

IRAN

Bargaining in the Iranian oil industry is nested within Iran's nuclear bargaining. In other words, Iran uses oil, tacitly and explicitly, to gain concessions in nuclear bargaining arena, and to maintain regime stability. Iran's oil industry is subject to unilateral U.S. sanctions, originally imposed by President Clinton, with a clear political goal in mind, regime change in Tehran, by using economic means – less oil revenue. Iran aims to invalidate the American attempt to isolate it and change the current regime, by protecting regime stability from outside threats (the U.S.) through maintenance of healthy bilateral relations with other key powers, such as China and Russia. This may help Iran in its attempt to acquire nuclear capabilities in the long-run. Iran also aims to protect regime stability from inside threats by ensuring oil revenues remain at high levels, what is essential for safeguarding political stability. Since Iran uses oil as a bargaining tool in order to gain concessions from other countries, this nullifies the U.S. attempt to achieve regime change in Iran by internationally isolating the country.

Introduction to Iran's Oil Industry

The history of oil industry bargaining in Iran is a story of gradual loss of international control and ownership of the Iranian oil industry.¹ IOCs had the full control over Iranian oil industry in the early stages of the twentieth century. This control gradually obsolesced as the century progressed, resulting in the full national ownership and control. As I brief outline the history of emerging Iranian control over its oil industry, it is evident that in the

¹ History of oil in Iran is ultimately a part of overall history of Iran. For more on various periods in the 20th century history of Iran, see Christopher de Bellaigue, *In the Rose Garden of the Martyrs: A Memoir of Iran* (New York: HarperCollins, 2005); Stephen Kinzer, *All the Shah's Men: An American Coup and the Roots of Middle East Terror* (Hoboken, NJ: John Wiley & Sons, 2003); Amin Saikal, *The Rise and Fall of the Shah 1941-1979* (London: Angus & Robertson, 1980); Anthony Parsons, *The Pride and the Fall: Iran 1974-1979* (London: Jonathan Cape, 1984); Shaul Bakhash, *The Politics of Oil and Revolution in Iran* (Washington, DC: Brookings Institution, 1982); Mohammed Reza Ghods, *Iran in the Twentieth Century: A Political History* (Boulder: Lynne Rienner, 1989); Ervand Abrahamian, *Iran Between Two Revolutions* (Princeton: Princeton University Press, 1982); and Manucher Farmanfarmaian and Roxane Farmanfarmaian, *Blood and Oil: A Prince's Memoir of Iran, From the Shah to the Ayatollah* (New York: Random House, 1997). For another portrait of modern Iran see Robin Wright, *The Last Great Revolution: Turmoil and Transformation in Iran* (New York: A.A. Knopf, 2000). Nikki Keddie, *Roots of Revolution: An Interpretive History of Modern Iran* (New Haven: Yale University Press, 1981) and the more recent *Modern Iran: Roots and Results of Revolution* (New Haven: Yale University Press, 2003) are classic studies of Iran's last 100 years.

process, Iranian regimes were very unstable and were overthrown on two different occasions. Thus, given such turbulent political history, regime stability is the main goal of any modern Iranian leader.

While the initial bargain from 1909, heavily favoured the British,² the April 1933 concession was signed on terms that were more favourable for the Iranians, but still overall in favouring the British.³ The British succeeded in retaining their monopoly of the Iranian upstream oil industry, and continued the half-century effort of “crudest exploitation.”⁴ However, on 1 May 1951, the Iranian Prime Minister, Mohammad Mossadeq declared AIOC nationalised, and set up the National Iranian Oil Company (NIOC) to take over from AIOC. The nationalisation meant Iranian ownership and control of the oil industry.⁵ However, Britain rejected the nationalisation as illegal and unacceptable, and was unwilling to give up “the jewel in the crown of BP.”⁶ Thus, with American help, Mossadeq was overthrown. Given the widespread anti-British sentiment in Iran, the new Iranian leader, Mohammad Reza Shah Pahlavi (referred to as the Shah) established his regime relying heavily on the Americans, what secured the American, rather

² Initially, in the early 20th century, the Anglo-Persian Oil Company (later Anglo-Iranian Oil Company, and later BP), in conjunction with the British government, made huge profits compared with what the Iranian government earned in royalties, taxes, and profit sharing. B. Shwadran, *Middle East Oil and the Great Powers* (New York: Praeger, 1955), pp. 33-37. Also see B. Nirumand, *Iran: The New Imperialism in Action* (New York: Monthly Review Press, 1969), pp. 26-34; L. P. Elwell-Sutton, *Persian Oil: A Study in Power Politics* (London: Lawrence & Wishart, 1955). Under the initial concession, the British gained the exclusive rights to explore, produce, and refine oil in all but five northern provinces of Iran, for sixty years. The British were soon able to develop the Iranian oil industry into a leading export sector. Iranian oil production rose dramatically from 1,650 bpd in 1912/13, to 28,000 bpd in 1919/20, and to 132,000 bpd in 1932, most of which was exported by the Anglo-Persian Oil Company. Jahangir Amuzegar and M. A. Fekrat, *Iran: Economic Development under Dualistic Conditions* (Chicago: Chicago University Press, 1971), pp. 18-19; Saikal, *The Rise and Fall of the Shah*, p. 13.

³ For more, see B. Nirumand, *Iran: The New Imperialism in Action*, p. 31, and J. C. Hurewitz, *Diplomacy in the Near and Middle East – A Documentary Record, 1535-1914* (Princeton: Van Nostrand, 1956), pp. 188-196.

⁴ S. H. Longrigg, *Oil in the Middle East: Its Discovery and Development* (London: Oxford University Press, 1968), p. 157. Moreover, in the course of time, they were reluctant to implement the new agreement in its entirety. Many Iranians grievances thus remained, and eventually prompted Mossadeq’s government to nationalise the Iranian oil industry in early 1951. Saikal, *The Rise and Fall of the Shah*, p. 23.

⁵ By the late 1940s and early 1950s a broad cross-section of the Iranian people had not only become conscious of their oil resources and their exploitation by the British against Iranian interests, but were also easily persuaded to rally for a cause that could restore their dignity. See Saikal, *The Rise and Fall of the Shah*, pp 38-9. For more on Iranian oil nationalisation and its aftermath, see Mary Ann Heiss, *Empire and Nationhood: The United States, Great Britain, and Iranian Oil, 1950-1954* (New York: Columbia University Press, 1997); Bakhash, *The Politics of Oil and Revolution in Iran*; Mostafa Elm, *Oil Power and Principle: Iran’s Oil Nationalization and its Aftermath* (Syracuse, NY: Syracuse University Press, 1992); Robert B. Stobaugh, “The Evolution of Iranian Oil Policy, 1925-1975,” in George Lenczowski (ed.), *Iran Under the Pahlavis* (Stanford: Hoover Institution Press, 1978); and James A. Bill and William Roger Louis (eds.), *Mussadiq, Iranian Nationalism, and Oil* (London: I. B. Tauris, 1988).

⁶ Sampson, *The Seven Sisters*, p. 138. It put on a display of gunboat diplomacy reminiscent of its actions in 1932, and it successively pursued an economic blockade of Iran and, as a result, the entire Iranian oil industry came to a virtual standstill, with oil production dropping from 661,000 bpd in 1950 to 29,000 bpd in 1952 (*The Economist*, July 18, 1953). This reduced Iran’s oil income to very low levels, increased its economic plight, and caused a severe strain on the implementation of Mossadeq’s promised domestic economic reforms. This, with some help from the CIA, resulted in Mossadeq being overthrown and imprisoned.

than British majority share in the Iranian oil industry.⁷ Shah's regime had traded the control over its oil industry, for what it needed to establish its rule. Only when the Shah abrogated the agreement in 1973, and enforced Iran's control over its oil industry, from production to pricing, did he finally begin to realise Mossadeq's nationalisation goal, his own long-term objective, and fulfil Iran's potential as an oil power.⁸

Iran implemented the Nationalization Act of 1951 in March 1973 with the "St. Moritz Agreement". It was to be valid for twenty years, and IOCs were turned into Iran's long-term and privileged customers.⁹ The realisation of Iran's oil potential in the interests of the country brought Shah's regime not only enormous and unprecedented wealth, but also diplomatic strength, with increasing influence in regional and world politics, and in its bargaining with the West, which was increasingly dependent on Iranian oil.¹⁰ By the late 1970s, the Shah failed to deliver the promises of economic prosperity and political independence. Thus, a wide range of groups within Iranian society questioned his regime.¹¹ The 1979 Iranian Revolution, which brought together modern and traditional groups in Iranian society, was caused by modernising impulses and by the disquiet with modernisation among traditional groups. The religious dimension gradually overwhelmed

⁷ Shah's regime, unlike that of Mossadeq who believed in revolutionary change, held that Iran's sovereignty over its oil industry should be achieved by applying an "evolutionary" method – gradually through accommodation rather than confrontation with the West. Shah's regime largely abandoned the "control" aspect of nationalisation and opted mainly for "ownership." Saikal, *The Rise and Fall of the Shah*, p. 97. Iran put the oil industry into operation as rapidly as possible with the help of U.S. mediation in settling the oil dispute with Britain. Therefore, in 1954, an agreement was signed with the Consortium of International Oil Companies, under U.S. auspices. In this agreement, which governed the regime's relationship with the consortium for almost nineteen years, Iran had agreed to a 40 percent share for BP in the newly formed consortium (For the full list of participants and their shares in the Iranian Consortium, see Sampson, *The Seven Sisters*, p. 146.).

⁸ Saikal, *The Rise and Fall of the Shah*, p. 99. The regime's progress in achieving ownership and control of Iran's potential as an oil power corresponded with its emergence from a position of heavy dependence on the United States and the IOCs in the 1950s, to a position from which it could conduct its domestic and foreign affairs with more flexibility, but in convergence with the interests of the West, in the second half of the 1960s. Domestically, Shah's White Revolution created a degree of domestic economic and political stability (For more, see Rouhollah K. Ramazani, "Iran's 'White Revolution': A Study in Political Development," *International Journal of Middle East Studies*, vol. 5, no. 2, 1974.). Further, the regime was aided by the changes in regional and international situations, including the formation and activation of OPEC as an effective cartel, and of which Iran was one of the founding members in September 1960, the Tehran agreement with the oil companies in February 1971, and the two Middle Eastern wars of 1967 and 1973 and their consequences. All of these were skilfully exploited by Shah's regime in order to achieve its own oil policy objectives.

⁹ Saikal, *The Rise and Fall of the Shah*, p. 120. Whose expertise was nevertheless needed for oil operations related to exploration and exploitation.

¹⁰ However, despite public sympathy with the Palestinian plight during the Yom Kippur War, the Shah continued to maintain an alignment with the U.S. and Israel and in October 1973, Iran defied the Arab oil embargo.

¹¹ These included Western-educated professionals, the students from secular universities, the traditional sectors of urban society, the National Front that sought a constitutional monarchy along the lines of the 1906 constitution, and a religious faction led by the Ayatollah Khomeini, demanding the overthrow of the Shah and the creation of an Islamic Republic. Venn, *The Oil Crisis*, p. 23. When in 1978 the Shah tried to repress the religious opposition to his regime, this caused considerable unrest, which was enhanced when, later that year, the Shah's economic policies, intended to address inflationary pressures, caused recession.

the radical elements, as students and mullahs combined, and in January 1979, the Shah fled.¹² Ayatollah Khomeini returned triumphant from his period in exile to steer the Iranian Revolution resolutely towards a religious, Islamic Republic.¹³ Soon after, Iranian relations with the United States were seriously damaged due to the hostage taking in the American Embassy in Tehran on 4 November 1979, which lasted for 15 months. While in the immediate aftermath the U.S. President Jimmy Carter responded by placing an embargo on imports of Iranian oil into the United States and by freezing Iranian assets, the Iranians counterattacked by prohibiting export of Iranian oil to any American firm.¹⁴ Since then, no Iranian oil reached American shores.

Today, Iran's economy relies heavily on oil export revenues - around 80-90 percent of total export earnings and 40-50 percent of the government budget. Thus, Iran is often viewed as a prototypical 'rentier' or petro-state.¹⁵ High oil prices in the recent years have helped Iran's economic situation. In 2004, Iran's GDP increased by 5.8 percent; and in 2005 and 2006, by 5.4 and 4.5 percent, respectively.¹⁶ The Ministry of Petroleum (MoP) has overall responsibility for the country's energy sector. NIOC is a subsidiary, which is responsible for oil and gas exploration and production, refining and oil transportation. NIOC is an agent of the state and the source of income for the entire structure of the Iranian welfare state.¹⁷ NIOC must follow government directives on what projects to pursue, and as the government is responsible for NIOC's budget, there is no room for company autonomy on deciding spending plans. Moreover, NIOC has little leeway in the wider course of

¹² Ibid, p. 24.

¹³ Inevitably, the strikes in the oil industry, which were commonplace before and during the Revolution, rapidly had an impact upon Iranian production, which dropped from 6 million bpd in September 1978, to 500,000 bpd in January 1979. Since Iran was the second largest oil exporter in the world, the impact of strikes was immediately felt on the oil markets, carrying prices from 13 to 34 dollars a barrel, and causing the second oil shock, and resulting in many oil companies being hard hit by the lack of supplies from Iran. This was particularly so for the BP, whose 40 percent of supplies came from Iran. Yergin, *The Prize*, p. 685.

¹⁴ As a result, little or no Iranian crude entered the United States ever since 1979. It is important to note that in 1978, a quarter of U.S. oil imports from the Middle East came from Iran. Energy Information Administration, "Monthly Energy Review," July 2004, www.eia.doe.gov/emeu/mer/petro.html [July 1, 2004]. This just caused more havoc on the oil markets, causing the price to rise to over \$45 a barrel. Yergin, *The Prize*, p. 702.

¹⁵ Hossein Mahdavy, "The Patterns and Problems of Economic Development in Rentier States: the Case of Iran," in M.A. Cook (ed.), *Studies in the Economic History of the Middle East* (New York: Oxford University Press, 1970); and Theda Skocpol, "Rentier State and Shi'a Islam in the Iranian Revolution," in *Social Revolutions in the Modern World* (New York: Cambridge University Press, 1994).

¹⁶ "Iran Country Analysis Brief," Energy Information Administration, www.eia.doe.gov, March 2005 [November 2, 2005].

¹⁷ Nearly all government spending, from the military to education to food subsidies, is ultimately derived from money NIOC remits to the national treasury. Daniel Brumberg and Ariel I. Ahran, "The National Iranian Oil Company in Iranian Politics," paper prepared in conjunction with an energy study sponsored by Japan Petroleum Energy Center and the James A. Baker III Institute for Public Policy, Rice University, March 2007, p. 24.

Iran's foreign relations, and in particular, when it comes to the crucial question of oil sales, which are crucial to Iran's national security.¹⁸ In a sense, since MoP practices high level of control over NIOC, there is a blurring of boundaries between Ministry and NIOC.¹⁹

In 2005, Iran held 137.5 billion barrels of proven oil reserves, second largest in the world, and 11.5 percent of world total, following discoveries in the Kushk and Hosseineih fields in 2004.²⁰ The vast majority of Iran's crude oil reserves are located in giant onshore fields in the southwestern Khuzestan region near the Iraqi border and offshore in the Persian Gulf, and in total, Iran has 33 onshore and 13 offshore oil fields.²¹ In recent years, some analysts believed that Iran's capacity would drop until new oilfield developments (Azadegan, Bangestan) come online, since Iran's existing oilfields have a natural decline rate estimated at 8-13 percent per year (300,000-500,000 bpd) and are in need of upgrading, modernisation, and enhanced oil recovery efforts (i.e., gas reinjection).²² For example, the EIA considered Iran's oil sector as "old and inefficient, needing thorough revamping, advanced technology, and foreign investment."²³

However, data from 2001-2005 proved these analysts wrong (see Table 6.1). During 2004 and 2005, Iran produced 4 to 4.1 million bpd of oil, and was the fourth largest producer in the world, considerably higher than 3.4 million bpd produced during 2002 (see Table 6.1). This is primarily so since the NIOC employs a large number of experienced and skilled workers, with many competent individuals, especially on the technical side. Throughout the slow-down in decision-making that followed the 2005 presidential election, NIOC maintained its operations and even had some success in stemming the decline in oil production.²⁴ Between the 1979 Iranian Revolution, before which Iranian oil production peaked at 6 million bpd, and 2004, Iranian oil production did not surpass 4 million bpd on annual basis (see Table 6.1 and Figure 6.1). Moreover, it reached a low of 1.3 million bpd in 1981 after the start of Iran-Iraq War, and during the 1980s, Iran maintained production

¹⁸ The more crucial the project is to Iran's larger foreign policy objectives, the less discretion NIOC maintains. Brumberg and Ahram, "The National Iranian Oil Company in Iranian Politics," pp. 31-2.

¹⁹ For more on MoP's control of NIOC, see Marcel, *Oil Titans*, pp. 85, 102 and 136-8. For more on NIOC, see <http://www.nioc.com>, and Brumberg and Ahram, "The National Iranian Oil Company in Iranian Politics."

²⁰ BP Statistical Review of World Energy 2005 and "Iran Country Analysis Brief."

²¹ Brumberg and Ahram, "The National Iranian Oil Company in Iranian Politics," p. 3.

²² Iran Country Analysis Brief."

²³ Ibid.

