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13 December 1979

PRIME MINISTER'S VISIT TO WASHINGTON

17 - 18 DECEMBER 1979

IRAN AND GULF SECURITY

Brief by Foreign and Commonwealth Office

POINTS TO MAKE

The Iranian Crisis

1. Reassert Britain's full support for US. Admire President's firmness and restraint. Important to concentrate on hostages: Iran's weakest point. Persistence and patience offer best hope. A long haul but our Ambassador in Tehran believes diplomatic pressure plus maximum use of intermediaries needed now.
2. Appreciate strong feelings in US. Had report of Vance's Brussels discussion of need for further actions. Prepared to pursue Chapter VII measures with you once we have ICJ decision. Chapter VII will remove many of our legal problems. But need to get widest consensus. We must remember British Embassy and community next in line as target. When it comes to choosing /actual

actual sanctions must also remember world financial system, energy balance and stability of friendly Gulf States all fragile. Further measures could have unforeseeable repercussions.

Possible Measures against Iran

3. (i) Freezing Assets

No existing legal powers unless there were Chapter VII UN Resolution. Even so grave doubts over action which could inflict serious damage on world financial system, just when we need it to re-cycle OPEC surpluses. Real danger oil producers will prefer to leave oil in ground if they lose confidence in security of their financial assets.

(ii) Oil Embargo

Loss of Iranian supplies could damage West as much as Iran. But prepared to consider joint action to resist high spot prices after OPEC meeting (17-18 December). Again no legal powers, but persuasion might work. Japanese must co-operate.

(iii) Ban on Arms Sales

We are not exporting arms ammunition or military spares, although (like the US) we have contractual obligations. Reluctant to make formal and explicit ban: could endanger Embassy and leave field open to Russians. But assure you our intention is no arms will be shipped until hostages released.

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(iv) Other measures

Break in relations or in air services could make some impact. But we believe our Embassy is of great value in present crisis. Ban on food sales or trade boycott need Community action. ECGD have been off cover for Iran since February.

Effect on the Gulf Area

4. West is now in difficult patch in Muslim world. Much at stake - oil, commercial market and the geopolitical balance. Iran is likely to be unstable for a substantial time, even if Khomeini dies or is overthrown. This instability could infect or affect others.

5. Soviet policy ambivalent. They will fish in troubled waters and take advantage of West's difficulties and mistakes. If present crisis ends in a break between Iran and the West, the Russians will try to catch Iran on the rebound, hoping for eventual takeover in Tehran by Left. Yet they are nervous about their own Muslim minorities and have problems in Afghanistan.

What should the West do?

6. First recognise limits on effective action by us. Much of this instability is domestically generated. We have no ready-made solutions to offer.

7. Nor must we show excessive anxiety about the possible effect of events in Iran on neighbouring countries; if we
/do

do so, we risk creating self-fulfilling prophecies. Although the Grand Mosque incident and Shi'a agitation in the Eastern Province pose questions about Saudi security, they do not mean that Saudi Arabia is about to go the same way as Iran, and speculation that it might can be damaging.

8. We do have some cards in our hands. We are not trying to impose Western models. The Islamic revival is potentially as anti-Soviet as it is anti-Western. Soviet policies in Afghanistan and South Yemen (PDRY) are far more worthy of criticism by the Islamic and non-aligned world than anything which the West has done. We must put across our understanding of Islamic sensitivities and not judge all Muslims by Khomeini.

9. After the present crisis, depending on the fate of the hostages, we must maintain a dialogue with the Iranians; if only to counter the myth that will be put about by the Soviet Union and others that the West had turned its back upon the Iranian revolution. Iran is a large power in local terms and has tradition of resistance to Russian pressure.

10. Outside Iran, one of the best antidotes for the current wave of Iranian and Shi'a extremism is local Arab nationalism. We should keep in close political touch with Arab rulers (even Iraq, where France and Britain may play useful roles). We must respond to requests for help over military training and equipment from the smaller countries in the area. We should welcome and discreetly assist the development of closer co-operation among them without pushing them faster than they are prepared to go themselves.

/11.

11. Must remember that stability in the Gulf area will also be affected by progress towards Middle East peace settlement. Clear that even traditional rulers attach great importance to a settlement, both out of conviction and because they feel vulnerable to domestic criticism of their friendship with the West which is labelled pro-Israeli.

12. Fragility of Gulf area likely to be chronic. We must reduce our dependence on imported oil. Do not believe military intervention to secure oilfields would help (except in worst case).

RN Ships in Indian Ocean (Defensive)

13. Our Task force returned from Indian Ocean as planned in late November. We received no US request to hold it in the area.

BACKGROUND

THE US AND THE CRISIS

1. The attached paper (MISC 27(79)3) sets out American action since the crisis began and examines options for further measures, and their likely effect on British interests.

IRAN INTERNAL

2. Khomeini successfully used the Embassy crisis and a wave of anti-US xenophobia to drum up support before the Referendum for the new constitution on 2 December. The 98% (of those voting) in favour was tarnished by the disturbances among Ayatollah Shariat Madari's Azabaijani followers in Tabriz. Economic problems (inflation, unemployment and falling oil production) have not yet eroded Khomeini's mass support but they are getting worse.

