along the lines of the following chart.



^aAs of July 1, 1974, organization title was changed to U.S. Support Activity-Iran (USAA-I)

USAREUR--United States Army, Europe

USAFE--United States Air Force, Europe

USNAVEUR--United States Navy, Europe

EUCOM European Command

ESA--European Support Activity

TAFTCO--Technical Assistance Field Team Command Element

ARMISH-MAAG--U.S. Military Mission with the Iranian Army and Military Assistance Advisory Group

However, the MAAG chief, as the senior Defense representative in the country with a broad perspective of U.S. military relations with Iran, remains responsible (under the auspices of the Ambassador) for all Defense personnel in-country. He, therefore, must keep abreast of TAFT activities, even though he lacks command authority over their operations.

SOME SKILLS SOLD ARE IN SHORT SUPPLY IN U.S. FORCES

Extensive sale of U.S. military skills could adversely affect the readiness status of U.S. Forces. We found that the U.S. Army and Air Force have shortages for many of the technical skills sold to Iran in TAFTs.

The TAFT agreement of February 1973 requires the Air Force to supply enlisted personnel under 53 different Air Force Specialty Codes. Specialty Codes essentially denote the technical skill, proficiency, and grade of the individual. According to Air Force projections for March 1974, there will be worldwide U.S. Air Force shortages-- 15 percent or more short of authorized strength--in 24 of the Specialty Codes associated with the TAFT agreement, 20 of which were identified as mission essential skills. Most of the shortages were above 20 percent and one was 36 percent of projected authorized strength. We were also told that a shortage in an individual unit of over 15 percent for a critical skill could adversely effect unit combat readiness.

Under the same TAFT agreement, the Army is supplying Iran personnel under 69 different Military Occupational Specialities identified by grade. An Army document, dated October 2, 1973, listing specialty shortages showed 34 of these skills supplied to Iran were in short supply to worldwide Army requirements. The listing did not specify the degree of shortage. A review of the U.S. Army in Europe military manpower requirements, however, showed as of February 28, 1974, that nine of these were in critical short supply to that command's needs.

CONCLUSIONS

We believe that, to the extent that U.S. arms sales to Iran are motivated by valid U.S. interests (discussed further in the following chapter), the TAFT concept is a

logical' means of assuring Iran's ability to effectively assimilate and use the arms.

We also concluded that it would be more logical and more effective for the TAFTs to be under command of MAAG and coordinated more closely with the Ambassador through the Country Team mechanism.

Although the military technical personnel supplied Iran through TAFTs is small compared to worldwide Defense requirements, we believe that consideration of U.S. technical skill shortages is warranted before sales of technical services. This would be particularly true for systems new to both the United States and Iran, such as the F-14.

GAO PROPOSAL

Accordingly, we suggested that the Department of Defense reconsider the command structure and TAFTs' relationship with the MAAG in Iran.

AGENCY COMMENTS

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Defense agreed that the TAFTs should be placed under command of the MAAG chiefs.

CHAPTER 4

RATIONALE FOR U.S. FOREIGN MILITARY SALES TO IRAN

U.S. Foreign Military Sales to Iran are governed largely by the Foreign Military Sales Act, as amended (22 U.S.C. 2751).

In general the Foreign Military Sales Act provides that all sales of military equipment or services shall meet the following criteria.

1. They must be consistent with **U.S.** foreign policy interests.
2. They must be consistent with the purposes of the **U.S.** foreign assistance program as embodied in the Foreign Assistance Act of 1961, as amended. Briefly, these purposes are:
 - a. To achieve international peace and security through the United Nations rather than by armed forces.
 - b. To furnish military assistance to friendly countries in the common defense against internal and external aggression, particularly to those countries threatened by active Communist or Communist-supported aggression or those in which internal security is threatened by Communist-inspired or supported internal subversion.
3. They must be consistent with the extent and character of the country's military requirement.
4. They must be consistent with the economic and financial capability of the recipient country.
5. The President must find that such sales strengthen **U.S.** security and promote world peace.
6. The recipient country must agree not to transfer title or possession of defense articles furnished it to a third party without the prior consent of the President.

The act further states that particular regard must be given, where appropriate, to proper balance among such sales, grant military assistance, and economic assistance; and the impact of such sales on social and economic development programs, and on existing or incipient arms races.

CONSISTENCY WITH U.S.
FOREIGN POLICY INTERESTS

U.S. policy in Iran and the general area, including the Persian Gulf and Indian Ocean, is shaped by economic interests and by security planning and requirements and the Soviet presence. U.S. officials believe that a strong Iran can further U.S. interest by providing a balancing military force in the area.

Economic interests

The most obvious U.S. economic interest in Iran is oil. Iran, being non-Arab, was the only Middle East oil-producing country that did not participate in the recent embargo of oil shipments to the United States, Europe, and Japan. Iran is the second largest producer in the Middle East, producing about 6 million barrels a day compared with Saudi Arabia's approximately 7 million barrels a day (pre-embargo). Roughly 7.8 percent of Iran's crude oil production for the first 9 months of 1973 was shipped to the United States and the West Indies (most of whose refined products go to the United States): 37.2 percent to Europe, including Scandinavia; and 33.6 percent to Japan. Iranian oil, then, accounted for about 6.4 percent of the oil imported by the United States, according to Embassy officials.

Strategic and military requirements

The same geographic factors that made Iran a cornerstone for empire builders of the past also make it of strategic value today. U.S. officials believe a strong government in Iran can exert influence for either disruption or stability throughout the Persian Gulf area, the Arabian Peninsula, and the Indian subcontinent and can affect U.S. interests in the Indian Ocean.

Persian Gulf and Arabian Peninsula

The United States has a vital interest in keeping the Persian Gulf open to shipping. Most Iranian oil exports go by ship through the gulf, as do those of Kuwait, Saudi Arabia, Bahrain, Qatar, and Abu Dhabi. The U.S. Naval

Station at Bahrain is also dependent on free passage through the gulf. Free passage into and out of the gulf could be affected at the "chokepoint" of the Straits of Hormuz (see map on next page) where the shipping lanes pass by the Oman Peninsula and several small islands. Shipping in the Straits could be subject to attack by artillery or surface-to-surface missiles and could be harassed by small craft.