²⁴ "Between a Rock and a Hard Place," *Petroleum Economist*, July 2006.

levels at some older fields only by using methods that have permanently damaged the fields.²⁵ However, despite these problems and against pessimistic Western predictions, in recent years Iran managed to increase its production to the highest level since 1979. In addition, a series of changes stand to benefit NIOC in future. Under the previous Oil Minister, Bijan Namdar Zanganeh, the managing director of NIOC, Mehdi Mirmoezzi, was regarded as a figurehead. However, the recently appointed head of NIOC, and the new deputy Oil Minister (since January 2006), Gholamhossein Nozari, has sound knowledge of the industry, as he was previously in charge of the oilfields in central Iran.²⁶

Table 6.1: Iran's Crude Oil Production and Consumption (Selected Years and 1994-2005)

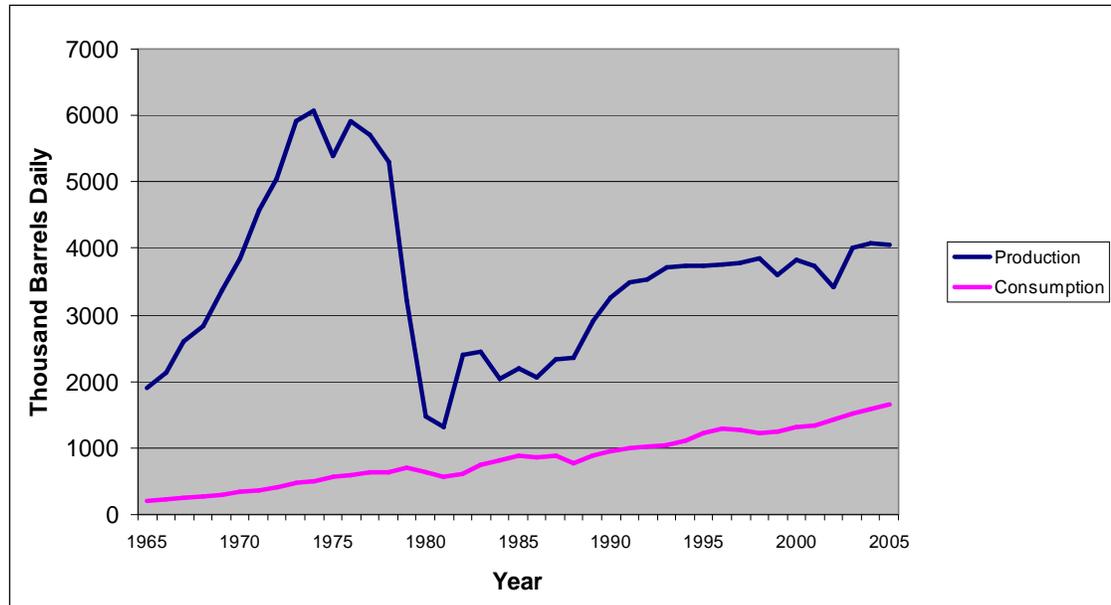
Year	Production (mbpd)	Consumption (mbpd)	Balance (mbpd)
1974	6.060	0.503	5.557
1981	1.321	0.570	0.751
1994	3.730	1.099	2.631
1995	3.744	1.227	2.517
1996	3.759	1.292	2.467
1997	3.776	1.269	2.507
1998	3.855	1.221	2.634
1999	3.603	1.243	2.360
2000	3.818	1.319	2.499
2001	3.730	1.331	2.399
2002	3.414	1.429	1.985
2003	3.999	1.513	2.486
2004	4.081	1.575	2.506
2005	4.049	1.659	2.390

Source: BP Statistical Review of World Energy 2006

Figure 6.1: Iran's Crude Oil Production and Consumption (1966 - 2005)

²⁵ Iran Country Analysis Brief."

²⁶ Ibid.



Source: BP Statistical Review of World Energy 2006

In 2005 Iran exported around 2.4 million bpd of oil (Table 6.1), with major customers including Japan, China, South Korea, India, Taiwan, and Europe, thus making it the fifth largest crude oil exporter in the world (see Table 1.1). Of total oil exports, 56 percent went to Asia and 29 percent to Europe. Iran’s domestic oil consumption, 1.6 million bpd in 2005, is increasing rapidly as the economy and population grow (see Table 6.1). This is exacerbated by the fact that Iran heavily subsidises the price of oil products, resulting in a large amount of waste and inefficiency in oil consumption.

Investment

With sufficient investment, Iran could increase its crude oil production capacity significantly, but it is uncertain if it can produce over its previous peak of 6 million bpd. The government has ambitious plans to increase oil production to over 5 million bpd by 2009, and 7 million bpd by 2024,²⁷ and it is counting on billions of dollars in foreign and local investment to increase oil production. While some have suggested this is unlikely to be achieved without a significant change in policy to attract such investment,²⁸ this may not be the case as many companies, both oil-importing countries’ NOCs and IOCs are

²⁷ Ibid.

²⁸ Ibid.

more than willing to enter Iran even under unfavourable terms. Attracting investment may not have to include a change in relations with the West, as new investment is likely to come from Chinese, Russian, Brazilian, Malaysian, and Indian, mainly state-owned oil companies. This is more than obvious in Venezuela (see Chapter 4), a country that is very efficient in attracting non-Western investment. Moreover, although not sufficient per se to achieve a significant increase in production, local investors can compete with foreign companies.

The Iranian constitution prohibits the granting of petroleum rights on a concessionary basis or direct equity stake. Iran is reluctant to allow more favourable terms for IOC investment, since due to the hard-fought process of nationalisation and strong negative feelings towards the British and the Americans, “Iranians display a feeling of pride in their industry and some resistance to foreign intrusions in it.”²⁹ However, the 1987 Petroleum Law permitted the establishment of contracts between the MoP, state companies and “local and foreign national persons and legal entities.” Buyback contracts, originally designed in 1995, are arrangements in which the contractor funds all investments, receives remuneration from NIOC in the form of an allocated production share, usually between 15 and 17 percent, and then transfers operation of the field to NIOC after the contract is completed.³⁰ It is important to note that Iranian MPs were as of mid-2006 studying a new bill that would give the Majlis (Iranian parliament) more supervisory powers over buybacks. Although terms of buyback contracts have been slightly modified in January 2004, the importance of these reforms, according to Roger Howard, “should not be exaggerated” as they still carry numerous disadvantages for foreign investors.³¹ Meanwhile, they benefit Iran in two major ways: firstly, they require that a contracted oil company transfers technology to the NIOC; and secondly, they necessitate maximum use of domestic engineering, technical, and executive capabilities in order to promote the quality of domestic sources, and thus reinforce the first requirement.

²⁹ Marcel, *Oil Titans*, pp. 39 and 42-3.

³⁰ For more on buyback contracts in Iran see “Iran Country Analysis Brief,” Roger Howard, *Iran Oil: The New Middle East Challenge to America* (London: I.B. Tauris, 2007), pp. 33-6; Mike Buntler, “The Iranian Buy Back Agreement,” *Oil, Gas & Energy Law Intelligence*, vol. 1, no. 2, March 2003; and Bindemann, *Production-Sharing Agreements*, pp. 75-81. For comparison between “buyback” agreements and PSAs, see Marcel, *Oil Titans*, p. 43.

³¹ For more detail, see Howard, *Iran Oil*, pp. 34-5.

In general, some argue that buyback agreements have not attracted the flood of foreign energy investment Iran both needs and wants,³² and that Iran's restrictive petroleum law remains a hindrance to foreign investment.³³ However, the ambitious agreement between Iran and China (through Sinopec) under which China may buy between \$70 billion and \$100 billion of Iranian oil and natural gas over the next 30 years, points to the contrary. This deal refutes complaints by European IOCs present in Iran, such as Total and Royal Dutch/Shell, who often complain about terms of buyback contracts,³⁴ and attempt to tacitly bargain for their improvement. As of 2006, foreign companies involved in 'buyback' oil operations in Iran came from the E.U. countries (U.K., France, Italy, Austria, Spain), Norway, Japan, Malaysia, India, China, Brazil, Canada and Russia.

Although in 1994, 23 percent of Iranian oil exports were moved by American IOCs,³⁵ in 1995, Iran became closed to the American oil companies, due to the official U.S. policy of isolating the Iranian economy. In 1995, President Clinton signed an executive order that bars American companies from conducting business with Iran. Clinton's decree took effect on 6 March 1995, stopping American companies from purchasing Iranian crude oil, \$4 billion worth of which had been bought in the previous financial year. After issuing the decree, Clinton stated, "there are times when important economic interests must give way to even more important security interests, and this is one of those times."³⁶ This decree was extended after 6 May 1995, when the President formally declared a national state of emergency between Iran and the United States, claiming "an extraordinary threat to the national security, foreign policy and economy of the U.S. constituted by the actions and policies of the government of Iran." The subsequent Executive Order was later consolidated and clarified by the administration on 19 August 1997 before being continued by President Bush on 14 March 2003.³⁷ In March 2004, President Bush extended the decree, citing the "unusual and extraordinary threat" to U.S. national security posed by Iran.³⁸ He once again extended the decree on 15 March 2006, citing exactly the same

³² "Iran Country Analysis Brief."

³³ International Petroleum Encyclopaedia (PennWell Corp., 2005), p. 149.

³⁴ See Sally Jones, Dow Jones Newswires, April 25, 2006.

³⁵ Howard, *Iran Oil*, p. 11.

³⁶ Cited in *ibid*, p. 12.

³⁷ Roger Howard, *Iran in Crisis? Nuclear Ambitions and the American Response* (London: Zed Books, 2004), p. 160.

³⁸ "Iran Country Analysis Brief."

reason.³⁹ Moreover, in 1996, the U.S. Congress adopted the Iran and Libya Sanctions Act (ILSA), imposing severe penalties on non-U.S. firms that invest more than \$20 million in Iran's oil industry.⁴⁰ This Act has been extended for five years in August 2001, and tightened, codified, and renamed to Iran Freedom and Support bill by the Congress in April 2006,⁴¹ but has not been invoked as of early 2007.

Unsurprisingly, the above measures have deterred U.S. firms from making investments in Iran's oil industry and buying Iranian crude,⁴² and against its will, Conoco had to give up a lucrative \$1.6 billion contract to develop two Iranian offshore oil fields.⁴³ However, ILSA has not been effective in stopping non-U.S. firms from investing in Iran, especially considering the number of foreign oil companies active in that country.⁴⁴ The European Union opposes the enforcement of ILSA sanctions on its members, and on 22 November 1996 passed Resolution 2271 directing EU members not to comply with ILSA.⁴⁵ American IOCs have argued that U.S. unilateral sanctions give their European rivals an unfair advantage,⁴⁶ and when considering the above, Iran is one case where interests of the U.S. government and those of its IOCs diverge. It is clearly against companies' interests not to be involved in Iran, the country with the world's second largest oil reserves. Joint Economic Committee of the U.S. Congress issued a research report on Iran's oil and gas

³⁹ Howard, *Iran Oil*, p. 13.

⁴⁰ See "Iran and Libya Sanctions Act of 1996," Public Law 104-172, August 5, 1996. There are six sanctions, two of which a company could potentially fall foul under the act. These include a ban on its imports of goods or services into the USA; a federal government ban on the purchase of its goods and services; the imposition of a loan ceiling of \$10 million by all U.S. financial institutions; prohibiting the sanctioned entity from acting as a primary dealer of U.S. treasury bonds; a ban on U.S. export-import assistance; and a denial of licences that approve the export of controlled technology to the company. Howard, *Iran in Crisis?* p. 160. For more on U.S. sanctions on Iran, see Patrick Clawson, "Iran," in Richard N. Haass (ed.), *Economic Sanctions and American Diplomacy* (New York: Council on Foreign Relations, 1998); Howard, *Iran Oil*, pp. 12-6; Jahangir Amuzegar, "Adjusting to Sanctions," *Foreign Affairs*, vol. 76, no. 3, May/June 1997, pp. 31-41; and Jahangir Amuzegar, "Iran's Economy and the US Sanctions," *Middle East Journal*, vol. 51, no. 2, Spring 1997, pp. 185-99. In April 2004, the ILSA had been terminated with respect to Libya.

⁴¹ For more, see Howard, *Iran Oil*, pp. 18-9.

⁴² For more detail see Kenneth Katzman, *Iran: Current Developments and U.S. Policy* (Washington, D.C.: Library of Congress, Congressional Research Service, June 3, 2003), pp. 10-12.

⁴³ Howard, *Iran Oil*, p. 12.

⁴⁴ See Meghan L. O'Sullivan, *Shrewd Sanctions: Statecraft and State Sponsors of Terrorism* (Washington, D.C.: Brookings Institution Press, 2003).

⁴⁵ "United States Country Analysis Brief." "The EU has a record of strong opposition to the United States' 1996 Iran-Libya Sanctions Act that penalises EU companies which invest in Iran's oil and gas industry; major British/Dutch, French and Italian oil companies have continued to invest there." House of Commons, Foreign Affairs Committee, "Foreign Policy Aspects of the War against Terrorism: Sixth Report of Session 2004-05," London: The Stationery Office Limited, April 5, 2005, p. 149. For more controversy that ILSA caused in the EU, see Peter Glossop, "Recent US Trade Restrictions Affecting Cuba, Iran and Libya – a View from Outside the US," *Journal of Energy and Natural Resources Law*, vol. 15, no. 3, 1997, pp. 212-47.

⁴⁶ "Study on Energy Supply Security and Geopolitics" (The Hague, Netherlands: Clingendael International Energy Programme, Institute for International Relations 'Clingendael,' January 2004), p. 168.

wealth in March 2006, arguing, “ILSA is believed to have limited Iran’s oil production capabilities.”⁴⁷ However, empirical evidence points to the contrary as Iran’s oil production between 1996, the year ILSA was adopted, and 2005, grew by 7.7 percent, or 290,000 bpd (see Table 6.1).

In 2006, the U.S. Government has been applying a lot of pressure against European governments to pressure the E.U.-based oil companies to pull out of Iran. Thus, in case stricter economic sanctions against Iran were implemented in future, both Total and Royal Dutch/Shell would abandon their activities in Iran. In addition, Royal Dutch/Shell and ENI of Italy have already decided not to bid for rights to develop Azadegan, a large Iranian oilfield mainly due to political reasons.⁴⁸

At times when oil prices are high and cash is not scarce, Iranian oil companies are able to invest in local oil projects. For example, MoP signed a deal with NIOC’s subsidiary PetroIran to develop technologically challenging Bangestan field. On 18 March 2005, a much-sought-after contract to develop this giant field was awarded to PetroIran, after having been delayed several times since 2001. Bangestan contains an estimated 6 billion barrels of oil reserves and produces about 250,000 bpd, but the field is one of the oldest in the country, requiring investment and complex technological applications. In April 2003, Shell stated that it was frustrated with the slow pace of negotiations on Bangestan, including numerous changes to terms of the project. Total and BP then unsuccessfully bid on the project, which was awarded to PetroIran. Development of Bangestan could cost \$3 billion over 10 years, and aims to raise output to 600,000 bpd.⁴⁹ Similarly, in bidding for the tender for Phase 1 buyback agreement for South Pars oil and gas field, PetroPars, a local company, undercut the next best bidder, Total, by over 50 percent, thus making Total’s bids on subsequent phases much more competitive.⁵⁰ These examples of domestic firms competing against IOCs in bidding for contracts show that at times when oil prices are high, Iran possesses both money and expertise to develop technologically complex and expensive oilfields, without relying heavily on foreign investors.

⁴⁷ Joint Economic Committee, “Iran’s Oil and Gas Wealth,” Research Report #109-31, March 2006, p. 4.

⁴⁸ See Christine Seib, “American Pressure Threatens UK Firms,” *The Times*, May 27, 2006; and Leverett and Noël, “The New Axis of Oil,” p. 69.

⁴⁹ “Iran Country Analysis Brief.”

⁵⁰ Brumberg and Ahram, “The National Iranian Oil Company in Iranian Politics,” p. 42.

CASE STUDY 6: Oil Industry and Nuclear Bargaining in Iran – ‘Using Oil as a Shield’

Oil industry bargaining in Iran is highly influenced by issue linkage. Iran uses oil as a bargaining chip in its nuclear bargaining with the international stakeholders. Oil has played a big part in Iran’s newly found nuclear defiance. Tehran uses oil to threaten retaliation against its enemies and critics, while it rewards those countries that take its side, notably China.⁵¹ In order to understand the importance of Iranian oil, and how it is used as a bargaining chip, I firstly examine Iran’s internal political structure in order to find the drivers behind Iran’s nuclear pursuit, and here I argue that regime stability is the primary goal of its current rulers. Secondly, I analyse the Iranian nuclear programme, and the U.S. response to it, which centres on the attempt to replace the current regime. Thirdly, I discuss the ineffectiveness of American efforts at regime change in Tehran, and argue that Iran’s oil has been the main culprit.

In the 1990s and in the current decade, the political stability in Iran has been affected by internal and external developments. Domestically, in the 1990s the ayatollahs were seen to be losing power, the political scene was increasingly fragmented and despite predictable American hostility, there were signs of liberal reform. However, the political powers of the conservative Supreme Leader Ayatollah Ali Khamenei, successor of the revolutionary Khomeini, dwarfed those of the elected reformist President Mohammad Khatami, evident in the power of Iran’s Guardian Council. Moreover, with hardliners regaining control of the parliament in 2004, and when Mahmoud Ahmadinejad, a hardliner, replaced Khatami as Iranian President following the June 2005 presidential election, any hope of liberal reform diminished since conservatives now dominate all the organs of government. Externally, according to Iranian hardliners, the U.S.-led wars in Afghanistan and Iraq were completing the final stage in the U.S. military encirclement of their country, which was denounced as an “axis of evil” member by U.S. President George W. Bush.⁵² Accordingly,

⁵¹ Howard, *Iran Oil*, p. xii.

⁵² Simons, *Future Iraq*, pp. 168-9.

there were suggestions that Iran would become a U.S. target after Iraq – a course of action favoured by Israel,⁵³ and that regime change was on the American agenda.

Stalwarts of the Islamic Revolution launched by Ayatollah Khomeini in 1979 control Iran's judiciary, the Council of Guardians (the constitution's regulator), and other powerful institutions, as well as key coercive groups such as the Revolutionary Guards and the Islamic vigilantes of the Ansar-e-Hezbollah. The hardliners consider themselves the most ardent Khomeini disciples and think of the revolution less as an antimonarchical rebellion than as a continued uprising against the forces that once sustained the U.S. presence in Iran: Western imperialism, Zionism, and Arab despotism.⁵⁴ In reaction to the U.S.-led overthrow of two regimes on Iran's periphery, Afghanistan and Iraq, they have adopted a wary stance, and even the influential moderate conservative former president Hashemi Rafsanjani warned, "We are facing a cruel and powerful U.S. government, and we have to be cautious and awake."⁵⁵ Iran's supreme religious leader, Ayatollah Khamenei, one of the country's most hawkish thinkers, shares the hardliners' revolutionary convictions and their confrontational impulses, and lately, the Middle East's changing political topography has forced his hand somewhat. With the American imperium encroaching menacingly on Iran's frontiers, Khamenei, who exclusively controls foreign relations as according to the Iranian Constitution, has been pragmatic on many issues.⁵⁶ Khamenei and other conservatives have tried to develop economic and security arrangements with foreign powers such as China, the European Union, Japan, India and Russia,⁵⁷ in order to preserve the regime stability and counter the American and Israeli threat.

