

# THE ROLE OF ECONOMIC & ENERGY RELATIONS WITH TURKEY AND RUSSIA IN IRAN'S NATIONAL STRATEGY

*Authored by*

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This paper was commissioned as part of a CSIS research project called “The Turkey, Russia, Iran Nexus: Regional Perspectives.” This project, which CSIS is pursuing in cooperation with the Economic Policy Research Institute of Turkey (TEPAV) and Institute of Oriental Studies (IVRAN) Moscow, is exploring evolving relations between these three pivotal countries and their implications for regional developments in the Caucasus, Central Asia, and the Eastern Mediterranean, and for their relations with the United States and other countries. It seeks to promote dialogue and a deeper understanding of these relations among experts and officials in all four countries. CSIS will develop a comprehensive assessment of the forces driving these relations and their long-term implications, and offer various policy recommendations. For more information on the project, please visit our website at <http://csis.org/program/turkey-russia-iran-nexus>.

## I. Introduction

Iran's geo-economic situation is characterized by two underlying facts:

- a) It houses one of the largest hydrocarbon reserve bases in the world;<sup>1</sup> and
- b) By virtue of having direct borders with 15 different states,<sup>2</sup> Iran fits into a diverse set of regions including the Middle East, Persian Gulf, Caspian Basin, and Central Asia.

This paper will examine the role of energy and regionalism in Iran's macro strategies by focusing on two neighboring countries, Russia and Turkey. Iran has had a long history of competition with both these neighbors, but it is interesting to see how new geopolitical realities as well as energy sector developments have paved the way for closer energy cooperation. These factors have been key drivers in the promotion of other bilateral and regional ties.

In order to understand the dynamics of Iran's relations with Russia and Turkey, this paper will first analyze two interdependent phenomena: Iran's regional strategy and developments in the country's energy sector. The analysis will then be concluded by focusing on the consequences of the mentioned policy areas on bilateral relations with Russia and Turkey.

## II. Iran's Regional Policy

Since the end of the Iran-Iraq war in 1988, Iran's official policy has given the highest priority to regional cooperation as a pillar of its foreign policy. During his UN address in 1997, then foreign minister Kamal Kharrazi, outlined that Tehran's "highest foreign policy priority...is to strengthen trust and confidence and peace in our immediate neighborhood."<sup>3</sup> Clearly, security as well as international relations considerations were the core elements in this decision, but energy and Iran's historical and cultural perspective have been earmarked as the main tools in achieving this goal. In fact, Iran already had institutional frameworks to pursue such a policy, the most important being the Economic Cooperation Organization (ECO) which was initially founded by Iran, Pakistan, and Turkey and later joined by the Central Asian and Caucasian states.<sup>4</sup> Furthermore, Iran's stated visions in consecutive Five-Year Plans<sup>5</sup> point to a diverse set of areas of cooperation such as regional trade, energy development, and security issues in order to achieve interdependency between regional states. Also, Iran's 20-Year Document<sup>6</sup> focuses on regionalism and calls for Iran to be the region's<sup>7</sup> top technological and economic power by 2025. Experts believe that the collapse of the Soviet Union in 1991 and the consequent emergence of smaller neighboring states to Iran's north facilitated the growing emphasis on regional cooperation. Iran's historical and cultural ties with her northern neighbors proved to be an asset that Tehran could utilize in its regional policies.

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<sup>1</sup> Iran has a combined oil and gas reserve amounting to 315 billion barrels of oil equivalent.

<sup>2</sup> Iran's land and sea borders with all her neighbors stretch 8,731 km (5,425 miles).

<sup>3</sup> Edmund Herzig, "Regionalism, Iran and Central Asia," *International Affairs*, 80, no. 3 (2004), pp. 503-517, [www.chathamhouse.org/sites/default/files/public/International%20Affairs/Blanket%20File%20Import/inta\\_395.pdf](http://www.chathamhouse.org/sites/default/files/public/International%20Affairs/Blanket%20File%20Import/inta_395.pdf).

<sup>4</sup> ECO members are Afghanistan, Azerbaijan, Iran, Kazakhstan, Kyrgyzstan, Pakistan, Tajikistan, Turkmenistan, Turkey and Uzbekistan.

<sup>5</sup> Iran produced its first Five-Year Development Plan (Plan) in 1989. The Plan sets out policy objectives in key policy areas and in the main macro document in government policy. The country is now in its fifth Plan which commenced in 2011.

<sup>6</sup> A document approved at the highest level of leadership in 2005 which sets out policy objectives until 2025.