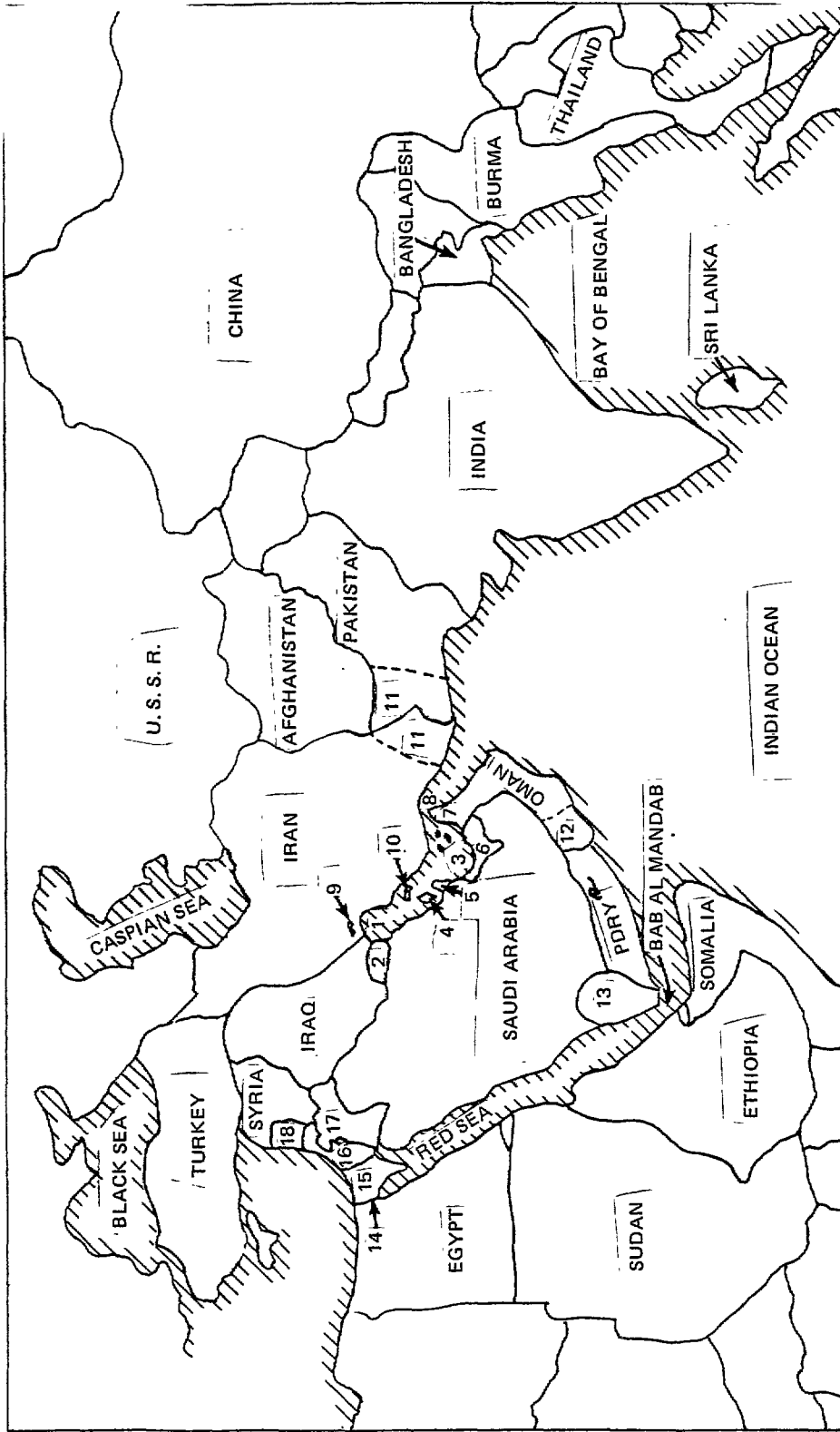
Until 1971 Great Britain was the major power and protector in the Persian Gulf area. In 1968 the British announced they were ending their protective role in the small Arab sheikdoms of the gulf, and in 1971 they withdrew their troops. Shortly after the British announcement of withdrawal, the Shah of Iran stated that if colonialism was leaving by one door it must not be allowed to reenter through another. He has said that Iran is determined to keep the Persian Gulf and the Hormuz Straits open, with or without the cooperation of the other littoral states.

In keeping with his decision that Iran must protect her vital interests herself and not look to the great powers for help, the Shah embarked on a program to modernize and strengthen Iran's military forces to a level consistent with this policy.

Just before the British withdrawal Iran moved her own troops onto the Turnb Islands and Abu Musa which control the passageway into and out of the gulf.

Iran is geographically in a position to influence affairs in the littoral states of the Persian Gulf and in the Arabian Peninsula. For example, Iran is concerned with Iraq's relationship with the Soviet Union. Iraq has received some of the best military equipment in the Soviet's inventory. Iraq supports the Baluchi separatist movement in western Pakistan and eastern Iran and the Dhofar Rebellion in Oman. Iraq and Kuwait had a border flareup in early 1973.

Iran is also concerned over the Dhofar Rebellion in Oman in which the Popular Front for the Liberation of the Occupied Arab Gulf is attempting to overthrow the Sultan of Oman. The Popular Front, according to U.S. officials, is supported by the Peoples Democratic Republic of Yemen, which in turn receives assistance from the Soviet Union, Cuba, Czechoslovakia, and other Eastern European Communist countries and has received support from China.



- 1. PERSIAN GULF
- 2. KUWAIT
- 3. TUMB ISLANDS AND ABU MUSA
- 4. BAHRAIN
- 5. QATAR
- 6. UNITED ARAB EMIRATES AND ABU DHABI

- 7. OMAN PENINSULA
- 8. STRAITS OF HORMUZ
- 9. ABADAN
- 10. KHARG ISLAND
- 11. BALUCHISTAN
- 12. DHOFAR

- 13. YEMEN ARAB REPUBLIC
- 14. SUEZ CANAL
- 15. SINAI
- 16. ISRAEL
- 17. JORDAN
- 18. LEBANON

^aPeoples Democratic Republic of Yemen

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On the other hand, Iran has provided troop, helicopters, and arms to the Sultan of Oman in resisting the Communist-supported war in Dhofar. Although the Shah apparently did not approve of Pakistan's treatment of East Pakistan (now Bangladesh), he strongly supports Pakistan's (formerly West Pakistan) current territorial integrity and has said Iran will help Kuwait if asked.

* Indian subcontinent

* About 30 of the 127 U.N. members are in the Indian Ocean region, and one-third of the world's population is there. Of those on the Indian subcontinent, India, Pakistan, and Iran play significant international roles. Although the United States has contributed greatly toward the economic development of these countries and has interests in them, the instability and intraregional antagonisms characterizing much of the Indian Ocean and subcontinent could serve to promote Soviet interests at the expense of the United States.

Since the mid-1950s, according to the Department of State, the Soviet Union has shown a clear interest in the Indian subcontinent, and almost two-thirds of its financial and economic aid has been to third-world countries in the Indian Ocean area. In recent years, India and Afghanistan have received Soviet military aid.

Iran has long had friendly relations with Pakistan, which has at times caused India concern. In the last year Iran has worked hard at cultivating good relations with India. The current government in Afghanistan has Soviet ties, which U.S. officials say causes Iran some concern, but Iran and Afghanistan have maintained good relations except for the period immediately following the 1973 coup.

Indian Ocean

* U.S. interests require free sea and air access to the Indian Ocean area for U.S. military and commercial traffic, including through the entrances to the Red Sea and the Persian Gulf.

* The difficulty of retaining free passage is illustrated by the fact that in 1971 people in a small boat armed with a bazooka attacked and damaged a tanker in the Straits of Hormuz. U.S. officials believe that hostile elements could attack merchant shipping in these straits

from the point of Oman which overlooks them. The normal shipping lanes pass close by this point but could, if necessary, be shifted closer to the Iranian shore, out of range of most land-based weapons except surface-to-surface missiles.

With the Soviet naval presence in the Indian Ocean an established fact, the United States faces the prospect of enhanced Soviet politico-military power flanking Africa, South and Southeast Asia, and Australia. This presence aids the Soviet's growing capability to control ingress and egress to and from the Red Sea (Bab el Mandab) and the Persian Gulf (Straits of Hormuz).

U.S. operational needs

Iran is also important because it provides the United States with reliable overflight and staging rights.

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CONSISTENCY WITH INTENT OF FOREIGN ASSISTANCE ACT OF 1961, AS AMENDED

The basic policy expression of the Foreign Assistance Act for military assistance states that:

"The Congress of the United States reaffirms the policy of the United States to achieve international peace and security through the United Nations so that armed forces shall not be used except for individual or collective self defense * * *."

The Department of State has concluded that Iran's basic foreign policy is compatible with this expressed policy inasmuch as the Shah has repeatedly expressed his adherence to U.N. principles, has not shown aggressive designs upon his neighbors--except for occupation of the Tumb Islands--and has demonstrated his country's willingness to settle international differences through the United Nations. To support its judgment, State Department officials cite the fact that Iran settled its longstanding claim to the Bahrain archipelago through the United Nations. Iran's claim to the islands goes back to the 16th century, when it occupied part of Bahrain in 1521. Iran exercised intermittent sovereignty over the islands from 1600 until 1783, when local Arabs seized control. These Arabs made treaties with Great Britain

in 1820, 1847, 1880, 1892, 1956, and 1961, but Iran did not relinquish its claim until after 1969 when the Shah suggested that the United Nations determine the desires of the people of Bahrain. When the opinion sample revealed public gratification for the course of action being taken, no hostility toward Iran, and virtually unanimous desire for independence as an Arab state, Iran made no more objections and relinquished its claim.