Conservatives, who view a conflict with the United States as inevitable, believe that the only way to ensure the survival of the Islamic Republic is to equip it with an independent nuclear capability, and they press for a nuclear breakout in defiance of international opinion. Moreover, "the nuclear temptation is widely shared across the Iranian political

⁵³ David Hirst, "Israel Thrusts Iran in the Line of US Fire," *The Guardian*, February 2, 2002.

⁵⁴ Ayatollah Mahmood Hashemi Shahroudi, the chief of the judiciary, said in 2001, "Our national interests lie with antagonising the Great Satan. We condemn any cowardly stance toward America and any word on compromise with the Great Satan." Kenneth M. Pollack and Ray Takeyh, "Taking on Tehran," *Foreign Affairs*, vol. 84, no. 2, March-April 2005, p. 23.

⁵⁵ Pollack and Takeyh, "Taking on Tehran," p. 24.

⁵⁶ *Ibid.*

⁵⁷ Iranian foreign policy has historically been underlined by pragmatism. See R. K. Ramazani, "Ideology and Pragmatism in Iran's Foreign Policy," in *Middle East Journal*, vol. 58, no. 4, Autumn 2004, pp. 549-59.

spectrum,”⁵⁸ and “many Iranians profess to support the government’s pursuit of nuclear technology.”⁵⁹ Ali Akbar Nateq-Nuri, a conservative presidential candidate in 1997 and now an influential adviser to Khamenei, dismissed Tehran’s 2005 negotiations with the Europeans, noting, “Fortunately, the opinion polls show that 75 to 80 percent of Iranians want to resist and [to] continue our program and reject humiliation.” Once in power, Ahmadinejad, a populist, a staunch supporter of Iran’s nuclear program, and a mirror image of George W. Bush due to his open disdain for the opinions of others about his policies, made a defiant speech at the UN on the nuclear issue, and refused to back down on Tehran’s discussion to resume uranium conversion. In the cosmology of such hardliners, nuclear arms have not only strategic value, but also currency in domestic politics. Iranian conservatives see their defiance of the ‘Great Satan’ as a means of mobilising nationalistic opinion behind a revolution.⁶⁰

If Iran acquires nuclear weapons capability, it would never use it. In other words, it would use its nuclear capability as a deterrent, and therefore in strictly defensive purposes, in order to maintain regime stability from outside threats.⁶¹ In general, according to Charles Glaser and Steve Fetter, “the key reason for a state to acquire nuclear weapons is deterrence.”⁶² Shahram Chubin and Robert Litwak argue that by developing nuclear weapons, Iranians “do not seek to threaten their neighbours.”⁶³ Ray Takeyh confirms this view, and argues that Iran’s quest for nuclear weapons stems “from a judicious attempt to craft a viable deterrent posture against a range of threats.”⁶⁴ In relation, Pollack and Takeyh argue that the demonstration of the deterrent value of nuclear weapons by North Korea may have

⁵⁸ Zbigniew Brzezinski and Robert M. Gates, “Iran: Time for a New Approach,” Report of an Independent Task Force Sponsored by the Council on Foreign Relations, Washington, D.C.: Council on Foreign Relations, 2004, p. 23; also see Kenneth M. Pollack, “Bringing Iran to Bargaining Table,” *Current History*, November 2006, p. 368.

⁵⁹ “Whistling in the Gloom,” *The Economist*, January 14, 2006, p. 28.

⁶⁰ Pollack and Takeyh, “Taking on Tehran,” p. 25.

⁶¹ Iran almost certainly does not intend to show off a nuclear bomb in an attempt to intimidate its regional enemy, Israel, or its global nemesis, the United States, as such hostility could be catastrophic for the Islamic Republic. De Bellaigue, “Iran,” p. 20.

⁶² Charles L. Glaser and Steve Fetter, “Counterforce Revisited: Assessing the Nuclear Posture Review’s New Missions,” *International Security*, vol. 30, no. 2 (Fall 2005), p. 113. The same logic is put forward by Kenneth N. Waltz, “The Spread of Nuclear Weapons: More May be Better,” *Adelphi Papers*, no. 171, 1981; and Waltz, “Peace, Stability and Nuclear Weapons,” in Robert C. Art and Robert Jervis (eds.), *International Politics: Enduring Concepts and Contemporary Issues* (New York: Longman, 2003).

⁶³ Chubin and Litwak, “Debating Iran’s Nuclear Aspirations,” p. 111. Moreover, they argue that “The only conceivable justification for Iran’s acquisition of nuclear weapons might be that they are needed as a deterrent against the U.S.” (p. 113).

⁶⁴ Ray Takeyh, *Hidden Iran: Paradox and Power in the Islamic Republic* (New York: Times Books, 2006), p. 140.

increased Iran's determination to acquire them.⁶⁵ Against the background of war in Afghanistan and U.S. and Israeli rhetoric about eradicating terrorists and the states that sponsor them, former Iranian President Rafsanjani invoked a hypothetical Muslim nuclear capability "as a second-strike deterrent against pre-emptive attacks by Israel or the U.S. against Iran."⁶⁶ Iranians argue that they need nuclear weapons to "equalise" and deter the U.S. acting alone or in concert with Israel.⁶⁷ For many in Tehran, "maintaining some sort of nuclear program offers the single most valuable enhancement of the country's bargaining position with Washington."⁶⁸ In this context, all the threatening references against Israel made by Ahmadinejad are not propounded as meaningful statements of policy but deployed as rhetorical devices designed to please mass audiences.

In summary, in the domestic arena, Iranian conservatives, who now fully control Iranian politics, seek regime stability. This, domestic goal, is overarching and influences Iran's foreign affairs.⁶⁹ Therefore, any foreign policy goals are subjected to and influenced by the main goal – regime stability from domestic and foreign threats (the U.S. and Israel). Development of nuclear weapons, maintaining high revenues from oil exports, close relations and support from China, Russia, India, Japan and the E.U. are all pragmatic means to this end. Therefore, the ability of Iran's pragmatic conservative leadership to deliver material benefits from oil and gas exports is used to ensure regime legitimacy and survival. It is easy to understand why regime stability is the most important objective given Iran's turbulent political history.

Table 6.2: Goals of Main Actors in Oil Industry and Nuclear Bargaining in Iran

Actor	Bargaining Goals
Iranian leaders	Primary goal of regime stability; hence increasing or maintaining the current levels of oil export revenues needed to maintain economic growth and domestic order; oil used as a bargaining token in nuclear weapons development, and nuclear weapons would serve as a deterrent against any outside threats
The U.S. government	Regime change in Iran; no nuclear weapons development by

⁶⁵ Pollack and Takeyh, "Taking on Tehran," p. 24.

⁶⁶ George Perkovich, "Dealing with Iran's Nuclear Challenge," Carnegie Endowment for International Peace, April 28, 2003, p. 6.

⁶⁷ Ibid.

⁶⁸ Brzezinski and Gates, "Iran: Time for a New Approach," p. 23.

⁶⁹ "The real challenge facing the Islamic Republic ... is internal." Robin Wright, "Dateline Tehran: A Revolution Implodes," *Foreign Policy*, vol. 103, Summer 1996, p. 166.

	the regime; moreover, since there is a need for additional sources of oil in line with its diversification policy, replacing the current regime in Tehran with a friendly one would resume Iranian oil exports to the U.S.
American IOCs	Entry into Iran regardless of which regime is in power
E.U. governments	Status quo preferred as long as Iran cooperates regarding its nuclear program; a lot of European oil companies active in Iran and much of Iranian oil heads to Europe
The government of the PRC	Status quo oriented; nuclear Iran tolerable; high importance given to increasing Iranian oil exports to China
The Japanese government	Although it would want to develop lucrative Iranian oil fields, it might have to succumb to the U.S. pressure against it
Vladimir Putin and the Russian government	Positive relations with the Iranian regime; aiming at increased oil and gas cooperation and investment opportunities, as well as nuclear research help, and conventional weapons sales
The Israeli government	Regime change in Iran; preserving nuclear hegemony in the region, and thus strictly against nuclear weapons development; not interested in Iranian oil
IAEA	Pushing Iran to allow more inspections into its nuclear program; hoping for Iran not to go nuclear; no direct involvement in oil
European oil companies	Status quo preferred, as American companies are not involved in Iran due to American sanctions, and thus they have less competition; hoping the U.S. will not punish them for violating the U.S.-imposed sanctions against investment in the Iranian oil industry
The Indian government	Increased energy cooperation with Iran

The Nuclear Issue

In the late 1980s, after the Iran-Iraq War, the need for electricity generation for reconstruction of the war-damaged economy was evident and as the maximum export of hydrocarbon resources was to be achieved for foreign exchange requirements, the focus was on rebuilding the Bushehr nuclear power plant, destroyed during the war.⁷⁰ Today, Iran has a civilian nuclear-power reactor under construction, as the Russians are building the 1,000 megawatt-electrical light-water reactor, of the Russian VVER type, at Bushehr.⁷¹ This power reactor is the first in a series of power reactors planned to generate 6,000 megawatts of electricity. It is reported that Iran intends to build a second power reactor at

⁷⁰ Isenberg, "The Fuel Behind Iran's Nuclear Drive."

⁷¹ It will use low enriched uranium as fuel. Under the contract, Iran has with Russia, the latter will provide the fuel for the lifetime of the reactor and will take back to Russia the spent fuel for storage and possibly reprocessing.

the Bushehr site of a similar type as the first and with Russian assistance.⁷² In addition, Iran operates four small research reactors, three supplied by China in 1992 and 1994, located at the Eshafan Nuclear Technology Centre, and one supplied by the U.S. in 1967, at the Nuclear Research Centre in Tehran.⁷³

In 2006, the IAEA concluded that Iran was in pursuit of nuclear weapons and the issue was referred to the U.N. Security Council on 4 February 2006.⁷⁴ In late March 2006, Iran was given a 30-day ultimatum to return to the negotiating table or face isolation.⁷⁵ Much of the argument over the intentions of Iran's nuclear program revolves around a single proposition: given that Iran has enormous oil and gas reserves, it has no need for nuclear power for domestic energy needs and thus its nuclear program will be used for nuclear weapons. Like much of conventional wisdom, is this a highly misleading and debatable cliché? Certainly, both sides of the debate have some strong evidence to support their argument.

On one side, there are those who believe Iran is developing a civilian nuclear program, as nuclear power is necessary for rising domestic energy consumption, while oil and gas are needed to generate foreign currency,⁷⁶ since earnings from oil make up 40 to 50 percent of total government revenues. Given that lower export-revenues directly reflect on the economic situation in the country, if Iran manages to secure an indigenous supply of nuclear fuel then more crude oil can be exported, and this would in turn bring in more revenues. Thus, since Iran's population and oil and gas consumption increased considerably, and oil production decreased, they argue that Iran's energy situation today is

⁷² Frank Barnaby, "Iran's Nuclear Activities," Oxford Research Group, November 2005, p. 2.

⁷³ Ibid.

⁷⁴ For more detail see "Iran Reported to Security Council," BBC News, February 4, 2006, http://news.bbc.co.uk/go/pr/fr/-/1/hi/world/middle_east/4680294.stm, [February 15, 2006].

⁷⁵ See "Iran Given Stark Nuclear Choice," BBC News, March 30, 2006, http://news.bbc.co.uk/go/pr/fr/-/2/hi/middle_east/4859540.stm, [March 31, 2006], and "In Quotes: Iran Nuclear Ultimatum," BBC News, March 30, 2006, http://news.bbc.co.uk/go/pr/fr/-/2/hi/middle_east/4861298.stm, [March 31, 2006].

⁷⁶ In showing that Iran possibly has genuine need for nuclear energy, some British officials argue that were it not for worries over potential military applications, Iran's attempt to meet burgeoning demand through nuclear power would make economic sense. The Foreign Affairs Select Committee of the British Parliament said in March 2004 that based on a study it commissioned, "it is clear ... that the arguments as to whether Iran has a genuine requirement for domestically produced nuclear electricity are not all, or even predominantly, on one side." Some U.S. arguments against Iran "were not supported by an analysis of the facts," the committee added, noting that much gas flared off by Iran – which U.S. officials say could be harnessed instead of nuclear power – was not recoverable for energy use. Cited in David Isenberg, "The Fuel Behind Iran's Nuclear Drive," Asia Times, October 13, 2005.

quite different from the late 1970s,⁷⁷ when the Shah's regime also pursued nuclear technology.⁷⁸ This pursuit was not alarming to the West at the time, since the U.S. President Gerald Ford signed a directive in 1976 offering Tehran the chance to buy and operate a U.S.-built reprocessing facility for extracting plutonium from nuclear reactor fuel.⁷⁹ Moreover, proponents of the argument that Iran's nuclear program will be used for civilian purposes argue that as a sovereign nation Iran is entitled to make its own sovereign decisions as to how to provide for its own energy needs.⁸⁰ Arguably, since Iran is a resource-rich country, among these resources, there are several uranium mines whose energy contents cannot be overlooked. Thus, expecting Iran to disregard this valuable resource is irrational.⁸¹ Finally, proponents of the argument that Iran's nuclear program will be used for civilian purposes claim that Iran derives strategic significance from its

⁷⁷ Iran, in years prior to the 1979 Revolution, had population of approximately 35 million, and was producing between 5.5 and 6 million bpd of crude oil, and its domestic consumption was between 10 and 11 percent of that output. Its annual natural gas production was roughly about 17 to 20 billion m³ of which some 7 to 8 billion m³ was exported to the Soviet Union and the remaining 10 to 12 billion m³ was consumed domestically (BP Statistical Review of World Energy 2006). In 2005, Iran had a population of more than 69 million, most of which are choking from air pollution. Iran's population is projected to rise to 81 million by 2015, 91 million by 2025 and 121 million by 2050 (John W. Wright (ed.), *The New York Times 2005 Almanac* (London: Penguin Books, 2004), p. 469). Meanwhile, in 2005, the country produced some 4 million bpd of crude oil, of which over 1.6 million bpd or over 40 percent were consumed domestically, and 87 billion m³ of natural gas, which was not enough to satisfy domestic demand of 88.5 billion m³, so Iran had to import natural gas (BP Statistical Review of World Energy 2006). Driven by a young population and high oil revenues, Iran's power consumption is growing by around 7 percent annually, and its capacity must nearly triple over the next 15 years to meet projected demand. For more, see Christopher de Bellaigue, "Iran," *Foreign Policy*, no. 148, May-June 2005, p. 19.

⁷⁸ The Shah argued that hydrocarbon resources would be too valuable to burn by the beginning of 21st century and most of Iran's electricity generation must be supplied from nuclear power plants by then (Saikal, *The Rise and Fall of the Shah*, pp. 127. and 160). Iran had signed a number of nuclear power construction contracts with France and West Germany and was negotiating with others for additional ones. The stated objectives of these undertakings were to generate electricity and desalinate water, and there was no overt opposition to the Shah's nuclear ambitions because of friendly relations between Iran and the U.S. (Isenberg, "The Fuel Behind Iran's Nuclear Drive").

⁷⁹ The deal was for a complete "nuclear fuel cycle" reactors powered by and regenerating fissile materials on a self-sustaining basis. Thus, the U.S. actually encouraged the Shah to develop a nuclear energy program, reasoning that substituting nuclear energy for domestic consumption would make available more Iranian petroleum for export. Muhammed Sahimi, "Iran's Nuclear Energy Program," *Harvard International Review*, vol. 26, no. 5, 2005. David Kay, speaking in November 2004 at a forum sponsored by the Center for Strategic and International Studies (CSIS) said "The first thing – of what we do know, and it's amazing how many Americans seem to skate over this – the first nuclear reactor given to Iran was given by the United States in 1967 – a five-megawatt trigger reactor, research reactor, under the Eisenhower Atoms for Peace Program. ... The other thing that Americans forget is that in 1974, the Shah announced a policy of 23,000 megawatts of nuclear energy in Iran. The U.S. reaction? [Former U.S. National Security Adviser and Secretary of State] Henry Kissinger beat down the door to be sure that the two U.S. constructors, General Electric and Westinghouse, had a preferred position in selling those reactors. We did not say, "It's a stupid idea, why would you want to do that when you are flaring gas and you have immense oil reserves?" We said, "That is very interesting; it's an example of how the Iranian economy is moving and becoming modern." Imagine in Iranian ears how it sounds now when we denigrate that capacity. They remember. We were sellers of nuclear reactors and wanted to be sellers of nuclear reactors to the Shah." Cited in *ibid*.

⁸⁰ Under Article IV of the Nuclear Non-Proliferation Treaty (NPT), member states are assured access to the benefits of civilian nuclear energy (UN Department for Disarmament Affairs, "The Treaty on the Non-Proliferation of Nuclear Weapons (NPT)," 2002, disarmament2.un.org/wmd/npt/npttext.html [November 12, 2005]).

⁸¹ Isenberg, "The Fuel Behind Iran's Nuclear Drive."

status as an oil exporter. Iran wants to maintain this status, and any initiative that would maximise Iran's hydrocarbon export potential has strategic value.⁸²

On the other side, investigators from the IAEA have discovered that Iran is trying to acquire the capability to enrich uranium and separate plutonium, activities that would allow it to make fissile material for nuclear weapons. The Iranian government has admitted to these activities only after the National Council of Resistance, an Iranian opposition group, announced that they were underway at sites in Natanz and Arak. Both the uranium enrichment and the heavy water production plants raise concerns.⁸³ Iran violated its Safeguards Agreement with the IAEA, required by the NPT, by failing to report many of its nuclear-related activities to the Agency. It has failed to ratify the Additional Protocol to its Safeguards Agreement with the IAEA.⁸⁴ Although there is no firm evidence that Iran intends to fabricate nuclear weapons, revelations of Iran's allegedly massive secret program have convinced even doubtful European governments that Tehran's ultimate aim is to acquire the weapons or, at least, the ability to produce them whenever necessary.⁸⁵

When taking all these factors into consideration, Iran's nuclear program appears aimed at dual, both military and civilian, purposes. If Iran wanted nuclear technology for peaceful uses, it is fair to ask, why did it hide and deny efforts to get that technology?⁸⁶ The Iranians argue that alerting the world to its nuclear acquisitions would have allowed the United States to block its supply lines. That may be true, but there is another possible explanation: Iran hid its interest in nuclear technology because that interest was primarily military in

⁸² Ibid.

