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Contacts with member countries: Iran - Correspondence 03

*Contracts
Iran (1973-1977)*

Folder 8

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WBG Archives

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Conversation with the Shah of Iran at Blair House -- July 27, 1973

1. The Shah used the conversation primarily to express his views on the political problems in the Middle East (the Soviet use of Baghdad as a center for Communist activity against Iran; the danger to Iran of the Soviet army of Iraq and Afghanistan; his hope that the countries of the region, meaning primarily Kuwait and Saudi Arabia, would ask for his military intervention in the event of military pressure from Iraq or other nations; the implications of the recent coup in Afghanistan, including the possibility that it was the Soviets who initiated the action through fifty junior military officers who in turn chose Daud as the political leader; the possibility that the Soviets intended the coup as a step toward dismemberment of Pakistan).

2. The Shah said he was suggesting to Amuzegar that in his speech to the Security Analysts in New York he suggest the possibility of the Arab States channelling their excess reserves through a bank to finance development throughout the developing world and he asked for my comment. I told him that my visit to the Middle East a few months ago was directed in part toward just that objective. As a first step, we hope to direct a portion of the reserves through the World Bank Group and that beyond that we believed it should be possible to establish other means by which their resources could be mobilized for development (I mentioned that just this morning I had authorized the assignment of Bank personnel to work with the Arab Development Fund to examine what institutional framework could be established for efficient investment of the oil receipts).

3. I reminded the Shah that in April of 1969 I had expressed my disappointment that the World Bank had not contributed significantly to the development of Iran and my desire that our operations in Iran be expanded substantially if that was the wish of the government. At that time he had indicated he wanted increased assistance from the Bank and I stated that we had in the five years ending July 1, 1973 substantially increased our lending compared to prior periods. I said further it was our hope that we could increase the level of Bank assistance very substantially in the next five years, particularly in support of advances in the social sectors including agriculture, education, and population. He expressed appreciation of that objective indicating that the investment objectives of the Fifth Plan which are already large were being revised upwards.

4. In conclusion, I emphasized we had but one objective and that was to assist him in the dramatic revolution which he had under way in Iran; that our technical assistance was, in my opinion, much more valuable than our financial assistance, but by its very nature, technical assistance might well lead to controversy and if the controversy ever reached a point where it was unproductive, I wanted him to inform me directly, either through Amuzegar or any other channel he chose.

5. The Shah concluded by urging me to visit Iran some time soon.

RMcN

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

FROM: Gregory B. Votaw

SUBJECT: IRAN - Audience with HIM, July 27, 1973

DATE: July 26, 1973

~~CONFIDENTIAL~~

APR 01 2013

WBG ARCHIVES

1. A background paper (July 23) reviews the status of current operations in Iran. This note aims to identify a shortlist of possible areas for discussion during your audience, scheduled for 11 a.m. at Blair House tomorrow.

2. Oil is always important in the Shah's calculations. It would be useful to know what developments he foresees, but I doubt that he will tip his hand in any very meaningful way. Two specific issues may be worth pursuing:

(a) Prospects for reopening Suez or building pipeline alternatives: More specifically, is there a role for IBRD in these gigantic undertakings?

(b) Tapping oil revenues for development: In the first big push for higher revenues a few years ago HIM argued forcefully that developed countries who were worried about higher consumer prices could lower their own internal taxes on oil products; meanwhile, he wanted a share of what had been collected in such taxes to finance development in Iran. Would HIM take the lead in imposing a tax on shipments of oil from Iran, the revenue from which could be administered by IDA to assist development of less fortunate countries? More generally, what are the ways in which countries blessed with oil can share this wealth in the interest of more widespread international economic development? In my view a gesture by petroleum exporting countries, combined with an invitation to importers to match their generosity, could produce significant resources for IDA and even more important psychological support for Replenishment. 1/

3. Agriculture and the rural sector are receiving more and more sophisticated attention by the Bank Group. In some ways the most ambitious effort the Bank staff has undertaken is the Task Force operation in Iran. Although you have exchanged letters with HIM on this and we arranged an audience for Sir John in October, tomorrow will be your first opportunity to tell the Shah directly of your hope that Iran will be the first member country to enunciate and implement a comprehensive program for rural modernization. You have frequently reminded us of the risks as well as the importance of this pioneering venture. I believe HIM would like to hear more from you on this subject.

1/ I believe the Alza Corporation of Palo Alto has offered HIM production rights for a new trachoma treatment process on the understanding that Iran will "invest" profits in free treatment services for LDC's especially in Africa. If there is any way the Bank or IFC can appropriately assist in any dramatic development of this sort, we will of course do so.

July 26, 1973

4. This is obviously very delicate ground. HIM sometimes talks as if he already has a fully articulated program for the rural sector; we do not believe this. We also know that he is fed up with "effete Western intellectuals" criticising agro-business and raising questions about land reform; he has said that there is an "intellectual conspiracy" abroad to undermine his achievements and aspirations in the rural area. He has accused the Bank staff of joining in that criticism. (Actually, the Bank staff's first reaction to the agribusiness idea was that investors were unlikely to go to Iran; later, when this proved wrong, the staff turned to a more constructive role of asking questions which need to be answered if Iran is to reap the full potential from agribusiness. This Socratic gadfly role is seldom welcomed enthusiastically by anyone; and I believe it is fair to say that, in this case, the dialogue on agribusiness has never been entirely satisfactory to either Iran or the Bank.) Fortunately, Sir John Crawford's technical and diplomatic skills have now opened up constructive discussions (and serious studies) on a wide range of topics; I believe you have a report on this directly from Crawford.

5. It will be important to learn how HIM views the Task Force effort and Iran's rural problem generally. It will be even more important to reassure him that you personally will advise him or his Prime Minister on policy prescriptions emerging from the Task Force effort, that this advice will be entirely confidential and that if, in the end, the Bank and Iran cannot agree on joint programs in the rural sector you intend to see that we part company without animosity or any politically embarrassing "confrontation". ✓

6. Bank lending in recent years and foreseen for future is largely in infrastructure and industry, at least as measured in dollar terms. Several points may be highlighted:

- (a) The Bank's proper role in Iran goes far beyond simple financing. We all know Iran has immense financial resources and considerable creditworthiness to enable very large direct borrowings in world capital markets. In these circumstances our financing is best tied to institutional improvements (e.g. streamlined management structures and modern accounting systems in rapidly growing power and telecommunications sectors), better sector planning (e.g. industry, roads, pipelines, etc.) or more careful project analysis (e.g. Tehran water supply). Iran tends to find our questions and our institution-building too time-consuming; officials say other money is available more readily from other sources. Of course it is! To some extent it is the very essence of the Bank's development mandate to explore with governments new dimensions in development planning. In the past the Shah has reacted very negatively to evidences of Bank leverage to force policy changes in Iran; he is proud of Iran's independence. Today we think we are working to support reforms he has decided to carry out, but he may still fear that Bank enthusiasts occasionally infringe on Iranian sovereignty.

July 26, 1973

- (b) Although we are preparing to invest substantial sums in power, telecommunications and industry (provided these loans do assist with important institutional/structural changes), we would be happier with a mix of projects that had a larger percentage of social projects than is now planned. I for one think we should do much more in education and the Region has given first priority to projects in this sector; but these projects emerge slowly. We want to be more closely identified with HIM's social reforms than the present lending program foresees.
7. Iran has been the most vocal member country, so far as I know, in criticising the Bank's policies regarding the allocation of currencies. Paragraphs 16-18 of the Background Note discuss this. Briefly, Iran objects to the Bank's practice of refusing to allow Borrowers to take probable future exchange fluctuations into account when awarding contracts; the low bidder gets the award even though Iran expects his currency to appreciate relatively to the second lowest bidder, and contracts are awarded in the bidder's currency - not in some "neutral, fluctuation-free" unit of account. Disbursements by the Bank are usually in hard currencies (recently, for example, largely in yen). And we call for softest currencies first during the amortization period of loans. All this makes IBRD money much more costly than 7-1/4 percent - and to some extent the price is unpredictable. The Iranians have done a lot of complaining about this during the last 6-9 months; as a result we have had many occasions to explain our predicament to them and to try to demonstrate that even at some cost higher than 7-1/4 percent IBRD funds are cheaper than alternatives currently available to Iran. The Shah has probably heard complaints about our allocation of currencies; it is much less likely that any Iranian has reported fairly to HIM why IBRD has had to continue operating with practices devised during a period of relatively stable exchange rates during the past two years of unprecedented fluctuations.
8. Pollution and especially traffic congestion is a subject Iran is just beginning to take seriously. Given the shortage of water, I fear pollution may become very serious before any of us know what to do about it. Meanwhile, the traffic situation in Tehran is a scandal. Cars have become a symbol of economic development; this is crazy. Taxes should be raised even further, especially in Tehran; Draconian controls should be introduced along with rapid improvements in public bus transportation. Our project represents a small beginning; with HIM's energetic support, however, it could represent a major turnaround in favor of rational urban planning, and we are delighted that HIM has given the Government strong support in its efforts to create a strong Tehran Development Authority (now in the final stage of consideration by Majles).
9. General: In any dynamic relationships there are arguments and complaints. There are plenty in our very active program in Iran. IBRD is thought to be rigid on procurement matters; our people think they have been very accommodating in response to Iran's suggestions and experiments. Such arguments are likely to be pursued vigorously in future; but we are working together, making adjustments on both sides and occasionally

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agreeing to disagree and part company. Meanwhile, I suspect HIM is very much aware that some complaints he hears about IBRD have little to do with us really but are part of the clash of personalities within Iran (e.g. Amuzegar family against the Farmanfarmaians, Rouhani vs. Valian). Personally, I find it very hard to tolerate the Bank being misused in this way, but we have so far found no way to avoid it completely.

10. Geopolitics: My best guess is that HIM will not discuss much about the Bank Group with you but will, as in the past, use the occasion to seek your views on political problems in the Middle East and South Asia and his plans for keeping peace in the Persian Gulf area.

cc: Mr. Knapp

GBVotaw:sap

OFFICE MEMORANDUM

TO: Mr. Robert McNamara

DATE: July 23, 1973

FROM: Gregory B. Votaw *J. Votaw*SUBJECT: IRAN: Background Paper

7/23

1. HIM Mohammad Reza Shah Pahlavi will visit Washington from July 24 until July 27, 1973. This note presents some background information on the Bank's lending program in Iran in the recent past and the prospects for the next two years, the recently launched Fifth Five-Year Plan, the Agricultural Task Force and the agricultural sector and matters currently of mutual concern.

The Bank's Lending Program in Iran in Recent Years

2. The Bank's total lending to Iran increased from \$70 million in FY69 to \$149.5 million in FY73. The net transfer of resources has increased from \$1.8 million to \$42.2 million over the same period. The program has become fairly well diversified in this time: we have made three loans in the agricultural sector, two in telecommunications, three to IMDBI, two in power and one each in education, family planning, roads, pipelines and ports.

The Tehran Urban Transport Project

3. ^{*Hyman} A loan for the Tehran Urban Transport Project, appraised in March 1973, and negotiated in June 1973, is to be presented on August 7. The project focuses on improvements in public transport in Tehran and on the long-term institutional framework necessary to enable decisions on urban investments to be taken on the basis of a rational urban plan. The French consultants, SOFRETU, had recommended the construction of a metro for Tehran. The Shah supports the metro. However, since this is such an expensive undertaking (some \$10 million per km.) the Government has agreed to review the SOFRETU study again, and have a further feasibility study parallel with the long term urban planning studies for Tehran, to examine the justification for a metro and the extent of construction that would be worthwhile in the first phase. The proposed Bank loan provides for detailed design of the first phase, provided the system is found to be economically justified.

4. You might take this opportunity to commend the Government for its positive decision to enact a law to establish the Tehran Development Council to oversee all infrastructure investments in the city. The Deputy Prime Minister, Dr. Asfia, has extended considerable cooperation to Bank missions on this project. You may also wish to tell the Shah that this will be the first Bank financed project in urban transport; that you feel that the project in Tehran has good prospects of success in ameliorating Tehran's traffic problems and in helping bring some rationale into urban decisions which have hitherto resulted in ad hoc growth; and that you hope that the Government will continue to cooperate with us to ensure, for both Iran and the Bank, that the project is successful. You could also take this opportunity to tell him that, for any public transport oriented policy to work,

President has seen

it is necessary that the Government introduce and enforce measures limiting the use of private cars in most parts of the city. (Naturally, this cannot be done until an efficient public transport system is available and this, we hope, will be the case as a result of the Bank financed project.)

Prospects for Further Bank Lending

5. Over the next five years, the lending program contemplated amounts to \$1,215 million, i.e. some \$240 million per year. This represents 15 percent of total gross foreign borrowings (\$8,100 million) required during this period according to the Fifth Five-Year Plan. For purposes of comparison, the Bank's operations program would amount to some \$1.7 billion, while Japanese delegations have pledged offers of about \$1.5 billion (public and private), the Germans \$1.2 billion and the British some \$1 billion over this period. The areas of particular concern to us have been agriculture and the social sectors. Recent statements by the Prime Minister and the Shah indicate that the Government is also concerned about progress in these areas and appears to be responsive to advice towards solving problems in these sectors. The statements have emphasized regional and social development which is essential to improving the standard of living of the poor.

6. You may wish to reiterate your desire to have the Bank finance more projects in the agricultural and social sectors (without necessarily reducing our participation in traditional areas). ✓

Agriculture

7. The Ministry of Agriculture (Rouhani) favors development through agribusiness while the Ministry of Cooperatives (Valian) favors the farm corporation route. This issue is affecting the Dez Irrigation project in Khuzestan where these Ministries have decided to test their two approaches. The Task Force is in the process of preparing a project for farm corporations, but we would hope that the bulk of the projects prepared by the Task Force would be for the benefit of individual commercial farmers rather than large-scale agricultural operations.

8. You may ask the Shah whether he has had any information on the Task Force now that it has been operating in Iran for four months. You could suggest that the Government make maximum use of the Task Force towards preparing projects they have in mind in agriculture and suitable for Bank financing, preferably those that would help the rural population. On agriculture, for example, the projects we have in mind for FY74 are in fisheries and credit. Projects for regional development and for livestock are planned for FY75. We have two further regional development programs scheduled for FY76-78 and would hope that these could encompass other social sectors such as education and nutrition in addition to their primary focus on agriculture.

Livestock

9. On livestock, Minister Rouhani has decided to go ahead with his plans for large State-owned agro-industrial complexes in Moghan and Fars, based on sheep fattening. We would like to participate in a project oriented towards the breeding and rearing aspects to ensure an adequate input to the slaughterhouses. Crawford has been in Tehran discussing with the Ministry the project the Task Force might be asked to prepare. As Iran is foreseen to be a net importer of meat for the next ten years or more, this is a sub-sector which deserves much more active attention than it has received hitherto, and we would be glad to participate in a meaningful effort to increase red meat production in Iran.

Social Sectors

10. We have made a first population loan in FY73; it includes provision for studies which should lead to a first loan for a nutrition project in FY75 and in both these areas we hope to have repeater projects every two years. You might commend the efforts made by the Government in the field of family planning and its pronouncements to improve the basic diets of the poorer urban and rural populations.

Education

11. The Minister of Plan and Budget (Majidi) and the Undersecretary to the Minister of Finance (Agah) have recently reiterated their wish to have increased Bank participation in the social sectors, particularly in education. The next education project is still under discussion. We had originally suggested a dispersed project for rural, vocational, technical and secondary education in several provinces. The Government, however, has asked that we finance one or more of three large university-type projects: The Arya Mehr Tehnical University, The Pahlavi University in Shiraz and The Hesarak Teacher Training College. Their argument is that Bank procedures would be cumbersome for the dispersed (small) projects, which they could do themselves anyway. They are more concerned about the need for expanding higher education facilities immediately because Iranians obtain most of their higher education overseas at great cost to the country; furthermore, in their view the lack of research facilities exacerbates the braindrain. We are now exploring the possibility of combining one of the large projects with some of the lower level education projects. The Shah, in the past, has been personally very interested in Arya Mehr and, judging by the fact that there is pressure to go ahead with it, he probably still is. It would be useful for you to know that a Bank mission will discuss the appropriate mix of projects to be financed in FY75 with Majidi, hopefully in the latter part of August.

Public Utilities

12. Power: We have explained to the Government that the Bank will not be able to finance the entire foreign exchange cost of the larger power projects in future and have discussed possibilities of joint and parallel financing and some of the advantages of procuring items in large packages even if the Bank were only to finance a small part. The Government appears

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to be very interested in this approach and we hope to try it out in one of the next power projects. You may explain the results of the Bank's efforts in mobilizing bilateral capital for power projects in Mexico and Brazil.

13. Water Supply: Bank financing has been requested for the Lar dam (Northeast of Tehran), aimed mainly at providing water for Tehran's needs from the late 1970s onwards and at improving agriculture in the Mazandaran area outside Tehran. The Government issued tenders in December, asking contractors to provide financing if Bank financing were not available. At our request for additional information to determine the economic justification, we understand that the Shah personally decided to cancel the tendering and await the Bank's review. The additional information we sought has been received, but indicates that there may be advantages in first constructing the Taleghan Dam (on the Taleghan Rud some 80 km West of Tehran) and deferring Lar for a few years. We have asked for information on the comparison of cost streams and will review it when a pre-appraisal mission visits Iran during the latter part of August. Since the Shah was personally involved in the decision to seek Bank financing, he may discuss the importance they attach to immediate construction of Lar. If he does, you may wish to indicate the status as far as our review is concerned. Also, construction of the Lar dam will necessitate an increase in tariffs if the Tehran Water Board is to be able to service the debt. You might explain Bank practice whereby users pay the financial costs of utilities.

Fifth Plan

14. The Fifth Five-Year Plan, which came into force with effect from March 21, 1973, emphasizes larger investments in social oriented sectors; 50 percent of total development allocations of Rls 1560 billion (approx. US\$ 23 billion) is planned to be spent on agriculture, education, health and other social services, and housing and construction, compared with 31 percent in the Fourth Plan.

Public Sector Allocations Under the Fourth and Fifth Plans

	<u>Fourth Plan 1/</u> <u>Allocation</u> <u>(b. rials)</u>	<u>%</u>	<u>Fifth Plan</u> <u>Allocation</u> <u>(b. rials)</u>	<u>%</u>
<u>TOTAL</u>	<u>577</u>	<u>100</u>	<u>1,560</u>	<u>100</u>
Agriculture and Livestock	51	9	208	13
Education and Training	35	6	230	15
Health and Other Social Services	50	9	169	11
Housing and Construction	43	7	174	11
Industry and Mining	116	20	230	15
Power and Water	149	26	322	21
Transport and Communication	131	23	221	14
Other	2		6	

1/ Revised 1971

Rials 68.17 = US\$1 from February 13, 1973.

The Fifth Plan envisages total Government development expenditure of about \$23 billion equivalent (82 percent Government direct fixed investment; 4 percent loans to private sector for fixed investment and 14 percent recurrent development expenditure). However, the Government is also committed to spending increasing amounts on defense. In 1972 defense expenditures were about \$1.5 billion (or about 10 percent of estimated GNP); they will probably approach \$2.0 billion in 1973. As at mid-1973, it is estimated that military expenditures will be equivalent to about 11 percent of GNP and about 60 percent of oil revenues. Although Iran's justification for this level of defense expenditure is based on the grounds of regional stability, some criticism has been made of this policy, as it causes constraints on the Government's development program.

Economic Mission

15. We understand that a revision of the Fifth Plan is contemplated. Apparently, this will be focused partly on increasing the capacity for steel production. A Basic Economic Mission will be in Tehran in September and this will be the first opportunity for the Bank to appraise the Fifth Plan in terms of targets, absorptive capacities, past performance, etc. Since the Shah gives the final word on these matters, you may mention the fact that the economic mission will be there and that we hope to be in a position to discuss the findings some time towards the end of the year. As there has been no economic mission to Iran since 1970, we hope to take this opportunity to analyze the situation in depth. You may seek the cooperation of the Government and indicate that the mission's findings will form the basis for the next review of the lending program in 1974.

