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Iran and Russia: A new alignment?

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Time for change

Iran's time in economic and geopolitical isolation looks likely to end soon, and Tehran appears to have made Russia its priority.

Building bridges

Tehran and Moscow have built links in recent years over nuclear power, control of the Caspian and Syria.

Gas-fired diplomacy

Russia currently sends around 170 bcm per year of gas to Europe, while Iran has plans to increase its gas production by around 160 bcm per year for export.

Iran and Russia: a new alignment?

FOR the past 30 years, Iran has lived in a more or less self-imposed geopolitical isolation. From Tehran, the view has been of a hostile US, its no-less hostile sidekick the UK, less-hostile Europeans usually aligned with the Anglo-Saxons, hostile Sunni Arabs across the water to the west, troublesome Sunni Pashtuns and Pakistan lurking in the east, Iraqi Sunnis dominating on its western border, and a chaotic semi-secular collection of 'stans to the north.

Less hostile Russians and Chinese have not been so unwelcome, especially when bearing hi-tech weapons, nuclear energy technology, chequebooks and a thirst for oil, but in sum Tehran might be forgiven for seeing the world as generally a hostile and godless place.

This era of isolation now looks likely to end. Concessions on its nuclear weapons agenda have brought Iran back into the geopolitical party, and it is looking for a partner. We are seeing signs that Tehran may have already quietly made its choice.

An obvious early question is "why any partner at all"? After a generation of fierce independence why would Tehran choose to submit to the constraints of a serious committed relationship? The answer lies in two obvious, and two less obvious, areas. The obvious benefits are old-fashioned – guns and money. Iran's economy has suffered under sanctions. Long-term real growth of around 3% has more than reversed (2012 saw a 6.6% recession), and its foreign currency reserves are largely locked up in sanctioned accounts.

Neither Iran's private nor public sectors are in a state to invest serious capital in its hydrocarbons industry, so we expect an early item on the Iranian agenda to be talks with external oil and gas investors *(see our Iran Investment Special Report)*. Political top-cover will be important, pushing Iran to the formation of a high-level alignment with, well, someone. That "someone" is unlikely to be Western. Historically Iran has traded a lot with China and very little with Russia, but there is evidence and logic that might see this change. In Iran "money" means hydrocarbons. Here, the sensitive agenda is not Liquids (our projections show that Iran's return to the market will not destabilise it much) but gas.

At present, Iran is not a gas exporter in any meaningful sense, consuming pretty much all of its 160 billion cubic metre annual production domestically. However, Tehran has plans to add at least another 160 bcm to output – the majority of this will come from South Pars, the world's largest gas field – for export. Whether that gas heads east or west, its volume is likely to trash gas prices for Iran and other exporters. Therefore Iran has a clear agenda to co-operate with other gas exporters to protect its margins.

> "Iran is home to around 34 tcm of gas, but at present it lacks extra production capacity for export.

Second, Iran has a power agenda that includes militaristic elbow-jostling in its near-abroad. During its isolation Iran's Sunni neighbours have built large and well-equipped first-rank military forces, which are presently demonstrating a surprising degree of capability and co-operation in Yemen. Iran has neither the technical depth nor the money to design and build weapon systems able to meet those forces head-on, but others do.

For littoral sea control Iran needs very fast, very agile and very large anti-ship missiles, while the control and defence of its own airspace needs, at a minimum, fast, agile and long-range SAM systems. Supply of first-rank weapons usually comes with relationship strings attached, and we see signs that Tehran is willing to sign up to a relationship to get them.

Our two less-obvious reasons to commit to a partner lie in two relatively new areas of power projection: cyberwarfare and space. Tehran discovered at Natanz how vulnerable a state can be to cyber-attack, when Stuxnet hit its centrifuges. While it could play catch-up (Iran has geeks too, and they are much less expensive than missiles), a preferable strategy is probably to partner with someone who is already in the Premier League.

In space, Iran has no chance of leaping into the first rank by itself. Whether it needs reconnaissance, positioning systems, communications or intelligence gathering, Iran knows that its old opponents across the Persian Gulf can reasonably expect to piggy-back on US space assets, giving a winning C4I advantage at any level of face-off. Iran will want to align with a space-capable partner if it wants to win anything more than a low-level insurrectionist struggle.

