It is of critical importance to the United States that Iran remain an independent and sovereign nation, not dominated by the USSR. Because of its key strategic position, its petroleum resources, its vulnerability to intervention or armed attack by the USSR, and its vulnerability to political subversion, Iran must be regarded as a continuing objective of Soviet expansion. The loss of Iran by default or by Soviet intervention would:

a) Be a major threat to the security of the entire Middle East, including Pakistan and India.

b) Perpetuate a communist denial to the free world of access to Iranian oil and seriously threaten the loss of other Middle Eastern oil.

c) Increase the Soviet Union’s capability to threaten important United States-United Kingdom lines of communication.

d) Damage United States prestige in nearby countries and with the exception of Turkey and possibly Pakistan, seriously weaken, if not destroy, their will to resist communist pressures.

e) Set off a series of military, political and economic developments, the consequences of which would seriously endanger the security interests of the United States.

The situation in Iran presents widening opportunities to the communist organisation there. Social unrest in spreading in the wake of nationalist agitation and disruption of the traditional structure of Iranian leadership and institutions. Government promises of early prosperity following the record of the British oil company have not been fulfilled. On the contrary, the inability of the interested parties to reach an oil settlement and the inability of Iran to dispose of its oil have contributed to a worsening of economic conditions. The resulting popular bitterness and frustration have increased receptivity to communist propaganda and agitation. The Government’s budgetary difficulties as a result of the loss of oil revenue have led to currency inflation, almost complete curtailment of public works, and fears that Iran’s military forces and civil administration may soon face demoralising reductions in size and pay. Meanwhile,
nationalist politicians show little understanding of the true nature of the communist threat and are vulnerable to communist efforts to infiltrate the nationalist movement.

While it is now estimated that communist forces will probably not gain control over the Iranian Government during 1952, it is clear that the situation contains very great elements of instability. If present trends continue unchecked, Iran could be effectively lost to the free world before an actual communist takeover of the Government.

In addition to the danger to us inherent in the loss of Iran, we must be very mindful of the British attitude in any action which we take. The U.K. traditionally has been the dominant Western power in that area of the world. Their prestige is considered by them to be of importance. Moreover, the U.K.'s fiscal position is such that it fears more the impact on its other commitments of a settlement of the Iranian controversy on terms favorable to Iran almost as much as it fears the loss of Iran to the free world. British properties have been expropriated, its nationals, at least to the extent of their participation in the oil industry, have been forced to leave, and its diplomatic mission has been withdrawn at Iran's initiative. Budgetary aid from the U.S. to bolster Iran's economy without our counseling as a condition precedent reasonable compensation or a method acceptable by the Iranians to determine reasonable compensation would damage greatly our relations with this peacemaker ally. Hence in any attempt to save Iran we must endeavor to do so in agreement, if not in collaboration with the U.K.

On the Iranian side, the following factors must be taken into account: (1) Iranian susceptibilities regarding, and fear of, any proposals put forward by foreign countries; (2) failure of the Iranians to understand the realistic commercial aspects of any proposals to restructure the oil industry; (3) the political importance in Iran of extremist nationalist views which demand complete public capitulation of the British.

The importance to the free world of a continuing flow of Mid-Eastern oil to our partners and a denial of oil to the Soviet bloc is vital. There is a genuine danger that in attempting to save Iran, we may take action which will seriously damage the fabric of the entire concessionary arrangements in the Middle East. Even were us to disregard the equities, compensation or its equivalent must be provided and commercial arrangements made of a character which do not vary too greatly from others now in operation. To reward Iran for having broken its contract.
contract is to invite similar action on the part of other States with attendant grave consequences to the free world's political and economic interests.

Thus, we are faced with three choices.

First, we can take no action, in the hope that the Iranians will become more reasonable as their internal situation matures. For a long time we have felt that this, in the light of their precarious internal situation, was far too dangerous for us to consider. This has been the U.K. policy and it has been tried unsuccessfully for 20 months.

Second, we could endeavor to support the present government by providing very large-scale budgetary aid. At best this merely buys time; it implies an operation without terminal date; and, more importantly, does not seem to us to be wise since it would take months until the new Congress could act.

Third, we could endeavor to find a solution to the oil problem and provide the funds incident to such a solution which would bolster up the present government in Iran until substantial income could be derived from the flow of oil. This seems to us to be the proper course and all of our efforts have been bent in this direction. We have had countless communications and conferences with our British friends, the most recent of which took place when a U.K. Mission conferred for several days with the U.S. government and the Anglo-Iranian Oil Company officials. As a result of these meetings and subsequent communications from them, we are working toward a solution along the following lines:

Compensation

The U.S. Government has thus far not receded from its position that, as a prerequisite to other action, an agreement must be worked out which will provide for settlement of the compensation amount through some form of arbitration. Alternatively, we have considered a lump sum settlement which might be acceptable to the British, provided the initiative came from Iran.

Commercial Arrangements
Commercial Arrangements

These would be worked out either by AEG alone, or by them in combination with one or several major U.S. oil companies, or by U.S. oil companies alone. The latter two, because of our anti-trust laws, require the authorization of the President. This has been tentatively given subject to a satisfactory over-all arrangement being worked out.

Fully mindful of the implicit risks in our relationship with the United Kingdom and in disturbing the other concessionary arrange-
mements, we are now consulting major American oil companies in an endeavor to appraise the feasibility of working out acceptable commercial arrangement. If successful, we shall endeavor to find a way to solve the problem of compensation.

Provision of Funds for Iraq

Authority exists under the Defense Production Act and funds are available to the extent of possibly $100 million which could be used to make an advance to the Iranian Government against purchases of petroleum or products. Such amount would defray the cost of starting up the oil business and provide a substantial balance for general purpose use by the Iranian Government.