Another major policy expression of the Foreign Assistance Act is that military assistance will be provided to countries threatened by external aggression or internal subversion, especially when such aggression and/or subversion is Communist-inspired or supported. It also states that such assistance should be supplied on the principle of self-help and cooperation.

State Department officials believe that Iran meets this criteria in view of the threats from Iraq, the Peoples Democratic Republic of Yemen, the Baluchistan separatist movement, and the Soviet Union.

The State Department has concluded that the Marxist People's Democratic Republic of Yemen has received support from the People's Republic of China, the Soviet Union, and Cuba in its efforts to take over the Yemen Arab Republic and in its support of the Dhofar Rebellion in Oman and believes that the group's success in these efforts could give it control of the Straits of Hormuz through which all Persian Gulf shipping must pass.

State believes that the Baluchistan movement in eastern Iran and western Pakistan is supported by both the new government of Afghanistan and by Iraq, both of which have strong ties with the Soviet Union.

Finally, the Department believes that, although the Soviet Union probably is not itself a direct threat to Iran at the present time, the Shah remembers Soviet designs on Iran manifested as recently as 1946, when the Soviet forces refused to leave Iran after World War II, in accordance with the Tripartite Treaty of Alliances signed in 1942.

CONSISTENCY WITH EXTENT AND CHARACTER
OF IRAN'S MILITARY REQUIREMENT

U.S. officials in Iran uniformly feel that the Shah's motives are purely for self defense. They said that the

Shah has explained his need for a powerful military force basically along the following lines.

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These more immediate threats that he sees are principally from (1) Iraq, (2) the Communist movements of the Peoples Democratic Republic of Yemen and the Dhofar Province of Oman, and (3) the Baluchistan separatist movement. Iraq's hostility represents a direct military threat to Iranian territory and oil industry in that the Abadan refinery complex lies right on the Iran-Iraq border--the Shatt al-Arab River--which has long been in dispute between the two. The Communist movements in the Arabian Peninsula represent a threat to oil shipments through the Straits of Hormuz. The Baluchistan movement threatens Iranian territory, and, perhaps more important, could be an avenue for the Soviet Union to extend its control to the Indian Ocean.

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CONSISTENCY WITH IRAN'S ECONOMIC AND
FINANCIAL CAPABILITY

In spite of the massive cash weapons buys and similar expenditures on economic development, Iran's foreign exchange reserves have increased (see p. 30). In an effort to keep reserves to a reasonable level and to prevent domestic inflation, the government recently announced that it would not borrow for any purpose in the new budget year and would make early repayments of some loans. Suf-
fice it to say that Iran can afford what she is buying.

STRENGTHEN U.S. SECURITY AND
PROMOTE WORLD PEACE

U.S. planners advance two reasons why a strong Iran may contribute to U.S. security. They both lie in the Total Force concept currently molding U.S. strategic defense planning and in the Agreement of Cooperation signed between the two countries in 1959.

Total Force concept

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The Total Force concept consists basically of including the total forces of both the United states and its allies in calculating the military strength.

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In our opinion, it will then work only for military events in which interest of the cooperating foreign country coincide with U.S. interests.

Agreement of cooperation

In 1955 Iraq, Turkey, Iran, Pakistan, and the United Kingdom agreed to help defend one another's security. The resulting agreement was called the Baghdad Pact. It later became known as the Central Treaty Organization when Iraq withdrew after its socialist coup in 1958. the United States did not fully join the Baghdad Pact, but participated in several of its committees and in 1959 did sign separate agreements of cooperation with Turkey, Iran, and

Pakistan. The agreement with Iran, signed March 5, 1959, alludes to the Baghdad Pact and the fact that the United States, in the interest of world peace, agreed to cooperate with the government making that declaration for their security and defense, and then in article I makes the following statement.

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

The Joint Resolution referred to is commonly called the Middle East Resolution (Public Law 85-7, as amended by Public Law 87-195). It states in part:

"* * * the United States regards as vital to the national interest and world peace the preservation of the independence and integrity of the nations of the Middle East. To this end if the President determines the necessity thereof, the United States is prepared to use armed forces to assist any nation or group of such nations requesting assistance against armed aggression from any country controlled by international communism: Provided, That such employment shall be consistent with the treaty obligations of the United States and with the Constitution of the United States."

RECIPIENT COUNTRY MUST AGREE NOT TO
TRANSFER TITLE OR POSSESSION OF DEFENSE
ARTICLES FURNISHED IT TO A THIRD PARTY
WITHOUT PRIOR CONSENT OF THE PRESIDENT

Paragraph B7 of the conditions listed on the standard Offer and Acceptance form (DD Form 1513) used by the Defense Department on sales to Iran sets forth this condition, except the term "Government of the United States" is substituted for "the President." This form, signed by both countries, constitutes the written contract. This clause was in effect on all sales cases examined.

CONSIDERATION OF PROPER BALANCE
AMONG SALES, GRANT MILITARY
ASSISTANCE, AND ECONOMIC ASSISTANCE

For all practical purposes, the United States no longer provides Iran with grant military or economic assistance.

IMPACT OF SUCH SALES ON SOCIAL AND
ECONOMIC DEVELOPMENT PROGRAMS

According to figures furnished by the U.S. Embassy, Iran is putting as much effort into programs of social and economic development as into military development. The following table shows the trend and compares Iran's budgeted expenditures on economic development and military development.

DEVELOPMENT, MILITARY, AND STATE BUDGET EXPENDITURES (note a)

<u>Year</u>	<u>Total budget</u>	<u>Development expenditure</u>	<u>Percent of total budget</u>	<u>Budget of Defense Ministry</u>	<u>Percent of total budget</u>
	(millions)			(millions)	
1345 (1966-67)	\$ 1,875.6	\$ 888.9	47.4	\$ 314.5	16.8
1346 (1967-68)	2,078.5	934.5	45.0	428.1	20.6
1347 (1968-69)	2,807.4	1,289.2	45.9	544.3	19.4
1348 (1969-70)	3,287.4	1,422.2	43.3	705.8	21.5
1349 (1970-71)	4,163.0	1,674.1	40.2	869.9	20.9
1350 (1971-72)	5,277.0	2,240.0	42.4	1,148.1	21.8
1351 (1972-73)	5,822.2	2,625.2	45.1	1,492.0	25.6
1352 (1973-74)	8,871.1	3,099.3	34.9	2,104.7	23.7
1353 (1974-75)	11,928.9	4,404.4	36.9	3,183.1	26.7

a/ U.S. dollars

Embassy officials state that Iran is spending as much, or more, on economic development as the country can effectively absorb and that the problem is not lack of funds for economic and social development, but lack of trained and educated people. They pointed out that Iran really did not pay much attention to economic development until 1963, when the Shah started his "White Revolution." That was just 11 years ago, which according to Embassy officials, is not long enough to see real results. Before that, Iran's basic social and economic system was not much different from that of a medieval feudal society, except for the oil industry. Many changes have been made since then, but by most accounts the country still has tremendous developmental needs.

Oil is the key to Iran's economic development as well as to its military development, as illustrated in the following table comparing governmental revenues and expenditures over the past, current, and next budget years.

	<u>1351 (note a)</u>		<u>1352 (note a)</u>		<u>1353 (note a)</u>	
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>
	(millions)		(millions)		(millions)	
Revenues:						
Direct taxes	\$ 630	13.4	\$ 829	12.2	\$ 1,000	5.9
Indirect taxes	908	19.3	1,210	17.7	1,500	8.8
oil	2,640	56.2	4,279	62.7	14,000	82.0
Other	520	11.1	506	7.4	570	3.3
Total	<u>\$4,698</u>	<u>100.0</u>	<u>\$6,824</u>	<u>100.0</u>	<u>\$17,070</u>	<u>100.0</u>
Expenditures:						
Development	\$2,625	45.1	\$3,099	34.9	\$ 4,404	36.9
Defense	1,492	25.6	2,105	23.8	3,183	26.7
Other	1,705	29.3	3,667	41.3	4,342	36.4
Total	<u>\$5,822</u>	<u>100.0</u>	<u>\$8,871</u>	<u>100.0</u>	<u>\$11,929</u>	<u>100.0</u>
Surplus or deficit	<u>-\$1,124</u>		<u>-\$2,047</u>		<u>\$ 5,141</u>	

a/ The Iranian year, based on the Solar Calendar of Hejira, runs from March 21 through March 20. Iranian 1353 begins on March 21, 1974.