BRITAIN'S ROLE

3. After the Americans we are the next most likely target for Iranian xenophobia. We have concentrated, with the Nine, in putting pressure on the Iranian Foreign Minister (since 28 November Mr Sadeq Gotzbzadeh) and on making public statements of support for the US. We are not mediating, but we are reporting facts and interpretation promptly to the US, who have been very appreciative. We have 21 Embassy staff and 6 dependants in Tehran. Our community is down to about 300. There are Royal Navy ships in the area. British Airways

/flights

flights were suspended as pilots were reluctant to fly into or over Iran at present. There is a considerable Iranian community in Britain (estimates range from 60 - 100,000) and low-level incidents are exploited by the Iranian Embassy here to sour relations. Our exports (January - October 1979) were £180m (the 1978 figure for the same period was £654m), and Iran provides about 5% of our crude oil imports.

GULF SECURITY

4. The smaller states of the Gulf which took the first after-tremors of the Iranian revolution in their stride, are now in a nervy state as a result of the US/Iran confrontation and the Grand Mosque incident. There have been demonstrations against the United States in Kuwait and Dubai and the Saudi Shi'a community rioted on the religious festival of Ashura (30 November). US freezing of Iranian assets has disturbed the better-off (however much they dislike Khomeini) as a dangerous precedent and could lead to renewed pressure to keep oil in the ground.

5. The traditional rulers face threats from:

- (a) The Shi'a elements in their population. These are a majority only in Bahrain where the ruler has managed to contain the threat so far. In other states, we believe the rulers will suppress Shi'a agitation and the latter risk being branded as Iranian Fifth Columnists.

/(b)

- (b) Puritanical religious opposition. The traditional rulers have made every effort to keep closely in step with religious opinion. But their private lives are often far from Islamic and the scale of corruption is immense. Fanatical religious groups, which were discounted as a political threat until the Mecca outrage, will now need to be taken more seriously.
- (c) Arab nationalist feeling. There is dislike of the rulers' Western connections and a feeling that they are not pressing the struggle against Israel. This has not yet taken a defined political form but it could be dangerous, particularly in the officer corps.
- (d) Social discontent and dislocation. Many of these states have leapt from a tribal economy into the consumer society in one generation. Although their inhabitants have been protected and considerably enriched, there could still be resentment at expatriates and symbols of westernisation. But because the bulk of unskilled workers are imported from abroad, the indigenous inhabitants of the states are, by birth, well-established on the social ladder.

6. These different elements could fuse if a crisis were provoked by US military action and the effect on friendly rulers could, at worst, be destructive, and, at best, render them less sympathetic to the West and more inclined to reduce oil production.

RN TASK FORCE IN INDIAN OCEAN

7. We could be criticised for allowing the naval Task force returning from the Far East to come back through Suez in the normal way in late November. We received no request from the US to direct this force and believe its presence near Iran would have increased the danger to our own Embassy and community.

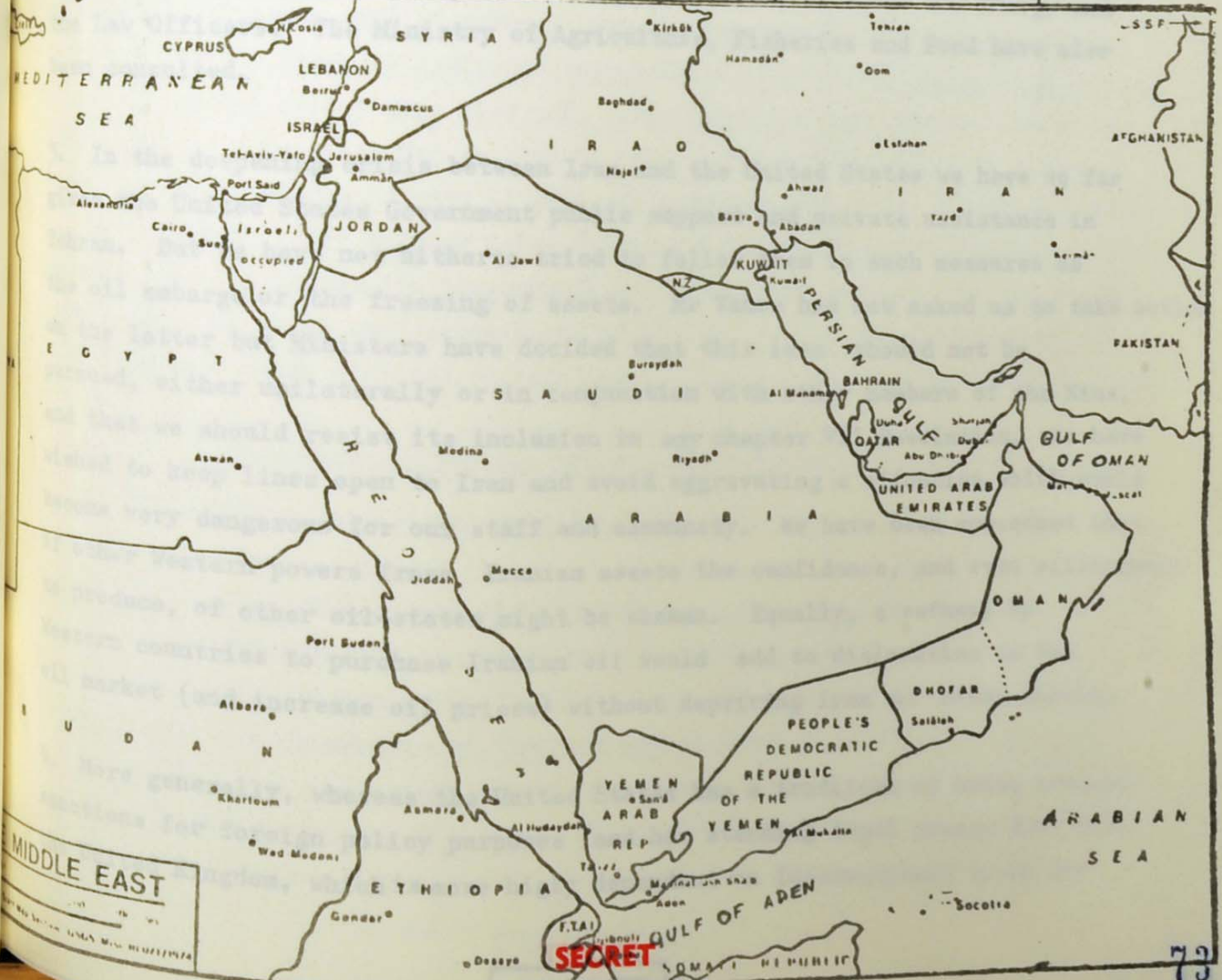
8. Attached are:

- (i) Fact sheet on the Arab Gulf States;
- (ii) Report on the Non-military Options for the US, and International Pressure. (MISC 27(79)3).

Foreign and Commonwealth Office

13 December 1979

	Population	Shia	Oil Production	British Exports Jan-Oct 1979	British Community
	Millions		mbpd	Millions £	
Iraq	12	55%	3.4	£ 166.6	2,300
Saudi Arabia	7.5	2%	9.5	£ 743.0	20,000
Kuwait	1.3	15%	2.10	£ 201.4	6,500
Bahrain	0.34	55%	0.053	£ 107	7,500
Qatar	0.2	25,000 Iranian Shi'a	0.48	£ 84.2	4,500
UAE	0.86	Some Iranian Shi'a in Dubai	1.83	£ 413.6	14,000
Oman	0.8	Negligible	0.3	£ 104.1	4,325
TOTAL	23	-	18.14	£1819.9	59,125



INTRODUCTION

1. This study considers -
 - i. possible further non-military means open to the USA to bring international pressure to bear on Iran, either to release the Embassy hostages or as retaliation if they were harmed;
 - ii. what the United Kingdom might be asked to do as part of the application of such pressure;
 - iii. the effectiveness and consequences of different forms of pressure, including the consequences for United Kingdom interests;
 - iv. any ways in which we might help the American government without incurring unacceptable damage to our own interests.

2. The study was conducted under Cabinet Office chairmanship and with the participation of the Treasury, Bank of England, Home Office, Foreign and Commonwealth Office, Ministry of Defence, Departments of Trade and Energy and the Law Officers. The Ministry of Agriculture, Fisheries and Food have also been consulted.

3. In the deepening crisis between Iran and the United States we have so far given the United States Government public support and private assistance in Tehran. But we have not hitherto tried to follow them in such measures as the oil embargo or the freezing of assets. Mr Vance has now asked us to take action on the latter but Ministers have decided that this idea should not be pursued, either unilaterally or in conjunction with other members of the Nine, and that we should resist its inclusion in any chapter VII Resolution. We have wished to keep lines open to Iran and avoid aggravating a situation which could become very dangerous for our staff and community. We have been concerned that if other Western powers froze Iranian assets the confidence, and even willingness to produce, of other oil-states might be shaken. Equally, a refusal by Western countries to purchase Iranian oil would add to dislocation in the oil market (and increase oil prices) without depriving Iran of other markets.

4. More generally, whereas the United States has a tradition of using economic sanctions for foreign policy purposes (and has standing legal powers for this), the United Kingdom, which is more highly dependent on international trade and

investment than all other major countries, has disliked as a matter of policy and interest the use of civil economic weapons for political purposes, except under the authority of and with the near universal applicability entailed by a mandatory United Nations Resolution. Experience in the use of economic weapons is that they have had little success and, even when in theory universally applied, have been very slow acting. And their use unsanctioned by international law has serious consequences for international economic relations.

5. But these factors need to be balanced against the right of the Americans to look to us for all possible support and our interest in helping avoid any risk of them becoming resentful towards their allies or reckless in their policy towards Iran if helpful advice and support is not forthcoming (see paragraph 11 below).

6. We take it as axiomatic that wherever possible we should act in concert with other countries, particularly with the Nine (on civil trade matters the Community can only act as one). By this the effectiveness of any measures will be enormously enhanced and our own exposure in Iran reduced (although our ties to the United States in Iranian eyes mean that we shall always be very much more exposed than our Partners). The West should also try as far as possible to ensure that any pressures it applies can reasonably be presented as justifiable under international law even if they cannot be given the cover of a mandatory United Nations Resolution under Chapter VII. This is particularly important for the United Kingdom and all countries other than the United States not directly involved in the dispute (see Annex A). Mr Vance's talks on 10 December fortunately showed that he had this point very much in mind.