⁸³ A heavy-water reactor is a particularly efficient way of producing plutonium for use in nuclear weapons. A uranium enrichment plant can produce the highly enriched uranium needed for nuclear weapons. Apart from these, there are other Iranian nuclear activities that raise suspicions. These include: the development of uranium mines; the construction of a uranium conversion facility at the Eshafan Nuclear Technology Centre (ENTC) to convert uranium ore (yellow cake) into uranium hexafluoride gas, suitable for use in gas centrifuges for the enrichment of uranium; and the operation of a pilot laser enrichment facility at Lashkar Ab'ad, now shut down. Barnaby, "Iran's Nuclear Activities," p. 1. For a detailed account of Iranian nuclear activities see Christoph Wirz, "Is Iran on the Way to Acquiring an Atomic Bomb?" Spiez, Switzerland: Spiez Laboratory, January 2004.

⁸⁴ Barnaby, "Iran's Nuclear Activities," p. 2. This protocol would permit the IAEA improved access to Iran's nuclear facilities, including the collection of environmental samples.

⁸⁵ For more on Iranian nuclear weapons program and its potential threat see Anthony H. Cordesman and Khalid R. Al-Rodhan, *Iranian Nuclear Weapons? The Threat from Iran's WMD and Missile Programs* (Washington, D.C.: Center for Strategic and International Studies, 2006); and Henry Sokoloski and Patrick Clawson (eds.), *Getting Ready for a Nuclear-Ready Iran* (Washington, D.C.: Strategic Studies Institute, October 2005).

⁸⁶ In a televised speech former president, Khatami insisted that Iran had no plans to build such weapons: "Iran has discovered reserves and extracted uranium... we are determined to use nuclear technology for civilian purposes." Khatami quoted in Simmons, *Future Iraq*, p. 176

nature. IAEA's failure to find hard evidence that Iran is trying to weaponise its nuclear technology does not mean that there is no such effort. There is plausible circumstantial evidence, most of it collected by the IAEA, to suggest that Iran's nuclear program is not purely civilian. For more than 10 years, Iran concealed important changes to its nuclear inventory and maintained a clandestine procurement effort.⁸⁷ Some of Iran's actions violated the explicit terms of the NPT; others flouted its spirit.⁸⁸

The U.S. Reaction

Iran, often referred to as a "rogue state"⁸⁹ and a part of an "axis of evil"⁹⁰ by the U.S. government and many American analysts, has been accused by the United States of supporting terrorism, possessing chemical weapons, having a growing nuclear weapons program, and as an enduring threat to Israel, an American ally in the Middle East.⁹¹ Thus, it is not surprising that "[The U.S.] will not tolerate the construction of a nuclear weapon" in Iran.⁹² Further, Iran is also hypocritically charged by Washington for abusing human rights and opposing Arab-Israeli peace.⁹³ When, on 13 December 2002, Iran asserted that its suspect nuclear construction sites were for peaceful purposes, and were fully open to United Nations nuclear experts,⁹⁴ the White House expressed great concerns over two

⁸⁷ It comes as no surprise then that "The United States and international intelligence communities have been unable to paint a full, accurate portrait of Iran's nuclear program." George Perkovich, "Changing Iran's Nuclear Interests," *Carnegie Endowment for International Peace*, May 2005, p. 2.

⁸⁸ Barnaby, "Iran's Nuclear Activities," p. 2.

⁸⁹ Rogue states are those that "brutalise their own people and squander their national resources for the personal gain of the rulers; display no regard for international law, threaten their neighbors, and callously violate international treaties to which they are party; are determined to acquire weapons of mass destruction, along with other advanced military technology, to be used as threats or offensively to achieve the aggressive designs of these regimes; sponsor terrorism around the globe; and reject human values and hate the United States and everything it stands for." *The National Security Strategy of the United States of America* (Washington, D.C.: White House, September 2002), p. 14. Iran was mentioned most times as a rogue state by American policy-makers between 1993 and 1998. Paul D. Hoyt, "The 'Rogue State' Image in American Foreign Policy," *Global Society*, Vol. 14, No. 2, 2000, p. 302.

⁹⁰ Collective term for rogue states, usually including pre-invasion Iraq, North Korea and Iran. See Jeffrey Record, "The Bush Doctrine and War with Iraq," *Parameters*, Spring 2003, pp. 4-21.

⁹¹ Simons, *Future Iraq*, p. 175. In addition to the alleged nuclear weapons program, the United States was frequently charging Iran for harbouring al-Qaeda terrorists in defiance of the will of the international community. Thus George Tenet, CIA director, said to the US Senate intelligence committee prior to the invasion of Iraq, "We see disturbing signs that al-Qaeda has established a presence in both Iran and Iraq." George Tenet quoted in *ibid*.

⁹² David E. Sanger, "Bush Warns Iran on Building Nuclear Arms," *The New York Times*, June 19, 2003, p. A1.

⁹³ Henry Precht, "War with Iran, or War with the Facts?" *Foreign Service Journal*, October 2005, pp. 32-3. For good overview of U.S.-Iranian post-September 11 relations see Bahram Rajaei, "Deciphering Iran: The Political Evolution of the Islamic Republic and U.S. Foreign Policy After September 11," in *Comparative Studies of South Asia, Africa and the Middle East*, vol. 24, no. 1, 2004, pp. 159-72.

⁹⁴ Mohamed El-Baradei, head of the International Atomic Energy Agency (IAEA), previously said that the sites were not yet operational, but criticised Iran for withholding details of the projects.

secret Iranian nuclear plants, which could be used to produce parts of nuclear weapons.⁹⁵ In opposing Iranian nuclear programme, Ari Fleischer, White House spokesperson at the time argued, “There is no economic gain for a country rich in oil and gas like Iran to build costly indigenous nuclear fuel cycle facilities. Iran flares off more gas every year than the equivalent power that it hopes to produce with these reactors.”⁹⁶ Moreover, although on 21 February 2003, Iran opened its nuclear sites at Natanz and Arak for inspection by Mohamed El-Baradei and other IAEA personnel, it seemed unlikely that Washington would be satisfied by agency’s findings.⁹⁷

It is clear that the United States and much of the Middle East, would prefer not having to deal with a nuclear Iran, and do not want this to occur. Thus, the U.S. has been considering various strategies to achieve a regime change in Tehran and to prevent Iran from going nuclear: economic sanctions; military action; diplomatic isolation; and the combination of any or all of the above. The regime change is crucial, as some have argued that “The White House ... simply cannot wait for the [Iranian] regime to collapse.”⁹⁸ For example, in suggesting policy options for Iran, Kenneth Timmerman argues, “We [the U.S.] should empower the pro-democracy forces to change the regime. We should do so openly, and as a government policy,” since the very existence of current Iranian regime poses a threat to world security.⁹⁹ Moreover, it is commonly argued, “More aggressive actions are deemed necessary” against the “rogues.”¹⁰⁰ According to a U.S. neoconservative Max Boot, “the only way to ensure U.S. security is to topple the tyrannical regimes in Pyongyang and Tehran.... Regime change may seem like a radical policy, but it is actually the best way to prevent a nuclear crisis that could lead to war.”¹⁰¹

⁹⁵ Such facilities are simply not justified by the needs that Iran has for their civilian nuclear program. Our assessment when we look at Iran is that there is no economic gain for a country rich in oil and gas like Iran to build costly indigenous nuclear fuel cycle facilities. Iran flares off more gas every year than the equivalent power that it hopes to produce with these reactors.

⁹⁶ Ari Fleischer quoted in Simons, *Future Iraq*, p. 175.

⁹⁷ *Ibid.*

⁹⁸ Shahram Chubin and Robert S. Litwak, “Debating Iran’s Nuclear Aspirations,” *The Washington Quarterly*, vol. 26, no. 4, Autumn 2003, p. 108.

⁹⁹ Kenneth R. Timmerman, *Countdown to Crisis: The Coming Nuclear Showdown with Iran* (New York: Crown Forum, 2005), p. 313 and 314.

¹⁰⁰ Hoyt, “The “Rogue State” Image,” p. 309.

¹⁰¹ Max Boot, “Think Again: Neocons,” *Foreign Affairs*, vol. 140, January/February 2004, p. 23. For more on reasoning behind the American push for regime change, see Amir Taheri, “Getting Serious About Iran: For Regime Change,” *Commentary*, November 2006, pp. 21-7.

Pollack and Takeyh argue that Tehran's course can be changed if Washington and the international community impose sanctions in order to derail Iran's drive for nuclear weapons. They argue, "The West should use its economic clout to" persuade Tehran to stop its "nuclear program in return for the trade, aid, and investment that Iran badly needs." Moreover, only if the mullahs recognise that they have a stark choice – they can have nuclear weapons or a healthy economy, but not both – might they give up their nuclear dreams. Arguably, with concern over Iran's nuclear aspirations growing, the United States and its allies now have a chance to present Iran with just such an ultimatum.¹⁰² If the U.N. Security Council passed a resolution to impose comprehensive economic sanctions without any vetoes, De Bellaigue argues that Iran's economy would hardly be able to withstand the sanctions.¹⁰³

An alternative way to take action against Iranian nuclear program, according to some analysts would be a pre-emptive, or preventive, U.S./Israeli attack on its nuclear facilities.¹⁰⁴ In this view, despite Iranian leaders' perception that nuclear weapons would improve Iran's security, Chubin, Litwak, and Perkovich argue that its pursuit of nuclear weapons actually increases chances of a U.S./Israeli attack, and makes Iran less secure from foreign threats.¹⁰⁵ Hence, these analysts believe that Iranian nuclear weapons pursuit makes very little strategic sense, especially since Saddam Hussein, a major threat to Iran, was removed from power in 2003 and nuclear Pakistan does not pose a threat. There already have been indications that Israel may conduct an attack against Iran. Former Prime Minister Ariel Sharon told the London Times in November 2002 that he would push Iran to the top of the "to-do list" after the war in Iraq.¹⁰⁶ A year later, Israel's Defence Minister, Shaul Mofaz declared an Iranian nuclear bomb "intolerable" and warned, "[O]nly a few months are left for Israel and the world to take action and prevent Iran from getting nuclear bomb."¹⁰⁷ Israel has recently been flexing its military muscles in ways not lost on

¹⁰² Pollack and Takeyh, "Taking on Tehran," p. 21.

¹⁰³ De Bellaigue, "Iran," p. 21.

¹⁰⁴ For more, see Arthur Herman, "Getting Serious About Iran: A Military Option," Commentary, November 2006, pp. 28-32.

¹⁰⁵ Chubin and Litwak, "Debating Iran's Nuclear Aspirations," p. 106; and Perkovich, "Dealing with Iran's Nuclear Challenge," p. 7.

¹⁰⁶ Stephen Farrell and Robert Thomson, "Iran is a Danger to the Middle East, to Israel, and to Europe," Times (London), November 5, 2002.

¹⁰⁷ Mofaz during meetings with counterparts in Washington, November 2003, as reported by Ma'ariv, November 16, 2003.

Iranian intelligence, and Iran can have no doubt about Israeli's willingness to pull the trigger, having witnessed the Israeli Air Force's destruction of Saddam's nuclear reactor at Osirak in 1981.

The third option for the U.S. has been to try to isolate Tehran, hoping that the lack of international allies would result in diminished international support for Tehran and foreign investment into Iran. While this attempt mainly targets the E.U.-3 (Germany, France, and the U.K.), it is also directed at Japan, Russia, and China. Below, I illustrate this by analysing the U.S. successful prevention of Japanese foreign investment in the Iranian oil industry, hoping that this would lead to a decline in oil production, and that falling export revenues would destabilise the regime. Thus far, this example is the only success that the Americans have had in their attempt to isolate Tehran.

Azadegan

In recent years, the U.S. government managed to coerce Japan into reducing its investment in Azadegan, a very large Iranian oilfield.¹⁰⁸ In 2003, the U.S. government threatened the Japanese that ILSA, which imposes severe penalties on non-U.S. firms that invest more than \$20 million in Iran's oil industry, would be invoked. According to the Japanese officials, the Americans have warned that members of a Japanese consortium might be punished with sanctions if they sign a long-pending deal to develop Azadegan, a big Iranian oilfield.¹⁰⁹ In addition, Richard Boucher, the State Department's spokesperson, said in 2003 that this was a "particularly unfortunate time" to be striking deals with Iran.¹¹⁰

Some Japanese officials, particularly in the Foreign Ministry, agreed with Boucher. They appreciated America's muscle as a deterrent to a nuclear-armed North Korea, and did not want to give the impression that they are indifferent to Iran's nuclear program, civilian or

¹⁰⁸ Azadegan was discovered in 1999, representing Iran's largest oil discovery in 30 years, and is located onshore in the southwestern province of Khuzestan, a few miles east of the border with Iraq. Reportedly, Azadegan contains proven crude oil reserves of 26 billion barrels, but the field is also considered geologically complex, making the oil more challenging and more expensive to extract. In January 2001, the Majlis approved development of Azadegan by foreign investors using the "buyback" model. "Iran Country Analysis Brief."

¹⁰⁹ "Will America Invoke Sanctions?" *The Economist*, August 2, 2003, p. 41.

¹¹⁰ *Ibid.*

otherwise.¹¹¹ However, others, who possessed more influence at the time, pointed that given its close alliance with the U.S., Japan had a stake in trying to moderate U.S. policy towards the Middle East, and therefore to protect its economic investment in the region.¹¹² Other Japanese diplomats were opposed to Japan pulling out of big Iranian investment by pointing to the deal's financial size (it could have been worth as much as \$2.8 billion) and to Japan's quest for secure oil supplies. Thus, Iran was advanced \$3 billion in loans in return, though neither side would put it that way, for giving the Japanese consortium exclusive negotiating rights.¹¹³

After the election of moderate president Khatami in Iran in 1997, and the lack of any change in Washington's hardline policies toward Tehran in the months and years that followed, Tokyo began to grow increasingly uncomfortable with the American line, and as a result, by 1999, the Japanese government began to seek closer relations with Tehran.¹¹⁴ In the following months and years, relations between Tokyo and Tehran improved rapidly, so when in February 2000 the Japanese-owned Arabian Oil Co. lost its long-term concession in Saudi Arabia, Japanese officials considered Iran as a suitable alternative.¹¹⁵ Tehran was pleased with Japanese interest, as its objective was to conclude negotiations and sign the agreement to develop Azadegan as soon as possible.¹¹⁶ While Washington applied some pressure, Japan was successful in handling it.¹¹⁷

¹¹¹ Ibid.

¹¹² For more on Japan's relations with Iran in particular and the Middle East in general, see S. Hayden Lesbirel, "Diversification and Energy Security Risks: The Japanese Case," *Japanese Journal of Political Science*, vol. 5, no. 1, 2004; and Alan Dowty, "Japan and the Middle East: Signs of Change?" *Middle East Review of International Affairs*, vol. 4, no. 4, December 2000.

¹¹³ "Will America Invoke Sanctions?"

¹¹⁴ This was symbolised by Japanese Foreign Minister Komura Masahiko's visit to Iran in August 1999, and the resumption of yen loans. Suvendrini Kakuchi, "Tokyo Warms to Iran, Despite US," *Asia Times*, August 14, 1999.

¹¹⁵ In November 2000, President Khatami visited Tokyo and announced that his government would give Japan preference in negotiations over the development of Azadegan oil field. Japanese Ministry of International Trade and Industry's (MITI) Minister Hiranuma Takeo was enthusiastic about this project, and pledged to work closely with Iranian Oil Minister Bijan Zanganeh to reach a deal quickly ("Khatami Visit: Iran Offers First Shot at Oil Field," *Japan Times*, October 31, 2000). In the following month, the Japan National Oil Corporation signalled its agreement to participate ("State Oil Firm to Help Drill Azadegan," *Japan Times*, December 29, 2000). Hiranuma visited Tehran with an 80-man delegation of Japanese economic leaders in July 2001, and relations between the two countries were on the fast track as MITI and business leaders were eager to get involved in the Iran market ("Japan, Iran Agree to Work toward Contract Regarding Azadegan Oil Field," *Japan Times*, July 10, 2001).

¹¹⁶ Hisane Misaki, "Crucial Days of Negotiations Lie Ahead for 'Oil Diplomacy'," *Japan Times*, August 18, 2001.

¹¹⁷ One Japanese official commented in August 2001: "We are not sure if the U.S. administration will apply the Iran-Libya Sanctions Act [ILSA] to Japan's development of the Azadegan oil field. But we remain opposed to taking a sanctions policy toward Iran ... If the U.S. punishes Japanese firms under ILSA, Japan may consider filing a complaint with the World Trade Organisation against the U.S. measures." Cited in *ibid*.

Then came 11 September 2001, and suddenly, Tokyo began placing much greater emphasis on the U.S.-Japan security alliance, and became more fearful of doing anything that would have annoyed Washington at that volatile time. Matters became even worse when President Bush, in his January 2002 State of the Union speech, identified Iran as one of the countries that support terrorism and included it in his “axis of evil.” At this time, the Japanese-Iranian negotiations continued, but at a very casual pace. Tokyo was now not in a hurry to close the deal.¹¹⁸ Finally, by June 2003, the business negotiations were more-or-less complete, and all that had to be done was to seal the agreement. Tokyo had kept Washington informed, and so just before the deal was to be signed, the Bush Administration launched a diplomatic offensive on Tokyo. National Security Adviser Condoleezza Rice, Secretary of State Colin Powell, and Deputy Secretary of State Richard Armitage threatened Tokyo: Signing this deal with Tehran could damage the U.S.-Japan alliance.¹¹⁹ They brought up the nuclear issue in Iran as a main concern, and in addition, pointed that Iran supported terrorists and had close relationship with North Korea.¹²⁰

Therefore, Japan was inclined to continue delaying, but in early July 2003, Iranian Foreign Minister Kamal Kharrazi released a statement that if Japan failed to act, then Iran would begin negotiating with China, India, and/or Russia on the Azadegan deal. Tehran reminded Tokyo that they had other options. At the same time, however, Tehran said that they still preferred Japan to other candidates, and that they would not give up on the negotiations.¹²¹ In August 2003, Kharrazi visited Tokyo and urged Japanese leaders to defy the U.S. pressure.¹²²

All along, one of the key men pushing for Japan to move ahead with the Azadegan deal was MITI Minister Hiranuma, who was in September cabinet reshuffle replaced by Nakagawa Shoichi, a rightwing nationalist, who was very sceptical about Iran. With the departure of Hiranuma, the Azadegan deal lost a key ally on the Japanese side. Aggravated

¹¹⁸ Hisane Misaki, “No Hurry over Iran Oil Deal: Meeting Target Date Could Have Strained U.S. Relations,” *Japan Times*, February 22, 2002.