So, if Iran wants to compete effectively on the international stage it pretty much has to pick a partner. There might be three willing candidates. The third, in status and appeal, is India. Proximity, a mutual antipathy to Pakistan, a common feeling about global superpowers, a natural connection of Liquid hydrocarbon supply and demand, a shared view of the economic power of the state and some moderately interesting Indian weapon systems (including nascent space assets) provide a motley collection of small reasons for an Iran/India Alignment.

Against these weak positives Iran will feel ▸▸

AS IRAN LOOKS TO EMERGE FROM ISOLATION, GEOPOLITICAL PARTNERS ARE CIRCLING...

the far stronger pull of larger economies, and India might reasonably conclude that some alignments offer more trouble than joy. We see India and Iran making friendly noises towards each other, but remaining, in the end, just uneasy friends.

Laying in wait

Two much more interesting partners lurk beneath Iran's balcony. During its generation of isolation Iran built a functioning relationship with China. Chinese C802 anti-ship missiles sit in Iranian arsenals, and large quantities of Iranian crude sit in China's Strategic Petroleum Reserve (SPR).

CNPC and Sinopec agreed multi-billion dollar investments in Iranian oil and gas projects before sanctions in 2011, and just days after Iran reached a framework nuclear agreement with the P5+1, Iranian officials were in China to discuss further investment. Our long-term forecasts show a substantial increase in flows from Iran to China over the next 30 years. China is Iran's largest trade partner too.

Strategically, Iran could be an important part of China's "String of Pearls" strategy to protect oil transit routes across the Indian Ocean. Alignment with Iran would give China a foothold in the Gulf, where its navy has become increasingly active. Chinese ships participated in a historic joint exercise with the Iranian navy in September 2014, carrying out anti-piracy drills. Some symptoms of this train of thought are already visible.

China has tried to integrate Iran into its multilateral institutions, welcoming Iran as a founding member of the Asian Infrastructure Investment Bank (AIIB) in April, and current noises suggest it is keen to induct Iran as a full member into the Shanghai Co-operation Organisation.

But Iran has also been courting Russia. The two states have history. Russia excised what are now Azerbaijan and Armenia from Iranian ownership following two Russo-Persian Wars in 1813 and 1826-8. Russia made further small attempts to nibble away at northern Iran in 1920, 1941 and 1945. But all that was a long time ago.

In the more recent past Tehran and Moscow have been busily building links over nuclear power, control of the Caspian (jointly obstructing the Trans Caspian gas pipeline), and Syria (where both support President Bashar al-Assad, though for different reasons). Both are also quietly hostile to the US, the Anglo-Saxon power team and NATO, and both have designs on their near-abroads that do not exactly fit into the framework of International Law. These designs are enabled by another shared asset – fragmented minority populations in near-abroad states who offer the potential for "protective" moves against neighbours. Russia has its ethnic minorities in Ukraine and the Baltic States, while Shiite minorities can be found in Azerbaijan, Lebanon, Yemen, Bahrain, Kuwait, Saudi, Afghanistan,

Pakistan and even India and Turkey.

Iran has already acted in Yemen and Bahrain to "support" Shiites, and Russia acted unilaterally over Ukraine. Both styles are much more forward and aggressive than China's slow python-like coiling around Taiwan and the South China Sea. We see Iran and Russia forming a much more comfortable "bad boys club" than Iran and China.

A shared rebellious and fractious approach to the same people does not, by itself, create geopolitical outcomes. Vital interests are much more powerful. We see some powerful vital interests pushing Iran and Russia together.

Original South Pars Developement Phase Targets

Phases	Target production rate mcm/d	Current production rate mcm/d	Planned start up	Expected start up
Producing	*354*	*300*		
1	26	25	2003	2003
2, 3	57	56	2002	2002
4, 5	48	48	2005	2005
6, 7, 8	91	90	2009	2009
9, 10	54	53	2012	2012
12	79	28	2012	2015
Expected	*431*			
11	57	-	2017	2022
13	57	-	2014	2020
14	57	-	2014	2020
15, 16	51	-	2011	2016
17, 18	51	-	2010	2016
19	57	-	2013	2020
20, 21	51	-	2014	2020
22, 23, 24	51	-	2014	2020
Total	**785**	**300**		

Gas

At present, Russia acts as Europe's main external supplier of methane, with around 170 bcm per year flowing west. Apart from the pleasingly large financial flows that result, the dialogue between Moscow and the West is undoubtedly flavoured and weighted by the reality that the EU's economy depends on Russia not obstructing gas flows.