Other Matters of Current Concern in Iran

16. There are two main subjects of general concern to the various Iranian agencies that deal with the Bank, namely, foreign exchange risks and procurement. There are three main issues concerning foreign exchange risks; i.e. (i) Bank disbursements in hard currencies; (ii) the assumption of foreign exchange risk by sub-borrowers; and (iii) foreign exchange risk in procurement contracts. Attachment II (Part A) reveals that the currency distribution of the disbursed portion of the Iranian debt due to the Bank has shown a substantial change from March 31, 1972 to June 30, 1973. While the portion denominated in US Dollars declined by 14 percent to \$79 million, the portion denominated in Japanese Yen increased by 91 percent to \$42.8 million equivalent, and that denominated in Kuwaiti Dinars increased nine-fold to \$20.4 million equivalent. The new currency distribution of Bank lending imposes a higher foreign exchange risk for the Government. Moreover, Attachment II (Parts A & B) shows that, as of March 31, 1972, the proportion of the three most important hard currencies (Deutsche Mark, Japanese Yen and Swiss Franc) in the debt due to the Bank (37.9 percent) was significantly larger than for the total foreign public debt of Iran (10.9 percent). This situation particularly affects agencies which borrow directly, as they find that their debt in Rials is subject to continuous fluctuations and, in some cases, substantial increases. You may explain

that you have been concerned with keeping interest rates down to Bank borrowers as a whole, and that this necessitates borrowings of hard currencies. You might also explain the current proposals aimed at ameliorating the inequities of the present disbursement system.

17. As the sub-borrowers of DFC's are usually less solvent than the DFC, the Iranians have taken the position that the foreign exchange risk should not be passed on to them but be borne by the DFC. Both IMDBI and ADFI are preparing proposals on how they expect to cover themselves against foreign exchange risks.

18. A third area of concern in Iran related to foreign exchange risks is the currency of contract signing for procurement under Bank loans. The Iranians would prefer to follow commercial practice, whereby bidders bear all exchange risks. We have explained to them that the Bank's practice is aimed at treating all members equally and that, in any case, over the life of the loan it is hard to foresee the relative positions of the various currencies and that there would be no advantage in denominating contracts in a currency of the borrower's choice. Also, if the borrower denominates a currency in the tender, the bidders may add a premium to their price for the exchange risk, thus distorting bid prices.

19. Some Iranian agencies express concern at the Bank's relative lack of flexibility vis-à-vis civil works contracts. Thus far, under all Bank loans, all civil works contracts, mostly for roads, have been awarded to joint ventures, or to Iranian contractors except in one case where foreign contractors were allowed to group bids and local bidders were not. In view of the efficiency and competitiveness of the local contracting industry, and the fact that there are hardly any restrictions on foreign firms that wish to form joint ventures with local firms and operate in Iran, they have sought to raise the size of the contracts eligible for ICB, and to limit bidding for some large works to local contractors. If the Shah raises this question, you may tell him about your efforts to examine what the Bank could do to develop domestic contracting industries; you may also wish to tell him of Sommers' study and say that the Region would, in future, have more flexibility in deciding the limits of contracts for ICB. You could explain to him that it would not be possible to limit all bidding only to local contractors under Bank loans.

Mr. Benjenk's Visit

20. Mr. Benjenk is expected to visit Iran in the first half of October for about ten days. This is his first visit to Iran and you might propose to the Shah that it would be useful if he could have an audience while he is in Iran, possibly towards the end of his stay. (By that time, we should also have a firmer idea about the Lar and Education II Projects.)

Oil Revenues for IDA

21. During the Fifth Plan, Iran is allocating some money for aid to less fortunate countries. Afghanistan is one of the countries to benefit from this aid. Oil revenues are projected to increase from \$2.5 billion in 1972/73 to \$5.0 billion in 1977/78 and to some \$10 billion in the early 1980s.

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Moreover, by the end of this decade, GNP per capita will have increased to close to \$1,000. You may wish to explore whether the Shah is inclined to allocate some of this increasing oil revenue for the IDA, thus helping Iran's image as one of the more philanthropic "developing" countries.

ESegura/SAiyer/gp

cc: Mr. Knapp
Mr. Benjenk o/r
Mr. Pollan

ATTACHMENT I

Lending to Iran, 1969-1973
(in Millions of US\$ Equivalent)

	<u>FY69</u>	<u>FY70</u>	<u>FY71</u>	<u>FY72</u>	<u>FY73</u>	<u>TOTAL FY69-FY73</u>
Dez Irrigation	30.0					30.0
Agricultural Dev. Fund of Iran		6.5		14.0		20.0
Telecommunications Co. of Iran			36.0		82.0	118.0
Industrial & Mining Dev. Bank of Iran	40.0		50.0	50.0		140.0
Education			19.0			19.0
Family Planning					16.5	16.5
Power I (TREC)			60.0			60.0
Power II (TAVANIR)					51.0	51.0
Highways		42.0				42.0
Pipelines (NIOC)				32.0		32.0
Ports I (PSO)				29.0		29.0
Total Lending	70.0	48.5	165.0	125.0	149.5	558.0
Gross Disbursements	18.8	25.1	43.3	59.1	81.5	
Less: Amortization	8.9	12.8	13.6	17.4	21.6	
Equals: Net Disbursements	9.9	12.3	29.7	41.7	59.9	
Less: Interest & Charges	8.1	9.4	11.0	14.2	17.7	
Equals: Net Transfers	1.8	2.9	18.7	27.5	42.2	

ATTACHMENT II

IRAN: TOTAL PUBLIC DEBT

A. TOTAL DEBT DUE TO IBRD (IN US\$ MILLION EQUIVALENTS):

	As of March 31, 1972		As of June 30, 1973		Net Increase
a. <u>Disbursed:</u>	(%)		(%)		
US Dollars	91.9	43.6	79.0	32.6	-12.9
Deutsche Marks	43.6	20.7	47.1	19.4	3.5
Swiss Francs	13.9	6.6	17.6	7.3	3.7
Canadian Dollars	11.1	5.3	9.9	4.1	- 1.2
Japanese Yens	22.4	10.6	42.8	17.7	20.4
Kuwaiti Dinars	2.2	1.0	20.4	8.4	18.2
Others	25.7	12.2	25.6	10.5	- 0.1
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sub total	210.8	100.0	242.4	100.0	31.6
b. <u>Undisbursed:</u>	<u>313.3</u>		<u>319.4</u>		<u>6.1</u>
Total	524.1		561.8		37.7

B. TOTAL PUBLIC DEBT OUTSTANDING (AS OF MARCH 31, 1972):

a. <u>Excluding IBRD:</u>	Amount in US\$ Million Equivalent		Average Interest Rate	Average Grace Period	Average Maturity
	(%)	(%)	(%)	(Years)	(Years)
US Dollars	2,038.9	44.7	5.76	2.4	9.5
Pounds Sterling	743.4	16.3	6.05	3.3	9.0
Deutsche Marks	452.4	9.9	5.49	2.7	11.5
Swiss Francs	25.4	0.6	6.01	1.4	4.4
Canadian Dollars	19.8	0.4	7.50	3.3	9.8
Japanese Yens	18.3	0.4	5.75	3.2	18.2
Others, including Eastern Europe	<u>1,267.4</u>	<u>27.7</u>	<u>3.42</u>	<u>2.1</u>	<u>15.5</u>
subtotal	4,565.6	100.0	5.14	2.5	11.3
<u>IBRD:</u>	<u>524.1</u>		<u>6.70</u>	<u>3.9</u>	<u>19.5</u>
Total	5,089.7		5.30	2.6	12.1

C. PUBLIC DEBT CONTRACTED DURING JAN. 1, 1971 - DEC. 31, 1971

a. <u>Excluding IERD:</u>	<u>Amount in US\$</u>		<u>Av. Interest</u>	<u>Av. Grace</u>	<u>Average</u>
	<u>Million Equivalent</u>	<u>(%)</u>	<u>Rate</u>	<u>Period</u>	<u>Maturity</u>
			<u>(%)</u>	<u>(Years)</u>	<u>(Years)</u>
U. S. Dollars	800.6	52.4	5.59	2.1	8.3
Pounds Sterling	447.9	29.3	6.52	3.5	8.4
Deutsche Marks	44.9	2.9	5.38	3.2	14.1
Swiss Francs	-	-	-	-	-
Canadian Dollars	19.7	1.3	7.50	3.3	9.8
Japanese Yens	-	-	-	-	-
Other	<u>215.5</u>	<u>14.1</u>	<u>3.19</u>	<u>1.7</u>	<u>14.5</u>
subtotal	1,528.6	100.0	5.55	2.5	9.4
b. <u>IBRD:</u>	<u>82.0</u>		<u>7.25</u>	<u>2.7</u>	<u>17.8</u>
Total	1,610.6		5.64	2.5	9.8

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THE BANK IN IRAN

Introduction

1. The recent increases in the price of petroleum appears to place Iran close to the upper limit of those countries considered eligible to borrow from IBRD. With a per caput GNP currently equivalent to around \$1,000 and expected to increase to \$1,500 by 1977, the case for continued IBRD involvement clearly needs to be considered carefully. The following paragraphs list some considerations regarding the future role of the Bank in Iran, the position and role of the Task Force, and the nature of any future Bank lending to Iran.

The Role of the Bank

2. The future role of the Bank in Iran clearly is going to be decided only after consideration of a broad range of factors, many of which cannot properly be considered by the Task Force. On the basis of the information that is available, however, the following arguments can be put for and against a continuation of Bank activity in Iran.

3. In the short- and medium-term, Iran patently does not need to use the Bank's financial resources per se. Not only is Iran now able to generate domestically all the capital and foreign exchange that she appears able to absorb in the foreseeable future, but the leverage gained from her control of the strategically vital commodity of the moment enables her to raise funds overseas on highly favorable terms.^{1/} These include suppliers' credit and export guarantees, particularly of military items and heavy industrial plant. The effectiveness of the leverage is illustrated by the recent agreements reached with several major industrial countries, including Japan and U.K.

4. Iran's per caput GNP is now high compared with most developing countries and the continued rapid growth anticipated over the next few years would normally be expected to disqualify her from access to Bank credit. In these circumstances the Bank's leverage through lending on economic, sectoral, or project policies will tend to decline. Although Iran may continue to need a range of advisory services for the foreseeable future, she is well able to contract these commercially or under bilateral programs, as she already does on a large scale. In any case, the Bank is not primarily a technical assistance agency and it is difficult to believe that there are not other countries that need or could benefit from Bank assistance in this field more than Iran.

^{1/} This leverage arises not only from being the world's second largest petroleum exporter, but also from the fact that Iran is the only major Middle Eastern oil exporter not to apply embargoes or quantitative limits to oil exports on the basis of political considerations.

5. There are, on the other hand, three general arguments in favor of continued Bank involvement in Iran. The first is that Iran can probably now be regarded as a resource surplus economy, and therefore offers potential for Bank borrowing as well as for IDA replenishment.^{1/} If the Bank wishes to raise capital in Iran, it may well be necessary to enter some quid pro quo arrangement under which the Bank provides technical assistance for Iran's development program in return for authority to raise funds locally.

6. The second argument for continuing Bank involvement in Iran is that the present situation can be regarded as only a temporary state of affairs, and that trends in world prices will sooner or later compensate for the colossal advantage given by the current terms of trade to oil-exporting countries. The government of Iran has long viewed its oil wealth as a limited resource and therefore one to be exploited carefully and constructively. Long-term planning is based on the conservative assumption that oil revenues will no longer be available in 20 years. The recent boost in prices has done nothing to change the basic strategy that Iran's economy must be independent of oil by 1990. This being the case, it can be argued that Iran needs continued Bank support both now, in order to develop a non-petroleum economy, and in the future when the level of development of the economy is no longer disguised by huge petroleum earnings and when Iran will no longer be able to finance her development program solely with her own resources.

7. The third argument follows on from this. For the great majority of Iran's population (perhaps as many as 70%) the level of socio-economic development implied by the national accounts is nothing more than a bad statistical joke. An estimated 70% of the rural population receive an income below \$200 per annum,^{2/} and it is probable that the majority of the urban population is in a similar income category. By any standard, these 20 million or so persons are eligible for Bank assistance. In other words, it can be argued that Bank activities that are likely to benefit these sections of the population should be continued irrespective of the degree of wealth revealed by the GNP. In Bank terms, this argument would indicate continued support for rural development, urban development and education.

8. The decision regarding the future role of the Bank will take into account also a number of other factors, not least of which will be the attitude of the government of Iran. Early indications are that there is a debate going on within the government; on the one hand there are those (largely those on the planning and policy side) who wish the Bank to continue to be involved in development of the country's economy in order to provide monitoring and control of the use of funds, planning, and technical services and to add weight to the reformist elements within government. On the other hand, there are those, particularly in the executive ministries, who see little benefit to be gained from Bank participation, which inevitably brings with it standards of evaluation and implementation and a number of conditions that are considered irksome and that only slow ministerial programs. Even if the government decides to continue the

^{1/} This possibility is enhanced by the recent removal of foreign exchange controls.

^{2/} Task Force estimates that 40 per cent of the rural population probably still receive a per caput income below \$100 per annum.

Bank's presence, the type of activity in which the Bank will engage -- whether with financing or just as technical assistance -- will inevitably affect mostly the executive ministries. Without the goodwill of those ministries it is likely that the Bank will be able to achieve less having lost the leverage that financing previously bought.

9. If it is assumed that both the Bank and the government agree that the Bank should continue its involvement in Iran, there then arises the problem of what form this involvement should take? Should the Bank continue a financing role, or should it be restricted to a technical assistance function? If financing is to continue, what should be the conditions of future loans? If the rationale of continued lending is to obtain leverage on policies and programs in specific fields, then the Bank will have to finance a significant share of project costs. But if lending is to be concentrated on the socially important sectors -- rural and urban development, education -- the foreign exchange component of project costs is likely to be low. To be able to gain the desired leverage, the Bank would therefore in many cases have to finance local costs. This, presumably, would meet with considerable opposition. There would also be a lot of pressure on the Bank from Iran to change its normal loan conditions; this is discussed in paras. 18-19 below.

10. The alternative, however, is also unattractive. For the Bank to perform a technical assistance function without the backing of any financial commitment will almost inevitably lead to the Bank becoming as ineffective as the other technical assistance teams in Iran, whether provided as part of aid or bilateral programs or contracted commercially by the government. In many cases they are simply ignored, and the influence of such teams on policy formulation or program implementation has been negligible. The Bank may be able to live on its prestige and goodwill for a while, but it will eventually meet the same fate. A Bank advisory group could have some influence on the Plan Organization, but the P.O. itself has limited influence over the executive ministries. And the executive ministries themselves would in most cases be potentially hostile to Bank advice in these circumstances. This relationship might be satisfactory if the Bank is merely seeking some token input in return for authorization to raise capital locally. But it would be unsatisfactory if the Bank is seeking to influence policy and programs in critical sectors. For Bank assistance to be potentially effective either it would have to be backed by a significant financial commitment, or it would have to be directed to the executive ministries at the request and with the goodwill and support of those ministries, or it would have to be acting for and with the support of a supra-ministerial authority (much of the influence of the Task Force rests on this last condition, and reference to the agreement between Mr. McNamara and His Imperial Majesty has been critical to the development of a dialogue with the executive ministries on a few occasions).

The Role of the Task Force

11. If it is decided that the Bank should continue to be involved in Iran's development, then the role of the Task Force comes up for discussion. It would appear that the Task Force would have a major role to play in future Bank activity because such activity appears likely to include more rather than less emphasis on the kind of planning and policy assistance that the Task Force is providing, and because the fields of agricultural and rural development are likely to be given

high priority in future Bank involvement. The question remains, however: what form should the services to be provided by the Task Force take?

12. Before tackling this question, it is necessary to make the point that there is a strong case for the continuation of Task Force activity in the field of agricultural and rural development. There is general agreement that progress in these sectors over the past decade has been minimal and that a substantially improved performance in the Fifth and Sixth Plans (1973-1983) is essential if major social and economic problems are not to emerge. The social arguments are that the rural population has benefitted little from Iran's recent economic growth, and that both relative and absolute rural poverty is likely to continue unless a major effort to improve on past performance is made now. The economic arguments are two-fold: first, that the continued expansion of Iran's industrial sector requires that the rural population (58% of the total population) enter fully into the monetary economy; and second, that the impact of food shortage and high world food prices that hit Iran in 1973 should be avoided in future by a reduction in Iran's dependence on world markets for staple food commodities.

13. This emphasis on agricultural and rural development is reflected in policy statements (in the Fifth Plan and in numerous statements from the Shah and political leaders), in the substantial increase in budgetary allocations to the agricultural ministries, in the increased authority and activity of the agricultural ministries, and in the very large programs for agricultural and rural development that have been proposed and are being drawn up. In other words, there is recognition of the need to give priority to these sectors, and there is substantial financial and political commitment to this end. What is lacking at present are the channels -- the means of raising rural production and income levels in a largely traditional rural society. It is in this respect -- the conceptualization, formulation and implementation of effective programs -- that the government needs, and appears to want, assistance.

14. It is possible to visualize the Task Force operating in one of the following capacities:^{1/}

- (a) As a general policy and planning advisory group attached to the Plan Organization. This could involve expansion of the Task Force's terms of reference beyond the field of agricultural and rural development.
- (b) As a policy and technical advisory group attached to one or more of the executive ministries (i.e. Ministry of Agriculture and Natural Resources, Ministry of Cooperation and Rural Affairs, or Ministry of Water and Power).
- (c) As a combination policy advisory/technical assistance/project preparation group working with all agencies engaged in rural development, similar to the role of the Task Force to date.

15. All these alternatives have their disadvantages. The first -- the general policy advisory role attached to the P.O. -- would be the neatest administratively and would follow precedents (e.g. the Bank office in Djakarta). It would, however, also tend to be the least effective. Although the P.O. would

^{1/} See Annex 1.

probably welcome this type of relationship with the Bank, the P.O. is now so weak vis a vis the executive ministries that the role of the Task Force would be so divorced from the practical problems of rural development and program implementation as to be almost academic. In other words, although there is a substantial need for the type of assistance that the Task Force could provide, within the existing political set-up it would not be possible to provide this assistance effectively through the P.O.

16. The second alternative is also unattractive. The nature of the decision-making process in the agricultural ministries is not such that a Bank advisory group would be likely to be effective. A number of such groups already operate ineffectively. The planning and evaluation capacity of the ministries is rudimentary, and these departments are weak in relation to the deputy ministers charged with policy execution. There is every possibility of the advisory group being largely ignored or utilized only to support one party or another in inter- or intra-ministerial battles.

17. The third alternative has proved relatively effective to date, with the Task Force maintaining a political independence while retaining some influence with the ministries through its authorization from His Imperial Majesty and through the leverage gained through actual or potential lending by the Bank. It does not seem in future, however, that the leverage gained from the Bank's financial support will be retained -- even if the Bank should continue to lend to Iran, it is reasonable to assume that the leverage it will gain from lending will be reduced. For the Task Force to be effective, however, some influence or leverage is essential. For this reason it is more important than ever that the work of the Task Force continues to be supported at the highest level. It can be expected that with the changing role of the Bank in Iran it will be necessary to redefine the terms of reference of the Task Force. The least precondition that will be necessary for the effective operation of the Task Force is that the support for its role and authorization of its terms of reference be restated at the highest level (i.e. between His Imperial Majesty and Mr. McNamara). Without this support, it is likely that the effectiveness of the Task Force would deteriorate to the level of other technical assistance agencies in Iran.