The Shah has also pledged that 80 percent of Iran's oil revenues will be spent on economic and social development within the country. There is a limit, however, to the amount of money that the economy can effectively absorb. The following comparison of oil revenues with economic development expenditures over the same 3-year period indicates that oil revenues are outstripping the country's ability to use them in economic development.

	<u>1351</u>	<u>1352</u>		<u>1353 (est.)</u>	
	<u>Amount</u>	<u>Amount</u>	<u>Percent of increase</u>	<u>Amount</u>	<u>Percent of increase</u>
	(millions)			(millions)	
Estimated oil revenues	\$2,640	\$4,279	62.1	14,000	227.2
Budgeted development expense	2,625	3,099	18.1	4,404	42.1
Budgeted defense expenses	1,492	2,105	41.1	3,183	51.2
Development expenditures as a percent of oil revenues		99.4	72.4	31.5	

Iran's fifth development plan for 1973-78 indicates that development expenditures will account for about 98.9 percent of oil revenues during these 5 years. This plan was issued, however, in June 1973, before the recent quantum jump in oil prices. It is not likely that Iran can spend that much on development. The Embassy economic staff believes that spending more money on development than Iran is now spending would not produce results any faster.

Classified materials deleted.

Iran and Iraq

Iran and Iraq have a longstanding dispute over their boundary and use of the Shatt al-Arab River stemming from the 1937 settlement made under British auspices. A steady flow of Soviet military equipment to Iraq began in 1958 following a socialist coup. Iraq has received a full range of offensive weapons, including medium bombers and fighter bombers, tanks and artillery, and guided missile patrol boats.

The military balance between Iran and Iraq is approximately as shown in the following tables. Table 1 compares the current inventory of the two countries.

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Classified materials deleted.

Classified materials deleted.

Classified materials deleted.

Table 2

Trend of Major Combat Aircraft Acquisitions
From Data of Stockholm International Peace Research Institute
(note a)

Year Acquired	Iran			Iraq		
	Number	Type	Supplier	Number	Type	Supplier
1953	-			12	DHMk52 Ftr.	UK
				10	Brstl BFtr.	UK
1954	-			-		
1955	-			5	F-86 Ftr	USA
				14	DHFB50 Ftr	UK
1956	25*	F-84G Ftr	USA	-		
1957	25*	F-84G Ftr	USA	7*	HkrHtrMk6 Ftr	UK
1958	25*	F-84G Ftr	USA	8*	HkrHtrMk6 Ftr	UK
				1	DHFB50 Ftr	UK
				3*	IL14 MR Bmbrs	Soviet
				19	MIG-15 Ftr	Do.
				3*	MIG-17C Ftr	Do.
				5*	YAK-11 Ftr	Do.
1959	70	F-86 Ftr	Canada	3*	IL14 MR Bmbr	Do.
				10	IL28 Bmbr	Do.
				3*	MIG-17C Ftr	Do.
				5*	YAK-11 Ftr	Do.
1960	-			4*	IL14 MR Bmbr	Do.
				4*	MIG-17C Ftr	Do.
				5*	YAK-11 Ftr	Do.
				8	MIG-17D Ftr	Do.
				8*	MIG-17/19 Ftr	Do.
1961	-			a*	MIF-17/19	Do.
				2	DHvmp. T.11	UK
1962	-			a*	MIG-17/19 Ftr	Soviet
				7	TU16 LR Bmbr	Do.
1963	-			3	HkrHtrT69 Tnr	UK
				6	HkrHtrT66 Tnr	UK
				14*	HkrHtrFGA9 Ftr	UK
				6*	MIG-21	Soviet
1964	-			13*	HkrHtrFGA9 Ftr	UK
				6*	MIG-21	Soviet
				4	HkrHtr F10 Ftr	UK
				6*	HkrHtr F59 Ftr	UK
1965	91	F-5A FtrBmbr	USA	6*	HkrHtrF59 Ftr	UK
1966	90	b/F-86 Ftr	West Germany	7*	HkrHtr F59 Ftr	UK
				25*	MIG-21 Ftr	Soviet
1967	-			25*	MIG-21 Ftr	Do.
				15	MIG-17/19 Ftr	Do.
				20	SU-7 FtrBmbr	Do.
1968	24 16*	F-5A FtrBmbr F-4D FtrBmbr	USA USA	10*	SU-7 FtrBmbr	Do.
1969	16*	F-4D FtrBmbr	USA	10*	SU-7 FtrBmbr	Do.

a/ The Institute frequently lists acquisitions over a period of years. For example, the F-84Gs were listed as 75 acquired in 1956-58. To simplify the table and facilitate comparisons we arbitrarily allocated acquisitions so noted (*) evenly over the years involved. This table is intended only to reflect an overall trend and is not accurate by individual year.

b/ Transferred to Pakistan

Classified materials deleted.

The press has speculated that Iran's current military buildup may cause India to increase its own military strength for fear that Iran and Pakistan might join forces against her.

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India's armed forces are superior in numbers and equipment to those of Iran and Pakistan combined. British press articles reported that India's 1973 defense budget equaled almost exactly the total 1973 defense budgets of Iran and Pakistan combined.

Iran and India have recently exchanged official visits, dealing primarily with foreign relations and trade. Statements made in the press by officials of both countries indicate that relations between the two are rather good at the present time, and Iran has assured India of its good will.

Iran and Arab States

There has also been speculation that Iran's current buildup might trigger a similar reaction on the part of her Arab neighbors other than Iraq, particularly Saudi Arabia and Kuwait which have discussed arms purchases in recent months, both with the United States and France. Media announcements indicate that Saudi Arabia will buy Mirage jet fighters from France. According to U.S. officials, this action cannot be attributed entirely to Iran's buildup. Both Arab countries have been preoccupied with Israel lately, and, through the oil embargo, both have entered the fray with Israel to a greater degree than ever before. Kuwait has had trouble with Iraq in the past and was invaded by Iraq in early 1973.

In our opinion it is difficult to say how much these two countries have been motivated by Iran's action. Iran's buildup and the Shah's numerous statements that the Gulf states must protect their interests themselves have undoubtedly made them think more of their own defenses. U.S. officials are doubtful that their recent purchases were made solely in fear of Iran and believe it likely they fear the same forces that Iran does.

CONCLUSION

On the basis of the above rationale, we believe that current U.S. sales to Iran generally conform to the requirements and criteria of the Foreign Military Sales Act.

MATTERS FOR CONSIDERATION BY THE CONGRESS

As the volume of cash sales under the Foreign Military Sales Act increase, the foreign policy impact also increases. Even though we found no firm contradictions to the requirements of the Foreign Military Sales Act, questions exist on the impact of such sales on arms races, extent and character of the military requirement, legitimate self-defense needs of the purchasing country, and other criteria set forth in the Act.

In 1973 and 1974 oil-producing countries, particularly those in the Persian Gulf, accumulated vast sums of capital due to significantly increased prices for their oil. For example, even with the large level of purchases, Iran's international monetary reserves increased from \$992 million to \$5.4 billion in the 9 months ended July 30, 1974. The oil-exporting countries in total increased their reserves by \$16 billion (or 125 percent) in the same period.

These countries are using this capital to greatly increase arms purchases. For example, Iran agreed to purchase more arms from the United States in 1974 than did the rest of the entire world combined in any other preceding year.

The Congress does not systematically receive timely information on the volume and makeup of such cash sales or on the nature of the military capability they provide the buyer. It is currently informed on deliveries of cash arms sales. However, such deliveries often come several years after the sales take place. Estimates of current and future year cash sales are provided only in totals by country.