ACTION ALREADY TAKEN BY THE UNITED STATES AND OTHER GOVERNMENTS

7. President Carter has embargoed oil imports direct from Iran. He has also made an order on 14 November to freeze all Iranian assets held in the United States and deposits held with United States banks abroad; the latest United States Treasury estimate of the total involved is \$8 billion (\$4 billion in the United States, \$3 billion on deposit with United States banks in London, and \$1 billion elsewhere). The Americans say the action was made in response to Iranian threats to withdraw their assets from the United States and to do so in a manner designed to hit the dollar. The

Iranians have now started legal action to withdraw their deposits on United States banks in London. Given the possibility of appeals it could take until spring to resolve. We would expect them to win since our understanding is that English law would be held to apply to the contract; and we think there would be a similar result in most if not all the other countries outside the United States where the Iranian Government holds deposits with branches of United States banks. But the situation is confused by other parallel legal actions relating to syndicated bank loans, and by conflicting statements on Iran's attitudes to its foreign debt commitments (Annex C).

8. The United States have initiated proceedings in the International Court of Justice and are pressing for an early decision from the Court on interim measures. We believe they have a good chance, perhaps within days, of getting such a decision calling on Iran to release the hostages. But there will be no means of enforcing this and the Iranians are almost certain to ignore it as they have done the Security Council Resolution. Such inaction by the Iranians will not of itself provide the Americans with legal grounds for further economic or for military action. But it could strengthen the case for Chapter VII action by the Security Council; the court automatically notifies the Security Council if it makes any order for measures. Chapter VII action could still be very difficult to obtain (see Annex A).

9. The Nine have protested on a number of occasions to the Iranian Foreign Minister against the Iranian action in holding the hostages. Foreign Ministers issued a statement in Brussels on 20 November to this effect which was followed by the Dublin declaration by Heads of State and Government on 30 November. The Commonwealth too have called for the release of the hostages. Many other countries in neither group have made diplomatic representations in Tehran. The Security Council adopted unanimously on 4 December a Resolution calling for the unconditional release of the hostages.

10. The United States have already made many efforts to mobilise non-aligned or Moslem intermediaries to intercede with Khomeini, so far with no success. They are encouraging an approach by the PLO. They may however not have exhausted all such avenues of approach and it could be worth going over this ground with them. President Assad of Syria is a Shi'a Moslem with international standing and good relations with Khomeini who might be considered; a major non-aligned figure such as President Tito might also be tried.

UNITED STATES INTERNAL PRESSURES

11. So far the President has won much support from the American public for his balance of restraint and limited action. The issue has become electorally very important to him and if the hostages are harmed or if the present situation of deadlock drags on there will be pressure for further United States action. Some United States frustration has already been vented (though not by the Administration) in increased irritation at the lack of supporting action, beyond verbal condemnation of Iran, by other Western countries. The United States is now starting to turn to its allies for supporting action and if it feels unreasonably rebuffed this could have damaging consequences extending well beyond the immediate issue and affecting future overall relationships within the Western alliance.

OTHER INTERNATIONAL ASPECTS

The Soviet Angle

12. The Soviet Union has taken a "correct" view of the seizure of the United States Embassy; has found it difficult to attain a working relationship with Khomeini, who has been consistently anti-Soviet; and must be concerned that the Islamic revival could infect its Muslim republics. But further measures against Iran by the West could lead to the total severance of ties and oblige Iran to turn to the Soviet Union for political, economic and even military support. Prevailing Iranian anti-communism and distrust of Russia could undoubtedly be set aside if Khomeini so instructed and if opinion felt that the Soviet Union was the only true friend of the Iranian revolution. The Russians could lay the foundations for an exclusive relationship with the successor regime to Khomeini. A close relationship between Russia and Iran could totally change the military balance in the area and increase the danger to our oil supplies. The prospect of a major East/West confrontation in an area where the borders of influence are confused would then be very real, particularly if the United States imposed a blockade or took any other form of military action.

Arab Opinion

13. None of Iran's Arab neighbours have any time for Khomeini and they are certainly worried by the Iranian revolution. They have reacted with surprising cohesion to Iranian threats to Bahrain and even Iraq seems ready to defend the Gulf status quo. The seizure of the Grand Mosque in Mecca will have made them particularly jumpy, and undermined their confidence in

Saudi internal stability. In any further upsurge of sectarian tension popular anti-Western feeling could run high - particularly in states like Bahrain, Kuwait and the UAE where there are substantial Shi'a communities - and governments, fearing for their own stability, would be unwilling to take a pro-Western line. Against this background, the Arabs may react with alarm and hostility to any measures taken by the West which suggest either military measures against Iran or further interference with the assets of oil producers.

Third World Reactions

14. While most Third World states have up to now supported the Americans and the cause of diplomatic immunity, there is a danger that if tension increases the original reasons for the dispute may be forgotten and it will be seen in stereotyped Third World terms as a dispute between American imperialism and an exploited and oppressed Third World power. The implications for Western interests generally could be serious.