¹¹⁹ Guy Dinmore, “US Presses Japan over Iran Oil Deal,” *Financial Times*, June 27, 2003.

¹²⁰ Kanako Takahara, “U.S. Pressure Places Iran-Japan Oil Deal in Doubt,” *Japan Times*, July 2, 2003; Hooman Peimani, “Americans Stymie Japan-Iran Oil Deal,” *Asia Times*, July 4, 2003; and “Editorial: Securing Oil While Keeping the Alliance,” *Japan Times*, July 11, 2003.

¹²¹ “Japan, Iran Defy U.S., Close In on Huge Deal,” *Japan Times*, July 15, 2003.

¹²² “Iranian Foreign Minister Urges Japan to Defy U.S.,” *Japan Times*, August 29, 2003.

with Japan's delays, Iran set a 15 December 2003 deadline. If Tokyo failed to clarify its intentions by that point, Tehran would begin negotiations with other countries.¹²³ However, Japan let the deadline pass, without taking any action. Nakagawa's policies of damaging Japan's relations with Iran were heavily criticised at home, and these heavy criticisms had some effect. In addition, in early 2004 Japan sent 550 of its Self-Defense Forces (SDF) to Samawa, Iraq, in accordance with Washington's strong wishes and this may have made Tokyo feel more secure about defying the Bush administration on Iran. Additionally, Iran's negotiations with the IAEA were improving at the time. Therefore, on 18 February 2004, a Japanese consortium led by Inpex finally went ahead with the \$2 billion Azadegan deal and signed the agreement.¹²⁴

While Richard Boucher criticised the deal, oddly, the hardline official, John Bolton, who was in charge of this issue in Washington, was not too harsh.¹²⁵ This may have reflected the fact that Washington was resigned to the eventuality of the deal, and that, in any case, U.S.-Japan relations were very strong at the time, especially with Japanese involvement in Iraq. Washington tacitly acknowledged the Iran deal was a quid pro quo for Iraq.¹²⁶ Even though the Bush administration did not push very hard, some commentators did attack the deal, arguing that Tokyo was making a mistake that could seriously damage the U.S.-Japan alliance.¹²⁷

Even after Azadegan deal was signed, its future remained in doubt, as Inpex, which held the development contract, has been accused of missing a series of deadlines on the scheme, amid suspicions that the Japanese NOC was buckling under US political pressure to exit.¹²⁸ In August 2004, Washington prodded Tokyo to cancel the deal and pursue oil

¹²³ "Iran Sets Deadline for Talks on Oil Development Project," *Japan Times*, December 9, 2003.

¹²⁴ "Japan Ignores U.S. Pressure, Will Develop Iranian Oil Field: Proliferation Policy Said Intact Despite \$2 Billion Deal," *Japan Times*, February 20, 2004. Inpex, which has no upstream experience of its own, hoped to bring in an international partner – possibly France's Total, Norway's Statoil, China's Sinopec, or Russia's Lukoil (Shell has indicated that it is not interested) – as the field's operator. It was hoped that the initial production of medium-sour crude oil from Azadegan could come in 2007, ramping up to 250,000 bpd by 2009 and 400,000 bpd in the long term. At its peak, Azadegan production was expected to account for as much as 8 percent of Japan's oil imports.

¹²⁵ Richard Hanson, "Japan, Iran Sign Major Oil Deal, US Dismayed," *Asia Times*, February 20, 2004.

¹²⁶ "U.S. Traded Iran Oil Deal for SDF in Iraq; Democrat," *Japan Times*, April 1, 2004.

¹²⁷ Robyn Lim, "Blinders on a Vital Interest," *Japan Times*, February 18, 2005.

¹²⁸ "Between a Rock and a Hard Place."

interests in Libya instead, but Tokyo did not accept this offer.¹²⁹ However, the balance of forces that supported the February 2004 deal was weakening. One of Japan's main arguments all along was that engagement with Tehran would help moderate forces make positive changes in Iran. The election of President Mahmoud Ahmadinejad in June 2005 seriously damaged that line of argument. In relations, the new political flare-up over Iran's nuclear program was negative for Japan-Iran relations. Both of these events put Tokyo's policy under serious strain by the U.S. pressure. Thus, in March 2006, U.S. Deputy Secretary of State Robert Zoellick had "informally" asked Tokyo to write off its investment in Azadegan.¹³⁰ It is worth noting that by mid-2006, the threat of ILSA had shaken up some Japanese business leaders, and Japan has curbed its oil imports from Iran by 20 percent.¹³¹

Michael Penn notes that the deployment of Japanese troops to Iraq "was motivated more by Japan's insecurity toward China and North Korea than by Japan's policy toward Muslim nations. Because of Japan's feeling of insecurity in East Asia, they felt that it was necessary to align more closely with U.S. policy in the Islamic world."¹³² If Japan aimed at getting closer to the U.S., it is very doubtful this would have happened if it invested heavily in Iranian oil. Hence, what happened in early October 2006 came as no surprise. Japan's inaction and its inability to stay in the game resulted in its Azadegan oil concession reduced from 75 percent to 10 percent. After lengthy negotiations, Inpex agreed to transfer the stake to NIOC, and as a result, the status of the project operator moved to the Iranian side, while Inpex became a minority partner.¹³³

The Limitations of U.S. Actions

Options available to the U.S. in order to achieve a regime change in Tehran with the ultimate goal of ending Iranian pursuit of nuclear weapons, which range between economic sanctions, military attacks, and/or diplomatic isolation (as illustrated above), at

¹²⁹ "Japan Nudged to Consider Libya Oil Deal: Senior U.S. Official Suggests Iran Development Plan Be Reconsidered," *Japan Times*, August 6, 2004.

¹³⁰ Christian Caryl, "A Delicate Balance," *Newsweek*, May 1, 2006, p. 28.

¹³¹ Megumi Yamanaka, "Japan Curbs Oil Imports From Iran on Concern Over Disruptions," *Bloomberg.com*, May 31, 2006.

¹³² Quoted in *ibid*, p. 29.

¹³³ "Inpex Stake in Azadegan Slashed," *Japan Times*, October 7, 2006.

first glance offer much hope for success in Washington. However, this is not the case, and that there are various issues concerning all of these options, which make them, and will likely continue making them, ineffective.

Firstly, sanctions against Iran are not likely to be effective. According to Scott Sagan, “as Washington learned with India and Pakistan in the 1980s and 1990s, sanctions only increase the cost of going nuclear; they do not reduce the ability of a determined government to get the bomb.”¹³⁴ IAEA chief Mohamed ElBaradei, said sanctions against Iran were “a bad idea,”¹³⁵ as even if multilateral sanctions are imposed against Iran, their effectiveness would be extremely questionable, especially given history of ineffectiveness of ILSA in particular, and of sanctions in general. They often fail to deliver the desired effect, and result in even worse situation. In addition, should comprehensive sanctions be imposed, the result could well be that Iran, similar to North Korea in 2003, would renounce the NPT and end all IAEA inspections,¹³⁶ and if Western pressure over its nuclear program increases in future, the Iranians have already threatened with this cause of action.¹³⁷ Leaving the NPT is allowed under the treaty¹³⁸ and it allows a state to develop nuclear power and nuclear weapons without inspections.¹³⁹ Several states with nuclear weapons, Israel, India and Pakistan, never joined the treaty, and according to some critics, the NPT has been under considerable pressure in recent years due to the U.S. failure to maintain and improve, but rather undermine the NPT.¹⁴⁰ Moreover, the U.N. Security Council’s imposition of comprehensive sanctions is unlikely since permanent members of

¹³⁴ Scott D. Sagan, “How to Keep the Bomb From Iran,” *Foreign Affairs*, vol. 85, no. 5, September/October 2006, p. 46.

¹³⁵ See “Iran Given Stark Nuclear Choice,” and “Sanctions against Iran ‘Bad Idea,’” BBC News, March 30, 2006, http://news.bbc.co.uk/go/pr/fr/-/2/hi/middle_east/4862912.stm, [March 31, 2006].

¹³⁶ Precht, “War with Iran,” p. 34. In April 2007, Ali Larijani, Iran’s chief nuclear negotiator with the West, warned that Iran would have no choice but to review its membership of the NPT if further pressure was applied by the West over its nuclear programme. Cited in “Iran Nuclear ‘Landmark’ Angers US,” BBC News, April 10, 2007, http://news.bbc.co.uk/go/pr/fr/-/2/hi/middle_east/6540083.stm, [April 10, 2007].

¹³⁷ “Iran Threat to Quit Atomic Treaty,” BBC News, May 7, 2006, http://news.bbc.co.uk/go/pr/fr/-/2/hi/middle_east/4981940.stm, [May 9, 2006]. Unless the row over Iranian nuclear program was resolved peacefully, Iranian parliament would, according to the MPs’ statement, “have no choice but to call on the government to retract its signature of the Additional protocol and to place on its agenda an examination of Article 10 of the NPT.”

¹³⁸ “Each party shall in exercising its national sovereignty have the right to withdraw from the treaty if it decides that extraordinary events, related to the subject matter of this treaty, have jeopardised the supreme interests of its country.” Article 10, Nuclear Non-Proliferation Treaty.

¹³⁹ “Iran ‘Could Quit Nuclear Treaty’.”

¹⁴⁰ For more details see George Perkovich, Jessica Tuchman Matthews, Joseph Cirincione, Rose Gottemoeller, and Jon Wolfsthal, *Universal Compliance: A Strategy for Nuclear Security* (Washington, D.C.: Carnegie Endowment for International Peace, 2005), pp. 24-6, 30, 133-57; and Kurt M. Campbell, “Reconsidering a Nuclear Future: Why Countries Might Cross Over to the Other Side,” in Kurt M. Campbell, Robert J. Einhorn, and Mitchell B. Reiss (eds.), *The Nuclear Tipping Point: Why States Reconsider Their Nuclear Choices* (Washington, D.C.: Brookings, 2004), pp. 22-3.

the U.N. Security Council, Russia, and primarily China, are opposed to any sanctions against Iran. Russian Foreign Minister Sergei Lavrov said his country remained opposed to sanctions against the Islamic Republic, and China remained committed to diplomatic solution.¹⁴¹

Secondly, military action is by no means an attractive option, and reasons are plentiful.¹⁴² An attack on Iran's prime nuclear site, the Bushehr nuclear power station, could have Chernobyl-level consequences stretching to Saudi Arabia, Kuwait and the U.A.E., all American allies.¹⁴³ Precision attacks on suspected Iranian nuclear facilities would most probably cause Tehran to seek a deterrent against further pre-emptive or preventive attacks by Washington and/or Tel Aviv. In case of such an attack, Tehran could use its capabilities to stir violence and instability in Shi'a dominated areas of Iraq, where Iran carefully cultivated its influence,¹⁴⁴ as its intelligence skilfully organised the Iraqi Shi'a population after Desert Storm.¹⁴⁵ For example, according to David Francis, "Iran could instruct its operatives in Iraq to sabotage Iraqi oil exports from the port of Basra. Shi'a are the dominant religious group in both Iran and southern Iraq. That would reduce world oil supplies by about 1.1 million bpd, a drop of 1.3 percent."¹⁴⁶ Additionally, Iran may also try to block oil shipments through the Strait of Hormuz, threatening vital oil exports from

¹⁴¹ See *ibid.*

¹⁴² In *The Persian Puzzle: The Conflict Between Iran and America* (New York: Random House, 2004), former National Security Council staffer Kenneth M. Pollack reviews the troubled relationship and cautions against U.S. military action. Also, see "Iran: Is there a Way Out of the Nuclear Impasse?" International Crisis Group, Middle East Report, no. 51, February 23, 2006, pp. 17-8; W. Patrick Land and Larry C. Johnson, "Contemplating the Ifs," *The National Interest*, no. 83, Spring 2006, pp. 26-30; Richard K. Betts, "The Osirak Fallacy," *The National Interest*, no. 83, Spring 2006, pp. 22-5; Anthony H. Cordesman and Khalid R. Al-Rodhan, "Iranian Nuclear Weapons? Options for Sanctions and Military Strikes," Center for Strategic and International Studies, working draft, August 30, 2006; and "US Military Action Against Iran: Hype or Possibility?" The Middle East Programme, Chatham House and Associated Press Television News Middle East Forum debate, March 30, 2006. For the challenges of U.S. preventive action and possible Iran retaliation see Michael Eisenstadt, "Iranian Nuclear Weapons (Part I): The Challenges of U.S. Preventive Action," *The Washington Institute for Near East Policy*, Policy Watch no. 760, May 27, 2003; Jeffrey White, "Iranian Nuclear Weapons (Part III): How Might Iran Retaliate?," *The Washington Institute for Near East Policy*, Policy Watch no. 762, May 29, 2003; and Paul Rogers, "Iran: Consequences of a War," Oxford Research Group, Briefing Paper, February 2006.

¹⁴³ Paul Rogers, "The Bush Administration, Insurgencies and Iran," Oxford Research Group, International Security Monthly Briefing, March 2005, p. 5.

¹⁴⁴ Robert J. Einhorn, "A Transatlantic Strategy on Iran's Nuclear Program," *The Washington Quarterly*, vol. 27, no. 4, Autumn 2004, p. 26; also see Lang and Johnson, "Contemplating the Ifs," p. 29; and Takeyh, *Hidden Iran*, pp. 184-5. For an overview of Iran-Iraq relations after the fall of Saddam Hussein see Anoushiravan Ehteshami, "Iran-Iraq Relations after Saddam," in *The Washington Quarterly*, vol. 26, no. 4, Autumn 2003, pp. 115-29.

¹⁴⁵ George Friedman, *America's Secret War: Inside the Hidden Worldwide Struggle between America and Its Enemies* (New York: Double Day, 2004), p. 334. For more on Iranian involvement with Iraqi Shi'a population after U.S.-led invasion of Iraq see pp. 308-13.

¹⁴⁶ Francis, "Why Iran Oil Cutoff Could Be Suicidal."

Saudi Arabia, Kuwait, and other Gulf states.¹⁴⁷ Finally, Iran can play the global terror card, and groups tied to Iran (Hezbollah in particular, not Al-Qaeda), continue to have robust capabilities and could cause a lot of instability over the short term.¹⁴⁸

Pre-emptive and preventive military strikes by either the United States or Israel in the name of counter-proliferation would be a political catastrophe of major proportions for U.S., regional, and global security. Such cause of action would raise Israel to 'enemy No. 1' in Iranian threat perceptions, which is much worse than the current Iranian perception of the United States as the main enemy. Even worse, a strike by Israel could make the Iranian bomb an Islamic bomb in the perceptions of Arabs and Muslims worldwide, making the current bilateral animus between Israel and Iran a global and regional security issue.¹⁴⁹ In addition, analysts suggest that a unilateral Israeli attack would be "very high risk," making it almost prohibitive.¹⁵⁰ To get to Iran, Israeli planes would have to fly over Saudi Arabia and Jordan, probably a *casus belli* in itself, given current political conditions; or over Turkey, also a problem; or over American-controlled Iraq, which would require U.S. approval of the mission. Further, Russia, China, and the European Union are committed to peaceful resolution of Iran's nuclear problem, and do not support military action against Iran.¹⁵¹ There are no legal reasons, which would allow the international community to conduct a large-scale military operation or to take a limited military action against Iran; thus, a possibility of creating an international coalition is practically excluded. Hence, it would be a "war in splendid isolation."¹⁵²

Military options are not logistically feasible or politically prudent in the context of high oil prices. Moreover, since they would be "costly, ineffective and counterproductive,"¹⁵³ they

¹⁴⁷ For more see Lang and Johnson, "Contemplating the Ifs," p. 29.

¹⁴⁸ *Ibid.*

¹⁴⁹ Michael Ryan Kraig, "Realistic Solutions for Resolving the Iranian Nuclear Crisis," The Stanley Foundation, Policy Analysis Brief, April 2005, p. 3.

¹⁵⁰ Mark Leonard, "Crunch-time on Iran: Five Ways out of a Nuclear Crisis," in Centre for European Reform Policy Brief, August 2005, p. 7.

¹⁵¹ For analysis of realistic solutions for resolving the Iranian nuclear issue see Kraig, "Realistic Solutions for Resolving the Iranian Nuclear Crisis"; and Leonard, "Crunch-time on Iran: Five Ways out of a Nuclear Crisis". For a projection of what war with Iran would look like, see Michael Duffy, "What Would War Look Like?" *Time*, September 25, 2006, pp. 20-4.

¹⁵² Timmerman, *Countdown to Crisis*, p. 312.

¹⁵³ *Ibid.*, p. 313.

are “currently not credible.”¹⁵⁴ For example, any attack on Iran at times when prices of oil are at almost record levels, would result in decline in Iranian production and exports, which would in turn have a positive effect on the oil prices, bringing them up considerably. Neither any of the oil producing states nor the U.S. through its release of strategic reserves would be able to compensate for the loss of Iranian oil.¹⁵⁵ For this reason, military options at times when oil prices are high are unwise.

Even if a full-scale war were launched against Iran, it would not be won as easily as that against Iraq. Iran has 800,000-strong army, people’s guard of several million men and officers, and ballistic missiles that can threaten the region, including the strategic Strait of Hormuz, U.S. military bases, Israel, oil export facilities in Saudi Arabia (Ras Tanura and Yanbu), and Europe. Iran is ready to use this power in case military action against it is imminent,¹⁵⁶ and in the event of an attack, Tehran has vowed to retaliate with devastating consequences. According to Amin Saikal, “given that the Iranian regime is far more resourceful, resilient and stubborn than that of Saddam Hussein, with a willingness to wear the risk of a confrontation irrespective of its damage to Iran, its threat of retaliation has to be taken seriously.”¹⁵⁷ Further, full-scale military action against Iran is not recommended because Iran is about four times the size of Iraq and its cities are isolated across vast deserts, and its population, three times that of Iraq, is 90 percent Shi’a, and has historically remained united in times of great stress and is intensely proud and nationalistic.¹⁵⁸

In case of military strikes on Iran, Kenneth Timmerman argues that not all of Iran’s hidden nuclear assets would be taken out,¹⁵⁹ as pre-emptive strikes are unlikely to be very effective.¹⁶⁰ Israeli air force flattened Iraq’s Osirak nuclear reactor in 1981, and one could suspect Israel to attempt a similar mission against Iran. However, Iran has learnt from that episode, as it has dispersed, hidden and buried its numerous facilities. Some sites, including

¹⁵⁴ Einhorn, “A Transatlantic Strategy,” p. 29.