GAO suggests therefore that, to secure timely information for its policy deliberations, the Congress may want to consider requiring the executive branch to periodically furnish information on the volume and nature of major cash sales that could materially increase the military capability of the purchasing nation.

CHAPTER 5

FOREIGN MILITARY SALES VERSUS COMMERCIAL SALES

The greatest share of Iran's arms purchases from the United States have been through the Department of Defense Foreign Military Sales (FMS) Program rather than directly from commercial sources. Fiscal year 1974 FMS cash sales to Iran were nearly \$4 billion, while direct commercial sales amounted to only Classified materials deleted.

The stated policy preference of both executive and legislative branches is for commercial arms sales. Inasmuch as most of Iran's arms purchases are of new equipment and not used equipment from Government stocks, we believe the policy question of the desirability of the U.S. Government acting as an intermediary in such sales deserves additional consideration.

In December 1973, section 1 of the Foreign Military Sales Act was amended to specifically encourage the use of commercial sales over Government foreign military sales whenever practicable.

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We noted that Iran, after purchasing F-4 aircraft under the FMS program in both 1967 and 1969, signed a letter of intent in 1970 to buy 77 more F-4s directly from the manufacturer.

The letter provided that if Iran could not arrange financing by a certain date, the major part of the agreement could be terminated at no cost to Iran. The smaller part of the agreement, for Classified materials deleted. was fulfilled, but the major part for 73 F-4E aircraft was terminated. Iran arranged to purchase the 73 aircraft under the FMS program, with part of the cost financed by the U.S. Export-Import Bank. Available records did not contain information as to why Iran decided to change from direct purchase to FMS. However, senior U.S. officials in Iran told us that U.S. military advisors in Iran at that time, in responding to

Iran's request for advice, had advised Iran that the contract purchase price for the aircraft was unnecessarily high.

For the benefits and risks to the U.S. Government resulting from its intermediary role in Iran's arms purchases from the United States, the argument has been advanced that potential exists for both the United States and a foreign purchaser to obtain a lower unit price by combining U.S. and FMS orders and thus assuring a manufacturer of a larger production run over which to distribute fixed costs.

Senior U.S. officials in Iran were of the opinion that having Iran use the FMS program rather than buy directly from U.S. suppliers has both the advantage of promoting a closer relationship with Iran/

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MAAG officials stated however, that they had often suggested direct commercial purchases instead of FMS to Iranian officials and would continue to do so.

CONCLUSIONS

We believe that the FMS process absorbs a lot of U.S. manpower. Financial protection and training could be provided to foreign government personnel on a short term, case-by-case contract basis by providing the services of experienced U.S. military contract negotiators and administrators to work as advisors with the foreign government procurement team in its direct dealings with manufacturers. This concept could retain the mutual advantages of government-to-government contact with resultant relationships of trust and influence while eliminating much of the manpower requirements of the present FMS bureaucracy.

Recognizing that

--Iran has had 10 years of experience in purchasing arms from the United States,

- most of these arms purchased by Iran are new equipment, and
- the stated policy preference of both the Congress and the executive branch is for commercial arms sales whenever practical, rather than for government-sponsored arms sales,

we believe the policy question of the desirability of the United States continuing to act as an intermediary in all such sales to Iran deserves additional attention.

RECOMMENDATION

We recommend that the Secretary of Defense explore the possibility of (1) helping Iran establish a mission in the United States for purchasing its arms requirements directly from U.S. suppliers and (2) providing procurement advisors somewhat as described herein, rather than continuing FMS to Iran, which absorbs significant numbers of highly trained U.S. military personnel.

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CHAPTER 6

INCOMPLETE COST RECOVERY ON ARMS SALES

Arms sales to Iran are a substantial cost to the United States, although the law requires recovery of all costs. To the extent that costs are not recovered, they become a form of invisible grant aid.

Unrecovered costs of the U.S. military sales program to Iran include

- at least \$10.5 million in administrative costs,
- about \$24.2 million in Export-Import Bank loans at concessionary interest rates,
- about \$327,000 in costs of TAFT not reimbursed by Iran.

The Foreign Military Sales Act (22 U.S.C. 2762) requires that, to the maximum extent possible, prices fixed under FMS agreements be sufficient to reimburse the United States for all costs involved.

INCOMPLETE RECOVERY OF FMS
ADMINISTRATIVE COSTS

Defense has determined that a 2-percent service charge should be applied to sales of arms and services through FMS to recover administrative costs of the logistics and procurement system. We found, however, that administrative costs of up to \$11 million annually have not been recovered, as follows:

- The 2-percent service charge does not include MAAG time spent on FMS administration. We estimate these costs at about \$5.8 million for MAAG and its European Support Activity support in fiscal year 1974 alone.
- We examined sales totaling \$769 million and found that the service charge was not fully applied on some sales, resulting in an undercharge of \$4.7 million. Available records did not reveal why the full service charge was not made. One official believed it represented a concession to Iran to ease the transition from grant aid to sales; another official believed that 1 percent had been determined to be closer to the actual cost.

In January 1974 a MAAG official told us that Iran expressed reluctance to pay the full 2-percent service charge on a \$844 million purchase of 30 F-14 aircraft under negotiation. Iran argued that 2 percent was too high on large sales but finally agreed to it. We noted that a July 1973 Defense study of the validity of the 2-percent charge concluded that (1) even though it may be too high on some large-dollar-value sales, it must be applied to all sales to recover undercharges on small sales and (2) continuing the 2-percent charge across the board was administratively preferable to trying to identify a more accurate charge for each sale.

ADVANTAGEOUS EXPORT-IMPORT BANK
INTEREST RATES

Export-Import Bank financing of Iranian purchases of U.S. arms could cost the United States about \$24.2 million over the lifetime of the loans because the interest rates charged were lower than those then being paid by the U.S. Treasury.

It is a stated policy established by the State, Defense, and Treasury Departments that U. S. Government financing of military sales to developed countries will be handled by the Export-Import Bank to the extent possible. Purchases by less developed countries are financed by the Department of Defense, and Export-Import Bank finances military articles and service only at the request of Defense. Export-Import Bank officials have set a ceiling of \$300 million a year on such financing.

Active Export-Import Bank military procurement loans to Iran are summarized below.

<u>Export-Import Bank military</u> <u>Loans to Iran</u>				
<u>Amount</u> (millions)	<u>Authorization date</u>	<u>Lending rate</u>	<u>Borrowing rate</u> (note a)	<u>Estimated U.S. gain or loss (-) over life of loan</u> (millions)
\$120	10-15-70	7-1/4	7-1/4	b/ \$ 0.2
70	7-1-71	6	6-3/4	-3.4
311	6-29-72	5	6	b/ 0.1
105	10-26-72	6	6-1/4	-1.2
130	6-1-72	6	6-7/8	-4.5
<u>220</u>	<u>3-16-73</u>	<u>5</u>	<u>7-5/8</u>	<u>-15.3</u>
<u>\$620</u>				<u>-\$24.2</u>

a/ Cost to Export-Import Bank

b/ in addition to the lending rate the Bank charges a commitment fee of one-half of 1 percent a year on the undisbursed balance of each authorized loan. This accounts for the gain on these two loans.

At the time of our review, the rate of interest charged by the Export-Import Bank on its long-term direct loans, both military and nonmilitary, had generally been 6 percent a year on the outstanding balance but was raised to 7 percent in February 1974. ^{1/} The interest rate paid by the U.S. Treasury on borrowed funds during this period was generally higher, ranging up to 7-5/8 percent.

TAFT COWMAND COSTS NOT RECOVERED

The addition in 1973 of command and control elements to TAFT units already programed resulted in lost personnel services costing about \$327,000. These personnel were added at U.S. initiative and, being outside the scope of the original agreement, were not included in the costs paid by Iran. Costs of these command elements have been included in the fiscal year 1975 TAPT package that was being negotiated with Iran at the time of our review. Thus, for a period of time, the United States will have received neither the services of these personnel nor reimbursement for them.