EFFECT OF POSSIBLE MEASURES ON IRAN

15. A list of possible measures, together with an assessment of their likely effects is at Annex B. None of these measures would exercise so crushing an effect that they would either immediately shake Khomeini's hold on power or force the Iranians to release the hostages. In the short run they might rather increase the anti-Western xenophobia in Iran which is a major factor in Khomeini's dominance, and increase the risk to the hostages and to Western embassies. But it would be unwise to assume that they would have no effect and that they could not in any way contribute to the release of the hostages. The problem both for the Americans and their allies is that although we can assess the capacity of various measures to damage Iran's economy etc we are quite unable to predict with any accuracy and certainty what their effect will be on Khomeini and the Revolutionary Council or on those actually holding the hostages.

16. The United Kingdom is particularly exposed to retaliation due to its link in Iranian history and mythology with the United States and the staff of our Embassy could very easily be put at risk. In the economic field it cannot be assumed that any Iranian retaliation against further US or Western measures would necessarily be in the field of those same measures or be limited to it. But the two major options open to them would be to withhold oil supplies (or sell only at very high prices or on the spot market - which is already their response to shell and BF over supplies for next year) or to withhold the considerable payments already due for imports.

DESIRABILITY OF AVOIDING MILITARY ACTION

17. The various options for further non-military action against Iran by the United States, and, if they agreed to United States pressure to join them in such action, by their main Western allies, cannot be considered in isolation from the possible consequences of military action by the United States for Western interests in Iran and the Gulf region. (The options for such military action are the subject of a separate study by the JIC.) These consequences could be extremely serious. The region is already in an unstable state following on the Iranian revolution, the United States/Iran confrontation and the attempt to seize the Grand Mosque in Mecca. Armed action by the United States could endanger the survival of the traditional regimes in the Gulf States and thus affect Western oil supplies and commercial opportunities, as well as the general world political balance. Even a quick limited punitive strike by the Americans following the death of some or all of the hostages would run most of these risks.

CONCLUSIONS

18. We have tried, in the short time available, to identify additional non-military options for the United States, alone or with other countries, which might be both feasible and effective as pressure on Iran. But the detailed assessments of the various measures set out at Annex B are far from encouraging. None offers much hope of bringing the release of the hostages and even the mildest of them, eg the suspension of diplomatic relations or imposition of additional immigration controls, would involve some additional risk to the hostages, to our residual staff in Iran (who must also be regarded as hostages in some degree since the Iranians might prevent their withdrawal) and to our trade and other interests.

19. It would undoubtedly be possible for the Nine, if they acted in concert and with the Americans, to inflict serious damage on the Iranian economy and discomfort on the people of Iran. But most of the options at Annex B would take practical effect only in the medium term although they might have some immediate demonstrative and psychological effect. There is too the real possibility that economic measures could hurt us more than they hurt Iran, not because that country has particular scope for counter-measures but because the repercussions in the world financial and energy fields could be

seriously unsettling at a time when the structure of the world economy appears fragile and when political stability in the Gulf area is less certain than for many years. There is a strong case for concentrating on the nub of the problem - the release of the hostages - through diplomatic means and avoiding over-reaction which may well cloud the issue and have far-reaching consequences for energy supplies, the world economy, East/West relations, and for the West's relations with the Arabs and the Third World.

20. The main hope therefore lies in a continued policy of patient diplomatic pressure within the normal bounds of international law - despite the difficulties this restraint may come to involve for President Carter with his domestic opinion. Further delay and restraint carries least risk to the hostages and offers a chance of Iranian second thoughts.

12 December 1979

UN CHAPTER VII ACTION

1. The desirability of acting within a broad framework of international law poses a particular problem in the context of suggestions for retaliatory action by others than the US. Whereas the US can reasonably found such action as they may be contemplating on their right of self-defence set out in Article 51 of the UN Charter and **can**, or may be able to, point to the exhaustion of other remedies (UN Security Council Resolution, International Court of Justice), the position of other countries, including the UK, is less clear cut. It would be possible to base an argument on the fact that the Iranian action is so serious a breach of general and not just bilateral international obligations that counter action by others than the damaged party is justified; but there would be considerable reluctance by many countries to accept this, both on legal and on political grounds. This underlines the significance of Chapter VII determination.

2. For the UK and for many other countries not directly involved in the dispute a UN Chapter VII resolution would remove many of the domestic legal problems of introducing the sort of measures under consideration. Our Permanent Representative says 'with virtual certainty' that there would not be enough support (nine affirmative votes) for a resolution; and he thinks it almost certain that the USSR would veto. But it could still be useful for the USA to try. Apart from its merits in legal terms and as a means of mobilising world opinion there is the additional point for the UK that any failure by the Security Council to approve sanctions in the case of Iran might strengthen our arguments over the next few months, particularly with the USA, against any move for sanctions on South Africa. The converse would be less true as any sanctions on Iran would not be an unquestionable precedent for the South Africa case.

POSSIBLE OPTIONS FOR NON-MILITARY MEANS OF PRESSURE

INTRODUCTION

1. The assessments given below of the likely effectiveness and consequences of various measures need to be seen against the very different timescales and purposes of inducing the Iranians to free the hostages and of possible retaliation if they were harmed. Given the unstable and emotional situation within Iran it is not possible to differentiate clearly either the likely effectiveness of various measures as potential leverage on the Iranian authorities and on those actually holding the hostages or the degrees of risk to the hostages which each might involve. But it must be assumed that any Western measure against Iran will involve additional risk to the hostages and to Western missions and that the more dramatic and effective the measure the greater the risk. Equally the more the United Kingdom stood out as taking the initiative or acting in isolation the greater the risk to our staff and interests.