Conditions for Bank Lending

18. The government of Iran -- and particularly the executive ministries in agriculture -- have (rightly or wrongly) resented the conditions applied to Bank loans to Iran. To a large extent this resentment is caused by the much higher standard of evaluation, implementation and accounting that such conditions necessitate. The government also argues, however, that some of the conditions are petty and are inappropriate for an economy at Iran's stage of development. This argument is applied particularly to projects in the depressed agricultural and rural sectors. With the recent increase in oil prices, the government is less likely than ever to be willing to accept those loan or project conditions that it considers unreasonable.

19. If it is decided to continue lending, however, then some of the conditions traditionally applied by the Bank to its loans may have to be changed. Central ministries, taking an overall view, do not wish to lower the standards applied by the Bank for the objective evaluation or effective implementation or

control of projects. Any such pressure must obviously be resisted. Indeed with Iran's increased financial resources, this form of control is more necessary than ever if serious wastage of funds is to be avoided. But some of the detailed loan or project conditions will undoubtedly be unacceptable to the government and the Bank may need to modify its traditional position on certain issues in the changed financial situation of the country. The following is a partial list of some of the terms and conditions traditionally applied by the Bank to its projects.

Terms of Bank loans. There does not seem to be any case for changing the terms of Bank loans to the Iranian government (maturity, grace periods, interest rate).^{1/}

Size of loans. In terms of Bank strategy, there may well be a case for a gradual reduction in the size of Bank loans and in the share of project costs financed through such loans. If loans are to be continued in order to gain leverage for technical assistance, however, it will not be feasible to reduce too much the proportion of project costs financed through Bank loans.

Local currency financing. There is clearly no case for financing local costs on country grounds. It can be expected, however, that in the priority sectors -- rural and urban development, education -- the foreign exchange component of projects will often be low. If the Bank is to be able to influence such projects, there will therefore be a case for financing local costs. Whether or not the Bank should do so will depend largely on the extent to which the Bank will acquire its influence through financial leverage or other means.

Procurement. Iranian legislation requires all goods to be procured locally when available. There does not appear to be any case for relaxing the normal Bank requirement for ICB in relation to financing of projects in Iran. This, however, will increasingly lead to reserved procurement for the purchase locally of certain goods. In agricultural projects this will apply particularly to tractors, agricultural machinery and well pumps and motors. As a consequence, the amount of foreign exchange eligible for IBRD financing is likely to be reduced.

Project selection. It would appear that the Bank can play a major role in assisting the government in its analysis of sectoral priorities and in project selection. To do this effectively, however, will require a continual and close monitoring of the Iranian situation. It is important that the Bank be increasingly rigorous in the selection of projects to be financed.

Project feasibility. Feasibility analysis of agricultural projects is generally poor, with the consequence that a number of poorly conceived or designed projects have been initiated. The Bank must continue to be rigorous in its technical and economic analysis of projects in this sector. In respect of the financial feasibility of projects, however, the rigour of the criteria applied should depend on the nature of ownership of the enterprise. If the project is one of public sector investment through a state-owned body, then given the explicit government policy of transfer of resources to the rural sector the financial feasibility of the project -- i.e. the returns to the

^{1/} It may be necessary, however, to change the conditions governing the use of such funds; these are discussed below.

project agency in relation to its costs -- is not of critical importance if the technical and economic feasibility of the project is demonstrated. If, however, the beneficiary of the project is a private individual or body -- as in credit projects -- then it is essential that the financial feasibility of the project be established.

Recovery of project costs. Traditional Bank practice is to require full recovery of current project costs and as full recovery of capital costs as the project can afford. This policy, however, has been evolved for resource deficit economies where fiscal difficulties or other problems of resource mobilization have limited the development program of the government. In Iran, however, these problems do not arise and at the present time and for the immediate future Iran will be a resource surplus economy. Recognizing the social and economic importance of stimulating production and raising incomes in rural areas, the government has adopted a policy of transferring resources to the rural sector. One form of such transfer is to finance development in agriculture in the form of grants or "soft" loans. This the government is now planning to do on a wide scale, but at a level commensurate with the resources available to the public sector. The direction of these transfers cannot be faulted on economic or sectoral grounds, and future Bank lending in the rural sector will have to accept that the level of cost recovery will, as a matter of policy, be low.

Subsidies. A similar argument applies to the granting of subsidies for agriculture and rural development. The government is developing a wide range of subsidies as part of its policy of transferring resources to the rural sector. These include low interest rates, investment grants, subsidies on fertilizer and improved seed, tax rebates and support prices. Again, the orientation of these subsidies appears to be in line with the economic and sectoral priorities of the country, and the level of subsidies appears to be within the financial resources of the government (this aspect will, however, need to be kept under review). If the Bank is to finance projects in the rural sector, therefore, it will have to waive the traditional rules against factor subsidies -- rules which again have been developed in economies greatly different to that of Iran today.

Institutional structure, technical assistance, training and monitoring. The interest of the government of Iran in continuing its relationship with the Bank probably rests largely in its belief that the Bank can provide useful assistance to Iran's development effort in these areas. The structure of the institutions active in agricultural and rural development is particularly weak, and provides one of the major constraints to the implementation of Iran's programs in these sectors. The Bank should give high priority to the impact of future projects on the structure of the institutions concerned. It can be expected that most projects in the rural sector will call for skills and expertise not readily available in Iran. There will undoubtedly be a need for technical assistance -- particularly in the early phases of the project -- and there will in most cases be a need for a training element in the project. As most of the projects in agriculture and rural development are likely to have similar training requirements, there is probably a case for a systematic analysis of training needs across the sector. Bank financing could then play a constructive role in meeting these needs in the medium- and long-term. The final contribution that the Bank could make through its projects is by monitoring the expenditure of funds

and project implementation. This monitoring can be done both directly, by the Bank itself, and -- perhaps more importantly -- indirectly through the establishment of a monitoring and evaluation capacity within the executing agency. As the level of expenditure in the rural sector increases, so the need for independent control of the use of funds grows.

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Annex 1 : ALTERNATIVES FOR THE BANK AND THE TASK FORCE IN IRAN

<u>Alternative</u>	<u>Role of Bank</u>	<u>Need for Bank Presence</u>	<u>Nature of Bank Presence</u>	<u>Role of Task Force</u>
A.	No further involvement - no lending - no borrowing	No	None	None
B.	As for Part 1 country - no lending - borrowing and/or IDA replenishment	No	None	None
C.	As for Part 1 country but with advisory input - no lending - borrowing and/or IDA replenishment	Yes	(i) General advisory group (ii) Agricultural advisory group (iii) Resident representative	(i) To be expanded to general advisory group (ii) To become agricultural advisory group (iii) To be replaced by resident representative
D.	Combination of borrowing plus lending, with net transfer of resources out of Iran - lending - borrowing and/or IDA replenishment	Yes	(i) General advisory group (ii) Agricultural Task Force (iii) Resident representative	(i) To continue along present lines (ii) To be expanded to general advisory group (iii) To be replaced by resident representative
E.	Continued lending, with net transfer of resources to Iran - lending - no borrowing	Yes	As at present (i.e. Agricultural Task Force)	To continue along present lines

OFFICE MEMORANDUM

TO: Files

DATE: March 13, 1974

FROM: Guy de Lusignan, Division Chief, EMFNA CP 1B

SUBJECT: IRAN - Mr. McNamara's Visit to the Plan and Budget Organization (PBO)

1. On February 21, 1974, Mr. McNamara paid a visit to the Plan and Budget Organization (PBO). He was received by Dr. Majid Majidi, Minister of State in charge of PBO. Mr. McNamara was accompanied by Messrs. Benjenk, Ljungh and de Lusignan. Also attended this meeting: Mr. Mejloumian, Undersecretary for Planning at the PBO, Mr. Safavian, Undersecretary in charge of Budget at the PBO, Dr. Manuchehr Agah, Undersecretary of State for Economic Affairs, Ministry of Finance, and Mr. Firouz Vakil, Director Planomatrix Bureau, Mr. Mehdi Amin-Salehi, Director of Information and Public Relations, Mr. Bakhtiar, Adviser to the Managing Director of PBO, Mr. H. Ashraf, Director Social Planning Bureau, Mr. Farrokh Aminzadeh, Director of the Population and Manpower Bureau, Mr. Fereidoun Mobasheri, Director of Natural Resources and Environmental Protection, Mr. Mohsen Fardi, Director of International Economics Bureau, all from the PBO.
2. Minister Majidi opened the meeting by briefly summarizing the good relationship that the Bank and the PBO had entertained over the last 15 years, and expressed his appreciation for the most recent operations that the Bank has processed. He referred to the changes which had occurred since the Fifth Plan, and stressed the new era which had now started and which will lead to a revision of the targets initially set up for the Fifth Plan. He informed Mr. McNamara that in this context, his staff was preparing a 20-year perspectives survey. By the end of April 1974, a first picture of the 20-year perspectives would be available, and by July, the Fifth Plan would be revised. This revision would enable the PBO to prepare next year's budget. Minister Majidi also indicated that a much more flexible budgetary system had been instituted, which covered a two-year period and would take account of the targets of the Plan. With respect to future operations with the World Bank, he assumed that on the basis of the new situation in Iran, and the new type of relationship which was going to be established, the Bank would continue to lend for certain types of projects. He informed Mr. McNamara of the list of projects which had been prepared for Bank consideration, and which was about to be transmitted to Washington. He emphasized that cooperation with the Bank would not be for foreign exchange as such, but to obtain technical advice on how to prepare and evaluate investment programs and specific projects. He hoped that Bank involvement would help improve the administrative and financial discipline of those agencies which could benefit most from the Bank's technical advice as well as from Bank loans.
3. Minister Majidi then asked his colleagues to draw up certain general considerations for the information of Mr. McNamara. Several speakers referred to the increasing oil revenues, but also pointed out that these sources would be available for a certain limited period of time

President has seen

of about 20 to 25 years. Foreign exchange surpluses resulting from the oil revenues would have to be used to accelerate economic growth, while simultaneously Iran would look for oil substitutes in a long-term perspective to keep the momentum of growth rate. A non-oil sector would have to be developed. In this perspective, Mr. Mejloumian mentioned as major constraints the development of urban centers, lagging and remote underdeveloped regions, as well as shortages and weaknesses in the agricultural sector. In other words, the PBO has to define as soon as possible, what type of economy Iran would be confronted within the coming 15 to 25 years, and what readjustments would have to be made, once oil and gas resources taper off. A major concern is to develop by-products from oil. While the public sector will be the determining factor for development, in the short and medium term, private sector and private consumption will, in the longer term, be much more important than today. It is therefore necessary to split the GNP not on the basis of oil revenues, but on the basis of the oil and the non-oil sectors. The Plan has to set up a strategy for year 2000, to enable the economy and the social structures to keep up with a reasonable growth rate and to generate income from other sources to avoid a critical recession, which could be foreseen when oil resources decline. Long-term growth perspectives will depend on improvement and development of industries and services as well as agriculture, with special emphasis on regional development.

4. One of Minister Majidi's assistants mentioned the very important problem of population, which today is 31 million and which is bound to reach 50 million within 20 years, more specifically by 1991, at which time the annual growth rate will be 1.6% against 3% today.

5. With regard to this last point, Mr. McNamara stressed the seriousness of the population problem and urged that inertia, which is the striking feature of population sector all over the world today, should be fought forcefully, i.e. by looking ahead to measures on how to do much more to reduce population rate. Even with a lesser percentage rate than the one forecasted in 1991, Iran's population might well reach 100 million persons by early year 2000. This would of course create dramatic problems. Therefore, a major effort of planning is necessary, data collection has to be made on how one can influence the forces that control the population rate.

6. Mention was made of the importance, within the coming 25 years, to make a major effort in education and training. The Education Mission, which just arrived in Iran, was commended and the PBO hoped that Bank and PBO staff would be able to analyze in depth the problems and solutions which this sector is facing. Suggestions like a new approach for training general practitioners, to revitalize traditional medicine, to train technicians and midwives instead of doctors for remote areas, were made.

7. The entire problem of rural development, not only in terms of improvement of agriculture, but also in terms of introducing industrialization to rural areas, such as in the promotion of small-scale industries in order to create jobs in rural areas, was elaborated.

8. Finally, one representative of the PBO mentioned the important problem of meat production, which is presently at 450,000 tons a year and which should reach 4 million tons a year by the end of the century. This involves a major effort which may not be fully successful and which may lead to seek protein substitutes in the longer term. In this respect, the figures of 9 to 10 million hectares of additional cultivable land was mentioned against 3.5 million under irrigation today. This objective seemed almost impossible, due to the shortage of water. One speaker concluded that while Iran could be self-sufficient in wheat, sugar and rice, the real bottleneck was availability of protein.

9. Mr. McNamara found the presentation made by Minister Majidi and his colleagues extremely interesting and highly sophisticated, and was extremely pleased by the points made by them. He took the opportunity of saying that, while he did not want to elaborate as yet to future offset arrangements which might be agreed upon between Iran and the Bank, he would like to know in what areas the Government of Iran and more particularly, the PBO, would like to obtain the technical advice of the Bank and the Bank's intervention and suggestions in reforming some institutions of the country. He felt, e.g. that Bank financing and involvement in projects like power generation or support for banks like IMDBI were not required any more, while agriculture, education, population and urbanization were four sectors where Bank knowhow, advice and contribution could be helpful. Actually, he added, due to the sophistication of Iran's investment programs and objectives, the Bank could learn something in the process. The Bank's involvement could result in bringing out, in a joint effort, some new innovative ideas which could be helpful also in other parts of the world. He concluded that a country like Iran has a dual economy and that the presence and the benefits gained by oil was also creating a very important income distribution problem and such type of dual economies were the toughest. There was need, therefore, to refine as much as possible existing and future data on the Iranian society, so that ill-founded assumptions may be prevented and productivity in all sectors may be increased.

10. Minister Majidi concluded that the sectors mentioned by Mr. McNamara were definitely those in which they would wish to have the Bank's advice and contribution. He added that he was aware of the necessity to refine statistics in the country and he indicated that an information center and a data bank were being established. Finally, he again expressed his appreciation for the work carried out until now by the Bank staff in Iran.

Cleared with and cc: Mr. A. E. E. Ljungh

cc: Mr. R. S. McNamara
Mr. B. J. Knapp
Mr. M. P. Benjenk
Mr. W. A. Wapenhans
Mr. G. B. Votaw
Mr. N. Horsley
Mr. A. Karaosmanoglu
Sir John Crawford
Mr. O. Price
Mr. W. Nijhof
Mr. V. Dubey
Mr. G. Wyatt
Mr. D. Haynes
Mr. H. Pollan

GdeLusignan/mj

16

OFFICE MEMORANDUM

TO: Files

DATE: February 5, 1976

FROM: W. A. Wapenhans

SUBJECT: IRAN - Working Luncheon with Ambassador Amuzegar

1. A working luncheon took place on February 3 at 1 pm. In addition to Mr. McNamara and Ambassador Amuzegar, Mr. Knapp and I attended. After the usual courtesies, the present and future status of Iran-Bank relations was discussed.

2. Ambassador Amuzegar stated that, following an audience with H.I.M., The Shah of Iran, and after consultations with Government officials in Iran, he could envisage the future relationship to rest on the following principal components:

- i) technical assistance would be continued on a reimbursable basis;
- ii) the offset arrangement for previous lending (\$50 million), already agreed in principle, would be completed in accordance with mutually agreeable disbursement procedures still to be worked out;
- iii) the Bank would continue to process the three agricultural loans in the pipeline, subject to the Board's approval, and the Bank's management would undertake its best efforts to secure such approval;
- iv) future lending to Iran would be offset by an undertaking in principle to co-finance in equivalent amounts Bank-supported projects in third countries for which requests for financing would have been received by Iran or the Bank and which would be located in countries to which Iran wished to extend development assistance; and
- v) provided the above components were acceptable to the Bank in principle, Iran would participate in the capital increase of the Bank and IFC (but not in the replenishment of IDA).

Ambassador Amuzegar stressed that these were integral parts of a package and should not be treated separately. He added that Iran expected to be treated as a Bank member subject to the same criteria and constraints normally applied to countries of a comparable level of development. In response to a question on Iran's participation in the fifth IDA replenishment, Ambassador Amuzegar stated that Iran had not previously contributed to IDA and was not in a position to do so now since it would have to borrow in the international market for such purpose; furthermore, Iran did not favor the decision-making process

that governed the use of IDA resources.

3. In response, Mr. McNamara expressed his concern about the status of our relations and the lack of meaningful communication. He recalled that he was given to understand during his visit to Iran that the Shah's and the Bank's objectives in supporting developing countries were entirely compatible, that Iran wanted to continue to benefit from Bank support though clearly on an offset basis, and that he had the general support of Iran in the furtherance of the Bank Group's mission. Instead, he had seen a disconcerting change in attitude leading to protracted discussion on technical assistance and on offset arrangements for loans previously made by the Bank. He was disturbed to see that scarce human resources, urgently needed for work on other countries, were deployed on activities in Iran without proper arrangements having been concluded. Mr. McNamara expressed disappointment regarding Iran's attitude on IDA but stressed that, irrespective of Iran's final decisions on IDA and capital increases, Iran's case would be treated as that of any other country in comparable circumstances. He was thus not prepared to accept that capital subscriptions (or IDA contributions, which he still hoped Iran would consider) should form part of the package relating to technical assistance and any future lending to Iran as outlined by Ambassador Amuzegar. Instead, he urged that future relations be seen in terms of three distinct elements:

- i) clearing up pending issues, namely finalizing the technical assistance arrangements, consummating the offset agreement relating to earlier loans on mutually acceptable terms, and advancing the existing pipeline of three agricultural projects;
- ii) considering Iran's case for future borrowing from the Bank in the light of the interesting co-financing/offset proposal advanced by Ambassador Amuzegar and the changed economic circumstances of Iran as they would emerge from the analysis of fresh economic data repeatedly promised by Iran; and
- iii) Iran's position regarding the capital increases and the fifth IDA replenishment.

Mr. McNamara made it clear that he had made a number of commitments to the Board which could not be easily changed and, if so, only on the basis of new evidence and innovative approaches. In this context, Ambassador Amuzegar referred also to the OPEC fund but did not have any up-to-date information on the modalities of its operations, though he deplored the fact that the target level for the first year of operations had apparently been reduced from \$1 billion to \$800 million.

4. There ensued a discussion on voting rights and Board representation. Ambassador Amuzegar inquired whether the question of voting power and Board representation would create problems comparable to those presently faced by the IMF. Mr. McNamara explained that there were distinct differences between the Fund and the Bank and that Board representation was more important for the Bank. He felt certain that a generally acceptable solution could be found in which the balance of regional representation would be preserved.