Iranian gas reserves have the potential to change this equation in both respects. If Iran were exporting another 160 bcm westwards the resulting competition would bring gas prices down to a small margin over cost – well below today's price structure.

This would reduce both Russia's income and its influence. Moscow therefore has a strong reason to gain relationship leverage over Tehran to bring Iranian exports into a cartel of some kind. Russia faces the same threat, and the same prize, in respect of gas supplies to China.

At present, China knows that surplus Russian gas more or less has to head east, parlaying into lower prices for China and lower profits for Russia. East or west, Russia's vital interest is to stop Iranian gas from arriving in Europe outside a gas cartel.

Iran doubtless understands this landscape as well as Russia, and is likely to trade its co-operation for strategic supplies of first-rank weapons systems (the S300/S400 SAM, the Moskit/SS22 SUNBURN anti-ship missile and modern air-independent conventional submarines being the most desired).

Both Iran and Moscow will benefit from co-operation on gas marketing, creating a small bi-polar Organisation of Gas Exporting Countries (a Moscow ideal for nearly a decade). Plans have been discussed for an Iranian gas pipeline to China, via Pakistan, under the "One Belt, One Road" slogan, and an initial agreement was signed last week.

It now seems likely that a small pipeline will indeed be built, extending the Iran/Pakistan route into China, but gas volumes are unlikely to be strategic to China, and the project feels to us more like China binding Pakistan into its orbit than the foundation of a China/Iran axis.

The Caspian

If they co-operate, Moscow and Tehran can exercise more or less complete control of the Caspian as an energy transit route to Europe, so obstructing future competition from Turkmen gas. This would serve a new Russia/Iran gas cartel, as well as leaving Turkmenistan more vulnerable to economic pressure from both Russia and Iran.

Europe

Our long-term forecasts show that Europe will grow increasingly vulnerable to possible interruptions to Liquids supplies from the Persian Gulf, and to competition for available Liquids from Asian buyers (not just China; everyone from India to Japan will be struggling to meet their Liquids demand by 2030).

At present, Russia has no Gulf footprint from which to play influence into the picture. Even if Assadi Syria survives, with Russia as its prime ally and supporter, Syria has no Gulf coastline, no Gulf naval bases and no major Gulf pipeline routes in its ambit. Alignment with Iran would in a stroke bring Russia into the heart of the Gulf from where it could support, or threaten, energy flows into Europe.

As North America's Liquids imports diminish, to be replaced by net exports from around 2029/30, the USA's interest in the Gulf will inevitably wane. Iran's partner, whoever that turns out to be, will be well positioned to succeed to the role of "Gulf Security Guard". Moscow is likely to relish the prospect of being "prime partner" of an Iran which in turn is the arbiter of Iraqi production, and dominates Gulf transport routes.