2. Paragraph 3 looks first at the wider adoption of the measures already taken by the US. Paragraph 4 then lists and assesses further measures which the US might adopt, alone or in the company of other countries, and does this very roughly in order of increasing severity.

MEASURES ALREADY TAKEN BY THE US IN ISOLATION

3. A. OIL EMBARGO

(i) US requests could take basically 3 forms -

- (a) an extension of their existing partial embargo (ie a refusal by other countries to take Iranian oil that would otherwise have gone to US companies);
- (b) a total embargo on Iranian oil imposed by all Western countries;
- (c) a refusal to pay high prices for Iranian oil.

(ii) The first would affect not more than 1 m bpd of Iranian oil and be unlikely to have severe consequences for the Iranian government. They would still be able to find Third World and other purchasers for the quantity of oil not taken up by Western countries.

(iii) The second, a total embargo, if it led to a virtual cessation of Iranian production except for local needs and for some third countries, would ultimately be much more serious for Iran. Oil sales are virtually its sole source of balance of payments revenues. She would be able to live

off her resources for at least a year using some \$3.5 billion of unfrozen free reserves for essential imports* but over that time she would run into a serious situation. However for the Western world the consequences would also be serious. The loss of Iranian supplies would probably not be sufficient in itself to trigger the International Allocation scheme as a whole. But it might be sufficient to do so for some countries such as Japan and lead to pressure for the application of the Scheme as a whole. Lower oil supplies would also lead to steep increases for world oil prices. For each \$5 a barrel increase OECD economic growth might be reduced by 0.75 per cent and the rate of inflation might rise by 1.25 per cent.

- (iv) So far as UK interests are concerned, both we and the Community now seem likely to be dependent on Iranian oil to a very similar extent, ie around 5 per cent of total supplies. However if a partial or total embargo were not effectively applied by all countries BP and Shell who are both significantly short of crude supplies would be hard hit. But it is possible that supplies available to them from Iran will in any event be substantially reduced next year.
- (v) Iran is now asking customers to pay exceptionally high prices for oil in 1980 irrespective of the outcome of next week's OPEC meeting in Caracas. The question of combined Western action to refuse such terms raises difficult issues of international oil policy which require separate consideration, if possible, after Caracas. Any action would have to be backed by all important Western countries including Japan. If Ministers were to decide on other grounds in favour of resistance to Iranian price demands that could be presented to the US Administration as a positive move: and if combined Western action were to prove possible that could be helpful with US public opinion.

*Iran also has yet to receive payment under the normal 60-day credit terms for oil already exported. This represents a further \$4.5 billion or so.

B. FREEZING IRANIAN ASSETS

- (i) The Americans have now asked us to freeze all Iranian assets in the UK and have presented opinion arguing that this is possible for HMG under existing UK legislation. Ministers have since decided against this, even in conjunction with other members of the Nine, and to resist any suggestion for its inclusion within a Chapter VII Resolution.

(ii) The Americans have put forward legal arguments about the use of our Exchange control Act powers. The Attorney General has concluded that they are probably wrong. His view is that if the Government were to use those powers as a purely political action there was more than an even probability that the Courts would hold that we had acted ultra vires. In the absence of safe powers under the Exchange Control Act on the Emergency Laws (Re-enactments and Repeals) Act 1964 new primary legislation would be needed (see also (iv) and (v) below)

(iii) In almost any conceivable circumstances such action on our part would be very damaging both to ourselves and to the West generally and likely to be ineffective. It would undermine one of the main foundations on which one of our most successful economic assets - the British banking community and the City of London - has been built. It could also seriously affect the world economy, particularly by reducing the faith of Arab oil producers in the security of their funds and thereby giving them further incentive to leave their oil in the ground; and by affecting the system's ability to recycle OPEC financial surpluses to the countries in need of them.

(iv) We have considered whether these difficulties could be substantially reduced if the freezing action were done in a way that was precisely related to the purpose of supporting the Americans over the hostages and did not extend wider. The important considerations are:-

- a. There should be agreement for similar action by a sufficiently large number of countries, preferably all EEC and other major financial countries including Switzerland, Japan and Canada. No doubt many of the countries concerned would, like the UK, need to pass legislation of their own to give effect to such an agreement. Collective action of this sort would help to make the freeze general enough to be effective, and would also reduce the risk of undermining the reputation of London as a safe haven for OPEC and other Third World assets in comparison to other main financial centres.

- b. Such action would need to be taken simultaneously and rapidly in all countries concerned, to avoid the danger of leaks and pre-emptive withdrawal of assets by the Iranians.
- c. The action would have to be specifically related to the hostages, and Iran's violation of international law and breach of the Vienna Convention. The UK legislation would state that it was to lapse as soon as the hostages were released (or by order, to cover other contingencies).
- (v) The Treasury and the Bank of England would have considerable reservations about the practicability and risks of such legislation, even when circumscribed in this way. In any case it is very unlikely that the conditions above would be met (especially simultaneous legislation in so many countries).