¹⁵⁵ Amin Saikal, “The Iran Nuclear Dispute,” *Australian Journal of International Affairs*, vol. 60, no. 2, June 2006, p. 197.

¹⁵⁶ “Iran’s Khatami Says Army Ready to Repel Strikes,” *The New York Times*, April 18, 2004.

¹⁵⁷ Saikal, “The Iran Nuclear Dispute,” p. 196.

¹⁵⁸ Precht, “War with Iran,” p. 32. For more on Iranian influence in Iraq, see Kenneth Katzman, “Iran’s Influence in Iraq,” Congressional Research Service, The Library of Congress, September 29, 2006.

¹⁵⁹ Timmerman, *Countdown to Crisis*, p. 313.

¹⁶⁰ Leonard, “Crunch-time on Iran: Five Ways out of a Nuclear Crisis,” p. 7.

Natanz, are up to 25 meters underground.¹⁶¹ Additionally, Western intelligence agencies are not confident that they know enough about Iran's nuclear program to ensure that all the relevant sites are hit.¹⁶² Moreover, even if the important targets were destroyed, Iran is so advanced in its program that it could recover the lost time relatively quickly, within one to five years.¹⁶³ All of the above factors make military option against Iran unfeasible. Richard Betts argues, "Military action might at best suppress Iran's nuclear ambitions temporarily; at worst, and no less probably, an attack could make them more intense and more dangerous."¹⁶⁴ At best, a military strike would set back Iran's program a few years, inflame public opinion there and unify the nation in its bid to go nuclear.¹⁶⁵

Finally, if either comprehensive economic sanctions are imposed against Iran, or if there is a military attack against its nuclear facilities, Iran would most likely retaliate by using the 'oil weapon', what would in turn cause havoc on world oil markets. For example, in 2005 Iranian officials claimed, "Oil could be used as a weapon to get its own way on nuclear issues."¹⁶⁶ In early March 2006, Iranian Interior Minister Mostafa Pourmohammadi supported this cause of action by arguing, "If they [the U.N. Security Council] politicise our nuclear case, we will use any means. We are rich in energy resources. We have control over the biggest and most sensitive energy route of the world... No means [for reprisals] will be ignored and we will not disregard any means."¹⁶⁷ Iranian intentions against those voting for sanctions before the U.N. Security Council are clear: "Iran will review its oil contracts," said Iranian Oil Minister Kazem Vaziri-Hamaneh, when asked about the consequences of possible sanctions.¹⁶⁸ In relation, on 14 March 2006, Iran threatened targeted oil boycotts against countries that support U.N. sanctions against it,¹⁶⁹ and "by talking of cutting its oil exports in retaliation [to economic sanctions], Iran helped talk up the market price of oil. A cut in supplies could send it far higher."¹⁷⁰ Many argued that any sanctions against Iran or any threat to Iran's exports of crude oil could push the price of

¹⁶¹ "When the Soft Talk has to Stop," *The Economist*, January 14, 2006, p. 32.

¹⁶² Leonard, "Crunch-time on Iran: Five Ways out of a Nuclear Crisis," p. 7.

¹⁶³ *Ibid.*

¹⁶⁴ Betts, "The Osirak Fallacy," p. 25.

¹⁶⁵ Fareed Zakaria, "Time to Face Reality on Iran," *Newsweek*, January 30, 2006, p. 9.

¹⁶⁶ David Thurtell quoted in "Iran Nuclear Tensions Drive Oil and Gold Higher," *The Straits Times*, February 7, 2006.

¹⁶⁷ Quoted in Nasser Karimi, "Iran Threatens to Use Oil in Nuke Standoff," *Guardian*, March 11, 2006.

¹⁶⁸ Mark Shenk, "Oil Surges on Forecasts of Decline in U.S. Gasoline Inventories," *Bloomberg.com*, March 14, 2006, <http://www.bloomberg.com>. [March 15, 2006].

¹⁶⁹ Stratfor, "China, Iran: An Oil Cutoff's Chief Victim," March 16, 2006.

¹⁷⁰ "All Still to Play for," *The Economist*, January 21, 2006, p. 46.

oil to \$100 a barrel,¹⁷¹ what surpassing the level reached during the oil shocks of 1973 and 1979, when adjusted for inflation. Pierre Terzian confirmed this view: “There are no sanctions on the oil sector in Iran that will not hurt the whole world at the same time.”¹⁷²

In early June 2006, Iran’s supreme leader, Ayatollah Ali Khamenei, threatened to block oil from leaving the Persian Gulf if Iran’s security was in danger: “Beware, if you make the slightest mistake over Iran, the energy flow through this region will be seriously in danger.”¹⁷³ In relation, Christopher Dickey argues, “[A]ny misstep in the campaign to deter Iran from developing nuclear technology that might be used for an atomic bomb could lead to an explosion in the cost of oil.”¹⁷⁴ Ian Bremmer adds that despite the fact that this “would badly damage its own economy”, “Iran’s threat to pull oil off the market is not an empty one, in part because the regime has few other weapons at its disposal.”¹⁷⁵ Thus, Iran’s calculus is essentially zero-sum, positing that Iran would be willing to accept pain in order to inflict it. If Iran takes 200,000 to 300,000 bpd (around 10 percent of its exports) of the oil market, oil markets would react not only to the fall in supply but also to fears of what Tehran might do next, and therefore, taking Iranian oil and gas exports out of the world market is something many countries would like to avoid.

All of the above gives a little less force to any parties pushing for economic sanctions or a military option. While sanctions would most likely be ineffective, fighting Iran would be bloody and endless. In such scenario, oil prices, which are already at almost record levels, would skyrocket. Washington and Israel would most likely stand alone in the world without even the “coalition of the willing” President Bush boasts of in Iraq. Finally, it is questionable whether Iran’s nuclear programme would be stopped, and even if it were slowed down, Iran would likely be even more determined to develop nuclear weapons in future. Below, I discuss the last U.S. option, diplomatic isolation, and assess whether it has been successful and if it is likely to be successful in future.

¹⁷¹ Francis, “Why Iran Cutoff Could be Suicidal,” Babak Dehghanpisheh and Christopher Dickey, “Devoted and Defiant,” *Newsweek*, February 13, 2006, p. 21, and Bremmer, “Playing the Oil Card.”

¹⁷² Quoted in Dickey, “The Oil Shield.”

¹⁷³ Quoted in “Risky Bargaining,” *The Economist*, June 10, 2006, p. 50. Also, see Richard Beeston, “Spiritual Leader Threatens to Cut West’s Oil Supplies,” *The Times*, June 5, 2006.

¹⁷⁴ Christopher Dickey, “The Oil Shield,” *Foreign Policy*, no. 154, May/June 2006, p. 38.

¹⁷⁵ Ian Bremmer, “Playing the Oil Card,” *Fortune*, April 17, 2006, p. 42. Also, see Peter Kiernan, “The Oil Weapon and Iran,” *Asia Times*, June 8, 2006.

One of the main goals of Iranian foreign policy “is to counter U.S. efforts to isolate it.”¹⁷⁶ This goal is influenced by the overarching objective of domestic regime stability, and is based on positive economic and/or military relations with other important powers, the E.U., China, India and Russia, which can help Tehran to balance the American threat. Thus, in recent years Iran has searched for and found strategic partners willing to accept its activities and willing to deal with it on a quid pro quo basis. For example, Iran’s carefully cultivated relationships with China and Russia are according to Sanam Vakil, “providing it with the economic and political coverage that it could never obtain from the West.”¹⁷⁷ China will resist pressuring Iran concerning its nuclear program, and will seek to guarantee the availability of energy supplies. Russia will also resist calls for sanctions against Iran.¹⁷⁸ Thus, after Japan exited the Azadegan deal, the Iranian Government was left with alternative options. Tehran previously suggested that if Japan exited the Azadegan deal under the threat of the ILSA, and did not begin work on the field by 22 September 2006, then China or Russia will be happy to step in.¹⁷⁹ Indeed, diplomatic and trade ties between Iran and China, and Iran and Russia have been very close, and it is very likely that China or Russia will become the ultimate beneficiaries of Japan’s efforts in Azadegan.¹⁸⁰ Below, I examine Iran’s close relationship with China and Russia, but also with India and the E.U.-3, other important powers used to counterbalance the U.S. effort to isolate Tehran.

China

Although the Sino-Iranian relationship has long and deep historical roots, China and Iran established diplomatic relations only in 1971, and became strategic allies as a result of Chinese arms sales in the 1980s. Despite the fact that both nations have experienced revolutionary change in the intervening decades, their continued relationship demonstrates that both countries value political pragmatism, strategic imperatives, and economic trade

¹⁷⁶ *Ibid.*, p. 22.

¹⁷⁷ Sanam Vakil, “Iran: Balancing East against West,” *The Washington Quarterly*, vol. 29, no. 4, Autumn 2006, p. 51. Also, see Mohammed E. Ahrari, “Iran, China, and Russia: The Emerging Anti-US Nexus?” *Security Dialogue*, vol. 32, no. 4, 2001, pp. 453-66.

¹⁷⁸ Richard N. Haass, “The New Middle East,” *Foreign Affairs*, vol. 85, no. 6, November/December 2006, p. 6.

¹⁷⁹ This possibility has been suggested in “Iran Plays China Card with Japan on Oil Deal,” *Japan Times*, May 26, 2006; “Iran Hints Suitors Set to Replace Inpex,” *Japan Times*, June 1, 2006; “Iran Eyes Russia, China if Japan Stalls on Oil Deal,” *Japan Times*, August 29, 2006; and “Between Rock and a Hard Place.”

¹⁸⁰ Mayumi Negishi, “China to Swoop on Iran Oil Field If Tokyo Pulls Support: Firms,” *Japan Times*, August 18, 2005.

above discrepancies in ideology and religion.¹⁸¹ The two countries share a similar narrative as historically great civilisations whose progress toward modernity was retarded by Western infringement,¹⁸² but the friendship is also built on commercial interests and a mutual commitment to a multipolar world to blunt U.S. influence.

Iran views its friendship with China as vital to its continued ability to resist pressure from the West and endure sanctions.¹⁸³ Meanwhile, China sees Iran as a major player in the Middle East, and a strong partnership with Iran has enhanced China's capacity to become an important player in regional affairs.¹⁸⁴ In early 2007, Iran was China's primary source of oil, and on average, it supplied 15 percent of China's annual oil imports.¹⁸⁵ Beijing's unquenchable thirst for oil supplies explains the ambitious Memorandum of Understanding that Iran and China (through Sinopec) signed in October 2004. Under this agreement, China may buy between \$70 billion and \$100 billion of Iranian oil and natural gas over the next 30 years, while developing Yadavaran, Iran's biggest onshore oilfield, and South Pars fields in the Persian Gulf, the largest natural gas reserve on the planet. On signing the deal, Iran's Petroleum Minister announced that Tehran would like to see China replace Japan as Iran's largest oil importer.¹⁸⁶ In addition, the two countries agreed to construct a pipeline in Iran to take oil 386 km to the Caspian Sea to link up with the pipeline from China to Kazakhstan.¹⁸⁷ It is no accident that Iran signed these agreements with a permanent member of the U.N. Security Council, which the United States would like to use to sanction Iran for its nuclear activities. After signing major energy deals with Iran, China would not respond to U.S. pressure, what makes it a very attractive business partner for Tehran. Illustrative of this is that after these agreements had been signed, Li Zhaoxing, the Chinese Foreign Minister, paid a visit to Iran, and stated that China saw "no reason" to refer Iran's nuclear program to the UN. China is reluctant to see any U.N.

¹⁸¹ Douglas, Nelson and Schwartz, "Fueling the Dragon's Flame," p. 5.

¹⁸² For more on historical roots of Sino-Iranian relationship, see John Calabrese, "China and Iran: Mismatched Partners," The Jamestown Foundation, Occasional Paper, August 2006, p. 3.

¹⁸³ Douglas, Nelson and Schwartz, "Fueling the Dragon's Flame," pp. 2 and 6.

¹⁸⁴ For more on this relationship, see Calabrese, "China and Iran: Mismatched Partners"; Douglas, Nelson and Schwartz, "Fueling the Dragon's Flame," pp. 5-10; Howard, *Iran Oil*, pp. 88-104; J. Brandon Gentry, "The Dragon and the Magi: Burgeoning Sino-Iranian Relations in the 21st Century," *The China-Eurasian Forum Quarterly*, November 2005; John W. Garver, *China and Iran: Ancient Partners in a Post-imperial World* (Seattle: University of Washington Press, 2006).

¹⁸⁵ See Tian Hui, "Energy Drives China to Big Iran Market," *Oriental Morning Post*, June 28, 2005 (author's translation) and David Harman, "China's Crude Oil Import Rises 3.5% in January," *Resource Investor*, March 1, 2007.

¹⁸⁶ Engdahl, "China Lays Down Gauntlet in Energy War."

¹⁸⁷ *Ibid.*

measures that prevented access to Iran's oil and gas, and is a major obstacle in any attempt by the U.S. to get sanctions imposed.¹⁸⁸

Iran's importance in Chinese foreign policy is evident in comments made by a Chinese scholar: "Iran is the key to the Gulf's security and stability ... China must strengthen its economic and political ties to Iran."¹⁸⁹ According to Dingli Shen, "Tehran is an energy source that Beijing cannot refuse and the protection of China's energy relationship with Iran is of vital importance."¹⁹⁰ David Lampton and Richard Ewing suggested that Beijing values its ties to Tehran highly enough to allow it to cause genuine strains in the Sino-American relationship.¹⁹¹ China's relationship with Iran is Beijing's deepest and most substantial bilateral relationship in the region.¹⁹² Meanwhile, "China occupies an important position in Iranian foreign policy,"¹⁹³ as it mitigates the impact of U.S. imposed restrictions on Western investment in Iranian oil industry.¹⁹⁴ According to an Iranian oil industry official, "China and Iran are perfectly matched for each other," as "China has the world's biggest market of customers and no secure resource for energy. We have a lot of energy, and we need foreign currency. And they have a lot of money to invest. It's a win-win situation."¹⁹⁵ Clear signs of close bilateral relationship between Beijing and Tehran were obvious when Chinese President Hu Jintao was among the first to congratulate Iran's new conservative president Mahmoud Ahmadinejad on his election victory in June 2005.

In return for oil and natural gas, Iran imports manufactured goods from China, including computer systems, household appliances and cars, and awarded China the right to build a fleet of super-tankers that will transport oil to China. Iran also promised to provide funds

¹⁸⁸ "Key Nations' Stances on Iran," BBC News, January 31, 2006, http://news.bbc.co.uk/go/pr/fr/-/2/hi/middle_east/4662676.stm, [February 15, 2006].

¹⁸⁹ Zhang Xiaodong, "China's Interests in the Middle East: Present and Future," *Middle East Policy*, vol. 6, no. 3, February 1999, p. 150.

¹⁹⁰ Dingli Shen, "Iran's Nuclear Ambitions Test China's Wisdom," *The Washington Quarterly*, vol. 29, no. 2, Spring 2006, p. 62.

¹⁹¹ Lampton and Ewing, *The US-China Relationship*, p. 26.

¹⁹² *Ibid.* p. 25.

¹⁹³ Mohsen Mirdamadi, a deputy chairman of the National Security and Foreign Policy Committee of the Iranian Parliament, quoted in "China has Important Position in Iranian Foreign Policy," *Islamic Republic News Agency*, August 7, 2004.

¹⁹⁴ Leverett and Noël, "The New Axis of Oil," p. 69.

¹⁹⁵ Ali Akbar Vahidi Ale-Agha, Deputy Managing Director of Petroleum Engineering & Development, an NIOC subsidiary, quoted in Vivienne Walt, "Iran Looks East," *Fortune*, February 21, 2005.

to upgrade China's refinery capacity to process Iranian crude.¹⁹⁶ Moreover, in recent years China built power plants, cement factories and joint shipping lines in Iran.¹⁹⁷ There are an estimated 250 Chinese companies engaged in various projects or else selling low-cost consumer products in Iran.¹⁹⁸ However, it is in terms of arms sales that links have been the strongest. Tehran found Chinese arms to be of good quality and cheaper than arms available from other sources. As a result, China quickly became Iran's foremost supplier of military equipment.¹⁹⁹ Beijing supplied Tehran with \$800 million worth of conventional weapons between 1995 and 2002.²⁰⁰ This relationship grew over the years, including Tehran's purchase of Chinese C-801 and C-802 anti-ship Silkworm missiles. It was after this sale that Washington began to worry about shipping traffic in the Strait of Hormuz and the safety of U.S. naval forces and general tanker traffic.

In addition, Beijing negotiated deals to supply Iran with equipment and technology useful for making nuclear, chemical and biological weapons, despite having signed international agreements prohibiting the proliferation of such technologies.²⁰¹ Beijing began assisting Tehran's nuclear program in the early 1990s, supplied Tehran with several research reactors, and expanded nuclear cooperation with Iran well beyond the limits of purely civilian research and technology.²⁰² In 2003, Gholamreza Aqazadeh, the head of Iran's Atomic Energy Organization, stated that Iran imported 1,800 kilograms of uranium hexafluoride gas from China in 1991, before China joined the NPT regime.²⁰³ If Iran is

¹⁹⁶ Fereidun Fesharaki and Kang Wu, *A Survey of Energy Investment Ties Between Asia and the Middle East* (Honolulu: East-West Center, June 1998), pp. 21-2.

¹⁹⁷ Barry Rubin, "China's Middle East Strategy," *Middle East Review of International Affairs*, vol. 3, no. 1, March 1999, p. 3.

¹⁹⁸ Calabrese, "China and Iran: Mismatched Partners," p. 6.

¹⁹⁹ Daniel Sutherland, "China Boosts Arms Sales to Middle East," *Washington Post*, April 4, 1998, p. A1.