CONCLUSION AND RECOMMENDATIONS

We conclude that Foreign Military Sales to Iran have not provided for recovery of all elements of cost.

We recommend that:

1. The Secretary of Defense take appropriate action to insure that FMS prices include all pertinent costs, including administrative time of MAAGs and any other personnel not normally considered part of the logistics system.
2. The Director, Office of Management and Budget, have action taken to fix lending interest rates and charges on long-term capital loans for military purchases at levels at least sufficient to recover the cost of such financing to the United States.

^{1/} This rate was used in participation with private financing to reduce the effective rate of interest incurred by the borrower on the total loan. The Export-Import Bank did charge the Treasury rate on loans where no private financing could be obtained, as for example, the first loan in the above table.

AGENCY COMMENTS

Defense advised us that it does attempt to recover all
costs and

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On July 17, 1974, the Office-of Management and Budget informed us it had been decided that the Bank would fix its lending rate on a loan-by-loan basis, ranging from 7 to 8.5 percent. One of the major reasons given for this change was the increasing cost of money to the Bank. The Export-Import Bank publicly announced this policy on July 9, 1974.

The Office of Management and Budget said this and other procedural changes will help insure that problems, such as those identified in this report, will not occur.

CHAPTER 7

INCONGRUITY OF PAST-DUE DEBTS

WITH CURRENT WEALTH

Iran still owes the United States over \$36 million from debts incurred after World War II, as shown in appendix V. Iran has made significant economic progress since then. Considering Iran's mounting foreign exchange reserves, we believe Iran should now be able to pay these debts which have long been in arrears.

U.S. COLLECTION EFFORTS

According to Embassy records, beginning in June 1949 and through May 17, 1954, notes were sent annually by the Department of State to the Iranian Embassy in Washington D.C., with a current statement of accounts, including interest due, and a request for payment of amounts due. In February 1957, the Iranian ambassador discussed with State officials the possibility of canceling the surplus property debts and was informed that cancellation would not be considered. Further notices were sent to the Iranian Embassy on May 23, 1960; to the Ministry of Finance on May 4, 1964; and to the Prime Minister of Iran on February 8, 1965.

Since February 1965 regular discussions of ways and means to handle the debt have taken place between U.S. and Iranian officials. An official notification regarding the debt obligations has been sent periodically to the Imperial Ministry of Foreign Affairs and other Iranian officials by the Department of State.

Embassy records also indicate that satisfactory progress on the debt issue was not realized until 1971, when, following a series of representations by Secretary of State Rogers and Ambassador MacArthur, the Government of Iran seriously entered into negotiations on this debt. Iran did close out two of these debts in March of 1973 with a payment of \$754,734.06.

A December 5, 1973, report by the Committee on Government Operations discussed the delinquent debt by Iran and pointed out that Iran was experiencing a healthy new prosperity from petroleum sales and could afford to pay its debt. The Committee recommended that the Department of State intensify its efforts to reach satisfactory settlement of the Iranian surplus property debt before the end of this year,

relaying to United States and Iranian officials the growing congressional concern over these matters. The Committee further recommended that State give high priority to efforts seeking debt repayment acceleration by those countries now in an economic position to make advance repayments.

In December 1973 U.S. officials told us that they believed the Government of Iran was fully aware at the highest level of the necessity for a prompt resolution of the debt problem and they considered that satisfactory progress was being made toward a settlement.

MILITARY MISSION COSTS

The United States is providing advisers to the Iranian Armed Forces (as cited on p. 8) at an estimated cost of \$12 million for fiscal year 1974. (See ch. 6 for a discussion of mission costs directly related to FMS.)

The agreements which established these missions in 1943 and 1947 provided for Iranian payment of compensation to mission members and payment of other mission costs.

The provisions for payment of personal compensation were changed following an Embassy note of April 10, 1961, to Iran which proposed that the payments of compensation be made to the U.S. Government instead of mission members because a then-recent act of the Congress prohibited U.S. officers and employees detailed to foreign governments from accepting compensation or other benefits from such governments.

In a note dated June 14, 1961, Iran agreed to pay personnel "emoluments" to the Chief of Mission if said personnel signed powers of attorney to the Chief.

According to State Department officials, Iran had paid these costs as agreed until 1950 or 1952 when payments were suspended because of a then-current state of emergency in Iran following nationalization of its oil industry in the early 1950s. State officials did not agree on whether the United States agreed to suspension or the nature of agreement, if any.

That state of emergency has long been over, but the United States continues to pay most operating costs and all personnel costs of MAAG and its administrative support element. Iran provides office space, utilities, gasoline, and similar support for these activities.

U.S. costs of operating MAAG and its European Support Activity is estimated to be \$12.3 million for fiscal year 1974 compared to Iranian contributions for the two activities of \$9 million as shown in the following table. The Gendarmerie Mission costs the United States \$659,000 annually.

1974 Budget Costs of MAAG and the Support Activity Compared with Value of Iranian Aid

	<u>MAAG</u>	<u>Support activity</u> (millions)	<u>Total</u>
costs to U.S.	\$ 7.24	\$ 5.11	\$12.35
Iranian aid	3.99	4.96	8.95
 Total U.S. cost and Iranian aid	 <u>\$11.23</u>	 <u>\$10.07</u>	 <u>\$21.30</u>
 Iranian aid as a percent of total	 36%	 49%	 42%

Although the agreements call for Iran to pay a large portion of the costs, State and Defense officials seem reluctant to approach Iran on the question because the United States now has a good relationship with Iran from which we derive much benefit, economic and otherwise.

CONCLUSION

In view of Iran's prosperity, concern over its mounting exchange reserves, and proposals to channel surplus funds into international lending institutions, we conclude that it should now be able to pay these debts and defray the cost of other services provided, recognizing that the United States gave the Iranian Government preferential treatment when it needed it during the years following World War II when it was economically weak.

RECOMMENDATIONS

Therefore, we recommend that the Secretary of State:

1. Continue efforts to collect past-due lend-lease, purchase agreements, and other debts.

2. Reach agreement with Iran on payment of military mission costs with due consideration for:
 - a. Different conditions and relationships between now and the date of original agreements.
 - b. That portion of MAAG costs that may not otherwise be reimbursed as FMS administration costs.

AGENCY COMMENTS

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CHAPTER 8

NEED FOR TERMINATING U.S. RESPONSIBILITIES

FOR MILITARY GRANT AID EQUIPMENT

IN IRAN

MAAG has not properly accounted for and reported the location, condition, and use of MAP equipment remaining in Iran's military inventory or given adequate consideration to selling Iran the residual rights to the equipment, as required by Defense regulations. MAAG estimated that MAP equipment having an original acquisition cost of \$252 million remained in Iran; Defense estimated that \$565 million worth of MAP equipment remained. The difference is still unreconciled. With the passage of time and Iran's transition to cash sales, the relative importance of this equipment has diminished; yet a residual right to the equipment is retained by the United States and accountability is still properly required by Defense.

The time required to administer FMS cases, the dispersal of YAP equipment throughout Iran, and Iran's intermingling MAP and FMS equipment have caused MAAG to lose visibility over MAP equipment and its use. As an alternative, MAAG requested Iran to provide MAP equipment inventories showing the desired information. Iran, too, finds this difficult, and has not complied. Most of the equipment is old and no longer used by the United States.

Continuing U.S. monitorship is plagued with administrative problems irritating to both MAAG and Iran and appears of little benefit to the United States. In spite of this and of Defense policy, MAAG has not proposed that Iran buy the residual rights to the equipment. Sale of the rights would (1) substantially reduce the accountability and reporting requirements, (2) assure Iran of continued possession, and (3) realize a cash return to the United States. Terms of sale can still require U.S. approval of transfers of the equipment to third countries and other conditions of sale as appropriate.

AMOUNT OF MAP EQUIPMENT
REMAINING IN IRAN

The United States furnished Iran \$836.7 million in military grant aid between fiscal years 1946-72. MAAG estimated that as of June 1973 major MAP property having an acquisition

value of \$252 million remained in Iran, as shown in the following table.