NB Iranian deposits with UK banks (at end September) amounted to around \$7 billions, of which some \$3 billions was with US banks and \$1½ billions with British-owned banks. These sums would not necessarily all be official Iranian balances as frozen by the US. Total UK banking claims on Iran amount to \$5½ billions, of which about \$2 billions to US banks and \$¾ billion to British-owned banks. \$400 millions of the Iranian government loan to the National Water Council is still outstanding. We know of no other large official Iranian investments in the UK. There are no up-to-date figures about direct and portfolio UK investments in Iran but those that are left may be worth a few million pounds.

ADDITIONAL MEASURES THE US MIGHT ADOPT, ALONE OR WITH ITS ALLIES

4. A. BREAK IN DIPLOMATIC RELATIONS

- (i) On 14 November President Carter asked the Prime Minister to reduce the size of our Tehran Embassy. He might yet ask us to sever relations. The Nine have all run down their missions in Tehran. Although our Embassy is still larger than others of the Nine, we shall be down to 21 staff and 6 dependants by Christmas (from a total of 86 at start-November). It would be

possible to withdraw Sir J Graham, "for consultations" without risk. If all the representatives of the Nine followed suit this could make some impression. But we should deprive ourselves of excellent advice and reporting, and the Americans would probably argue against such a move until the hostages are released.

- (ii) A formal break of relations and departure of staff would have to be handled with extreme care. Britain remains public enemy number two and there is a real possibility that our staff at least might be prevented from leaving. It would be necessary to run down our posts without publicity and only announce a formal break when the number of potential hostages was reduced to a minimum. If relations were broken off, we could expect our two large compounds (rough value £70 - 80 million) to be sequestered and it might be impossible ever to regain them, although eventually we might get compensation. We should leave our hard-core community (300 - 400) exposed, but those concerned know the risks and have chosen to live in post-revolutionary Iran. We should also wish to reduce Iranian missions in Europe in size (and this would reduce the revolutionary government's control over their communities outside Iran).

B. IMMIGRATION CONTROLS

There are no complete statistics of the number of Iranians here but we have a tentative estimate that there are 20,000 Iranian students alone. Several hundred Iranians a day still arrive at Heathrow. More are refused entry than any other nationality but we are limited by the Immigration Rules and the number of doubtful cases is so great that Immigration Officers have to concentrate on the worst cases and accept that others will slip through. Many Iranians already here or arriving are not supporters of Khomeini. The US Administration's attempt to take selective action over Iranians already in the United States has run into difficulty in the Courts. But their visa requirements give them full and flexible control over new arrivals and the Home Office view is that we badly need such control over Iranians arriving here. If, however,

we introduced a full visa requirement this would be unlikely to help in any way to free the hostages although if seen as a gesture in support of the Americans rather than as a measure taken purely out of the UK's own needs it could increase the risk to our Embassy staff and their numbers would have to be increased to operate the new requirement. We have recently warned the Iranians that we may need to introduce tighter controls unless they themselves can reduce the flow (see the Home Secretary's letter of 16 November and the Foreign and Commonwealth Secretary's reply of 27 November - not attached).

C. BAN ON ARMS SALES

- (i) The MOD have contracted to supply some tank spares and ammunition to Iran. Ministers agreed in June 1979 that, subject to satisfactory financial arrangements being made, these deliveries should proceed. Appropriate payments of sums due have now been made and necessary letters of credit opened and the MOD is ready to recommence supply. No spares and ammunition have been supplied since the hostages were taken in early November and Defence and FCO Ministers have agreed that for the time being no supplies should be declared for shipment and that administrative delays should be offered as the excuse if one is called for. This is the current position.
- (ii) An overt Arms Embargo would do no immediate damage to the Iranian Government but the Armed Forces are eager to obtain delivery of spares and ammunition which they must have if they are to be used as effective instruments of law and order. They can therefore be expected to press for supplies in due course.
- (iii) Apart from these the only other item of defence equipment likely to become available for delivery in the near future is the Fleet Replenishment Ship 'Kharg' being completed at Swan Hunter's Tyneside yard which might be ready to sail, if final bills were paid, in February 1980.

- (iv) An overt Arms Embargo might thus deprive the Ministry of Defence of £30 million of current business and inevitably the final loss of perhaps as much as £100 million in respect of sums due for earlier supplies and services. The Defence Industry at large would also be likely to forfeit all prospect of recovering debts currently owed by Iran, amounting to £150 million or more, as well as the prospect of all future business with Iran. The United Kingdom has been the second largest supplier of arms after the United States.
- (v) We should always use extreme care in applying an Arms Embargo as a political measure as this risks our reputation as a reliable supplier and has, in the past, seriously damaged our trade. In this case we should only contemplate doing so if our Community Partners were ready to declare a total embargo.
- (vi) A US/EEC boycott could have a very serious effect on the efficiency of the Armed Forces as time progressed. Iran would be able to rely on the Soviet Union for new purchases but this would involve the virtual write-off of an immense inventory of advanced Western equipment. A step of this kind would leave arms supplies almost entirely in the hands of the Soviet Union, whose political leverage would be enormously increased (cf, Ethiopia in 1976).