5. It was agreed that, on the basis of these discussions, a paper setting forth our understanding of the principles of our future relations would be prepared and discussed further with Ambassador Amuzegar.

cc: Mr. McNamara
Mr. Knapp
Mr. Cargill
Mr. Paijmans

WAWapenhans:rs

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OFFICE MEMORANDUM

TO: Memorandum for the Record

DATE: May 11, 1976

FROM: Jonathan C. Brown

SUBJECT: SENEGAL - Mr. McNamara's Meeting on the Pahlavi Project

1. On April 9, 1976, Mr. McNamara met with the Ministers of Planning of Iran and Senegal, Messrs. Magidi and Seck, accompanied by Ambassador Coulbary of Senegal, Ambassador Amuzegar of Iran and Messrs. Stephanian, D. Diouf, and J. Diouf of IRASENCO. Present for the Bank were Messrs. Knapp, Chaufournier, Wapenhans, Fuchs, Paijmans and myself.
2. Minister Magidi began the meeting by reviewing previous Iranian assistance to Senegal in agriculture, for the proposed Diama Dam on the Senegal River, and for the Industrial Free Trade Zone near Dakar. He said that Iran and Senegal are now cooperating on a much larger effort, the Pahlavi Project, 1/ which would include a phosphate mine, refinery and fertilizer plant. Iran and Senegal have jointly established IRASENCO with initial capital of \$80 million to finance the project. Infrastructure associated with the project, in particular a mineral/petroleum port, would be financed entirely by the Government of Senegal. Minister Magidi said the purpose of his visit to Mr. McNamara was to ask the World Bank to consider financing the port.
3. Minister Seck traced the evolution of Iranian-Senegalese cooperation ending in the establishment of IRASENCO. He asked the Bank to help in further studies, to organize donors and finally to finance the mineral/petroleum port. There are indications that other infrastructure would be done by other agencies. 2/
4. Mr. McNamara asked how much the World Bank would be requested to finance, who would finance the industrial units and where would their products be sold. Mr. Magidi said the Port would cost about \$90-100 million but there was no estimation at this stage of how much might be asked from the Bank. He added that the OPEC Fund could be approached to help finance the port if the Bank thought the project was justified. The industrial units would be financed by IRASENCO's capital and by commercial loans and suppliers' credits. Refinery products would be for the most part consumed locally while the phosphates would be exported. Mr. Magidi added that it would be important in realizing the project that the World Bank give assurances on the viability of the Pahlavi Project as soon as possible.
5. Mr. McNamara concluded by saying that the first priority would be for the Bank's staff to establish the economic and technical viability of the project. If the conclusion were favorable then the amount of possible Bank participation would depend on a number of factors: (i) an estimation of Senegal's creditworthiness; (ii) a determination as to whether Bank lending

1/ See Mr. Thalwitz's memorandum of March 19, 1976 to Mr. Knapp.

2/ Canadian interests may finance the power plant with a suppliers' credit and CIDA is interested in power distribution. To our knowledge, there is no other source of finance for the road and rail connections or for storage facilities.

would be in substitution for present projects in the Senegal lending program or additional; and (iii) if Bank financing were additional, it would face the constraints imposed by the Bank's present level of capital.

Cleared and cc: Mr. Chauffournier

- cc: Messrs. McNamara (through Mr. Burmester) ✓
- Knapp
- Wapenhans
- de la Renaudière
- Fuchs
- Paijmans
- Brandreth
- Cash
- de Lusignan
- Dewey
- Gillette
- Billington
- de Leede

JBrown:dlt

OFFICE MEMORANDUM

CONFIDENTIAL

TO: Memorandum for the Record
FROM: Martijn J. W. M. Paijmans J
SUBJECT: IRAN-Bank Relations

DATE: April 12, 1976

DECLASSIFIED

APR 01 2013

WBG ARCHIVES

1. On April 9 Messrs. McNamara, Knapp and Wapenhans met with Minister of State Majidi, Head of the Central Plan Organization, and Ambassador Amuzegar. I was also present.
2. Mr. McNamara opened the discussion by saying that in his view Iran needed the Bank's help. Technical assistance presented no problem as it is already in effect and we have reached agreement on reimbursement. With respect to Iran borrowing from the Bank, we do not yet know whether the country qualifies for net borrowing and we are waiting for data in support of the Government's request. An additional category of problems in this respect is the scarcity of resources which has--for the first time--emerged because the Bank's lending program is reaching its statutory limits. This problem is connected with the issues of the Selective and the General Capital Increases; without the latter an upper ceiling to lending of \$5.8 billion will have to be established. Any borrowing by Iran would have to be accommodated within this limit and a major question is how to do this without penalizing other, less fortunate, developing countries.
3. If net borrowing cannot be justified, or until it can be justified, a possible alternative would be to follow the "Thai-formula" the characteristics of which were explained by Mr. McNamara, who added that he was most anxious to continue the Bank's association with Iran, but that practical problems did exist to the extent that he did not even know yet how the three projects we are presently working on can be fitted in. In any case, Mr. McNamara felt, Iran can benefit from our technical assistance.
4. Minister Majidi said that if the Bank looked predominantly at "the financial side of our relations" (i.e. the need to buy back or offset) it would be difficult to find a solution. Iran had proven, he said, that if and when it has sufficient resources it is ready to contribute to the Bank's programs, but to tie such contributions--in whatever form--tightly to its borrowing from the Bank would be difficult. If the country would again be in position to buy Bank bonds it would most certainly do so. Although the Minister underwrote the philosophy behind the Bank's policy of offsetting, dictated by its resource constraints, he felt that the nature of the two elements (borrowing and lending) was different. Furthermore, he feared that Iran would not be able to satisfy the Bank fully with respect to proof of eligibility for net borrowing.
5. Mr. McNamara responded that absence of a justification would indeed create a problem as our member countries are, and would be, reluctant to let us use our limited commitment ability for countries that do not have a demonstrable need to borrow.

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Memorandum for the Record

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April 12, 1976

6. If Iran's resource position were sufficiently strong to self-finance its investments, or to borrow from other sources (viz the Bank's charter), Bank vetting of development projects would remain possible through the technical assistance mechanism. As indicated before, however, an alternative might be the "thai-formula" under which the Bank's net investment in Iran, in an amount of some \$10 million, should not create a problem. Therefore, Mr. McNamara felt that the buy-back arrangement was the best possible arrangement at this time.

7. Messrs. Majidi and Amuzegar said that Iran's eligibility problem should be tackled first. Both were aware of the absence of answers to our questionnaire left with the Minister of Finance following the October visit of Mr. Cargill and myself. Dr. Amuzegar acknowledged that the questionnaire was reasonable but he suspected that it could not be fully answered. He elaborated on the problem of forecasting balance of payments flows, in particular where Iran's foreign commitments were concerned. He said that it was practically impossible to go beyond the data that had been provided to the IMF. He is scheduled to go to Tehran in a fortnight and will personally attempt to obtain a maximum of information. It was then decided that the Region would review the questionnaire, eliminate questions on which answers had been provided to the IMF in the course of the Fund Consultations (these data are already in the Bank but fall clearly short of what we need), and further reduce the questions to the irrevocable minimum. This redraft will be handed over to Ambassador Amuzegar early in the week of April 11, and regional staff will be available for follow-up discussions. During the brief discussion on data, Minister Majidi explained that Iran was keeping the minimum of foreign exchange reserves required to finance about three months of imports, and also that Iran's own investments abroad did not exceed \$300 million, in spite of the unfortunate and great publicity given to some headline-making investments.

8. Dr. Amuzegar returned to the problem in the second category, as explained by Mr. McNamara, namely the scarcity of Bank resources. He said that whatever the outcome on the eligibility question the problem of Bank lending to Iran would remain, as any loan amount would have to be taken away from other Bank members. Mr. McNamara responded that lending to Iran, with or without buy-back, should not be impossible; he did not yet know however exactly how it could be arranged--lending to Iran simply cannot replace lending to another country--but he was willing to consider all possible courses. Minister Majidi reacted that although he, personally, and his Plan Organization felt that a buy-back arrangement would still be profitable for Iran because what is important for the country is "cooperation with the Bank", it would be very difficult indeed to convince the technical ministries and organizations to accept such a formula which did not allow for any monetary contribution to their investment budgets. Mr. McNamara responded that if net lending would

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Memorandum for the Record

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April 12, 1976

not be possible for the Bank, and if buying back would not be possible for Iran, he still thought that the two needed each other. The Bank wants to help Iran, the President thinks that it can do so, and he stated that we want to adapt ourselves to the unusual situation which has emerged with respect to Bank-Iran relations. He quoted the assistance provided by the Bank to Saudi Arabia and Venezuela as examples of the Bank's ability to make such adaptation.

9. At the end of the meeting, which took place in a very friendly atmosphere, the President and the Minister both agreed that the direct and frank exchange of views had been beneficial and that it had clearly defined the issues.

MPaijmans:gg

cc: Mr. McNamara's office (2)
Mr. Knapp, Mr. Cargill
Mr. Wapenhans
Mr. de Lusignan

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
THROUGH: Mr. J. Burke Knapp
FROM: Willi A. Wapenhans, Vice President, EMENA Region
SUBJECT: IRAN: Your meeting with Minister Abdol-Majid Majidi

DATE: April 8, 1976

1. Although Ambassador Amuzegar has made clear to us that, in his opinion, Minister Majidi will only wish to discuss technical aspects of our cooperation, he may wish to raise some general points relating to Iran-Bank relations.
2. With respect to the technical aspects of our operations, I am attaching a memo from Mr. Paijmans. Also attached is a biographical sketch on Minister Majidi.
3. With respect to the overall relationship, the Aide Memoire on Iran-World Bank Relations has been transmitted to Ambassador Amuzegar with a memo from Mr. Knapp, dated March 25. Ambassador Amuzegar has forwarded this document to the Minister of Economic Affairs and Finance, whose Ministry is in charge of this subject. As Ambassador Amuzegar is leaving in a few days time for Iran, he intends to follow it up in Tehran.
4. I would like, however, to draw your attention to two outstanding matters related to our relationship:
 - i. During last October's discussions in Iran on Bank-Iran relations, Minister Ansary offered to provide us with economic data in support of Iran's request for renewed net Bank lending. A questionnaire on these data was prepared and discussed in Tehran within two days of this offer. It asked for further information on the balance of payments situation and its forecasts for the coming years, as well as more accurate figures on the inflows and outflows of funds, and particularly on Iran's commitments and disbursements of aid and investments abroad. No response has yet been received to this questionnaire. On the other hand, we have obtained clearance on the Country Economic Memorandum which can now be distributed to the Executive Directors.
 - ii. Attached to the Aide Memoire is the Vice President, Finance's proposal for a further offset loan against the remaining two Bank loans approved in FY75, in the amount of US\$50 million. We have not yet received any reaction to our proposal, which is based on earlier discussions between Bank staff and Iranian authorities.
5. Finally, we intended to send at the end of next week a mission to Tehran to finalize by end May our technical assistance work program beyond FY76, first, in agriculture and rural development, and, secondly, in any other sectors for which the Iranians may wish to obtain Bank assistance, in particular,

Mr. R.S. McNamara

- 2 -

April 8, 1976

in the field of education. We received today a cable from the Deputy of Minister Majidi, who indicated that, because his Minister intended to discuss future technical assistance activities with us in Washington, it would be preferable for the mission to be delayed by four weeks.

Attachments

GdeLusignan/MJWPaijmans:pl

Biographical Sketch
of
Dr. Abdol-Majid Majidi

Dr. Majidi is 48 years old. After having graduated in law from Tehran University, he pursued postgraduate studies in economics at Harvard, and obtained his PhD in law from Paris University. He started his career in the Administration as Superintendent of the central budget in the Plan Organization. In 1966, Abdol-Majid Majidi became head of the Central Budget Bureau with the rank of Assistant to the Prime Minister. In 1967 he became Minister of Agricultural Products and Consumer Goods, and in November 1968, he was appointed Minister of Labor and Social Services. In March 1972, he was asked to take over the Plan and Budget Organization with the rank of Minister of State. He is fluent in French and English. Minister Majidi has been following very closely all the activities of the Bank since 1972, and has shown an understanding for our views and positions, as well as our work, fully supporting the continuation of our operations. He is, however, convinced, because of the hastily-prepared projects and misallocation of resources of recent months, that the Bank's activities should regain momentum in Iran through resumption of net lending in key sectors, such as infrastructure, agriculture, education, urban development.

OFFICE MEMORANDUM

TO: Mr. Willi A. Wapenhans

DATE: April 8, 1976

FROM: Martijn J.W.M. Paijmans

SUBJECT: IRAN: Brief Prior to H.E. Abdol-Majid Majidi's Visit to Washington.

1. H.E. Abdol-Majid Majidi, Minister of State in Charge of Plan and Budget Organization, will be in Washington on April 9, arriving April 8, evening, and leaving April 10, morning. Attached is a short biographical note.

2. As you know, the purpose of Minister Majidi's visit is to meet with Mr. McNamara on April 9 at 3:00 p.m., together with the Minister of Plan of Senegal, Mr. Seck, for discussions on a project in Senegal for which the Iranians and the Senegalese would like Bank financing and technical assistance. However, a meeting was arranged with you in Dr. Amuzegar's office with the Minister the same day at 10:00 a.m.

3. As I indicated in my memo to you of April 1, the meeting with the Minister is likely to focus on the technical aspects of our cooperation, to use Dr. Amuzegar's own words. Therefore, this memo only aims at summarizing the status of our present operations. However, considering the meetings that we had with the Minister last year, particularly during Mr. Cargill's missions, it would not be unlikely that reference would be made by the Minister to some general aspects of Iran-Bank relations. Reference is also made to this possibility in the last paragraph of my April 1 memo to you following my telephone conversation with Dr. Amuzegar.

Projects Under Preparation

4. Kermanshah Agricultural and Livestock Development Project: Loan Committee package has been cleared by all departments concerned, and has been transmitted to you through my memo of April 7. We do not intend, however, to invite for negotiations, subject to Loan Committee concurrence, until we explore with the Iranians some of the main issues of the project (namely, legislation, project execution, water distribution and charges) the details of which are given in my memo of April 7 (see copy attached for easy reference).

5. Small Farm Consolidation Project: The Loan Committee Package has been cleared by the departments concerned. We still expect some comments from David Haynes on the covering memo (however, again, for easy reference, we are attaching the draft memo). I intend to send you the package not later than tomorrow. The issues of project organization, and, more importantly, of concessory credit, require guidance from the Loan Committee before discussing our recommendations on this project with the Iranians prior to negotiations. For this project, as well as for Kermanshah, it is planned for Mr. French-Mullen to join Mr. de Lusignan on April 20 in Tehran for carrying out these discussions. Mr. de Lusignan will arrive in Tehran on April 16, together with Mr. Armstrong for discussions on technical cooperation.* Mr. French-Mullen has left for Sanaa. He has to be told by April 18 whether to proceed to Iran or not, based on Loan Committee's reactions.

*Following the cable received today from the Deputy of Minister Majidi, this mission may be delayed.

April 8, 1976

6. Rural Cooperative Project: This project has been reviewed at yellow cover also with the Iranians, who have received extracts of the report with a letter flagging the basic issues. The discussions were held in February. However, the draft yellow cannot be processed into green for Loan Committee until we receive a decision from the Government of Iran on the channeling of credit and the organization of the project. At the preparation stage and during appraisal, credit was to be channeled to rural cooperatives through regional cooperative banks to be established under the project. It now seems that there is a preference in Government circles, although not in the Ministry of Cooperatives and Rural Affairs, as to the credit being channeled through the Agricultural Cooperative Bank and its branches. However, because of the differences of opinion between various governmental circles, the Ministry of Economic Affairs and Finance, the Central Bank and the Plan and Budget Organization have to make a decision. A meeting was to be held this week in Tehran to this effect, with a view to transmitting the position of the Iranians to the Bank, which will have an effect on the finalization of the Appraisal Report, and, as a result, of the draft President's Report and the Loan Agreement. We expect to reach Loan Committee stage around approximately the end of the first week of May.

7. You will recall that the processing, if any, to the Board of these three projects requires, in any event, the satisfactory conclusion of the offset arrangement of US\$50 million.

Technical Cooperation

8. Agriculture. Work is progressing satisfactorily under the work program for the current fiscal year agreed upon for technical cooperation in agriculture and rural development. Staffing rearrangements are under processing: first, the replacement of Mr. Price by Mr. Naylor, who is to take up his new functions some time in May/June, but who would pay a visit to Tehran during Messrs. Armstrong's and de Lusignan's visit, mid this month. Second, Mr. Purcell is to be replaced, as well as Mr. John Wrigley. Discussions on the work program for FY77 have not yet started in detail. The objective of Messrs. Armstrong's/de Lusignan's visit is to review with Mr. Price and the Iranian authorities the amount of work to be expected in agriculture and rural development beyond FY76.

9. Education. Messrs. Erder and Stewart will be in Tehran April 13. Messrs. Armstrong and de Lusignan will attend their concluding meetings, which may result in a work program for FY77/78.

10. Finally, Messrs. Armstrong and de Lusignan will explore whether the Iranians are expecting Bank assistance in sectors other than agriculture and education, such as regional and/or urban development. You will recall that these sectors were mentioned by Minister Majidi, along with agriculture and education, during his meeting end-January with Messrs. El Darwish and de Lusignan.

Attachments

GdeLusignan:pl

OFFICE MEMORANDUM

TO: Mr. J. Burke Knapp

DATE: March 19, 1976

FROM: Wilfried Thalwitz, Acting Vice President

SUBJECT: SENEGAL - The Pahlavi Project: Request to meet Mr. McNamara by the Ministers of Plan of Iran and Senegal:Summary

Iran and Senegal have recently announced their intention to build a refinery/petrochemical complex, mineral port and new phosphate mine in Senegal. The total cost for the project,^{1/} named after the Shah of Iran, would be about \$436 million. We have received a cable (translation attached) from Senegal asking Mr. McNamara to meet on April 12 with the Minister of Plan of Senegal, Mr. Ousmane Seck, and the Minister of State for Planning and the Budget of Iran, Mr. Abdol Majidi. The purpose of this mission according to the telex is to ask the Bank to participate in the Pahlavi project's basic infrastructure, in particular port, transportation and communications facilities.

1. As a result of various meetings over the last few years between President Senghor and the Shah of Iran the idea emerged of a joint Senegalese-Iranian project based on Iranish crude refined in Senegal for the export market and phosphate mined in Senegal and exported to Iran. In early 1975 the two countries commissioned Arthur D. Little to do a general economic feasibility study of the project which was followed by a more detailed study by Soros and Associates of the mineral port. We have followed the progress of this project in general but until last month Senegal has not been prepared to furnish us with details.^{2/}

2. In early February, Mr. Seck revealed the structure of the project. Senegal and Iran have jointly established IraSenco which will have paid-in capital of \$80 million. Senegal's 50 percent participation will be financed by an Iranian loan of \$40 million at 8 percent interest repayable in 14 years with four years grace. IraSenco will then borrow on the international money markets and from development institutions, on the basis of a guarantee by Iran and Senegal, additional funds to finance: (i) 100 percent of a petroleum refinery with an initial capacity of 1.5 million tons and possible extension to 2.5 million tons. The first phase is estimated to cost \$130 million, the output will be exclusively for export; (ii) 61 percent of a new \$200 million phosphate mine (Tobene) with a capacity of 2 million tons per year; (iii) 46 percent of a \$7.6 million amonia and urea plant with a capacity of 680 tons per day; and (iv) 50 percent of the \$5.0 million Shell gasoline distribution system in Senegal.^{3/}

^{1/} All costs in this memorandum are as of end 1975.

^{2/} We believe that the Government of Senegal has been reluctant to involve us in large industrial projects because of our role in preventing the proposed Dakar-marine ship repair yard from going ahead in the absence of firm market assurances.

^{3/} The balance of investments referred to in paragraphs (ii), (iii) and (iv) would, we assume, be financed by foreign private or Senegalese public enterprises.

*Iran
feasibility
not
done
could
Senegal
for about*

3. The total initial investments by IraSenco in these four projects would be about \$256 million in 1975 prices. The petroleum and phosphates will be purchased at "world market prices".

4. Senegal by itself will be responsible for financing the infrastructure associated with the project:

- (i) a \$110 million mineral/petroleum port for the Pahlavi project and for iron ore from the proposed Faleme mine which is currently being studied by Krupp (Germany) and BRGM (France);
- (ii) \$50 million for power generation for the project. The power distribution system (\$5 million) will be financed by CIDA as part of a larger power distribution project;
- (iii) \$10 million for constructing a railroad connecting the phosphate mine with the port;
- (iv) \$10 million for roads, water, telecommunications and geotechnical studies.

5. According to our conversations with Mr. Seck in early February, Iran has promised to assist Senegal in obtaining money for the infrastructure from the OPEC development fund for which pledges have been reported. Our information on the project is very general. We have an idea of what was in the Arthur D. Little report but have not been given a copy; in February Mr. Seck gave us the Soros study on the port. We are in the process of gathering more information; our questions center on the following areas:

- (i) Are the prospects for the export of refined petroleum products in West Africa favorable. Our initial investigation suggests they are not. Thus assured markets becomes a critical issue;
- (ii) Are the price forecasts for petroleum and phosphates such that both countries will benefit; how will the risks and benefits be divided between Senegal and Iran; what must Senegal receive to justify the fact that it must finance the infrastructure itself;
- (iii) Is it possible to go ahead with the very expensive mineral port based on IraSenco operations alone without being certain that the 5-6 million tons per year of iron ore from Faleme (see para. 4) will be available;
- (iv) Are there alternatives to the present project conception, such as expanding the present refinery in Senegal, and how receptive would the two countries be to alternatives.