	<u>Army</u>	<u>Air Force</u>	<u>Navy</u>	<u>Total</u>
	(000 omitted)			
Combat vehicles	\$ 41,900	\$ -	\$ -	\$ 41,900
Support vehicles	65,596	2,001	893	68,490
Weapons	28,740	-	-	28,740
Communication and electrical equipment	17,485	8,038	80	25,603
Aircraft	637	43,198	-	43,835
Ships and crafts	-	-	32,803	32,803
Other	<u>8,204</u>	<u>2,052</u>	<u>-</u>	<u>10,256</u>
Total	<u>\$162,562</u>	<u>\$55,289</u>	<u>\$33,776</u>	a/ <u>\$251,627</u>

a/ Includes an estimated \$67.2 million of equipment which is or soon will be obsolete.

Defense officials in Washington, however, said equipment with an acquisition value of \$565 million remained in Iran according to their records. We believe this is indicative of the problems in the MAP management system.

Since fiscal year 1968, Iran has also purchased large quantities of military hardware from the United States and other countries (see p. 4). The MAAG role in surveillance of the use and disposition of MAP property has understandably diminished since the advent of FMS. Our review of MAAG surveillance and monitoring of MAP property was made keeping in mind the relative increased importance of FMS over grant aid.

The Foreign Assistance Act of 1961, section 623(a)(3) assigns primary responsibility for supervising end-item use of MAP property to the Secretary of Defense. Within their areas of responsibility, this function is delegated to the Unified Commands and, where appropriate, delegated further to MAAGs or other Defense elements. The primary responsibility for MAP activities in Iran has been assigned to the European Command and further delegated to MAAG.

LACK OF VISIBILITY AND SUPERVISION OF MAP EQUIPMENT

Under present conditions and procedures, MAAG does not exercise supervision over MAP equipment location, condition,

and use as required by Defense regulations. As a condition for a country's eligibility to receive grant equipment the Foreign Assistance Act requires the country to permit U.S. monitorship over use and disposition of the equipment.

Lack of inventory data

Our discussions with MAAG officials and review of pertinent records indicate that, except for major equipment, MAAG has little visibility over MAP property. A MAAG Navy section official advised us that only within the last year has any concentrated effort been made to identify such property.

In September 1973 MAAG requested from Defense a listing of delivered or partially delivered items to help build an inventory data base on MAP items distributed to Iran. A MAAG official, however, said he believed the listing to be only 50-percent accurate.

Until July 1973 Iran had never been asked to submit a one-time or annual recurring inventory report--as required by Defense--of MAP property. However, as of January 1974 MAAG and the Iranian military have been negotiating a requirement for submission of an annual inventory report of MAP major end items. We believe that, even if the inventory requirement is successfully negotiated, it may not be possible for the Iranian military to actually take an inventory. MAAG officials and the Iranians claim that much MAP equipment has lost its identity. For instance, a MAP truck may now have an engine, tires, and other components acquired through FMS. MAP radios have been rebuilt with FMS parts.

The Iranian Air Force response of November 28, 1973, to MAAG's initial proposal for an inventory of grant aid equipment was negative, stating:

"Since sending military assistance items was stopped several years ago and items resembling them can be found in large quantities at subordinate units, recognizing and location of such items are not possible * * * Request you (MAAG) provide delivery and document number of the items in question so that we can take further action."

A MAAG Air Force section official told us that the data requested by the Iranian Air Force was not available.

Supervision of end-item use

The Military Assistance and Sales Manual requires U.S. supervision of end-item use but provides that this may be satisfied by periodic submission of reports by the recipient country, if Defense elements supplement and verify such reports by physical inspection, observation, and other means as may be practical. Our discussions with MAAG representatives and review of MAAG inspection reports revealed that MAAG has not effectively verified Iranian reports on use and condition of MAP property.

From July 1971 to December 1973, the MAAG Air Force section made only 22 inspections of MAP property. A review of the reports on these inspections showed them to be rather superficial. The Army section inspections appeared to us less superficial, but the number dropped from 187 in 1971 to 78 for the following 2 years.

MAAG officials apparently understand the requirement for monitoring the use and condition of MAP property but stated that, due to the demands on their time of FMS and advisory responsibilities, they just did not have time to personally do it and must trust the integrity of the Iranians. One MAAG official also believes that monitoring MAP property end-item use may not be feasible or plausible under the current FMS environment.

INADEQUATE CONTROL OVER MAP MATERIAL DECLARED EXCESS

MAAG has not required prompt action by Iran on MAP material declared excess to Iran's needs.

MAAG personnel also do not inspect MAP property that Iran determines to be scrap nor do they generally witness Iranian demilitarization of MAP equipment being scrapped, as required by Defense pursuant to law. As a result we believe the United States has little assurance that (1) excess MAP material is promptly available for U.S. needs elsewhere, (2) MAP material declared scrap by Iran might not actually be repairable and thus could be re-distributed to MAP programs elsewhere, or (3) scrapped military equipment is properly demilitarized and not used for military purposes elsewhere,

Defense guidance manuals state that if MAP property excess to a participant country's needs is not used for other

MAP programs or for active U.S. military needs, it may be disposed of as follows: (1) when a special government-to-government arrangement exists for disposal, disposition will be made in accordance with that arrangement, (2) in all other cases disposition will be made in accordance with the Defense Disposal Manual and related instructions. Defense procedural manuals also state that when MAP property is declared excess to the needs of its armed forces by the holding country, MAAG or other Defense elements responsible for MAP administration in the country will determine its condition. To the extent practical, the determination will be based on physical inspection by qualified U.S. personnel. It further provides that each unified command is responsible for adequate records being kept on each country under its jurisdiction to reflect accurately MAP property redistribution and disposal actions each year.

According to MAAG officials, excess MAP material furnished to Iran is disposed of in the following manner.

- If MAP material is determined to be excess, the applicable Iranian military service is to report it to its counterpart in MAAG.
- MAAG is to screen the excess, first against demands of other U.S. military assistance programs and secondly against other U.S. military requirements.
- If there are no U.S. requirements for the MAP excess, Iran is to dispose of it by sale in-country to private interests. The agreement requires a representative of the appropriate MAAG service section to be present at the sale.
- Proceeds from the sale are to go into a special fund, controlled by Iran, to purchase training aids for the Iranian military.

Below are some of the more significant weaknesses we found in MAAG control over determining, reporting, and disposing of excess MAP material in Iran.

- MAAG has accepted without question Iran's designation of condition of assets reported excess and does not inspect this material. The inherent weaknesses in this procedure are that assets determined by Iran as scrap may in fact be recoverable or repairable and

could be made available for redistribution to other MAP countries or used for other U.S. military requirements.

- Defense regulations and implementing instructions require that local disposal by demilitarization be accomplished by the Iranian military in accordance with applicable U.S. directives and guidance furnished. A MAAG Army section directive dated June 4, 1972, requires that the demilitarization process be witnessed by Army section advisory personnel. MAAG officials said that demilitarization actions are generally not witnessed by MAAG personnel. They assume that the Iranian Military has demilitarization capability.
- MAAG Army section records showed 178 reports of Army MAP excess with an estimated acquisition value of \$5.7 million for fiscal years 1970 through 1973. A review of the 178 reported excess actions revealed that only 68 of them were completed. More than 50 percent of the incomplete excess actions were reported in fiscal years 1970-71. The MAAG Army section is aware of this problem and in September 1973 wrote to the Commander of the Iranian Army requesting clarification for some of the more recent incomplete excess actions.

NEED FOR SALE OF RESIDUAL RIGHTS OF U.S. MAP PROPERTY

Before our review, U.S. program managers had not formally considered the relative merits of the sale of U.S.-owned residual rights of MAP grant aid equipment remaining in Iran.

Defense procedures state that "Where practical and consistent with overall U.S. objectives and interests foreign countries will be encouraged to purchase the residual rights of the U.S. Government to material furnished as grant aid."