<sup>7</sup> For the purpose of the mentioned document, Iran sees its "region" as all the neighboring countries excluding Russia.

Considering the region's recent past as well as Iran's strained relations with western nations, Iran's strategic interests in the region have evolved around the following concepts:<sup>8</sup>

- Developing a positive relationship with Russia as a counter-balance to tensions with western countries;
- Developing positive trade and investment relations with immediate neighbors, especially the larger markets such as Russia, Turkey, Iraq, and Pakistan;
- Utilizing energy interdependency through cooperation in the fields of oil, gas, and electric power in order to put Iran's massive resource base to strategic and economic use;
- Utilizing regional relations to undermine the effects of western pressure, especially in circumventing sanctions (traditionally the UAE was utilized for this purpose, but in recent years, Iran has been working more closely with Turkey and Central Asian states).

Interestingly, as many analysts have confirmed, Tehran's approach towards its neighbors has been remarkably free of ideological influence.<sup>9</sup> Consequently, regional relations have in many cases taken on a very pragmatic nature focusing on infrastructure investments, gas pipelines, and electricity grids being connected as well as cooperation on issues such as security and fighting drug trafficking. The role that energy transit has played in Iran's regional relations can also be understood in the context of Iran being the country that connects two of the world's top energy hubs, i.e. Persian Gulf and the Caspian Basin (see map below).

Iran's increased emphasis on regionalism was also partly motivated by the growing drive among western governments to sanction and isolate Tehran. The calculus has been that a growing interdependence with immediate (particularly strong) neighbors would compel key regional players not to allow a full Iranian isolation.

A closer look at Iran's actual energy and trade interconnectivity with her immediate neighbors underlines how far Iran has moved in her emphasis on regionalism. Iran's trade with her immediate neighbors has been on the rise (see table below).

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<sup>8</sup> Findings based on various interviews with Iranian officials such as former deputy foreign minister Abbas Maleki and former Iranian Ambassador to the UN Mohammad Hadi Nejadhosseinian.

<sup>9</sup> Shireen Hunter, "Iran's Pragmatic Regional Policy," *Journal of International Affairs*, 56, no. 2 (Spring 2003), pp.133-147.

**Table 1: Iran's Trade with Neighbors, Persian Year 1389****(21 March 2010 to 20 March 2011)**

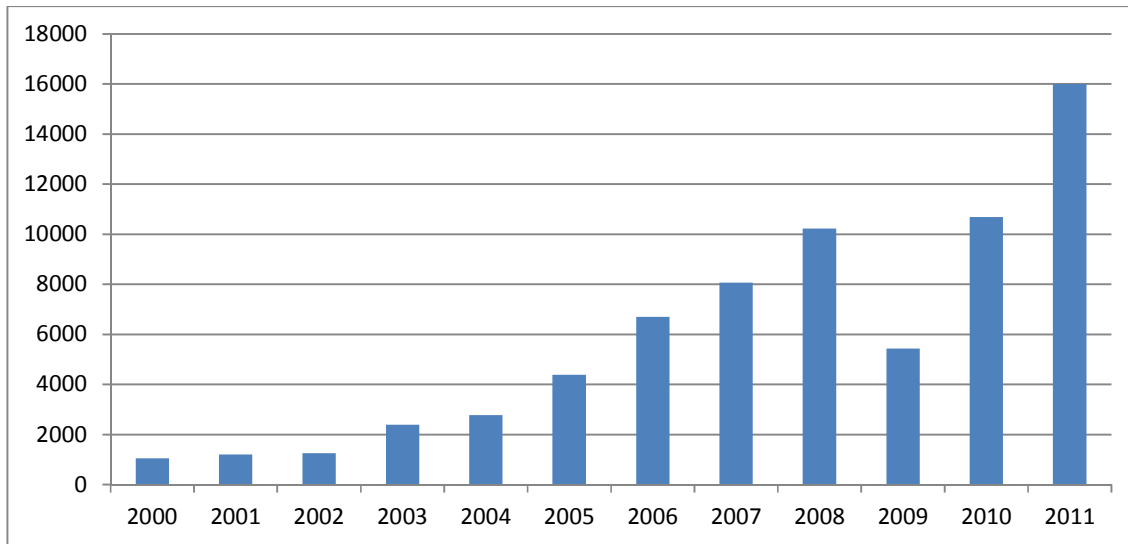
Country	Exports (million US\$)	Imports (million US\$)	Total (million US\$)
UAE	3,336	16,700	20,036
Turkey	6,844	2,464	9,308
Russia	331	1,130	1,461
Iraq	4,537	46	4,583
Saudi Arabia	80	171	251
Pakistan	551	382	933
Turkmenistan	415	86	501
Afghanistan	1,378	10	1,388
Azerbaijan	375	111	486
Armenia	113	40	153
Kazakhstan	69	124	193
Qatar	74	17	91
Bahrain	24	31	55
Oman	107	75	182
Kuwait	95	115	210