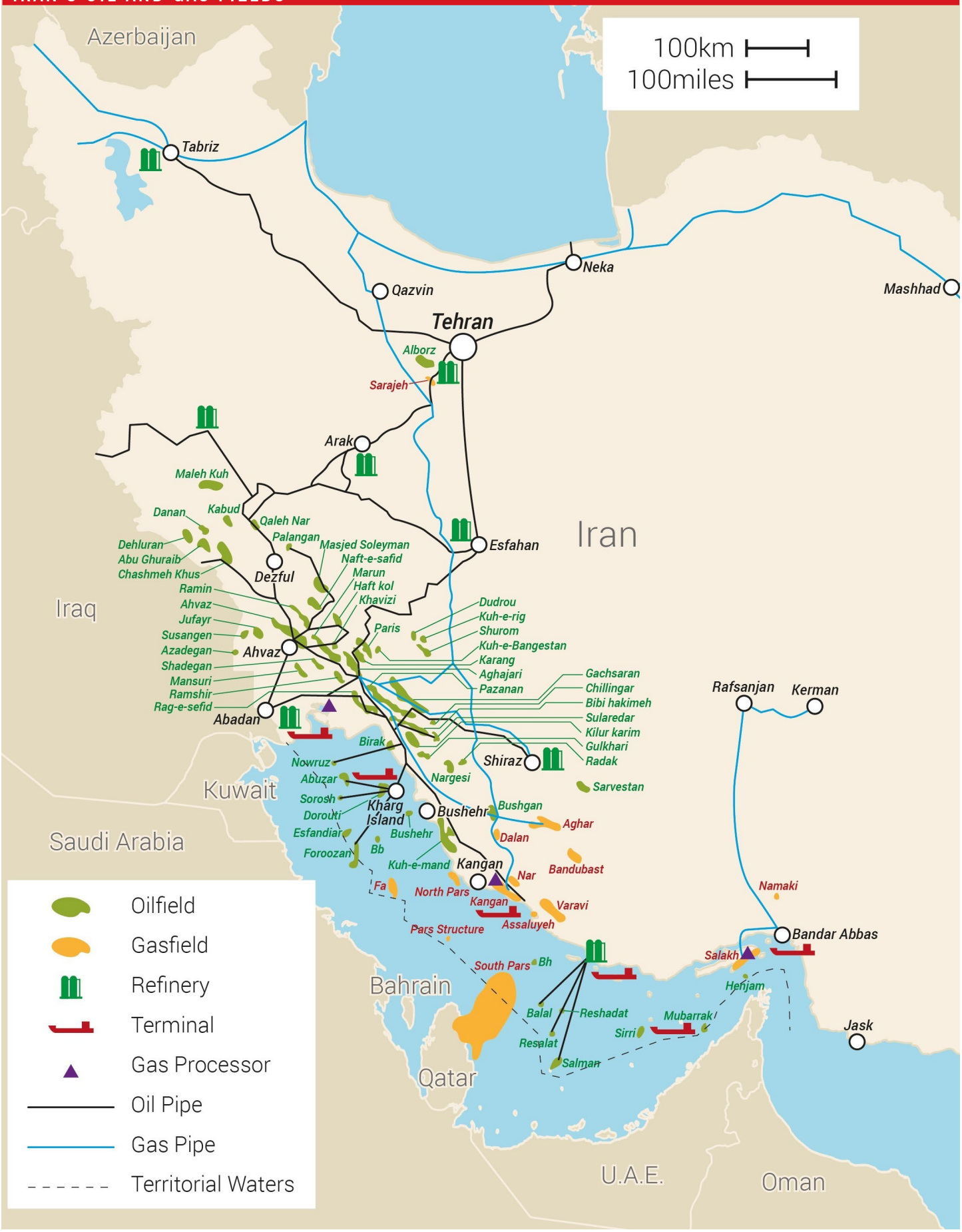
While most of the benefits would flow to Russia, there is no reason to expect Russia not to pay for them with large investment flows and first-rank weapons sales. Iran and Russia's feelings about Europe would coincide – antipathy to the UK and France (which is building links with Saudi and Qatar) and indifference to Spain and Italy.

Saudi

Russia has no deep historical relationship with Saudi, but Iran does. Apart from the sectarian Shiite/Sunni antipathy (deep, intense and acrid), there is a disconnect between Iran's self-image as the Gulf hegemon and the present reality that Tehran itches to correct.

If that correction brings with it influence over Saudi production flows (through control of Hormuz) Iran would not complain. On its own Iran can do no more than promote low-intensity strife for its Sunni neighbour by stirring up Shiite trouble around Saudi's extensive borders (Bahrain in 2011, Yemen today, perhaps Kuwait tomorrow). With Russia on side, Iran could take more aggressive action. We saw a small example of heightened aggression just recently, with the "arrest" of a US-owned ship in Hormuz. Given the right technical and geopolitical support Iran

IRAN'S OIL AND GAS FIELDS



could scale trouble up to high-intensity conflict if, or when, Russia's forces in the Gulf balance the diminishing presence of the US. It must quickly be added that in this context we are talking about a long time scale – perhaps a decade or more from now.

Would China be willing to support Iranian aggression in the same way? Probably not. China's interests lie in keeping the flow of hydrocarbons from the Gulf secure, and in securing its title to the South China Sea. Neither agenda turns on who owns or runs Gulf oilfields, so long as they take a Chinese cheque.

Turkey

After 60 years as a secular NATO state, Turkey is now circling a geopolitical roundabout trying to work out which exit to take. One road leads to membership of the EU – with access to EU markets, free emigration and a tide of EU structural subsidies flowing into corporate profits, but that would probably require a return to secular multi-party politics, and a toning down of Turkey's authoritarian justice system.