Sale of U.S. residual rights to Iran would have the mutual advantage to the United States and Iran of eliminating the U.S. monitoring and supervision requirement with its attendant inventories, inspections, and reports. Currently Iran must seek U.S. approval to make internal redistribution of grant aid equipment. Iran's management flexibility is also diminished when it wants to modernize grant aid equipment under the FMS program, as illustrated by the following case.

In July 1973 the Iranian Vice Minister of War expressed concern that Iran was spending a large sum of money to modernize M-47 tanks acquired through MAP, but, because of the U.S. residual right in MAP equipment, the tanks could be called back by the United States if needed. He requested MAAG to obtain information on the cost and actions necessary for Iranian purchase of the residual rights to the tanks.

MAAG requested information from the Army, which in July 1973 advised MAAG that the Iranian Government could purchase the residual rights for 5 percent of the original acquisition cost of \$131,900 per tank. The records indicated an inventory of 404 M-47 tanks in Iran; the total price of residual rights, therefore, was \$2.7 million,

Also, in the event Iran purchased the residual rights, title would then rest in the Iranian Government, with identical rights and limitations as those under FMS, thus requiring U.S. approval before transfer to any third party.

Iran did not purchase the residual rights to the M-47 tanks.

CONCLUSIONS

The last of military equipment grant aid to Iran was programmed for fiscal year 1969. Since fiscal year 1968, Iran has also purchased large quantities of military hardware through FMS. This purchased material has been commingled to such an extent with MAP materiel that separate accounting for MAP materiel probably is not possible.

The MAAG role in surveillance of the use and disposition of MAP property has diminished to a point where it is ineffective. We can understand the problems associated with surveillance of MAP property--caused in part by the shifting of emphasis to FMS.

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RECOMMENDATION

We recommend, therefore, that the Secretaries of State and Defense explore with Iran the desirability of buying the residual rights to U.S. grant aid equipment currently in Iran.

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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

JUL 17 1974

Mr. J. K. Fasick
Director
International Division
General Accounting Office
Washington, D. C. 20548

Dear Mr. Fasick:

I have been asked to respond to your May 15 letter to Roy Ash requesting comments on a GAO recommendation concerning Export-Import Bank lending for military sales to Iran. The GAO recommendation, made in the draft report "Issues Related to United States Military Sales and Assistance to Iran," is that such lending be at rates no lower than Treasury Department borrowing rates.

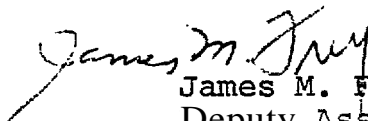
The issue raised by the GAO goes beyond Exim support for military sales to Iran to the overall question of Eximbank lending policies. This issue is particularly timely in light of high commercial interest rates and increased demand for Eximbank resources. The Eximbank has recently taken steps to assure that export credits are made available for the most needy borrowers. As you know, earlier this year the Eximbank lending rate was increased from 6 to 7 percent in conjunction with efforts to get other major exporting countries to reduce the subsidy element in their official credits. Subsequently, it has been decided that the Eximbank will fix its lending rate on a loan-by-loan basis within the 7 to 8.5 percent range. One of the major reasons for this change was the increasing cost of money to the Bank.

In addition, the Eximbank has reduced its participation in export loans to 30 percent and increased the required down-payment on a case-by-case basis, thus increasing the effective financing cost. It has also tightened screening procedures to eliminate those cases in which Eximbank's financing is

less likely to be needed. We believe that the revised Eximbank lending procedures will help assure that problems such as that identified by the GAO will not occur.

As you requested, I have coordinated this response with other appropriate agencies within the Executive Branch.

Sincerely,



James M. Frey
Deputy Associate Director
for International Affairs

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IRAN'S PAST-DUE DEBTS TO THE UNITED STATES

<u>Agreement</u>	<u>Date</u>	<u>Transaction</u>	<u>Amount</u>	<u>Terms</u>	<u>Paid</u>	<u>Outstanding balance</u>
Agreement of Purchase	12-12-45	Sale of: 1. U.S.-UK fixed installation-2. U.S. railroad cars	\$ 2,819,983.47	3 installments of \$939,994.49. No interest	\$ 912,769.49	\$ 1,907,213.98
Surplus Property Agreement	3-11-47	Sale of all U.S.-owned immovable property at Abadan Airport	\$ 136,682.00	3 installments of \$45,560.67. No interest	\$ 136,682.00	(a)
Surplus Property Agreement	7-29-48	\$26,000,000 credit for purchase and care of U.S. property	\$21,389,845.47	12 installments starting 1-1-50 ending 1-1-61 at 2 3/8% annual interest	-0-	\$21,389,845.47 (principal) \$12,192,211.92 (interest to 1-1-74) (24 years at \$508,008.83)
Lend-Lease Settlement	12-20-45	Agreement to pay in 12 installments for lend-lease goods provided under a previous Iran commitment to pay for in cash	\$ 8,541,040.75	12 installments. No interest	\$7,829,287.39	b/\$ 711,753.36
Miscellaneous		Cash payment transactions and air transport charges under lend-lease	\$ 124,378.32	Cash	\$ 34,378.32	\$ 90,000.00
Army Mission	1947	Transportation of advisors and dependents	\$ 45,165.00		-0-	\$ 45,165.00
Various FMS logistics support		Army Navy	\$ 40,619.00 853,690.00		-0- -0-	\$ 40,619.00 853,690.00
AID loan 265-G-023 c/	1967		\$ 110,056.00		-0-	\$ 110,056.00
Total			\$34,061,460.01		\$8,913,117.19	b/\$37,340,354.73

a/ Outstanding balance of \$91,121.34 was paid in March 1973. In March 1973, the State Department accepted a payment of \$663,612.72 in total settlement of an outstanding balance of \$711,753.36.

b/ Exceeds original balance because of accrued interest.

c/ Delinquency on this loan arose from AID's ignoring Iran's request on treatment of overpayments. Iran requested that its 1970 overpayments be applied against 1971 billings. Instead AID applied the funds against loan principal.

DEFENSE-RELATED PRIVATE CONTRACTORS IN IRAN

Approximately 30 U.S. firms operating in Iran on defense-related contracts have about 900 civilian employees in-country. Among these firms are

Boeing

Raytheon

Bowen-McLaughlin-York

Control Data Corp.

I. T. & T.

Hughes Aircraft

Iran Aircraft

Lockheed Aircraft Corp.

Northrop

Bell Helicopter

Motorola, Inc.

Stanwick Corp.

General Electric

Westinghouse

Philco-Ford

McDonnell Douglas

Computer Sciences

PRINCIPAL OFFICIALS RESPONSIBLE
FOR ADMINISTERING
ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
<u>DEPARTMENT OF STATE</u>		
SECRETARY OF STATE:		
Henry A. Kissinger	Sept. 1973	Present
William P. Rogers	Jan. 1969	Sept. 1973
ASSISTANT SECRETARY FOR NEAR EASTERN AND SOUTH ASIAN AFFAIRS:		
Alfred L. Atherton	Apr. 1974	Present
Rodger P. Davies (Acting)	Feb. 1974	Apr. 1974
Joseph J. Sisco	Feb. 1969	Feb. 1974
UNITED STATES AMBASSADOR TO IRAN:		
Richard M. Helms	Mar. 1973	Present
Joseph S. Farland	May 1972	Feb. 1973
<u>DEPARTMENT OF DEFENSE</u>		
SECRETARY OF DEFENSE :		
James R. Schlesinger	July 1973	Present
William P. Clements, Jr. (Acting)	May 1973	June 1973
Elliot L. Richardson	Jan. 1973	May 1973
Melvin R. Laird	Jan. 1969	Jan. 1973
ASSISTANT SECRETARY OF DEFENSE (International Security Affairs):		
Robert Ellsworth	June 1974	Present
Amos A. Jordan (Acting)	Jan. 1974	May 1974
Robert C. Hill	May 1973	Jan. 1974
Lawrence S. Eagleburger (Acting)	Jan. 1973	April 1973
Dr. G. Warren Nutter	Mar. 1969	Jan. 1973

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