²⁰⁰ Richard Grimmett, *Conventional Arms Transfers to Developing Nations, 1995-2002* (Washington, D.C.: Library of Congress, Congressional Research Service, 2003), p. 59. China sold Iran a variety of armoured vehicles; fighter planes; artillery, anti-tank, surface-to-surface, and anti aircraft missiles; small ships; naval mines; and land- or naval-based cruise missiles. For more details see Michael Eisenstadt, "Chinese Military Assistance to Iran: Trends and Implications," in *Asia and Pacific Rim Institute, Chinese Arms and Technology Transfers to Iran, June 1997*; Bates Gill, *Silkworms and Summitry: Chinese Arms Exports to Iran and the US-China Relationship* (American Jewish Committee, 1997); Bates Gill, "Chinese Arms Exports to Iran," *Middle East Review of International Affairs*, vol. 2, no. 2, May 1998; and Yitzhak Shichor, "Unfolded Arms; Beijing's Recent Military Sales Offensive," *Pacific Review*, vol. 1, no. 3, 1998.

²⁰¹ Barry Rubin shows that China has violated its commitments under the Missile Technology Control Regime (MTCR) by supplying Iran with unconventional long-range missiles. China acted against the NNPT by supplying Iran with equipment and technology useful for making nuclear weapons. Finally, by selling chemical precursors, production equipment and technology to Iran, Beijing violated the Chemical Weapons Convention. Rubin, "China's Middle East Strategy," p. 4. Also see Timmerman, *Countdown to Crisis*, pp. 119-20, 130.

²⁰² Joseph Cirincione, *Deadly Arsenal: Tracking Weapons of Mass Destruction* (Carnegie Endowment for International Peace, June 2002), p. 150. For more details, see Timmerman, *Countdown to Crisis*, pp. 103-4, 107, 157-9.

²⁰³ Najmeh Bozorgmehr and Judy Dempsey, "E.U. to Join U.S. in Pressing Tehran on Nuclear Checks," *Financial Times*, June 11, 2003, p. 4.

today well on its way toward an indigenous nuclear-weapons capacity, then it is thanks in no small part to Beijing.²⁰⁴

China's cooperation with Iran did not go unnoticed in Washington, and Beijing has been encouraged to pressure Iran to surrender its nuclear ambitions. However, China feels little threat from Iran's nuclear program, and is unlikely to ignore the UNOCAL case (see Chapter 5), when American strategic interests prevented CNOOC from acquiring that mid-sized oil independent.²⁰⁵ Bill Powell highlighted the crucial importance of China's decision in the implication of possible U.N. sanctions: "For whether the world stands any chance of eventually imposing sanctions that might get the mullahs' attention will be decided in China, by President Hu Jintao and the leadership of the Chinese Communist Party."²⁰⁶ It is easy to predict Beijing's decision, as it will "not support a largely Western action to sanction Iran,"²⁰⁷ and will use its veto power to prevent sanctions against Iran in case they are on the U.N. Security Council agenda. In similar manner, China has in past blocked Council action against Sudan because of its oil interests there, despite the genocide in Darfur. The same day that Iran was given a one-month deadline to end uranium enrichment or face possible sanctions, China's head of central planning, Ma Kai, was in Tehran trying to finalise plans for Sinopec to develop Yadavaran oil-field.²⁰⁸

Russia

Besides China, Iran also uses Russia's support to balance the U.S. attempt at isolation. Since 1995, Russia has been the primary supporter of Iran's nuclear program.²⁰⁹ This support was so evident that "stopping Russian assistance to Iran's nuclear program was a high priority for the U.S. throughout much of the 1990s."²¹⁰ Despite a long-standing

²⁰⁴ For more, see Jing-Dong Yuan, "China and the Iranian Nuclear Crisis," *China Brief*, vol. 6, no. 3, February 1, 2006.

²⁰⁵ Diengli Shen argues that CNOOC's failed attempt to acquire UNOCAL "raised Iran's value to Beijing in its search for energy security." Shen, "Iran's Nuclear Ambitions Test China's Wisdom," p. 62.

²⁰⁶ Powell, "The New Power in the Persian Gulf," p. 56.

²⁰⁷ Shen, "Iran's Nuclear Ambitions Test China's Wisdom," p. 65.

²⁰⁸ Douglas, Nelson and Schwartz, "Fueling the Dragon's Flame," p. 8.

²⁰⁹ For more details, see Timmerman, *Countdown to Crisis*, pp. 229-30; Vladimir A. Orlov and Alexander Vinnikov, "The Great Guessing Games: Russia and the Iranian Nuclear Issue," *The Washington Quarterly*, Spring 2005, pp. 49-66; Robert O. Freedman, "Russia and Iran: A Tactical Alliance," *SAIS Review of International Affairs*, vol. 17, no. 2, 1997, pp. 93-109; Freedman, "Putin, Iran, and the Nuclear Weapons Issue," *Problems of Post-Communism*, vol. 53, no. 2, March/April 2006, pp. 39-48; and Carol R. Saivetz, "Russia's Iran Dilemma," *Russian Analytical Digest*, no. 6, September 19, 2006, pp. 9-11.

²¹⁰ Einhorn, "A Transatlantic Strategy on Iran's Nuclear Program," p. 21.

history of Russian meddling in Iran, bilateral ties today are at their highest level since World War II.²¹¹ Russia's experience with Iran, whether in Tajikistan, where the two countries cooperated to end a brutal civil war, and elsewhere in the former Soviet domain, where Iran abstained from fomenting Islamist revolutions, or with respect to Chechen separatism, which Iran has de facto condemned, has been largely positive.²¹² Alexander Maryasov, a long-standing Russian ambassador to Tehran argues, "We [Russia] are in agreement with Tehran that no other great foreign power should gain influence in the Caspian Sea," and Russia and Iran are likely to expand cooperation based on these "identical views."²¹³ This cooperation is, for example, evident in the fact that in the 1990s Iran cooperated with Russia in the development of the Caspian energy fields. In addition, while suspicious of U.S. and Turkish designs on the region, the two countries worked to thwart the U.S.-backed Baku-Tbilisi-Ceyhan (BTC) pipeline, as by coordinating with Gazprom, NIOC lowered the price of oil swaps with Turkmenistan, Kazakhstan, and Azerbaijan.²¹⁴ However, their joint efforts to thwart the importance, and prevent the construction of BTC pipeline were unsuccessful. Moreover, more recently, it has been suggested that Iran and Russia are working on preliminary plans to establish a "Natural Gas OPEC," with the ultimate goal of blocking European efforts to diversify sources of their natural gas imports.²¹⁵

Based on close cooperation, some have even gone so far as to suggest that Russia and Iran reached a strategic partnership abiding by their interests.²¹⁶ A more plausible view of Russo-Iranian relationship is offered by Ray Takeyh, who argues, "During the past decade, a tacit yet important bargain has evolved between Russia and Iran." In this bargain, on one

²¹¹ Athanasiadis, "A Troubled Triangle."

²¹² Dmitri Trenin, "Russia's Nuclear Policy in the 21st Century Environment," *Proliferation Papers*, Institut Français des Relations Internationales, Paris, Autumn 2005, p. 24; A. William Samii, "Iran and Chechnya: Realpolitik at Work," *Middle East Policy*, March 2001; Kaveh L. Afrasiabi, "Russia Plays a Double Game Over Iran," *Asia Times*, November 4, 2006; and Takeyh, *Hidden Iran*, p. 78.

²¹³ Quoted in Klevevan, *The New Great Game*, p. 140.

²¹⁴ R. Hrair Dekmejian and Hovann H. Simonian, *Troubled Waters: The Geopolitics of the Caspian Region* (New York: I.B. Tauris, 2001), p. 78. Also, see Robert O. Freedman, "Russian Iranian Relations in the 1990s," *Middle East Review of International Affairs*, vol. 4, no. 2, 2000; and Arbakhan Magomedov, "Russia's Policy Toward the Caspian Sea Region and Relations with Iran," *Russian Analytical Digest*, no. 6, September 19, 2006, pp. 16-7.

²¹⁵ Magomedov, "Russia's Policy Toward the Caspian Sea Region and Relations with Iran," p. 17. Besides, Russia, through Gazprom, purchased stakes in several natural gas industry companies in Libya, and signed a wide-ranging cooperation agreement with Sonatrach, the Algerian NOC, after Russia forgave Algeria's \$4.7 billion debt. Besides Iran, Algeria and Libya are precisely the supplier countries that the Europeans named as possible alternative sources of supply to Russian gas.

²¹⁶ Pepe Escobar, "Russia and Iran Lead the New Energy Game," *Asia Times*, July 20, 2006. For more on Russo-Iranian relationship, see Howard, *Iran Oil*, pp. 104-11.

hand, Iran has emerged as Russia's most important partner in the Middle East and as a valuable market for its cash-starved defence industry. On the other hand, Iran has kept a low profile in Central Asia and has refrained from destabilising a region critical to Russia's security. According to Takeyh, this important relationship has "led Moscow to provide Iran indispensable diplomatic support, particularly at a time when its nuclear portfolio is being addressed in a variety of international organisations."²¹⁷

Russia, together with China, is one of Iran's most important weapons suppliers, and Russian arms deliveries to Iran are a key aspect of the close relationship, which itself has been described as "one of the most important geopolitical episodes of the post-Cold War era."²¹⁸ Between 1991 and 2001, Russia has supplied \$3 billion worth of modern weapons to Iran.²¹⁹ In December 2005, Russia confirmed a deal to sell 30 surface-to-air (Tor M1) missile systems to Iran for \$1 billion, drawing criticism from the United States and Israel. These missile systems are capable of protecting a target from up to 48 incoming planes or projectiles to a range of six kilometres. The Tor M1 purchase is just the first stage of a more comprehensive Iranian purchasing program, as there are ongoing talks between Moscow and Tehran to purchase S-300 strategic air-defence system, which has a range of 150 km and is one of the most sophisticated in the world.²²⁰ Russia has also agreed to upgrade Iran's small fleet of MiG-29 interceptor planes to make them more effective against enemy aircraft.

Further, Russia works to complete the Bushehr light-water nuclear reactor, which is to be operational by November 2007, and views Iran as a lucrative market for its civilian nuclear industry. In February 2005, Moscow and Tehran concluded an agreement under which spent nuclear fuel from Bushehr would be shipped back to Russia.²²¹ In September 2005, Russia, together with China, abstained in the IAEA vote, which declared Iran in violation of its NPT commitments for having hidden its enrichment work, thus clearly showing

²¹⁷ Takeyh, *Hidden Iran*, pp. 78-9.

²¹⁸ "Study on Energy Supply Security and Geopolitics", p. 168.

²¹⁹ A. Cohen, "Putin's Foreign Policy and US-Russian Relations," *The Heritage Foundation*, no. 1406, January 18, 2001. For more details, see Timmerman, *Countdown to Crisis*, pp. 197-203; and Mikhail Barabanov, "Russia on Iran's Market for Arms," *Moscow Defense Brief*, no. 1, 2006, pp. 12-5.

²²⁰ Owen Matthews and Kevin Peraino, "Iran: Bolstering Its Defenses," *Newsweek*, December 19, 2005, p. 4; Andrew Kramer, "Russia to Sell Anti-Aircraft Missiles to Iran in Billion-Dollar Deal," *New York Times*, December 3, 2005; Lyuba Pronina, "Moscow Inks Arms Deal with Tehran," *Moscow Times*, December 5, 2005.

²²¹ Trenin, "Russia's Nuclear Policy," p. 24.

their support for Iran. In addition, in late March 2006, both countries refused to have Iran's nuclear activities declared "a threat to peace and security" at the U.N. Security Council, since this could open the door to tougher action in future.²²² Moreover, the Putin government has maintained that Russia would not support U.N. Security Council resolutions that condemn Iran's nuclear energy program or apply economic sanctions against Iran.²²³ To the Kremlin, Iran has been a well-behaved neighbour, which has kept out of Chechnya, and the Russians want to keep it this way.²²⁴ Russia also benefits from any speculation of Middle Eastern instability (particularly concerning the Iranian nuclear program), that keeps oil prices high. Likewise, if not constrained, a part of Iran's agenda is to drive oil prices even higher, and one can see a lot of mutual interest.²²⁵

India

As part of Tehran's eastern diplomatic offensive, it has built solid trade relations with India and is pursuing a common policy in Central Asia, a key strategic region.²²⁶ In January 2005, the state run Indian Oil Corp. (IOCorp) reached an agreement with the Iranian firm Petropars to develop a gas block in the gigantic South Pars gas field, home to the world's largest reserves.²²⁷ At the same time, India is cooperating with Iran on securing Persian Gulf sea-lanes and is helping develop Iran's Chahbabar port into a regional hub. In addition, there has been a rapid expansion in energy ties. Iran and India are currently engaged in a joint project to build a gas pipeline that would also cross Pakistan. Dubbed the "peace pipeline", the \$4.5 billion project could cement relations between Iran, India and Pakistan.²²⁸ Unsurprisingly, Washington signalled its displeasure with India's collaboration with Iran when U.S. Secretary of State Condoleezza Rice stated that

²²² "Diplomacy Drags," *The Economist*, April 1, 2006, p. 39.

²²³ Jephraim P. Gundzik, "The Ties That Bind China, Russia and Iran," *Asia Times*, June 4, 2005; "Imposing Sanctions on Iran Illegal – Russian Diplomat," *MosNews*, April 30, 2006, <http://www.mosnews.com>, [April 30, 2006].

²²⁴ "Russia is not a Piece of Furniture," *The Economist*, April 22, 2006, p. 47.

²²⁵ Ariel Cohen, "How the U.S. can Crash a Cosy Club," *The Straits Times*, June 15, 2006.

²²⁶ For more on Indian-Iranian relationship past and present, see Kemp, "The East Moves West," Farah Naaz, "Indo-Iranian Relations 1947-2000," *Strategic Analysis*, vol. 24, no. 10, May 2001; A.K. Pasha, *India, Iran and the GCC States* (New Delhi: Manas Publication, 2000); Howard, *Iran Oil*, pp. 111-22; John Calabrese, "Indo-Iranian Relations in Transition," *Journal of South Asian and Middle Eastern Studies*, vol. 25, no. 5, Summer 2002; Harsh V. Pant, "India and Iran: An 'Axis' in the Making?" *Asian Survey*, vol. 44, no. 3, July/August 2003; C. Christine Fair, "Indo-Iranian Relations: Prospects for Bilateral Cooperation post-9-11," in Robert Hathaway (ed.), "The 'Strategic Partnership' Between India and Iran," *Asia Program Report*, no. 120, April 2004; and C. Christine Fair, "Indo-Iranian Ties: Thicker than Oil," paper presented at the 2006 Global Dialogue on Energy Security, Beijing, China, October 16, 2006.

²²⁷ Jason Athanasiadis, "A Troubled Triangle: Iran, India and Pakistan," *Asia Times*, April 22, 2005.

²²⁸ For more see Sonya Fatah, "A Pipeline of a Pipe Dream?" *Fortune*, December 26, 2005, pp. 24-6.

Washington had concerns over the pipeline deal. In a rare snub to Washington, and after beginning to realise that links with Tehran translate into diplomatic coin in Washington, India responded by saying that long-term energy security, not politics, would dictate its energy policy.²²⁹ “I think that there are a number of companies working in Iran, including a large number of European companies,” Indian Petroleum Secretary S. C. Tripathi said. “A large number of countries are having economic relations with Iran, therefore it should be possible for us also to work out a reasonable and well-drafted and well-crafted hydrocarbon agreement with Iran. I think it should be possible.”²³⁰

The Indo-Iranian relationship has much more to it than simple oil and gas interests. India and Iran, similar to China and Iran, have cultivated limited military relations, conducting a joint naval exercise in March 2003 that was motivated on Tehran’s part by the U.S. naval presence in the Persian Gulf. Iran is also seeking India’s help for servicing its naval and air-force equipment, including its MiG-29 jets. According to a recent CSIS report, “Iran’s Developing Military Capabilities,” Tehran sought India’s help in developing batteries for submarines, which are more suitable for the warm waters of the Gulf than those supplied by Russia. Unlike Beijing, anxious not to antagonise Washington, New Delhi has been cautious in keeping its distance from Iran on the nuclear issue, although it has claimed to help Tehran with generating nuclear energy.²³¹

The E.U.-3

The European countries’ policy toward Iran differs from that of the U.S.²³² For example, when the Clinton administration decided in 1995 to impose sanctions against investments in Iran, the American action pushed the Europeans to make a choice. They were to either work with Washington to squeeze Tehran to stop its nuclear programs and end its alleged terrorism, or continue to trade with Iran. Not a single European government was willing to cut economic links with Iran to side with the United States.²³³ More recently, unlike in the case of Iraq, the European leaders have commonly stated that they would oppose

²²⁹ Ibid; and Wesley, “The Geopolitics of Energy Security in Asia,” p. 8.

²³⁰ Ibid.

²³¹ Ibid.

²³² For more see Bruno Tertrais, “A Fragile Consensus,” *The National Interest*, no. 83, Spring 2006, pp. 31-4.

²³³ Wright, “Dateline Tehran,” p. 171.

military action against Iran.²³⁴ On 17 June 2002, the E.U. gave the green light to launch formal trade relations with Iran, despite heavy pressure from the U.S. Hence, today, the E.U. is Iran's main trade partner. In 2000, the E.U. imports from Iran totalled over \$8 billion, more than 80 percent of which consisted of oil products, and exports to Iran amounted to \$5.5 billion.²³⁵ Although the E.U. does not provide Iran with weapons or nuclear technology, its energy investment and diplomatic support are valuable assets for Tehran. Another factor contributing to difficulties the U.S. is facing in getting the E.U. to stand by its side regarding Iran is the fact that Iran began pricing its oil in euros, and as of late 2006, 57 percent of Iran's oil exports income was received in euros.²³⁶ If this trend continues, the euro could establish a foothold in the international oil trade, which would be beneficial to the EU. It would also be beneficial to Iran as it would be logical that Iran is paid in the national currency of one of its major customers.²³⁷

The E.U. often acts as a negotiator and thus helps the U.S. in pressuring Iran to abandon its nuclear program, and for most Europeans, Iran's nuclear ambitions became a major preoccupation since August 2002 when an Iranian opposition group publicly disclosed the locations of two previously secret nuclear facilities in Iran. Nevertheless, the E.U. can do very little to punish Iran. If it attempts to impose sanctions against Iran, this would hurt the E.U. economy just as much as Iran's, as a large share of Europe's oil and gas comes from Iran (see Table 6.3).²³⁸ Thus, Iran sees its growing commercial ties with Europe as a source of advantage over Europeans. This is rightly so, as Europe would find it hard to replace oil and gas it imports from Iran with that from other sources, especially

²³⁴ "Study on Energy Supply Security and Geopolitics", p. 168.