6. The Government of Senegal has put considerable political capital into the Pahlavi project. There have been numerous exchanges of visits of high officials between the two countries concluding in the visit to Senegal last month of the Empress and the Prime Minister of Iran to put the first stone into the new city^{1/} which will be created to house workers for the project. The outline of the project has been publicly announced increasing Government's commitment to its present scale.

Recommendation

7. In view of the importance of this project for Senegal, of Iran's involvement and of the request from these two high officials, we believe Mr. McNamara should meet with the two Ministers. We cannot at this time pass a judgment on the Pahlavi Project and while we will attempt to get additional information about it before April 12, we will probably not be in a position to make a firm recommendation about the merits and the risks of the project and the position which should be taken by the Bank. However, we hope to learn more about the details of the proposal during the visits of Messrs. Majidi and Seck and plan to hold technical discussions with the Iranian/Senegalese delegation after the meeting with Mr. McNamara.

8. We have discussed the Senegal request with the EMENA Region which feels that as matters concerning our relations with Iran stand today, the desirability of a meeting between Mr. McNamara and Minister Majidi should be carefully thought through. There is still the outstanding Aide Memoire to be finalized following Mr. McNamara's luncheon with Dr. Amuzegar, Chief of the Iranian Economic Mission. This Aide Memoire specifically refers not only to the overall framework of the Bank/Iran relationship, but also, further to a proposal from the Government of Iran, to the possibility of Iran co-financing Bank supported projects in countries of Iran's choice as a counterpart or "offset" to the Bank resuming net lending in Iran. Considering the reference made to the OPEC Fund, this approach could be an initiative towards pressing us into an early implementation of this proposal.

^{1/} The costs of this city, which will also be borne by Senegal, are not known.

cleared with and c.c. Messrs. Pajmans
de Lusignan

c.c. Messrs. Cargill
Chaufournier o/r
Burmester
de la Renaudière
Fuchs
Brandreth
Cash
Gillette o/r
Payson
de Leede
Billington

Mr. Chaufournier

Following the Grand Iranian-Senegalese Cooperation Commission, M. Abdol Magidi Minister of State for Plan and Budget of Iran and the Minister of Plan and Cooperation of Senegal have been designated to present to Mr. McNamara the investment program for the Keur Farah Pahlavi Complex (the old Cayar project). This presentation is to request participation of the Bank in financing this complex, in particular the port, transportation and communications, etc. The Minister of Plan of Iran and I shall be happy to have a meeting with Mr. McNamara on April 12. It may be possible to have a working level meeting under your direction. Sincerely,

Telex unsigned but assume it must be Ousmane Seck,
Senegalese Minister of Plan and Cooperation.

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: April 8, 1976

FROM: J. Burke Knapp

SUBJECT: SENEGAL - The Pahlavi Project: Visit by Ministers of Iran and Senegal

You will be receiving a visit tomorrow afternoon from Mr. Majidi of Iran and Mr. Seck of Senegal who will ask about Bank assistance in financing infrastructure related to certain joint ventures by the two countries in Senegal, including an oil refinery and phosphate mining development. Attached is a memorandum on this subject to me from Mr. Thalwitz, dated March 19. Mr. Chauffournier is meeting Mr. Seck this afternoon, and Mr. Wapenhans will be seeing Mr. Majidi tomorrow morning. We may therefore have further information for the meeting.

The external financing requirements for the infrastructure concerned are large and it would be very difficult to fit them into our present Bank/IDA lending program in Senegal unless some special security were obtained. The first thing we think of is an Iranian Government guarantee, which you will note is to be given with respect to the refinery, phosphate mine, etc. themselves. You will also note that co-financing is contemplated from the OPEC Development Fund.

With regard to the last paragraph of Mr. Thalwitz' memorandum, the Aide Memoire was transmitted by me to Mr. Amuzegar on March 25, and we have had no response except his statement that he was forwarding it to Mr. Ansary. You will recall that we rejected the Iranian proposal to have our loans to Iran offset by their loans to developing countries; this point was made in my covering memorandum to Amuzegar, rather than in the Aide Memoire itself.

Attachment.

cc: Messrs. Chauffournier
Wapenhans

JBKnapp:vm

OFFICE MEMORANDUM

✓ IRAN P/M
" Proj. Dev. (T.A.)
" Population Sector
" ARDSD Gen.

TO: Memorandum for the Record

FROM: Syed A. Wasay Moini *[Signature]*

SUBJECT: IRAN - Mr. McNamara's Meeting with Dr. Jahangir Amuzegar

DATE: August 4, 1976.

1. Dr. Jahangir Amuzegar met with Mr. McNamara on July 28, 1976. Also present were Messrs. Knapp, Bart and Moini.
2. Dr. Amuzegar started off by saying that due to a decision to transfer all the economic work to the Embassy he would, from now on devote most of his time to the Fund and the Bank.

Economic Information and Bank Lending

3. Dr. Amuzegar then said that on his recent visit to Tehran he was told that all the data asked for had been supplied to the Bank. On being told that this was not so he said that Iran could only give the data and projections it had, which had been given to the Fund, and this was on 1976/77 and 1977/78. He then dilated on the political and other difficulties inherent in projecting over a long period. Iran did not set the prices of its oil or its imports and this created tremendous uncertainty. Iran could not reveal its strategy regarding oil. Iran did not have any idea as to what the pace of utilisation of its aid commitments would be. The data available to the Fund for 1976/78 showed an increasing deficit in Iran's balance of payments and that its reserves were already down to three months' imports. The gap between Iran's imports and export earnings is projected to be about \$2 billion this year and would continue to widen over the next 4-5 years. Iran's external aid commitments, which now totals \$12 billion (the bulk earmarked for India, Pakistan and Egypt) would contribute to the deficit although it is not possible to say when, and - in certain cases - whether, disbursements would take place. It is clear that Iran needs not only technical assistance from the Bank but also to borrow externally and that the Bank must respond. After all the Bank is helping so many other countries at higher income levels than Iran.

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4. Mr. McNamara said that regarding projections and forecasts, the uncertainty of oil prices cannot possibly present any more of a problem than Zambia's copper exports which fluctuated widely but estimates are nevertheless required and are prepared for Zambia. He said it was not credible that Iran did not have three or five or ten year projections. We do not ask for access to Iran's secrets but information based on existing commitments regarding imports such as defense contracts and for external aid. This information supplemented by realistic projections of other imports, oil production and domestic and external investments could provide a fairly good picture. Bank staff could assist by plugging in price assumptions if that was the only problem. Even with such data it was not going to be easy to demonstrate to the Executive Directors that Iran needs Bank assistance. He wanted Dr. Amuzegar to realize that the situation had changed greatly since their conversation in the Spring. The Bank is now working under a strict lending ceiling and very rigid rationing will soon come into effect. Even with the most convincing projections on Iran the task would be formidable. Anyway, the first step has to be cooperation in putting together realistic and acceptable projections. That is required to prove the need for Iran's borrowing and for Iran's credit worthiness to all concerned. In fact such data would be required even to convince us. For instance, the trends in imports and exports seemed to be alarming. He had not delved into Iran's balance of payments data, but going on what Dr. Amuzegar said and what the newspapers reported, he feared that Iran was headed for great problems. He doubted that the oil income could increase sufficiently to sustain such a rapid increase in imports. Dr. Amuzegar said that oil production is expected to regain past levels and to increase beyond them and it is also expected that defense outlays would stabilize.

5. Dr. Amuzegar said Iran would attempt to provide whatever information it could but he was afraid that by the time the Bank staff and Executive Directors were satisfied that Iran had a case for normal borrowing, Iran would probably be barred because of its high income level. Mr. McNamara expressed doubt about Iran's economy growing so rapidly but Dr. Amuzegar insisted that Iran would grow from its present \$1600 per capita level at 12-15% per annum over the next three-four years. He, therefore, felt that pursuing the proposal he made earlier of Iran offsetting its future Bank borrowing by co-financing with the Bank in other countries, was preferable to the normal borrowing approach. His proposal would involve additionality as Iran would top by, say, \$200 million, the \$5.8 billion of Bank lending in a given year; the Bank would match this \$200 million through direct lending to Iran, which would be the vehicle for technical assistance. He further explained his proposal using Senegal as an example. If Bank lending to Senegal is programmed at \$20 million for a particular project, then the Bank would (under this proposal) only provide \$10 million and tell Senegal that Iran would provide the other \$10 million. Mr. McNamara asked as to how this would benefit Senegal? Dr. Amuzegar replied that it would not provide any additional benefits for Senegal. Dr. Amuzegar then said it would however provide certain political benefits for Iran vis-a-vis Senegal. Moreover, both Iran and Senegal would benefit from the Bank's technical assistance. How could we satisfy our

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Executive Directors that Iran's co-financing would be additional aid that would not have been available if the arrangement with the Bank was not in existence? It can be done, said Dr. Amuzegar, by the Bank choosing the country and the project and by knowing in advance what Iran's existing aid commitments were. Most of Iran's existing aid commitments are to neighboring countries such as Afghanistan and Pakistan and to India and Egypt and the Bank could also get the information on existing commitments from these countries. In addition, the Bank would, by spreading its funds, be able to expand its operations despite the overall lending ceiling.

6. Mr. McNamara said that the technical assistance argument was valid. It meant, however, that the Bank would need to double its staff input -- working on projects in Senegal and in Iran -- but this could be justified if the benefits were clear. Although this consideration did not bother him too much, he felt that Bank technical assistance could be provided in other and simpler ways. Dr. Amuzegar reminded Mr. McNamara that he himself had said to the Shah that technical assistance without the support of lending was not likely to be effective. Mr. McNamara agreed that this is generally so but could not Iran use the Thai formula and buy back, say, 90 percent of the Banks loans. It would thus save us the headache of trying to convince the world about the complicated triangular arrangement and yet utilize the Bank's expertise. Mr. Amuzegar commented that Iran would not get any good will from other countries, under this formula.

7. Mr. Knapp said he wanted to comment on four points made by Dr. Amuzegar. First, whatever data Iran may provide or we may build up, it was not likely that we could satisfy our Articles and our Executive Directors that Iran's requirements were such that they could not be met through Iran's access to other sources of borrowing, without Bank lending. Second, the technical assistance aspect had not been borne out by our recent experience on three agricultural projects where our staff just could not convince their Iranian counterparts about their recommendations and the projects had got grounded. Third, he could not see the Executive Directors being convinced of the 'co-financing as an offset' proposal because it would be almost impossible to demonstrate additionality regarding Iran's external assistance. Fourth, he would contest Dr. Amuzegar's statement about Bank lending to countries with income levels far exceeding Iran's and at some later date would provide details to Dr. Amuzegar to show that the Bank is in fact phasing out its lending to high income countries and the movement in this direction is accelerating. Dr. Amuzegar retorted that Mr. Knapp talked of the future while his statement was about the present.

8. Mr. McNamara said that he felt that Iran should try to make out a case for normal lending. If its economic requirements were so evident this would certainly be the route to follow. However, if this cannot be done we would need to consider special arrangements. He personally felt uneasy about the co-financing arrangement. Nevertheless, we would re-study the proposal and see if it could be worked into an acceptable form. Dr. Amuzegar said he had faith in the President's ingenuity.

Technical Assistance

9. Mr. McNamara went on to say he was ready to assist Iran whenever it needs the Bank. He wanted Iran and the Bank to work together. He was very disappointed to learn that Iran had decided to discontinue the Bank's assistance in agriculture because whatever our limitations there was much we could have contributed to Iran's agricultural development. The money involved was such an insignificant amount. Dr. Amuzegar said he agreed and had also been very upset on hearing of the decision. He explained that, as Minister Majidi had said two months ago, the Ministers concerned felt that technical assistance without financial backing was an unnecessary imposition.

North-South Dialogue

10. Mr. McNamara asked Dr. Amuzegar about his reading of the progress in this dialogue. Dr. Amuzegar said that there had been almost no progress and he did not expect any at this time given the political situation in the United States and West Germany. The best solution would be to put the entire discussion in abeyance for the time being. In fact, Jamaica had suggested a year's suspension of the talks. He added that he was surprised by the hard line being taken by Germany, France and Japan in support of the United States positions in all such discussions, including those in the I.M.F.

Population Control

11. Mr. McNamara said he was interested in finding out what was being done regarding controlling the population in Iran. Dr. Amuzegar gave an evasive answer, but said that a census is at present under way in Iran and this should provide better data on fertility, mortality, etc. and permit appropriate policy decisions.

Future Travel and Meetings

12. While leaving the room Dr. Amuzegar asked Mr. McNamara as to when he was likely to visit Iran again. Mr. McNamara said he was fairly tied up in the foreseeable future. Dr. Amuzegar said that as Minister Ansary visits Europe often it may be possible to ask him to see Mr. McNamara on one of Mr. McNamara's stopovers in Europe. Should this be possible, Dr. Amuzegar would also fly over and join in the meeting. Mr. McNamara said that it may be possible to arrange such a meeting.

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Discussion Before Meeting

13. During a brief discussion before the meeting between Amuzegar and Messrs. Bart and Moini, Mr. Amuzegar asked what had been done with the gray colored economic memorandum on Iran (of May 10, 1976) that was meant for the Executive Directors. Mr. Bart told him that it was in fact distributed to the Executive Directors. He then asked as to whether it had been discussed by the Executive Directors. Mr. Bart said it had not, as it did no more than report on the current situation. It contained no projections, and we were awaiting data that would allow us to work them out. Mr. Amuzegar said that was what he proposed to discuss with Mr. McNamara. He asked us whether the economic data we had requested had been received. I told him that Mr. El Serafy had been in Iran about 1-1/2 months ago for this purpose. He had only been given detailed information regarding the current year: 1976/77. As we had stated (in our memorandum of April 15, 1976) we needed, in addition, detailed projections for the next year or two and more general ones covering four-five years. (Mr. Knapp joined us at this point)

14. Mr. Amuzegar started to explain the difficulties Iran had in compiling longer term economic and financial projections. Mr. Knapp said that the problems with projections is confronted in all countries and all the time. His fear, however, was that even if the data could be secured it probably would not sufficiently demonstrate that Iran had no other source of financing available and had to rely on the Bank. (We were called into Mr. McNamara's room at this point).

Cleared with and cc: Mr. Bart

cc: Messrs. Knapp
Cargill
Paijmans
Goodman
Knox
El Darwish
Horsley
de Lusignan
Burmeister

OFFICE MEMORANDUM

TO: Mr. Maurice P. ~~Bart~~, Acting Vice President, EMENA Region DATE: July 28, 1976
 THROUGH: Norman Horsley ~~X~~, Acting Country Programs Director, EMENA CPDI
 FROM: S.A. Wasay Moini, Acting Division Chief, EMENA CPDIB

SUBJECT: IRAN: IBRD Two-Year Bonds

1. Mr. H.C. Hittmair (Deputy Treasurer) has requested me to bring the scheduled September, 1976 US\$350 million bond issue to your attention in connection with the meeting with Mr. Amuzegar. He requests that, if appropriate, this may be mentioned to Mr. Amuzegar.

2. Iran, at present, holds US\$62.05 million of IBRD two-year bonds. Of this total, US\$15.25 million consists of the US\$200 million September 15, 1974 issue that will mature soon. We would like Iran to subscribe US\$25 million, as it did in March, 1976, so that it not only contributes to the refinancing of the maturing issue, but also helps the Bank in raising additional funds.

3. Previous Issues

a. March, 1976

Iran Subscribed:	US\$25	million
Iran Allotted :	US\$25	million

b. September, 1975

Iran Subscribed:	US\$10	million
Iran Allotted :	US\$ 8	million

c. March, 1975

Iran Subscribed:	US\$15	million
Iran Allotted :	US\$13.8	million

d. September, 1974

Iran Subscribed:	US\$25	million
Iran Allotted :	US\$15.25	million

cc: Messrs. Goodman, Hittmair, Hattori, Paijmans (o/r), de Lusignan (o/r)

SAWMoini:pl

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
through: Mr. J. Burke Knapp
FROM: Maurice P. Bart, Acting Regional Vice President, EMENA

DATE: July 21, 1976.

SUBJECT: IRAN: Mr. Jahangir Amuzegar's Visit

1. You are meeting with Mr. Jahangir Amuzegar at 4.00 p.m. on July 22. The following briefly reviews the present position on various aspects of our relations with Iran and the current economic situation.

Iran/Bank Relations

2. Overall Relationship: We have not received a response to the Aide Memoire on "Relations between Iran and the Bank" (Annex I) sent to Mr. Amuzegar by Mr. Knapp on March 25, 1976. Nor has the Government provided us with the economic data referred to in the Aide Memoire (paragraphs 6 and 9) which would have enabled us to assess in particular balance of payments prospects and to review the case for a possible resumption of normal lending.

3. Financial: The \$50 million offset against the two loans approved in FY75 has not been made so far. Iranian officials have repeatedly confirmed that they recognize this to be an outstanding obligation. They have, however, been insistent that we must agree on a formula that would equate the two flows (i.e., disbursements from our loans and the payment of the proceeds of the offsetting loan from Iran). We have communicated a specific proposal regarding the outstanding \$50 million (attachment to the Aide Memoire). We have not received a response to our proposal so far.

4. Project Lending: The pipeline has now been reduced from three to only one agricultural project. The appraisal reports on the other two projects are being revised for sending to Iran as technical assistance, because we do not see any prospect of resolving our major differences on project issues. The third (Rural Cooperatives) could move to negotiations quite rapidly if the general relationship with Iran (especially the basis of future lending) could be clarified. In the absence of an Iranian response to the Aide Memoire by August, 1976, we would edit the appraisal report for this project also and send it to Iran as part of our technical assistance.

July 21, 1976

5. Technical Assistance: Iran declined to enter into any general contractual agreement for reimbursable technical assistance. We, therefore, established an arrangement (by exchange of cables) regarding technical assistance in agriculture and rural development for FY76. In recent months, we have pressed the Iranians for an extension of the arrangement, or at least an agreement on the work program for FY77, before the fiscal year began. On June 30, 1976 Iran informed us that, while they may request ad hoc assistance in the future, they could not "make effective use" of the services of our resident mission beyond July 1, 1976. Consequently, the mission is being closed. We have billed them \$527,521 for the first three quarters of FY76, but we have not received any payment so far, although we were recently told that steps are underway to do so. We intend to bill them for the last quarter of FY76 and for the closing-down costs in FY77, by the end of August, 1976. Sir John Crawford is in the Bank and we shall be discussing with him today the reasons which may have led the Government to request the termination of the mission. It is possible that, as may be speculated from Minister Majidi's statement in his meeting with you last April, the Iranians wanted to dramatically reaffirm their oft-repeated position that they do not want to dissociate the question of Bank technical assistance (and reimbursement for it) from that of future Bank lending.

6. Project Supervision: Seventeen projects are under supervision. The progress in execution is generally satisfactory.

Recent Economic Developments

7. Domestic: During 1975/76 GNP grew 4-5 percent in real terms against the target rate of 12 percent. We estimate GNP per capita to have reached \$1436 in 1975. Crude oil production was 11 percent below the previous year. The economies effected in public spending during 1975/76 in response to lower oil revenues reportedly amounted to 7 percent (\$1.7 billion) of total appropriations. The 1976/77 budget shows a small deficit (\$0.6 billion) excluding foreign aid and investments; if they are included, the deficit increases to \$2 billion (see Annex II for details). About half of this is to be borrowed abroad. The 1976/77 budget estimates project growth in fixed investment relative to current expenditures, and a decline in the contribution of oil and gas to total revenue. During 1975/76 the wholesale price index showed an increase of 3.9 percent and the cost of living of 9.9 percent, compared to 15.9 percent and 15.5 percent, respectively, during the preceding year.