Another sees Turkey steadily abandoning two generations of secular government in favour of a moderate Sunni religious state – the rational wing of the Moslem Brotherhood. This exit might lead to regional seniority (once Assadi Syria has been laid to rest) as the democratic Islamist leader of a loose moderate Sunni club, and might then result in its elevation to "regional superstatus", as the arbiter of regional power between Syria, Iraq, Saudi, the Gulf States, and outwards to Russia, Iran and the West. That the same route leads away from NATO is unlikely to bother Ankara: Turkey is already rather less a member of NATO than it used to be, and is showing clear signs of discomfort at having to co-operate with NATO against muslims. A third exit is signposted "Energy Corridor". This road leads to Turkey carrying Russian and Iranian gas to Europe, and so gaining influence both east and west. The Energy Corridor track does not of itself deliver regional superstatus, but it would certainly converge with that goal.

Seen from Iran, some of these routes are collaborative (gas transit, keeping the Kurds down, keeping NATO at a distance) but more are confrontational, bringing Sunni/Shia conflict, a contest over regional influence, the end of Assadi Syria and uncertainty over whether Iraqi oil ends up being controlled by Sunnis or Shias. Rather than risk losing its (confrontational) goals, Iran's strategy seems better served by an Iran/Russia alignment than an Iran/Turkey one. With Russia on side looming to its north, and in the Black Sea, Turkey's relative strength and position would be undermined, while Iran would feel much more comfortable facing off Sunnis with Russia's heft behind it. Russia will see benefits too – regional influence, an element of control over Liquids and gas flows, arms sales, and even a possible bonus prize in the eventual separation of Turkey from NATO.

The US

All three parties to the dance share an antipathy to the United States. Iran's is personal – Kermit Roosevelt's successful assault on Mr Mossadegh still hurts. Russia's feelings for the US flow more from Realpolitik, while China's are as yet more theoretical than real.

Iran will feel more comfortable with Russia's immediate and unequivocal feelings than it would with China's delicate, subtle and as-yet not quite formed stance towards the US. If China did trip into conflict with the US over the Senkaku islands or the South China Sea (both look possible over the next decade) Iran would not enjoy sacrificing its new-found return to the society of states over conflicts which are distant, and in which it has no vital interests at stake. In contrast, a Russian move on Georgia is much more in Iran's backyard, and it probably wants to be in on the decision, if not the spoils (the Donetsk Republic this week recognised the Russo-Georgian enclaves as states).

In sum, once more we see Iran choosing Russia over China as a partner against US policy.

Israel

When looked at close-up, Iran's antipathy to Israel has always been a little puzzling. The two states do not appear to have competing vital interests. On a sectarian view, it is odd that Iran's Shiite state should be so defensive of Sunni Palestinians. Rather one might expect Iran and Israel to find common ground in their non-Arabism. This was more or less what happened between 1947 and 1979 – Israel and Iran were peaceful trading partners, exchanged ambassadors, intelligence, oil, money and weapons.

Even after the Khomeini revolution Israel supplied Iran with US$500 million of weapons per year for use against Iraq. But this mutual tolerance died in the heat of Ayatollah Khomeini's linking of Israel with the US, and as the rhetoric grew more acidic Iran seemed to adopt Sunni Palestinian interests under the banner of Pan-Islamism as the source of an aggressive anti-Israeli stance. Iran's anti-Israeli momentum then increased when it found Lebanese Shiites in the front line of Israel's attack on Lebanon. With so much rhetoric expressed so loudly for so long it will be hard to row back.

Today Iran still has no vital interests that compete with Israel's, other than ones that flow directly from its vocal condemnation of Israel's Palestine policies. In practice that is irrelevant. Iran's stance is firmly that the state of Israel should give way to a state of Palestine, so the key question here is whether Tehran would see Russia or China as the better partner to pursue its Israeli goals.

Once more, China seems geographically

peripheral, and too wise to sacrifice geopolitical capital on an argument in which it has no vital interests at stake. Russia's relationship with Israel is much warmer than Iran's. Large numbers of Russians emigrated to Israel after 1991, and Russian is now a major language in Israel. Russia's earlier agenda, to support Syria and Palestine against Israel, seems to have been diluted in the face of this fact. Russia is buying weapons and food from Israel, and is one of the latter's significant suppliers of oil.