D. BREAK IN AIR SERVICES

British Airways stopped serving Tehran under pressure from their pilots but services are now likely to resume. To stop the Iranair service between Tehran and London would be to breach our treaty obligations to Iran, unless there was a mandatory UN resolution. Stopping of air services largely as a political gesture by major countries would be a bad precedent, encouraging such action by others. Iranair are currently earning about £1 million gross revenue per month from this service (BA's earnings are about the same and they are also carrying many of the passengers on to the USA), but loss of that would be no more than a pinprick, and the Iranian and foreign passengers affected are those least likely to concern the Iranian regime. All air services between Tehran and London could not be stopped without stopping a Pakistan International Airlines' service as well. The inconvenience caused to passengers would in any case not be severe, since there are alternative routes available via the Gulf and Eastern Europe.

E. BAN ON FOOD SALES TO IRAN

i. Food imports are a particularly vulnerable point in Iran's economy. In 1978 she imported food worth \$2 billion. This figure has probably increased this year. There have been extensive grain purchases from the United States, Canada and Australia and purchases of foreign meat from Australia and New Zealand. This has probably provided Iran with stocks for some months at least if further imports were now cut off, but it is doubtful whether new sources could make up for any interruption in the third of their grain normally supplied from Western sources.

ii. The United Kingdom could only take action as part of a move by the Community as a whole, which in turn should have the backing of an appropriate United Nations resolution binding on all member countries. Only 3 per cent of the Community's exports to Iran consist of food (United Kingdom food exports to Iran in 1978 may have totalled about £15 million). Any United States request to the Nine for action would presumably be preceded by equivalent action by the United States itself given its own role as a major supplier.

iii. Although Iran is very vulnerable on this point it would have to be kept in mind that, besides the inevitable risk to our staffs in Iran and to other Western interests, a concerted Western embargo on food exports would be particularly calculated to arouse Third World and other sympathy for Iran, whatever the provocation. It would be correspondingly difficult to mount any effective action in the United Nations.

F. TRADE BOYCOTT

i. A civil trade boycott against Iran would require as a matter of Community Law to be authorised by the Community as a whole.

ii. Unless Iran had first acted against Community countries such action by the Community would not be justified without the backing of an appropriate United Nations resolution which would be binding on other countries as well as on the Western nations. As regards imports from Iran, a trade boycott would have no effect unless it

included an embargo on oil, since other imports are very small. The effect on Iran of a stoppage of all exports from the United States and the EEC would be to reduce considerably the already limited economic activity, but apart from fairly early food shortages (cf 4 E. above) material effects might well take some time to achieve - Iran has already carried on for quite a long time with a substantial degree of industrial chaos. The effectiveness of the action would be reduced by the extent to which the Iranians were able to continue to import substitutes from friendly countries and to find loopholes in the West's boycott machinery.

iii. The effect on the United Kingdom of the loss of visible exports, currently running at an annual rate of £200 million would also be generally unwelcome in this country. British contractors now working again on two large projects in Iran (worth over £100 million) would lose them. The impact on employment in the United Kingdom is unlikely to be significant, except in the case of Talbot Cars (formerly Chrysler), which have now restarted the manufacture and export of car kits to Iran. The residual United Kingdom investments in Iran, probably worth several million pounds, would be lost. Outstanding payments to United Kingdom exporters (ECGD's total present commitment is £649 million) would clearly be vulnerable.

NB. ECGD COVER

ECGD suspended cover in February on commercial grounds. In June Departments agreed to the reintroduction of a very limited amount of new short-term cover under Schedule 2 (national interest), but only for British suppliers to certain joint ventures. There has been no publicity given to this and the public position is that ECGD remains off cover for this market.

LEGAL ACTIONS FOLLOWING THE UNITED STATES FREEZE OF IRANIAN ASSETS

Bank Markazi Iran (the Iranian Central Bank) has initiated legal proceedings against five United States banks in London seeking to withdraw deposits held with them. Similar action is being taken in Paris against the Paris branch of Citibank. At the same time Citibank in London are seeking a declaration from the Courts that the steps taken under the laws of the United State to block official Iranian assets apply to deposits of the Bank Markazi held at Citibank's London branch (the United States Government has been made a party to this action). The actions before the English courts are likely to take a little while to resolve - and taking account of the possibility of appeals might last until the spring.

2. Other legal actions are related to a default officially notified by Chase Manhattan Bank on a \$500m Imperial Government of Iran syndicated loan when the interest payment due on 15 November failed to arrive. (Iran gave instruction for the payment, which was frustrated by the United States freeze, and have accordingly pleaded 'force majeure'; many bankers question whether the declaration of default by Chase was justified in such circumstances). Under the loan agreement, the whole loan becomes immediately due and payable, and members of the loan syndicate can take steps to protect their interests. Chemical Bank in London for example has obtained an injunction preventing removal of Iranian official balances with the United States banks concerned, to a total of \$510m. The same injunction has the effect of 'freezing' any loan service payments by the National Water Council, the only British public sector borrower from Iran. In Germany Morgan Guaranty have obtained an injunction freezing the Iranian Government share holding in Krupp, to secure their claims on Iran under the same loan agreement. It is not yet clear that there have been any subsequent defaults on other Iranian public sector syndicated loans (of which some \$4-5 bn have been raised in recent years).