July 21, 1976

8. External: During 1975/76 oil exports were \$19.2 billion, \$1.3 billion less than projected. Merchandise imports at \$25.3 billion were \$1.7 billion less than earlier assessments. The balance on current account was positive at \$2.3 billion; and on capital account, the deficit was \$3.8 billion; the performance on both was better than expected. Foreign exchange reserves of the Central Bank stood (in March, 1976) at \$6.6 billion compared to \$7.5 billion a year ago, (see Annex III for details).

Attachments

Cleared with and cc: Messrs. Goodman, Knox, Horsley, El Darwish

SAWMoini:nhl

OFFICE MEMORANDUM

Annex I

TO: Mr. Jahangir Amuzegar

DATE: March 25, 1976

FROM: J. Burke Knapp

SUBJECT: Relations between Iran and the World Bank

Please find attached two copies of an Aide Memoire which we have prepared for discussion with your authorities on the subject of the future relationships between Iran and the World Bank.

Please note that this Aide Memoire does not respond to a proposal which you tentatively put forward during your lunch last month with Mr. McNamara, namely, that disbursements on future World Bank loans to Iran might be offset by disbursements by Iran on loans to developing countries to be co-financed by the World Bank and Iran. Upon reflection it has seemed to us that this proposal does not meet the needs of the situation:

- a) If we can agree upon new lending to Iran on a normal basis, such an arrangement would not be necessary.
- b) If the Bank concludes that some kind of financial counter-contribution by Iran is required, we think we would have great difficulty in persuading our Board that your proposal would accomplish that purpose. The arrangement you propose might not bring any real new financial contribution by Iran; indeed, it would be open to the criticism that in making new loans to Iran, the Bank would merely be taking over from Iran some of the financial burden of commitments that you had already made for assistance to the developing countries.

I shall be out of town tomorrow but will give you a call on Monday to see if you would like to discuss these papers.

Attachments.

cc: Messrs. McNamara
Cargill
Wapenhans ✓
Goodman
Rotberg

JBKnapp:vm

AIDE MEMOIRE

Iran - World Bank Relations

I. Introduction

1. Since H.I.M., the Shah of Iran, and Mr. McNamara, President of the World Bank, met in February 1974, basic changes have occurred in the world economy and in Iran's economic situation. These changes also have an impact on the relationship between Iran and the World Bank Group. It is thus timely to review the present relationship and to work towards such changes and modifications as hold promise of expanding areas of mutually beneficial cooperation. To this end, a series of meetings have taken place during recent months and most recently (February 3, 1976) between Ambassador Amuzegar and Mr. McNamara.

2. This aide memoire (i) reviews the present status of relations, (ii) sets forth the broad principles of future cooperation, and (iii) proposes a program of action in the light of recent discussions. It is intended as a working document on the basis of which further detailed discussions can be initiated.

II. Present Status

3. The Bank has made five loans for a total of US\$200.5 million equivalent to Iran since March 1974. The Government of Iran has, over the same period, lent to the Bank a total of US\$350 million. In keeping with Iran's stated intentions, this total included US\$200 million of net lending to the Bank; another US\$150 million was provided as direct offset lending for the first three Bank loans extended after March 1974. A further offset loan against the remaining two Bank loans (1046-IRN and 1047-IRN) in the amount of US\$50 million has been agreed in principle. Technical arrangements for the transfer of these latter funds in relation to Iranian withdrawals of the Bank loan proceeds remain to be completed. A proposal for the completion of these arrangements, based on earlier discussion between Bank staff and Iranian authorities, is attached hereto.

4. The Bank has continued to extend technical assistance to Iran, mainly, though not exclusively, for agricultural and rural development and for education. In March 1975, the Bank decided to extend substantial technical assistance to oil exporting capital surplus countries on a reimbursable basis only. Consequently, the Bank, in July 1975, submitted to the Government of Iran proposals for a technical cooperation agreement and for technical assistance services on a reimbursable basis. In October, the Government expressed the wish to finalize technical assistance arrangements on that basis for the current fiscal year in the field of agricultural and rural development. In an exchange of cables (January 21 and 22, 1976), the Government agreed to reimburse the incremental costs of such services from July 1, 1975 through June 30, 1976. Total reimbursable costs for the fiscal year are presently estimated at about US\$1.02 million. Work programs, covering about seven direct professional manyears, and billing procedures have been agreed and are being implemented. Discussions have also started on a larger, multisectoral technical assistance program for FY1977.

5. Simultaneously, the Bank has offered on various occasions support for Iran's external assistance program. Such support could range from services for co-financing to advice on institutional arrangements for the extension of external assistance, and is to be rendered free of any charges. Relevant information and documentation for such activities has been provided to Iranian authorities. So far, no tangible cooperation in this area has emerged but discussions continue.

6. Also, the Bank has continued its economic work on Iran. Recently, Iranian authorities have commented on the final draft of a country economic memorandum being prepared for the Bank's Board of Directors. This report, inter alia, assesses Iran's short-term balance of payments prospects, but only tentatively because of prevailing uncertainties. The recent deterioration in the balance of payments, together with the effects of capital exports resulting from existing aid and investment commitments abroad, may necessitate adjustments in the Five-Year Plan and in the strategy to be followed for short- and medium-term economic management. Iranian authorities have agreed to provide additional data which would allow a more comprehensive assessment of Iran's economic prospects. The Bank intends to complete its analysis of this subject as soon as these data become available. In particular, such an assessment will provide the basis for more definitive conclusions regarding Iran's medium- and long-term external borrowing requirements, and the extent and form of future Bank lending to Iran.

III.

Broad Principles of Future Cooperation

7. Recent discussions between Iranian authorities and Bank staff suggest that a framework for future cooperation can be built on the following four principal components: (i) technical assistance; (ii) lending to Iran; (iii) Bank cooperation in Iran's external assistance program; and (iv) Iranian support of the World Bank Group. The broad contents of each of these components - subject to further discussion and refinement - are outlined in the following paragraphs.

8. Technical Assistance: The Bank would continue to provide and expand technical assistance to Iran on a reimbursable basis at the request of the Government. Such services would not necessarily be linked to possible lending operations and would not be limited to any specific sectors. Technical assistance would be rendered in response to specific Government requests for activities and in sectors in which, in the Bank's determination, it has a comparative advantage over other sources of assistance and has available the requisite expert manpower. Such assistance could extend beyond sector and project work and include regional as well as macro-economic planning. For the administration of such services, annual work programs and budgets would be prepared and agreed well before the start of the respective fiscal year of the Bank.

9. Lending: Future Bank lending to Iran would be considered on the basis of either (a) normal lending in accordance with criteria and terms commonly applied by the Bank to lending to higher income countries in comparable economic circumstances, or (b) lending accompanied by "buy-back" arrangements under which Iran would take a major participation in

each Bank loan. The feasibility of resuming normal lending would be considered by the Bank in the light of Iran's economic and, in particular, balance of payments prospects, including its access to other sources of capital. Such consideration would need to be based on a full analysis of reasonably reliable data on the domestic and external economic situation, development objectives and economic performance. In view of the level of Iran's per capita income, Bank lending would normally be directed in either case (a) or (b) to projects and sectors which call for a high technical assistance input, and for which other sources of finance are not readily available. It would also be subject to agreement on sector and project conditions appropriate to the specific case.

10. If the Bank should be unable to conclude that the resumption of normal lending would be justified, it would consider (subject to Bank approval) lending to Iran for economically viable projects on the basis outlined in paragraph 9(b), with Iran taking a participation of 90% in each Bank loan as it is approved. Under this arrangement, the Bank would also provide the entire range of services associated with its normal lending.

11. Bank Cooperation in Iran's External Assistance Program: The Bank continues to stand ready to cooperate with Iran in its external assistance program. If the Government so desired, such cooperation could include, but would not necessarily be limited to, (i) the joint appraisal and co-financing of economically viable projects in countries of Iran's choice, the supervision of their implementation, and the administration of disbursements; (ii) consultation on the organization and procedures for Iran's external assistance programs; and (iii) to the extent desired, training and staff secondment for such programs, all as the Bank can reasonably render. Except for staff secondment, such services would be free of charges and would be provided in the context of the Bank's extensive framework of economic analyses and preinvestment work in countries likely to be beneficiaries of Iran's external assistance programs.

12. Iranian Support for the World Bank Group: Iran demonstrated its concern for the economic development of the LDC's by calling, early in 1974, for joint efforts to increase the flow of funds to developing countries and by entering into generous bilateral aid commitments. More recently, Iran has also played a leading and constructive role in the establishment of the OPEC Fund. Nevertheless, it continues to be one of the basic concerns of Iran and the Bank that developing countries are not receiving sufficient assistance on suitable terms under efficiently operated assistance programs. In this context, Iran has indicated its intentions to play, within the limits of its ability, a constructive role in the provision of resources to the World Bank Group. It is hoped, therefore, that the discussions on such pending issues as the selective capital increase of the Bank, the proposed increase in the capital of IFC, and the fifth replenishment of IDA will continue in the spirit of Iran's general support for the World Bank Group and its role in development assistance. However, these matters are to be considered independently of any actions to be taken in establishing a new Bank lending program for Iran.

IV.

Program of Action

13. Aside from continuing work on projects in Iran, agreed technical assistance, and economic work, specific action is required in the following areas:

(i) agreement on the technical arrangements for the remaining US\$50 million offset lending along the lines set forth in the attachment;

(ii) provision by Iran of economic and balance of payments data needed for the completion of the Bank's economic and balance of payments analysis and release of its country economic memorandum to the Board of Directors;

(iii) completion by the Bank of its review of Iran's eligibility for and the justification of resumption of normal Bank lending;

(iv) completion of the appraisal of, and negotiations for, three agricultural projects presently under consideration by the Bank and their submission to the Board of Directors for approval on a lending basis to be determined;

(v) completion of discussions and agreement on expanded technical assistance program for FY1977; and

(vi) further discussions on any support Iran may wish to obtain for its external assistance program.

14. On the assumption that the broad outlines of the future relationship between Iran and the Bank set forth above are agreed upon, the Bank would resume its work on the preparation of a lending program in areas requested by Iran and in accordance with practices normally followed in high income countries. Initiation of such work is urgently needed if lending on the basis of either of the alternatives set forth in paragraph 9 above is to be resumed on a sustained basis.

Technical Proposal for Offset of
Loans 1046-IRN and 1047-IRN

Disbursements under Loan 1046-IRN have aggregated US\$15 million equivalent to date. Disbursements in respect of both loans are expected to be completed in 1979 and both loans will be repayable to the Bank over the period 1979 through 1988. This will result in an average life of about eight years for the principal amounts of the two loans. The aggregate principal amount totals US\$52.5 million equivalent. However, since the early offset operation was for a total of US\$150 million against Bank lending of US\$148 million, this proposal would cover the net difference of US\$50 million only.

The arrangements for the loan to the Bank reflected below provide (a) that the principal amount of the loan and interest thereon would be identical to the above-mentioned two loans to Iran, (b) that payment of the proceeds of the loan would be substantially in line with the actual disbursements under the two Bank loans to Iran, and (c) that the average life of the loan would be substantially the same as the average life of the two Bank loans to Iran. The proposal is as follows:

Amount : US\$50 million.

Interest Rate : 8% per annum payable semi-annually on the outstanding amount of the loan, on March 1 and September 1.

Payment of Proceeds : (a) US\$15 million, representing the amount of US\$15 million equivalent already disbursed under 1046-IRN, payable to the Bank on or about April 1, 1976; and

(b) amounts equal to the US dollar equivalent disbursed by the Bank under Loans 1046-IRN and 1047-IRN, payable to the Bank on March 1 and September 1 of each year. (If any part of the undisbursed portions of Loans 1046-IRN or 1047-IRN is cancelled, a prorata cancellation would also be made in respect of the loan to the Bank).

Maturity : The full amount of the loan to the Bank would be repayable on March 1, 1985. Taking into account the period over which the proceeds of the loan would be payable to the Bank, this results in an average life of about eight years.

SUMMARY OF GOVERNMENT FINANCES(billion rials) ^{*/}

	<u>1974/75</u>	<u>1975/76</u>	<u>1976/77</u>
	Actual	Revised Budget	Budget
<u>Revenues</u>	<u>1,536</u>	<u>1,804</u>	<u>1,912</u>
of which Oil and Gas	<u>1,205</u>	<u>1,481</u>	<u>1,409</u>
<u>Expenditure</u>	<u>1,536</u>	<u>1,804</u>	<u>2,057</u>
of which: Fixed Capital expenditure	349	523	701
Current expenditure	826	1,079	1,227
Foreign aid & investments	161	177	105
<u>Surplus or Deficit</u>	<u>-</u>	<u>-</u>	<u>145</u>

SUMMARY OF GOVERNMENT EXPENDITURE

(billion rials)

	<u>1974/75</u>		<u>1975/76</u>		<u>1976/77</u>	
	Actual	%	Revised budget	%	Budget	%
General Administration	118	8.7	178	9.9	251	12.2
Defense	373	27.4	526	29.2	567	27.6
Social Affairs	232	17.1	323	17.9	398	19.3
Economic Affairs	291	21.4	430	23.8	579	28.2
Other <u>a/</u>	<u>346</u>	<u>25.4</u>	<u>347</u>	<u>19.2</u>	<u>262</u>	<u>12.7</u>
TOTAL	<u>1,360</u>	<u>100.0</u>	<u>1,804</u>	<u>100.0</u>	<u>2,057</u>	<u>100.0</u>

a/ Obtained as a residual*/ 1 US dollar = 70 Iranian rials

Source: Iran Budget ("Minister's Version", in Farsi), Tehran, 1976.

BALANCE OF FOREIGN EXCHANGE PAYMENTS AND RECEIPTS

(US\$ million)

	<u>1974/75</u>	<u>1975/76</u> <u>1/</u>	<u>1976/77</u> <u>2/</u>
Oil Exports	18,671	19,211	19,526
Non-oil Exports	694	700	800
<u>Total Exports</u>	<u>19,365</u>	<u>19,911</u>	<u>20,326</u>
Imports	10,344	15,300	17,600
Services net	807	2,300	2,300
<u>Total "Imports"</u>	<u>11,151</u>	<u>17,600</u>	<u>19,900</u>
<u>Balance on Current Account</u>	<u>8,214</u>	<u>2,311</u>	<u>425</u>
Capital Inflow	435	700	2,100
(official)	(257)	(300)	(1,600)
(private) (net)	(178)	(400)	(500)
Capital Outflow	-3,700 <u>3/</u>	-3,883 <u>4/</u>	-2,700
Repayments	(-1,313)	(-800)	(-800)
Loans and Investments	(-2,387)	(-3,083)	(-1,900)
<u>Balance on Capital Account</u>	<u>-3,265</u>	<u>-3,183</u>	<u>-600</u>
<u>Errors and Omissions</u>	<u>-30</u>	<u>-</u>	<u>-</u>
Change in Reserves (- = increase)	<u>-4,919</u>	<u>872</u>	<u>174</u>

1/ "Official Estimate"2/ Bank Markazi Projection3/ Capital outflow includes \$300 mln. deposit with BIS, \$537.1 mln. lending to IMF Oil Facility and \$350 mln. World Bank bonds.4/ Capital outflow include \$483 million lending to IMF Oil Facility.Source: Bank Markazi Iran

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Mr. McNamara's Office

Boards of Governors · 1976 Annual Meetings · Manila, Philippines

INTERNATIONAL MONETARY FUND

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL FINANCE CORPORATION

INTERNATIONAL DEVELOPMENT ASSOCIATION

Annual Meeting
Manila, Philippines
October 6, 1976

MEMORANDUM

Prior to August 30, 1976:

Mail Address:

JOINT SECRETARIAT - ANNUAL MEETINGS
IMF - IBRD AND AFFILIATES
WASHINGTON, D. C. 20431 U.S.A.

Cable Address:

INTERMEET
WASHINGTONDC (USA)

Telex Addresses:

(RCA) 248331 IMF UR
(ITT) 440040 FUND UI
(WUI) 64111 INTERFUND

After August 30, 1976:

Mail Address:

JOINT SECRETARIAT - ANNUAL MEETINGS
IMF - IBRD AND AFFILIATES
P.O. Box No. 7510
MANILA INTERNATIONAL AIRPORT
PHILIPPINES

Cable Address:

INTERMEET
MANILA (PHILIPPINES)

Telex Addresses:

(RCA) 7227613
(ITT) 7420400
(WUI) 7227613

TO: Memorandum for the Record
FROM: Martijn J.W.M. Paijmans
SUBJECT: IRAN - Mr. McNamara's Meeting with
H.E. Hushang Ansary, Minister of
Economic Affairs and Finance

1. The meeting started with a private discussion between Mr. McNamara and the Minister who were later joined by Messrs. Khelif, Knapp, Benjenk, Burmester and Paijmans, and for Iran Messrs. Hassan Ali Mehran and Ambassador Jahangir Amuzegar.

2. When the meeting was complete Mr. McNamara announced to Mr. Khelif and the Bank staff that Iran had the feeling to be treated inequitably as compared to other countries, roughly in the same category with respect to per capita income, balance of payments situation, general level of development. The President stated that he wanted Iran to be treated at least as equitably as other comparable countries, if not more favorably in view of the efforts the country was undertaking to address its problems in the area of economic and social development. Mr. McNamara said to be willing to resume net lending but that this would only be feasible while maintaining equity among the Bank's membership.

3. This question therefore requires a review of:
- (i) the exact situation of Iran on the basis of relevant information such as:
 - income per capita
 - balance of payments reserves
 - ability to borrow in the capital markets
 - (ii) this situation in, and with respect to, comparable countries.

Further to this major issue there are some other pending questions, Mr. McNamara mentioned the \$50 million offset and the T.A. invoices. To address these issues properly Mr. McNamara and Minister Ansary had decided to set up a Working Group which should meet in the very near future for the first time, in Iran

Manila
October 6, 1976

4. After Messrs. McNamara, Knapp and Burmester left the meeting the discussion continued under Mr. Benjenk and it was decided that for the side of the Bank the first meeting should be attended by Mr. Paijmans and senior departmental staff; further routine meetings could be handled by departmental staff. It was also decided that Mr. Kooros and Mr. Paijmans would immediately meet to set up an agenda and time for the first meeting.

5. A discussion followed, mainly between the Iranian representatives about the availability or unavailability of basic information required by the Bank according to questionnaires previously submitted to the Government. Minister Ansary basically decided Iran should be able to provide the Bank with the same type of forecasts as were arrived at in the Algerian case. This case, referred to by Mr. Benjenk, was the exercise in which the Region had been able to determine that country's eligibility for borrowing in spite of it being a major oil exporter. In this context Mr. Benjenk promised to make available to Iran relevant reports on Algeria (in particular where forecasts were concerned). / The Program Division will follow up on this matter. _/

6. Messrs. Benjenk and Ansary agreed that this exercise was of major importance as it would touch upon the very basis of Bank/Iran relationship. Both agreed that all possible efforts should be made to reach a clear understanding of the situation, whatever it might mean for future lending. In this context Minister Ansary made the observation to his colleagues that "we have problems in our own Government" in that no agreement could be reached on matters in which Iran owed to the Bank. The Minister also said that he and Mr. Mehran would make themselves available in case of any difficulty that might emerge during the Working Group meeting in Tehran.

MPaijmans:gg

cc: Mr. McNamara's office (2), Messrs. Khelif, Knapp, Benjenk, Knox
Burmester, Dubey, Aiyer, Kavalsky

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: May 20, 1977

FROM: J. Burke Knapp

SUBJECT: IRAN

In connection with the attached memorandum from Mr. Paijmans, briefing you for your meeting next week with Dr. Ansary, I have two suggestions to make for your consideration.