²³⁵ *Ibid.*

²³⁶ Carl Mortishead, "Iran Turns from Dollar to Euro in Oil Sales," *Times* (London), December 22, 2006. This occurred even before the new Iranian Oil Bourse (IOB) was launched. For more on IOB, see "New Year Ambition for Iran's Oil Bourse," *Middle East Economic Digest*, vol. 50, no. 11, March 17, 2006, p. 11; and Clark, *Petrodollar Warfare*, pp. 150-60.

²³⁷ The U.S. dollar has been the strongest currency of the world for more than half a century, with about 70 percent of all currency reserves in American dollars. This is closely related to the fact that oil, the most important commodity traded in the world, is mostly priced in U.S. dollars, and hence the majority of oil importing countries have to buy their oil in U.S. dollars, which in turn forces them to keep most of their foreign currency in dollars. Thus, Iran's move is a part of very intelligent, creative strategy to go on the offence in every way possible and mobilise other actors against the U.S., as oil in euros would benefit the E.U. and it would loosen the grip the U.S. has on OPEC members. If Iran launches the IOB, the U.S. dollar could weaken and the euro could strengthen, thus making imported goods more expensive for the U.S. and threatening its economic growth.

²³⁸ In addition, in 2004, German companies exported goods worth \$4.43 to Iran, and Germany was the largest exporter of goods to Iran. See "Key Nations' Stances on Iran." If sanctions were implemented against Iran, German exporters would suffer due to a loss of an important market.

considering recent developments concerning oil and gas imports from Russia, and at times when oil supplies are extremely tight and there is limited spare production capacity.

Table 6.3: Iran's Oil Exports to Europe (2001-2005; kbpd)

	2001	2002	2003	2004	2005
Italy	206.5	189.0	202.2	226.5	293.8
France	72.9	76.3	111.4	124.8	210.7
Others	568.9	445.3	520.1	567.5	556.7
Total Europe	848.3	710.6	833.7	918.8	1,061.2

Source: Organization of the Petroleum Exporting Countries, OPEC Annual Statistical Bulletin 2005 (Vienna, Austria: Ueberreuter, 2006), p. 85.

Very few of European IOCs have felt bound by unilaterally imposed U.S. sanctions against Iran (ILSA).²³⁹ In September 1997, when the French company TotalFinaElf and the Russian giant Gazprom struck a \$2 billion deal with Iran to develop the huge offshore South Pars field in the Persian Gulf, Washington issued thinly veiled threats to fine the company's branches in the United States, but Total's CEO Thierry Desmarest remained unimpressed. "Nobody recognises the extraterritorial character of the law, which goes against the principle of sovereignty in relations between nations. We reckon we are free in our movements," he concluded. Lionel Jospin, the French Prime Minister, who noted, "no one accepts that the United States can now impose their laws on the rest of the world"²⁴⁰, seconded Desmarest. The Clinton administration acquiesced, assuring that Total would not face legal consequences in this case.²⁴¹ European companies have taken advantage of the absence of American competition on the Iranian oil market. A French diplomat suggested, "We [France] continue not to accept the sanctions of the United States. We generally reject the American logic that Iran must be isolated."²⁴² France, along with other European countries, seeks instead to integrate Tehran economically, and hence, just in 2001, trade between France and Iran grew by 50 percent.²⁴³ Although it is important to note that most European IOCs have recently put their potential projects in Iran on hold because of the political uncertainties and pressure from the United States,²⁴⁴ in summary,

²³⁹ Kleveman, *The New Great Game*, p. 136.

²⁴⁰ Both quoted in Amineh Parvizi Mehdi, *Towards the Control of Oil Resources in the Caspian Region* (New York, 1999), p. 113.

²⁴¹ Kleveman, *The New Great Game*, p. 136.

²⁴² *Ibid.*

²⁴³ *Ibid.*, pp. 136-7.

²⁴⁴ Leverett and Noël, "The New Axis of Oil," p. 69.

European policy towards Iran has diverged from Washington's, and this transatlantic divide has been playing into Iranian hands.²⁴⁵

With the exception of Japanese withdrawal from the Azadegan project, the evidence presented above suggests that rather than Iran, the U.S. has been isolated in its policy towards Iran. Tehran has been largely successful in balancing the pressure, which it receives from Washington by pursuing skilful diplomacy to gather support mainly from Beijing and Moscow, and to a lesser extent from New Delhi and various European capitals. Thus, the U.S. attempt at isolating Tehran diplomatically has been too tame.

Outcome

As of early 2007, there is no end in sight for the Iranian nuclear saga, since Iran is neither close to acquiring nuclear weapons capability nor close to giving up its pursuit. Iran has long used oil as a tool for statecraft,²⁴⁶ and in recent years, Iran has successfully used its oil connections with China and Europe, and various other connections with Russia, to pursue its nuclear program. Oil prices increase every time there is talk of sanctions or military action taken against Iran, due to the speculation associated with potential Iranian retaliation to sanctions or military action, which would involve oil. This shows how important Iranian oil is to the international oil market and it gives Iran a crucial bargaining chip in its pursuit of nuclear technology. Iranian leaders are pursuing nuclear technology in order to maintain regime stability from outside threats, particularly the U.S. and Israel. While they use oil to support their nuclear pursuit, oil also plays a crucial role in maintaining regime stability from inside threats, as oil export revenues are the lifeline of the economy. In order to maintain or increase its oil exports revenues, Iran needs to maintain or increase its oil export volumes,²⁴⁷ and in order to do so its oil industry needs investment. While some of this investment is generated locally, the rest comes from abroad, as companies from China, Russia, France, and many more countries, continue investing in Iran's oil exploration and production, despite the U.S. sanctions. Considering

²⁴⁵ For more on transatlantic divide over Iran, see Howard, *Iran Oil*, pp. 45-71.

²⁴⁶ For more, see Brumberg and Ahran, "The National Iranian Oil Company in Iranian Politics," p. 31.

²⁴⁷ This implies that Iran needs to increase its production, since its domestic consumption has been rising steadily, and is thus eating into the oil available for exports.

the surging demand for oil imports in China and India, and the lack of opportunities for oil companies in many other countries, it is highly likely that these funds will keep on coming. Currently, Iran, China, Russia, and European oil companies are clearly on the winning side of the bargain, and the U.S., its oil companies, Japan, and Israel are on the losing side. For others, the E.U.-3 and India, who are stuck between a rock (the U.S.) and a hard place (Iran) it is rather unclear.

Analyses and Conclusions

In the post-Iraq war environment the Tehran regime feels insecure, especially since the Pentagon now uses offensive doctrine of pre-emption as an add-on to its measures against non-deterrable threats (“axis of evil” states), as evident in the case of Iraq.²⁴⁸ Iranian knowledge that Israel, a country that does not have diplomatic relations with Iran, has nuclear weapons creates a deep environment of insecurity in Iran. Thus, nuclear weapons would give Iran the implicit threat of retaliation against any international or regional actor that may choose to threaten its sovereignty. Iran’s policy-makers have calculated that they can move forward with the country’s nuclear program without any serious repercussions. Instead of worrying about what the U.S. might do to hold back their nuclear program, Iranians have skilfully gathered support from Russia, and most importantly, China. The Sino-Iranian alliance is mutually beneficial: Iran supplies the energy-hungry China with oil, which is essential to China’s rapidly expanding economy (see Table 6.4). While in 2004 and 2005, around 11 percent of Chinese crude oil imports came from Iran, thus making it the third largest source of crude oil for China (Table 6.4), this figure increased considerably by early 2007, when with 515,000 bpd, or 15.6 percent, Iran became the largest source of China’s crude oil imports.²⁴⁹ Japan and India are in the similar situation as China regarding their oil imports from Iran (Table 6.4), and thus both countries have much to lose for not supporting Iran internationally. In return for access to its crude oil, China provides Iran with military and civilian nuclear technology, weapons and most importantly, diplomatic support. Sino-Iranian dealings are fuelled and politicised by both countries’ dislike of the United States.

²⁴⁸ For more detail, see Record, “The Bush Doctrine.”

²⁴⁹ David Harman, “China’s Crude Oil Import Rises 3.5% in January,” *Resource Investor*, March 1, 2007.

Table 6.4: Iran's Oil Exports to Asia (2004 and 2005; kbpd)

	2004	2005
Japan	630	581
China	266	287
India	220	205
South Korea	178	194
Asian "Big Four"	1,294	1,265
Total Oil Exports	2,506	2,390

Sources: "China and Japan's 10 Crude Suppliers 2004 - 2005," INTERTANKO, February 6, 2006, <http://www.intertanko.com>, [March 9, 2006]; BP Statistical Review of World Energy 2006.

In past, Iran threatened to review its oil contracts with countries voting in favour of sanctions before the U.N. Security Council. Its threat will hold much weight with China, especially as in the past Iran cancelled an energy project with India worth \$22 billion, because India voted in favour of IAEA draft resolution threatening to bring the Iranian nuclear issue before the Security Council.²⁵⁰ If China, the state which has so far been most adamant about keeping any international chastising of Iran, ever voted in favour of comprehensive sanctions, it would risk losing badly needed oil supplies from Iran. In other words, voting against the Iranian interests would have negative consequences for China because Iran is China's major oil supplier, and its supplies could be reduced or cut. If China continues its international support of Iran it will likely be rewarded by winning over the contract to develop the world's second largest oil field, Iran's Azadegan, recently given up by Japan after U.S. pressure.²⁵¹ If the nuclear controversy leads to Iran's total isolation from European and Japanese oil companies, then Tehran will increasingly turn to Chinese NOCs, supplement their investment capital with expertise from more technologically advanced Russian companies, and rely on government-to-government marketing deals.

Iran's nuclear ambiguity is calculated, a reaction to the vulnerability it feels. The imminent security threat from the U.S. and Israel might cause Iran to back down, but it could also

²⁵⁰ Xiao Jue, "Iran Retaliates Those Who Cast Yes," *Global Times*, September 30, 2005 (author's translation). The United States, Australia, Britain, France, Germany, Canada, Argentina, Belgium, Ghana, Ecuador, Hungary, Italy, the Netherlands, Poland, Portugal, Sweden, Slovakia, Japan, Peru, Singapore, South Korea, and India voted for the resolutions; Pakistan, Algeria, Yemen, Brazil, China, Mexico, Nigeria, Russia, South Africa, Sri Lanka, Tunisia, and Vietnam abstained, and Venezuela voted against the resolution. "International Consensus Against Iran Fails," *Tehran Times*, September 25, 2005.

²⁵¹ Iran's Islamic Republic News Agency report quoted in Bremmer, "Playing the Oil Card."

have the opposite effect, encouraging Iran, just like North Korea, to leave the NPT,²⁵² and to develop a nuclear weapon as fast as possible. After all, a country that sees the U.S. as a potential threat to its security would likely place substantial value on nuclear weapons, because they are the only means of offsetting U.S. conventional superiority.²⁵³ However, Iran is likely to neither back down nor become a nuclear weapon state in a short period of time. Iran's drive for nuclear weapons has thus far been checked by a combination of potential obstacles created by Russia, the United States, Europe, and the IAEA, but it has not been entirely blocked, and more obstacles will emerge in future. In past, Russia has slowed completion of the nuclear reactor at Bushehr, and managed to persuade Iran to agree to return the used fuel. The United States has applied unilateral sanctions, attempted to isolate Iran, and hinted at forceful regime change. Europe has partially restrained investment and warned of future sanctions. Finally, the IAEA has insisted on full disclosure of Iran's nuclear programs and inspections on demand, alleged Iran of violating its NPT obligations and referred the case to the U.N. Security Council for enforcement. However, getting to the Council is one thing; getting action from it is another. In this multidimensional chess game, Iran has moved strategically and pragmatically in response to each of its opponents, seising openings to move its nuclear program ahead wherever and whenever they arise.²⁵⁴

Military options against Iran are not logistically feasible or politically prudent in the context of high oil prices, and are currently not credible and illegal. Therefore, for these reasons, Iranian regime appears secure from any outside threats. Some have argued that complete or substantial economic isolation, including severing trade relations and prohibition for Western companies to conduct business with Iran, as the U.S. has already tried in the oil industry, would almost bring the country to a halt.²⁵⁵ The problem with this approach is that sanctions are generally ineffective, and they would almost certainly be ineffective in

²⁵² Iran could abandon the NPT if forced to limit nuclear activities, Mahmoud Ahmadinejad, its hardline president says. "Iran 'Could Quit Nuclear Treaty'," BBC News, February 11, 2006, http://news.bbc.co.uk/2/hi/middle_east/4703434.stm. [February 15, 2006].

²⁵³ Glaser and Fetter, "Counterforce Revisited," p. 112. For analyses of states' nuclear acquisition decisions, see Scott D. Sagan, "Why Do States Build Nuclear Weapons? Three Models in Search of a Bomb," *International Security*, vol. 21, no. 3 (Winter 1996/97), pp. 54-86; and T.V. Paul, *Power versus Prudence: Why Nations Forgo Nuclear Weapons* (Montreal: McGill-Queen's University Press, 2000).

²⁵⁴ Graham Allison, *Nuclear Terrorism: The Ultimate Preventable Catastrophe* (New York: Times Books, 2004), pp. 162-3.

²⁵⁵ Matthew Karnitschnig, "European Firms React to U.S. Hard Line on Iran," *Wall Street Journal*, January 28, 2005.

the Iranian case.²⁵⁶ Further, Russia and China would vote against the imposition of any comprehensive sanctions. Finally, the American attempt at isolating Tehran has backfired, and instead, the U.S. government has been isolated in its Iran policy. High oil prices have greatly enhanced national revenue from oil exports and have allowed the Iranian government to keep popular disaffection manageable.²⁵⁷ At the moment, hopes for a regime change within Iran do not seem realistic, and internal stability is ensured as long as revenues from oil exports are maintained at their current, high levels. The bottom-line is that Iran uses both its oil wealth and its attempt to acquire nuclear weapons in order to maintain and ensure the regime stability, which is threatened from domestic and international actors. During its nuclear pursuit, “it is the high price of oil that most bolsters a sense of immunity in Tehran,” and “while energy prices remain high, Iran’s leaders believe, and all Iranians hope, that the world will not dare boycott Iranian oil.”²⁵⁸

Issue linkage is very influential in the process of Iranian nuclear bargaining, and may be crucial in determining the outcome. Main factors influencing nuclear bargaining come from Iranian domestic bargaining arena, Iranian oil industry bargaining, China’s domestic bargaining arena, and are influenced by high oil prices. Iran’s regime stability crucially influences nuclear bargaining. In order to ensure their regime’s stability, Iranian leaders use the ‘oil weapon’ to gain support in the international arena in order to block sanctions, continue their nuclear pursuit, and balance the U.S. attempt to isolate Iran and force regime change. Hence, Iran offers oil for support at the U.N. Security Council and for other international support, which it primarily receives from China. Thus, Iranian oil industry bargaining is the crucial reason why Iran receives Chinese support, and hence it has an important, albeit indirect impact on nuclear bargaining. Due to their desperate need for more oil in order to fuel their growing economy, the Chinese are more than willing to invest in Iran’s oil industry, despite American pressure against this. Chinese and other countries’ investment in Iran’s oil industry help Iran maintain its oil export revenues, which are essential to keep domestic discontent manageable. Finally, besides foreign investment, current high oil prices also help Iran in receiving large oil export revenues, essential for domestic political stability. High prices also make oil exploration and

²⁵⁶ Vakil, “Iran: Balancing East against West,” p. 61; Cordesman and Al-Rodhan, “Iranian Nuclear Weapons?”

²⁵⁷ Perkovich, “Changing Iran’s Nuclear Interests,” p. 5.

²⁵⁸ “Whistling in the Gloom.”

production very profitable, thus providing oil companies with a higher incentive to invest in Iranian oil.

Besides the Iranian government, which is successfully attracting investment in the Iranian oil industry, and is receiving necessary revenues from oil exports, Chinese, Russian, Brazilian, Malaysian, Indian and other developing countries' NOCs and European IOCs are currently the main beneficiaries from Iranian oil industry bargaining. Since the American IOCs are prohibited from investing in Iran, and the Japanese companies are now only minority players, the others have less competition. The European companies may soon find themselves on the losing end of the bargain as their governments have recently succumbed to the U.S. pressure, and some of them have indicated that they may exit Iran if any comprehensive sanctions against the Islamic Republic are implemented. Thus, the future looks promising for many NOCs willing to maintain and increase their investments in Iran, and therefore also for the Iranian government, which, if there is high interest for investment in Iran, will be able to maintain current favourable terms of investment and its control over the oil industry.

Relationship with Hypotheses

The case study of Iran's contemporary oil industry bargaining has direct relevance to all of the hypotheses set in Chapter 2. Evidence presented in this case study is supportive of hypothesis one. Due to their weak bargaining power, the IOCs have been on the losing side of their bargain with Iran in the current decade, and were not able to improve their investment terms vis-à-vis the Iranian government. Evidence is not supportive of hypothesis three. Since the interests of American IOCs and the U.S. Government are not aligned concerning Iran, then the U.S. Government does not support the American IOCs in oil industry bargaining in Iran, and thus, the American IOCs are not successful in their bargaining. In addition, evidence presented is supportive of hypothesis three, since the IOCs are losing bargaining power in general, and in Iran in particular, due to the rise and interference of the NOCs from oil importing countries, such as China. Additionally, evidence is mixed with regards to hypothesis four, since although both China's and Japan's oil supply security is perceived as threatened when bargaining in Iran, with concerns related to the oil supply security dominating China's oil industry bargaining in Iran, only

China emerges victorious. Finally, empirical evidence is not supportive of hypothesis five, as Iran uses oil, explicitly and/or tacitly, in its bargaining with other actors, and this allows it to gain concessions from these actors, particularly in its pursuit of nuclear technology. These primary conclusions will be elaborated on in the following chapter when I discuss my findings in more detail.