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DEPARTMENT OF STATE

3036

Memorandum of Conversation

2/19/70

DATE: February 19, 1970

SUBJECT: U.S. FY 1970 Military Sales Credit for Iran

PARTICIPANTS: H.E. Mehdi Samii, Managing Director, Iranian Plan Organization

Mr. Joseph J. Sisco, Assistant Secretary of State, NEA JJS
Mr. Jack C. Miklos, Country Director for Iran
Mr. Walter M. McClelland, Deputy Country Director for Iran

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Mr. Samii explained that he had come to the United States because of GOI concern about the FY 1970 U.S. foreign military sales (FMS) credit to Iran. Ambassador MacArthur had informed him that since Congress had not passed the FMS legislation, the FY 1970 credit agreement could not be signed until later, perhaps April, when Congress had acted. The GOI is concerned because of further payments it must make on its F-4's this year for which there is at present no provision in the GOI budget that has been submitted to the Majlis. Mr. Samii had to determine whether or not there was liable to be a problem with the credit and, if so, perhaps make some accommodation in the Iranian budget for it.

Mr. Sisco said that the USG is thinking in terms of a $100 million credit again this year, although until Congress completed action on the FMS legislation, we could not give any assurance on this point.

Mr. Samii also expressed the GOI's concern about the USG's intention to include at least 50% private credit in the FY 1970 credit. He said that the GOI was hoping for a 75/25 USG/private credit split, the same as last year. Mr. Samii also expressed concern about high interest rates on the credit, especially the private credit portion.

Mr. Sisco said that although the days of 6 1/8% USG credit seem to be gone this year, he noted Mr. Burns' opinion that the U.S. economy has reached a peak and is beginning to cool. This could lead to lower interest rates by the time the credit is negotiated; however, Mr. Sisco believed that the interest rate on USG credits would probably still be about 7½% or higher, with private credit at 9% or so.

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Mr. Sisco assured Mr. Samii, however, that the USG would do the best it could for Iran.

Mr. Samii then explained Iran's economic and financial situation. He said that there had been a 25% increase in defense expenditures for next year so that about half of the ordinary budget will be spent on defense. This means that all other sectors of the budget had to be pared and these cuts put additional pressure on the development budget. Mr. Samii explained that in addition to defense allocations in the ordinary budget, military construction (about $100 million) is to be charged to the development budget. Even some of the civilian projects, such as telecommunications, have a large military element. Mr. Samii added that expenditures of foreign loans for military purposes are not shown in the budget, although the servicing of these loans is shown.

Mr. Samii also commented that the Iraqi situation had required the GOI to squeeze all of its ordinary expenditures except education during the current Iranian year in order to obtain $7 million to meet emergency costs. Development expenditures were not affected only because they could not legally be touched.

In response to Mr. Sisco's question as to when, as an economist, Mr. Samii would begin to worry over excessive defense spending, Mr. Samii said he was already concerned. His main problem was with large defense purchases abroad and, although he thought the World Bank's estimate of Iran's debt service ratio was high, it did point up a difficult problem. Most defense loans are short and medium term (average about 4½ years) at high interest rates. Loans from the U.K. and Italy had more favorable interest rates than U.S. loans, but required large down payments (22% for U.K.; 10% for Italy).

Mr. Samii continued that these large military expenses are worrying. In today's circumstances (British withdrawal from the Persian Gulf, tension with Iraq) top priority has to go to defense. However, if the U.S. credit is to be a 50-50 USG/private funded credit at high interest rates, this may be impossible for Iran to bear and he (Samii) may have to ask the Shah to reconsider the credit and use Iran's own resources cutting back other programs where necessary rather than borrowing at such a cost.

Mr. Samii continued that it was a most crucial decision whether or not to allow the economy to slow down in such fields as agriculture and industry so that funds could be spent for defense purposes. If it is true that Britain leaves the Gulf in 1971, then Mr. Samii said Iran will have to be a pivot of stability in the area; however, this means not merely defense, for a stable economy is what will really sustain Iran in these circumstances. Mr. Sisco agreed and said that Iran's economic stability affects not only Iran itself, but also has implications for the whole region.