1. Future Loans to Iran. I think the review of our future over-all Bank lending program, based upon a rising level of lending in real terms, will indicate that we can "afford" to lend some money to Iran without seriously restricting our ability to lend to other lower-income creditworthy countries. If we were to resume lending to Iran we might try to justify it along the lines of the Iranian proposal, that they would devote corresponding amounts to loans to developing countries. However, I think this would be complicated to work out and would always pose the difficult question of the "additionality" of the Iranian loans. I suggest that a more promising approach would be to justify some new loans on the basis that they would "maintain our stake" in Iran in the face of the net capital repayments to the Bank (excluding interest) that Iran would otherwise be making commencing in 1979. (see Annex C to the Paijmans' memorandum). For example, if we were to make new loans of \$200 million over the next year or so, we would defer the date when Iran would be making substantial net repayments to the Bank until FY1984.

2. The \$50 million Offset Loan. It is obviously embarrassing for us not yet to have arranged this offset loan after having promised the Board that we would obtain it to "neutralize" the affects of the ADBI and Fisheries loans made in August and September 1974. The negotiations for this loan got bogged down over the whole question of our relations with Iran, and over the issue of whether disbursements under the offset loan should be made by Iran forthwith or only pari passu with disbursements by the Bank on the loans which were to be offset. However, I think an opportunity arises for us to clean this matter up in connection with the cancellations on the Population and Urban Transport loans referred to in paragraph 9 of Mr. Paijmans' memorandum. Even though these loans were made in May and August 1973 respectively (i.e., before we instituted offset lending in Iran), I think it would be reasonable to treat the \$39.7 million of cancellations on these loans as satisfying an equal amount of the \$50 million undischarged offset commitment from Iran, and to so inform the Board. As for the remaining \$10.3 million, perhaps we could persuade the Board that it would be reasonable to forget about this in the light of the fact that since September 1974 Iran has increased its holdings of two-year Bank bonds by a net amount of \$37 million (although of course, two-year bonds represent only a short term offset unless they are renewed).

cc: Mr. Cargill
Mr. Paijmans

JBKnapp:dpw

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara, President
 (THROUGH: Mr. J. Burke Knapp, Sr. Vice President; Mr. Maurice P. Bart, Acting RVP, EMENA)
 FROM: Martijn J.W.M. Paijmans, Director, EMENA CP I
 DATE: May 18, 1977
 SUBJECT: IRAN: Your May 23 Meeting with Minister of Finance

Status of Relations

1. After unsuccessful attempts in FY75 and 76 to obtain Iranian contributions to the Third Window and IDA V, and the closing down in July, 1976 of our Technical Assistance Mission, your first meeting with Dr. Ansary was in Manila. At that meeting, you and he agreed to set up a work group that would look into Dr. Ansary's allegation that Iran had not been treated equitably by the Bank. On that occasion, your reaction was also that Iran would have to be treated as equitably as comparable countries, if not more favorably, in view of its efforts to address economic and social development issues. Following the decision to set up a working group, considerable effort has been made towards getting our relations with Iran on a more agreeable course.

2. In February of this year, I had discussions in Iran on the basis of a very frank and confidential report ("Joint Iran/World Bank Working Group -- Background Paper," approved by you in January, 1977) that compared Iran's past treatment with that of a number of other Bank member countries selected by Minister Ansary. The outcome of these discussions -- reported upon in detail (please refer to Attachment A to this memorandum) -- was in summary:

- i. Iran now understands the rationale of the Bank's decision not to finance projects during the past two years;
- ii. Agreement was reached on a number of pending questions (problem projects, arrears in payments, provision of data);
- iii. A work program was agreed upon to address the format and type of possible future Bank activities in Iran.

3. You may wish to be reminded that, following the February discussions, Iran paid its long outstanding T.A. bill of \$804,000.00, agreed to its participation in the selective capital increase, continued to support the Bank's two-year Bond issues (March 1977 subscription: \$25 million) and became generally more responsive to our operational communications.

4. Under the work program agreed upon in February, we have started, on the basis of information which was then provided, the drafting of a report that would analyze the case for possible future Bank activities in Iran (including the need for and possible justification of lending). A rough draft of the report has been completed, and will be discussed in Tehran starting this May 23. The report will be completed, with further

May 18, 1977

Iranian information and the addition of some other sections, to allow a clearer insight into the situation, and, therefore, facilitate a senior management decision. This process will take us into late June.

5. The Iranian authorities are, of course, fully aware of the situation described above (but, they do not know that we intend to add to the report some sections that will not be discussed with them). Consequently, Minister Ansary cannot -- and, as far as I know, does not -- expect a decision from you at this stage on future Bank activities in Iran.

6. From our discussions last February, the Minister is also fully aware that, whatever the outcome of our internal review may be -- and it will not be available before late summer anyway -- our Board would have to be approached in case any future lending might be contemplated. This, again -- the Iranians realize -- would take time. A way of dealing with this matter -- in case of a favorable management review outcome -- might be the compilation of a full-size Economic Report on Iran by which means the Board might be informed of the situation in the country, without putting forward any specific request as a means to test the waters. Such a possible tactic was briefly touched upon during the February discussions.

7. I believe that the purpose of Dr. Ansary's desire to meet with you is partly a gesture, partly to have the benefit of your views on some wide-ranging subjects. In particular, to:

- i. confirm to you personally his pleasure with what Iran feels to be "improving relations." Your letter of March 28 (Attachment B) is seen as an expression of your and the Bank's desire to entertain friendly relations, and to make an effort in that direction, whatever the practical outcome may be;
- ii. discuss with you the future of the Third World, of the Bank and the role Iran could conceivably play therein (please refer to Attachment A, paras. iii., and 11-13), a subject on which the Minister expressed his thoughts quite freely in February intimating that he was in favor of a very active role for Iran in the Bank, but that he had problems in the Cabinet.

Other Background Information

8. Financial: The \$50 million offset against the two Bank loans approved in FY75 has not been made so far. This subject was intentionally not pursued during the February discussions. The recent and proposed cancellations of undisbursed balances in IBRD loans (refer to para. 9 below) could, perhaps, be considered in this regard. Iran's total holding

of two-year Bank Bonds, at present, amounts to \$66.2 million. It may be noted that, for some years, Iran has responded very well to our invitation to subscribe, and has usually been allotted a smaller amount than its subscription. The past and projected flow of funds between Iran and the Bank is set out in Annex C.

9. Project Supervision: Sixteen projects are, at present, under supervision. The undisbursed balances in the loan accounts amount to \$222.5 million. The disbursements have been slow and have lagged behind the physical progress of the projects. The Iranian Government agreed to the cancellation of \$15.9 million of the \$16.5 million loan for the Population project owing to lack of progress on the project. The \$23.8 million undisbursed balance of the \$42 million loan for the Tehran Urban Transport project is expected to be cancelled end-June, 1977 (currently the loan's closing date).

Recent Economic Developments

10. Iran's economy grew enormously in the last three years largely due to the oil price increase; in 1975/76 the GNP was \$53 billion (making per capita income \$1,600 on standard conversion, and \$1,440 by the Atlas formula). But, as a result, its growth has become highly sensitive to oil production and exports. For instance, an 11 percent reduction in oil production in 1975/76 pulled GNP growth down to 5 percent, while a 12 percent increase in 1976/77 may push growth up to 15 percent. However, rapid growth (15-20 percent a year) is reported in the non-oil sectors, largely as a result of very heavy investment. The balance of payments still shows a current account surplus (though much less than previously), but it is projected to turn into deficit in a year or two. On capital account, the balance is heavily in deficit on account of debt amortization and active lending and aid. Gross international reserves were \$10.1 billion at end-February, 1977, equivalent to nearly six months of imports. During CY1976, Iran contracted to borrow in the Eurodollar and bond markets \$1,431 million (not all of which has been disbursed), as compared with \$245 million in 1975, \$114.5 million in 1974 and \$726.9 million in 1973. These borrowings are generally on medium term, and the spread above LIBOR tends to be more favorable than for other international borrowers.

11. Iran is currently in the process of drawing up its Sixth National Economic Plan (March 1978-1983). A sober reassessment of the country's limitations is underway, and a more realistic approach to development seems to prevail. Major economies in public spending have been initiated, including stabilization in money terms of defense outlays. The Plan is expected to give more attention to the neglected social services, and to a reduction of income inequalities. Oil revenues at levels in excess of \$20 billion a year are foreshadowed in the next several years, and, these, if supplemented by adequate domestic mobilization efforts, could produce very promising results.

May 18, 1977

General

12. Iran, it appears, has many motives for desiring better relations with the international institutions in general, and the IMF/World Bank, in particular. During the last two years, Iran has suffered considerable setbacks that appear to have induced a sense of realism, but also created self-doubt and insecurity. First, Iran's development effort has confronted major problems and much costly waste due to (i) poor planning and coordination; (ii) hasty cut-backs due to resources falling short of projections and large import cost increases; and (iii) limited execution and management capacity and corruption. Second, the frequent criticism of political repression and of overspending on defense in the foreign press has encouraged domestic opposition and also made the Government aware of image problems. Third, the overt differences in OPEC seem to have eroded confidence, and the incipient emergence of Saudi Arabia as the pace-setter evidently rankles. Fourth, recent prominence given to Saudi Arabia, Kuwait and the UAE in international forums (such as the recent Interim Committee meetings in Washington) reportedly causes some heartburning in Iran. For these reasons, we believe Iran is keen to secure Bank support of some sort, and, if possible, approval for its development efforts.

Attachments

cc: Messrs. Knox, Aiyer (o/r)

SAWMoini/SElSerafy/MJWMPaijmans:pl

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara, President
 THROUGH: Mr. Munir P. Benjenk, Vice President, EMENA Region
 FROM: Martijn J.W.M. Paijmans, Director, EMENA CP I
 DATE: February 28, 1977
 CONFIDENTIAL

SUBJECT: IRAN - Discussions Held in Tehran from January 29 to February 5, 1977

Summary of Discussions

i. At the outset of our meetings quite a suspicious attitude prevailed on the Iran side - ours was firm but, I believe, sympathetic - and during the lengthy discussions an understanding gradually developed. In summary:

- a. Our main line firmly was that Iran has been treated equitably; with respect to the future the Bank has an open mind, but we certainly want an active working relationship with Iran which we consider an important member country. We therefore regretted the unnecessarily tense relations which I felt were mainly the result of misunderstandings and possibly mistakes on both sides.
 - b. For Iran, once they were convinced of our sincere wish to cooperate to the fullest without any preconceptions, a most cooperative attitude evolved. At the end of the mission Minister Ansary recognized that mistakes had certainly been made by Iran, and expressed his pleasure that you had agreed to the review that had taken place and with its results which he termed to be very satisfactory. He also spent considerable time discussing the Bank and Iran's future relationship with a genuine interest in our institution.
- ii. The practical results achieved are:
- a. Provision of information and data by Iran to enable the Bank to start assessing the country's situation and needs, and willingness by all authorities involved (Finance, Plan, Central Bank) to help us to the fullest to make an objective assessment.
 - b. Arranging payment of the still outstanding full T.A. incremental cost of \$864,000 over FY76, which includes the cost of closing down ARDAM.
 - c. Understanding by Iran of the Bank's rationale and decision-making process regarding lending to Iran over the past two years (on the basis of the paper we had prepared).
 - d. A decidedly better understanding by us of Iran's situation, problems, policies, capabilities and also intentions vis-a-vis the Bank.
 - e. Mutual agreement on a program of economic work in the next ten months.

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- f. Agreement on immediate action by Iran on a number of problem projects whose performance had been unsatisfactory (one project to be cancelled in March and a second in the months ahead; on others, technical agencies will be called to task by Minister Ansary).

iii. Beyond these points Minister Ansary, in our concluding 1-1/2 hours session, went to great lengths to explain his Government's wish not only to normalize relations with the Bank but in fact to strengthen them further on the common basis which had been found. He expressed his thoughts about the Bank's future and Iran's role in the international community in such an open, concerned and constructive way that I felt compelled to suggest a discussion between you and the Minister in the not too distant future. The Minister would very much welcome an opportunity for a totally informal discussion which could take place for example in Europe on one of your travels. He specifically asked us to convey to you his best regards and appreciation for the Bank's open mind and frankness.

iv. The discussions are reported upon in detail in the paragraphs below (the issue of the Bank's future is dealt with in paragraphs 11-13), under the following headings:

Introduction

General Atmosphere

Closure of ARDAM

Dialogue/Changes of Substance

Motivation for Seeking Bank Assistance

Recent Domestic Policy Initiatives

Areas in which assistance is sought

Iran's Future Role in the Bank

Outlook

Performance of Ongoing Projects

Outstanding Offset

Technical Assistance Payment

Conclusions and Recommendations.

Although I believe that the scene has been set for a possible constructive relationship with Iran -- also with respect to its overall role in the Bank family (Iran has again requested a \$25.0 million subscription for the March Two-Year Bond Issue) -- we should very much be aware indeed of the sensitivity of the Iranians and further establish and maintain our contacts accordingly.

Introduction

1. Further to Mr. Benjenk's memorandum of January 5, 1977 to you on the Joint Iran-Bank Working Group, discussions were held in Tehran from January 29 to February 5, 1977. Messrs. Dubey (Chief Economist, EMENA Region), Aiyer (Programs Division Chief), and El Serafy (Senior Country Economist) joined me in these discussions. The background paper prepared following the understanding reached in Manila between the Iranian Minister of Economic Affairs and Finance (MEAF), Dr. Houshang Ansary, and yourself, was used as a starting point for the discussions which then led to the subject of future relations between Iran and the World Bank. During our stay, we also touched upon other outstanding matters, namely, the pending \$50 million of World Bank loans still to be offset by Iran, payment for technical assistance rendered in FY1976, and performance under ongoing Bank projects.

2. The detailed discussions on the background paper were held - as was indicated in Manila - with the Vice Minister for Economic Affairs, Dr. Ahmed Kooros. In addition, the mission also had meetings with the Minister of the Plan and Budget Organization (PBO), Dr. Abdol-Majid Majidi; the Governor of the Central Bank, Dr. Hassan Ali Mehran; the President of the Agricultural Development Bank of Iran (ADBI), Mr. Mehdi Samii; the Managing Director of the Industrial and Mining Development Bank of Iran (IMDBI), Mr. A. Gasem Kheradjou; and the Deputy Minister of Economic Affairs and Finance, Dr. Jalil Shoraka, and reviewed problems faced by ongoing projects with Dr. Jamshid Ashrafi, Vice Minister for Investments and Foreign Assistance. At the conclusion of our stay, a long meeting was held with Dr. Ansary on Saturday, February 5, following his return the previous day from Europe. I also took the opportunity to update the Iranian officials on the proposed consultative group meeting on Egypt on which I have reported to you separately.

General Atmosphere

3. The "strictly confidential" background paper had been studied in detail by officials in the MEAF, and also, we were told, by the Governor of the Central Bank and the Minister of PBO. Few of the substantive points in the paper were questioned, and, although at the outset of the discussions the atmosphere was quite tense, as they progressed, they were held in a very constructive and cooperative spirit. After the discussion on the paper was finished, the Bank was complimented on the paper's frankness and explanations, and, I believe, that it was accepted that the Bank has not been inequitable in its treatment of Iran in the past. It is important to point out that, after the initial problems had been overcome, in all our meetings, the officials were most cordial and receptive, and the desire of the Government to reestablish a positive relationship with the Bank, and, thereafter, to further strengthen their relationship was stressed by all of them. The meetings provided for a more candid exchange of views on both sides than I have seen hitherto in Iran. All officials, including the MEAF, accepted that there had been misunderstandings on both sides of the other's positions, and that the Government and the Bank may have committed some mistakes. This was in contrast with the past few years when it has been extremely difficult to get any admission of possible mistakes on the part of the Iranians.

Closure of ARDAM

4. The Governor of the Central Bank, PBO and ADBI all mentioned that the professional work of the ARDAM staff was very welcome, useful, and helpful to the policy-makers. We were repeatedly told that ARDAM's closure was a symbolic gesture, the only one that the Government felt it could make to show the Bank its dissatisfaction with the tenor and pace of the dialogue between Iran and the Bank. It is worth noting that many of ARDAM's policy recommendations are likely to be included in the Sixth Plan; one, regarding a change in the fragmented organization of the sector has already been implemented in December, 1976.

Dialogue/Changes of Substance

5. Over the past 18 months whenever the Bank had asked the Government of Iran to provide data on its economic position or prospects, or on its aid outflows in order to study Iran's case, this information was never received, and, on occasion, was said to be unavailable. Moreover, they were always reluctant to discuss with us projections of economic parameters to enable us to substantiate their need for official assistance.

6. On this occasion we found a willingness to gradually respond more positively and we have finally been provided with considerable detailed data on Iran's aid pledges, commitments and disbursements, along with data on the economy, together with information on government policies, including information on the budget for 1977/78, which is yet to be presented to the Parliament. The government officials also said that, while they do not have any reliable or firm projections beyond 1977/78 (which could possibly be extended to cover the whole of 1978) because of uncertainties on the income side, they would be pleased to review and comment upon any projections we may make; MEAF has given us their preliminary projections for 1980 of macroeconomic parameters (shown in our background paper for the other countries with which Iran was compared). The Government would be agreeable, as we suggested, to having a preliminary review of the economy by a Bank mission in April with a more detailed review in the fall, at which time the Minister of PBO said the contents of the draft Sixth Plan which will be ready would be made available to the mission.

Motivation for Seeking Bank Assistance

7. We have tried to determine why Iran is interested in having Bank assistance, given that it has access to large sums of money and can finance expert consultancy services with its own resources. The principal response from government officials and confirmed by Minister Ansary can be summarized as follows. When oil income rose in 1973, the technical ministries were asked to invest (i.e., spend funds) as rapidly as possible; these ministries sought whatever funds they needed through the budget. As a result, the past three years have witnessed the emergence of a number of bottlenecks in the economy, and in some areas, progress has been disappointing to the top echelons of government and growth has been distorted. To be able to restore the impressive 10-12 percent annual economic growth rate attained consistently before 1973, the Government has decided during 1976 to control

spending by eliminating waste. Financial and operational discipline, made even more necessary by the very recently changed prospects for oil revenues, could be aided, the Government feels, by an outside agency such as the Bank. Also, they feel that the Bank can bring objective advice and expertise, which is otherwise unavailable to them in certain sectors of the economy; and, it could lend support to some of the newer policy initiatives of the Government in the economy. Dr. Ansary also mentioned that the Bank should see its relationship with Iran in a long-term perspective, and, as the leading development institution, should want to be associated with a developing country such as Iran which is likely to be among the first developing Bank member countries to achieve take-off (see paragraph 11 below). On grounds of past economic performance, he felt that Iran's case clearly merits consideration for Bank assistance. Also, although the Iranians have good access to the capital markets (which they propose to tap for \$1 billion for the first quarter of CY1977), they feel that the terms of such borrowings are usually not suited for the projects they wish to undertake, and more importantly that Bank lending brings with it technical expertise and wide experience in development.

8. Other arguments on a political plane that we sensed during some conversations are that Iran has grown extremely sensitive and almost paranoid about criticism from the outside which was negligible three years ago when exporters' order books were being filled, but has now mounted and comes from all quarters, including the United States. Iran is cast as a country not interested in personal liberties or social goals, only because outsiders are unaware of the policy measures being implemented by the Government. Iran has even lost its hitherto leading voice in OPEC. The presence of the Bank in Iran would imply endorsement of some of the Government's economic policies. Also, a report issued by the Bank and distributed to its Board would serve to explain Iran and could improve Iran's image in economic and social areas.