Iran therefore has one possible partner who does not care, and another who would probably oppose or tone down its visceral Israeli policy. The latter stance may actually not be unwelcome. Iran's Israel policy is ultimately an obstacle to its emergence as a regional leader (causing much trouble for no geopolitical benefit) and that makes it possible that Iran would use this as an opportunity to tone down its rhetoric slowly, using Russia as the "intermediary". There are small signs that this is already happening. Tehran actively points out that its stance on Israel is an anti-state stance, not an anti-Semitic stance, that Islam regards both Judaism and Christianity as legitimate Abrahamic religions, that the same God governs all three faiths, and that Jewish Iranians are allowed to worship freely in Iran without persecution. The message gets lost in the noise created by earlier more aggressive and less measured pronouncements, but it is there all the same.

Style

Weapons and oil aside, Iran and Russia share another asset – fragmented minority populations in near-abroad states who offer the potential for "protective" moves against neighbours. Russia has its ethnic minorities in Ukraine and the Baltic States (and, as it happens, Israel), while Iran can point to Shiite minorities in Azerbaijan, Lebanon, Yemen, Bahrain, Kuwait, Saudi, Afghanistan, Pakistan and even India and Turkey. Iran has already acted in Yemen and Bahrain on this foundation, and Russia in Ukraine. There seems to be a community of style as well as a community of interests.

In sum, we see many reasons why Iran and Russia should form a new alignment.

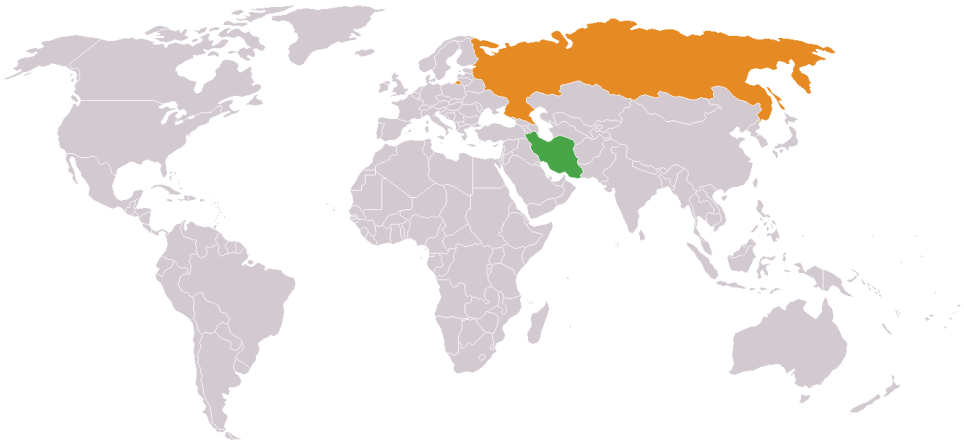
Those are the arguments. Does the evidence bear them out? The picture will emerge only slowly, but small picsels are beginning to appear at regular intervals.

Last week Russia and Iran joined up their money transmission systems. Moscow is pressing for an early lifting of the arms embargo on Iran, and has lifted its own ban on the supply of the S300/400 system, with a decree on 13 April authorising supply of the S300 to Iran.

Moscow has said it will support Iran if and when the Yemen civil war comes to the UN. On April 16 Iran's defence minister declared that Iran would co-operate with Russia, India and China to oppose NATO expansion in Europe. LUKoil has announced plans to invest in Iran. Back in January Russia's defence minister visited Tehran and signed a co-operation deal (whose details are yet to emerge). Russia is expecting to build up to eight nuclear power plants in Iran – an investment which would increase Iran's installed power capacity by about a quarter.

True, China is investing large sums in Iran's Liquids industry, but these do not rebut our conclusions. Russia's production surplus, around 7 million bpd today, will remain at that level at least until 2030, and we believe that Russia will be content to see most of that flowing to Europe, keeping it in a strong position in its wrangles over its near-abroad, while Iranian and Iraqi crude flows east to Asia.

An alignment would not stop Iran trading with other customers, likely to include India for both gas and Liquids, via one route or another, and China for Liquids. But our overall conclusion is that a new Russia-Iran alignment is under construction, and will become obvious over the next five years. A quick look suggests that the effects of this new partnership will be greater in the power politics sphere than in the Liquids market, but we will be taking full account of possible Dynamic effects in our next DIF this summer. At present, it does not look like the Long-Term Liquids picture will radically differ from past DIFs.❖



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