Recent Domestic Policy Initiatives

9. On the economy, the Government appears to have taken several new policy initiatives, some of which were explained to us. In an attempt to curb waste in government, all ministries and public sector agencies have been told to curb employment by between 15 and 25 percent this year. In the 1977/78 budget, no new projects are foreseen, in order to allow the public sector to concentrate its investments on completion of ongoing projects. Furthermore, even the Sixth Plan (1978/79-1982/83) will focus at the outset on completion of ongoing projects before launching any new ones. The Government has, over the past year, been giving considerably increased attention to reducing regional and personal income disparities. The individual governors of each province are being given a portion of the budget, for implementation, and the Sixth Plan will be a combination of several regional plans. In agriculture, they will be responsible for implementing projects in their governorates from this year. The expenditures for the governorates outside Tehran have been increased. In the discussion of the working paper, the officials pointed out that on matters such as income distribution, Iran was more progressive than Brazil, Mexico and Venezuela. Also, more

recently, Iran seems to have become more active than before in pursuing policies aimed at reducing personal income disparities. In the area of domestic savings, direct taxes which form 8 percent of total income in 1976/77 are to be revised to 20 percent by 1982. The Government also expects to implement measures to increase non-oil exports to raise their share in total exports. All these, they feel, are objectives that deserve support from the Bank.

Areas in which assistance is sought

10. The officials unanimously felt that technical assistance alone without lending would be ineffectual in Iran, because such advice is listened to but not readily implemented. The work of ARDAM, they felt, provided, to some extent, evidence of this. Our own experience over the last three years, when too many projects became problem cases in spite of close supervision, also tends to confirm this judgment. The Government seems to be interested now in a relationship with the Bank which would include both lending and some technical assistance. The Ministers explained that there were certain specific areas where the Government would like to receive general advice from the Bank for which it would be prepared to pay. This would be in large industrial projects and in the power sector, including procurement for such projects which evidently tend to be complex, and fraught with dangers for Iran (cf. our role in Saudi Arabia), and in higher education and training. They felt that the Bank could give more sound and objective advice than consultants. Payment for such services was only briefly mentioned and said not to be a problem. They would like to establish a lending relationship in major infrastructure projects on a selective basis, and mentioned irrigation, transport (railways and ports) and communications. They would like the technical agencies to benefit from the Bank's technical capabilities and financial discipline in the projects for which lending is sought. Given the extensive medium-term planning that has been going on and the number of studies it has initiated, PBO felt that it should be possible to identify suitable projects. They also pointed out that, given the ambitious targets and the existing bottlenecks, most of the projects would have an urgent label and that they would have to be processed speedily.

Iran's Future Role in the Bank

11. Dr. Ansary explained that the highest levels of government had discussed Iran's role in the Bank and the possible increase thereof in whatever form, but that he had so far been unable to justify a change. This was because they felt that they did not have a meaningful relationship with the Bank and mainly because they receive no benefits from their membership in the Bank. Dr. Ansary agreed that partnership in an institution as the Bank carried a certain significance by itself in view of the joint responsibility for the world community but he also alluded that Iran was in the process of graduating from Part II, while having little expectation of benefitting from increased exports by virtue of participation in the Bank, therefore it was not yet a full Part I country. We discussed that Iran was not unique in this situation and Dr. Ansary suggested that the Bank should give thought to making it worthwhile for this type of country to continue their interest in the institution. He recognized that Iran's case

for assistance from the Bank was marginal, because a slight change in either projected income or expenditures could shift its position from one of need to one of surplus. He was also aware that by a slight increase in suppliers credits or other outflows, the Bank's help would not be needed. He said, however, that if the Bank could do something for Iran at this point (when Iran felt it needed the Bank), on whatever basis, it was not unlikely that the Government would consider increasing its participation in the Bank's capital structure and even in the overall activities of the Bank (during the preparatory discussions IDA was mentioned by both parties as an important instrument of international cooperation). He repeatedly spoke of normalizing and further strengthening relations with the Bank (it should be pointed out that after Saudi Arabia contributed \$200 million to the OPEC Fund, Iran announced its contribution of \$210 million*).

12. Dr. Ansary mentioned that the Iranians would be prepared to discuss further the basis on which Bank lending would be possible, recognizing the Bank's financial constraints. He made it very clear that, given the present and foreseeable financial position of Iran, whereby its income is not expected to continue to rise significantly and is all needed for its own development, the Government had decided to make no further new aid commitments. This position will not change unless there is a change in Iran's oil income. He recognized that as long as Bank lending to Iran would mean depriving some other more needy country, we would have to move away from traditional approaches. A possibility he mentioned was one whereby Iran would commit to a new project in a country acceptable to both the Bank and Iran, and on the basis of Bank appraisal, an amount equal to that committed by the Bank for a project in Iran. In the circumstances, the Minister said that the approach he proposed would mean that Iran would commit new funds only because it was seeking to borrow from the Bank. To continue to ask for proof of additionality, he stressed, would mean that we would never be able to reach a workable arrangement. Under the changed circumstances I felt that "additionality" could indeed no longer be realistically pursued as an avenue toward normalization, at least at this moment.

13. The Minister made it clear that these were his personal thoughts. He said that, upon receipt of a "signal" from the Bank on "opening the doors", he could take these matters (Iran's future in the Bank and the "quid pro quo") up with his authorities.

Outlook

14. Judging by the gestures made by the Iranians we met during our mission, we have no doubt that they are strongly interested in a normalization in our relationships. They have also hinted that an increased role for Iran in the Bank could follow once Bank help would begin. There is no question that, given their extreme sensitivity (which is not new), it will not be easy to tackle policy matters, particularly with the technical ministries, but Dr. Ansary and Dr. Majidi are confident that, if handled adroitly, we should be able to reach common ground on any such matter, notwithstanding the highly centralized system of decision making in Iran (H.I.M. the Shah chairs Cabinet meetings on alternate weeks).

* As contribution to the first year operating capital; recently Iran agreed to provide a further \$20 million to OPEC Fund.

15. The government officials, including Dr. Ansary, were at pains to point out that, although in the recent past, the Bank felt rebuffed on some of its recommendations, e.g., in the case of tariffs on the Lar Project, where the negotiations were terminated, the Government had, in fact, later adopted the recommendations. Thus, they had raised water tariffs, although not to the same extent as the Bank had suggested; they had allowed for concessions for agricultural and other selected categories of users. Similarly, while the Bank's criticism of the organizational structure in the agricultural sector was not well received at the time (1970), it was taken into account in the recent reorganization of the sector (in December, 1976), which has been consistent with the Bank's (ARDAM's) recommendation (see paragraph 4). It was repeatedly pointed out to us that wherever the Bank's work touches upon issues of government policy, these matters can be resolved, provided that they are handled delicately.

Poor Performance of Ongoing Projects

16. As to poor implementation of ongoing projects, we have given the Iranians a candid presentation of the situation, and, at our suggestion, they have agreed that we should cancel the unutilized balance of \$15.9 million of the Population Loan (\$16.5 million, approved in May, 1973). We have also indicated that we propose not to extend the closing date of the Tehran Urban Transport Project in June, 1977, and to cancel the unutilized balance, and that we may do the same for the Fisheries Project unless there should be a dramatic improvement in implementation. Our Iranian interlocutors indicated they too felt such action to be the best solution, however they had not wished to initiate any movement toward cancellation, since they felt this might have been misunderstood by the Bank and thus further jeopardize the relationship. As for the other projects, Dr. Ansary was quite disturbed upon learning of patently unsatisfactory performance and he has undertaken to take a personal interest in following their progress, and has asked that his staff follow these projects with more diligence than hitherto!

Outstanding Offset

17. So as not to avoid the subject, we briefly mentioned the outstanding issue of offset arrangements. The Iranians stressed that one of the key causes of the misunderstandings was the offset arrangement agreed upon in February, 1974, because they felt it had never been clearly established exactly what the offset involved for them and whether it was commitments (as we insisted) or disbursements that should be offset. Thus, while expressing their readiness to meet their commitment to offset all loans received in FY1975, they felt that the arrangements should be fair to both sides. I did not pursue this matter further, except for noting their readiness in principle to consider settling the outstanding offset of about \$50 million, mainly because this clearly was not the moment to push this issue and also since we did not have prior clearance from Headquarters for acceptable alternative arrangements. The cancellation of undisbursed balances of two projects totalling about \$30 million is a point to be considered in this context.

Payment for Technical Assistance

18. During our stay, we obtained the MEAF's undertaking that the \$864,000 owed to the Bank for technical assistance (during FY76 and closing of ARDAM mission) would be paid forthwith. They explained that the delay in completing this payment was apparently because the Ministry of Agriculture and Natural Resources was unaware that funds for this payment were included in their budget. Whatever the real reason, the two Vice Ministers of Finance personally followed up on this matter for several days in order to arrange for actual payment but obviously not without Dr. Ansary's blessing. We were informed by the MEAF on February 21 that the money has been sent.

Conclusions and Recommendations

19. The attitude in Iran towards the Bank during this mission became remarkably different from that of the past two years. The Iranians categorically stated that they "need" Bank assistance, and that they are interested in receiving it. This they say is because without such outside assistance it might be difficult for them to sustain their very high development momentum and to achieve their goal of a 10-12 percent annual growth rate over a longer term. Also, they are prepared to review with us their economic parameters, which they say will indicate financial deficits for the Sixth Plan period. We are now analyzing the information presently available on the economy. They have also become conscious of the waste in their economy that has grown over the past three years, and have been instructed to cut such waste. Furthermore, they seem to be interested in pursuing progressive policies towards the types of social and regional objectives that the Bank has endorsed in other member countries, and they are asking for the Bank's advice and support in furthering these objectives. They were categorical that they propose no new aid commitments this year. Lending by the Bank to Iran may enable a continuation of Iran's aid to other countries. There is also the possibility of Iran's enlarged participation in the activities of the Bank Group if the Bank should respond positively to Iran at this stage. With respect to the views of the Executive Directors on Bank lending to Iran, the matter could either be left until a project is presented, or brought up - implicitly - through the means of an economic report, which could be distributed before the first project is presented. The Minister of Finance and his Vice Ministers have asked to discuss the economy further and in greater detail in April with Bank staff and to receive an economic mission in the fall; they would also be ready to have preparatory discussions on a proposed work program with the Bank on the operational side - which would cover arrangements for receiving Bank advice - in late April.

20. In view of (i) the positive gestures towards the Bank by Iran, beginning in Manila, (ii) Iran's highly commendable economic performance over the past 15 years, and the recent progressive policy initiatives of the Government, (iii) its potential economic and financial position in the years to come, and the possibility of its playing an enlarged role in the Bank, and (iv) its eminent creditworthiness and high absorptive capacity, I recommend that, even if the case of Iran's need for Bank assistance is marginal, we consider it favorably for such assistance and maintain flexibility in asking for a satisfactory quid pro quo.

21. Towards this end, I have agreed in principle with Dr. Ansary to proceed as follows:

- a. a small mission will visit Iran in late April when the 1977/78 oil revenue expectations and investment plans are likely to be more firm to obtain more details on the economy;
- b. we will also review with them in detail, but on a tentative basis, their views on a likely operational work program (technical assistance, sector work and selection of areas for possible lending) to be able to assess its budgetary implications;
- c. an economic mission will visit Iran in the fall of 1977 for an overall review of Iran's economic prospects and of the then drafted Sixth Plan.

22. In order to enable the definitely positive atmosphere to be sustained, I would like to recommend that you write shortly to Dr. Ansary referring to this mission, confirming your intention to consider Iran's case for Bank assistance favorably, which is in line with your observation at Manila that in view of the efforts the country was undertaking to address its problems in the area of economic and sectoral development Iran should be treated at least as equitable as comparable countries if not more favorably. Considering Dr. Ansary's wish to be instrumental in strengthening the World Bank by working out a formula that might specifically prove to be beneficial for countries such as Iran, I would like to suggest that in this letter you also express your interest in meeting him at a mutually convenient venue in Europe to discuss the matter further.

cc: Messrs. Knapp
Benjenk
Dubey

MSAiyer/MPaijmans:sap

FINANCIAL FLOWS IRAN/BANK^{1/}

Attachment C

(in million US dollars)

	Fiscal Years						
	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
<u>Transfer to Iran:</u>							
A) Disbursements of existing IBRD loans	101.5	167.2	153.9	138.2	86.4	33.9	18.0
B) Interest Payments on Loans to Bank (total \$350 million) ^{2/}	<u>4.0</u>	<u>20.0</u>	<u>28.0</u>	<u>28.0</u>	<u>28.0</u>	<u>28.0</u>	<u>28.0</u>
Total Transfer to Iran	<u>105.5</u>	<u>187.2</u>	<u>181.9</u>	<u>166.2</u>	<u>114.4</u>	<u>61.9</u>	<u>46.0</u>
<u>Transfer to IBRD:</u>							
A) Servicing of Existing IBRD Loans:							
Amortization	17.2	22.5	32.3	32.4	36.8	40.9	48.9
Interest & Charges	<u>21.7</u>	<u>30.5</u>	<u>40.0</u>	<u>50.2</u>	<u>50.9</u>	<u>52.9</u>	<u>52.0</u>
B) Loans to IBRD	<u>200.0</u>	<u>150.0</u>	-	-	-	-	-
Total Transfer to IBRD	<u>238.9</u>	<u>203.0</u>	<u>72.3</u>	<u>82.6</u>	<u>87.7</u>	<u>93.8</u>	<u>100.9</u>
<u>Net Transfer</u> ^{3/}							
A) To Iran	-	-	109.6	83.6	26.7	-	-
B) To IBRD	133.4	15.8	-	-	-	31.9	54.9

^{1/} Preliminary estimates, subject to revision. The purchase and retirement of Two-Year (Central Bank) Bonds are not included.

^{2/} \$350 million principal is due at the end of 12 years (1986) and only interest (at 8% p.a.) payments due annually.

^{3/} The cancellation of the undisbursed balance of the loans for Population and Urban Transport (\$15.9 million and \$23.8 million respectively) in the last quarter of FY77 would change the net transfer figures given above thus:

	<u>FY1978</u>	<u>FY1979</u>	<u>FY1980</u>
To Iran	17.4	-	-
To IBRD	-	41.3	58.0

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT
WASHINGTON, D. C. 20433, U.S.A.

OFFICE OF THE PRESIDENT

March 28, 1977

His Excellency
Dr. Houshang Ansary
Minister of Economic Affairs and Finance
Avenue Nasser Khosrow
Tehran, Iran

Dear Dr. Ansary:

I am writing to convey to you my personal thanks for the cordial, pleasant and constructive discussions that you had with Mr. Paijmans and his colleagues in Tehran on February 5. I was also very pleased to learn that the detailed discussions that our mission had with your colleagues and other officials of your Government provided for frank and fruitful exchanges of views between our two sides, and that they have greatly helped to clarify our respective situations and promise to pave the way for the renewed spirit of cooperation that we both feel should, at all times, characterize our relationship. We very much value your country's membership in the World Bank, and I would like you to rest assured that we in the Bank shall do all we can to be of use to Iran.

Our staff is now working on a broad analysis of Iran's economic position based on information received in February. On the basis of the understanding reached during the mission, we are arranging for a brief visit by a Bank economist in the next few weeks to review with your officials a first draft of that analysis. This should then provide a clearer view as to Iran's requirements and attendant policies and, thus, indicate the direction that cooperation with the Bank could take.

As Mr. Paijmans explained to you, we will then set ourselves the task, in the light of our current financial constraints and the decisions of the Executive Directors arising out of this, and in the light of the clarified needs and economic position of Iran, of exploring with you a workable financial relationship. I have taken note of the various points raised during the Working Group discussions, and I very much hope we shall be able to surmount the difficulties which might impede progress towards a substantive relationship satisfactory to both sides.

I also appreciate very much the sentiments that you expressed on the larger questions of the role and potential in the World Bank of countries such as Iran, which could be regarded as in the process of moving away from Part II to Part I status. This is a most important matter which deserves more thought, and one which I would be very interested in pursuing with you further.

His Excellency
Dr. Houshang Ansary

- 2 -

March 28, 1977

I am sure that the Bank can make a useful contribution in the context of the problems faced by Iran at this stage of its development in such areas as development planning, efficient resource mobilization, and structural reforms in various sectors of the economy. I was also pleased to learn of some of the recent economic and social policy initiatives of the Government, such as those aimed at reducing regional and personal income disparities and improving educational opportunities and nutritional standards. A comprehensive economic mission by the Bank could serve to highlight the details of these and other policy measures in an economic report distributed to our Executive Directors.

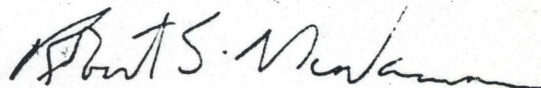
In order to move concurrently on all areas of interest, I understand that you indicated your agreement in principle to an economic mission which would include sector specialists to visit Tehran in the fall of 1977 for a detailed review of the economy and the draft Plan, with a view also to identifying possible areas that may be suitable for Bank activities, the basis for which we hope can be agreed upon before or at that time.

In order to enable us to discuss further the matter of workable financial arrangements and the overall place of countries such as Iran in the World Bank, I hope that it will be possible for us to meet at a mutually convenient time in Europe or elsewhere.

I look forward to hearing from you soon.

With kind regards.

Sincerely,




Robert S. McNamara

Cleared with and cc: Messrs. Knapp, Benjenk, Paijmans

MSA
SEISerafy/MSAiyer/MJWMPaijmans/MPBenjenk/JBKKnapp:pl
March 21, 1977

cc: For Mr. McNamara's Office (2)



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OFFICE MEMORANDUM

CONFIDENTIAL

TO: Memorandum for the Record

FROM: Martijn J.W.M. Paijmans, Director, EMENA CP I

SUBJECT: IRAN - Meeting with Mr. McNamara

DATE: September 26, 1977

DECLASSIFIED

APR 01 2013

WBG ARCHIVES

1. On September 26 Mr. McNamara met with the Minister of Finance, Dr. Ansary, who was accompanied by Messrs. Mehran, Governor of the Central Bank, and Kooros, Deputy Minister of Finance, as well as Mr. Amuzegar, Iran's Executive Director at the IMF. For the Bank attended Messrs. Knapp, Benjenk, Burmester and Paijmans.
2. Mr. McNamara mentioned to hope that our next step, an economic mission, would be helpful, also in view of the technical assistance it could provide through its analysis, assistance which he understood was actively sought by Iran.
3. Mr. McNamara explained the still difficult resource situation of the Bank and IDA which, together with increased awareness of serious and unfilled needs in the developed countries, did not make a resumption of lending to Iran easy. Nevertheless, he personally backed lending to Iran. However, he had to be in a position to demonstrate that Iran was making contributions to development aid flows. If a formula could be found for this aspect Mr. McNamara thought that an active program could be worked out combining the technical assistance and advice actively sought by Iran with financial flows possibly in the order of magnitude of \$150-200 million. This amount, although not very large, was based on an estimated 6 projects per year, thus allowing a broad sector coverage, for approximately \$30 million each. Mr. McNamara explained however that number of projects and areas of involvement would be open for discussion with the Iranian authorities. He mentioned that from its side the Bank would for example be interested in being involved in employment creation and low per job capital investment projects but he observed that Iran might not feel this to be an area for immediate cooperation.
4. Dr. Ansary emphasized the beneficial character of the active Iran-Bank relationship of the past and appreciated the progress that was being made in reactivating this relationship. He welcomed the forthcoming economic mission. The possible amount of lending was not very high he said but he understood its basis. Iran's favorable attitude vis-a-vis the developing countries was well known, the Minister said, and was regularly reported upon. He had interpreted Mr. McNamara's observations to that effect to mean that more emphasis should be put by Iran on its aid policies and to have understood that he should look into coming up with a specific reaction to Mr. McNamara's proposal for example by earmarking part of what was now bilateral aid for IDA contributions.
5. The Minister said that on the details as to the shape of lending operations, these details could be worked out by the staffs, he would concentrate on the main issue and he took it upon himself to be back to Mr. McNamara with an answer.

cc: Mr. McNamara's Office (2)
Messrs. Knapp, Cargill, Benjenk, Aiyer

MPaijmans:sap