*Source: Iran Chamber of Commerce, Industries and Mines / Ministry of Commerce*

Interestingly, while Iran's trade with countries like Turkey, Iraq and Afghanistan has grown consistently in the past few years, Iran's overall trade volume with Russia fell by 38 percent, which is a clear reflection that expansion of bilateral trade is not a consideration in the case of Russia (more on that later).

In the case of Iran-Turkey trade volume, mutual trade has grown from a mere \$1 billion in 2000 to over \$16 billion in 2011 (see graph below):

**Graph 1: Iran-Turkey Trade Volume (in million US\$)**



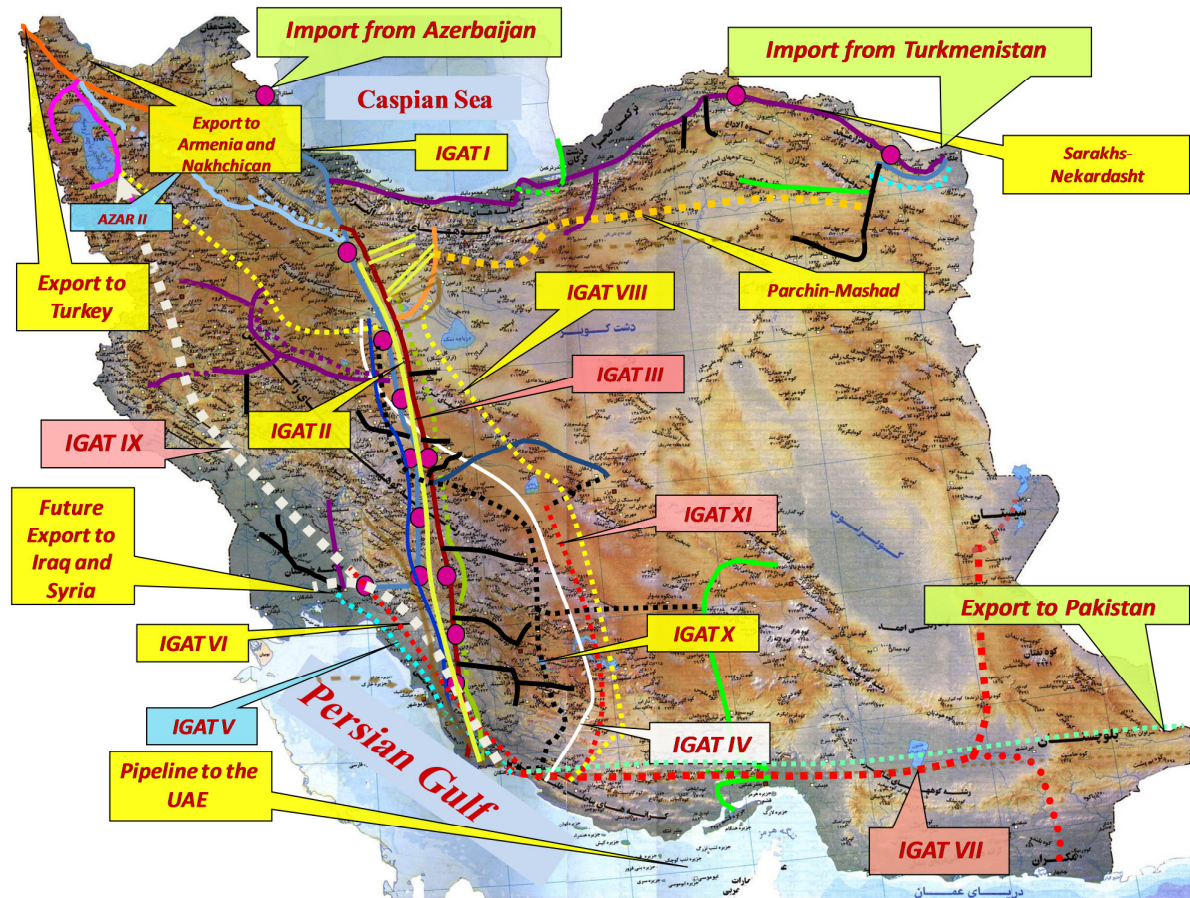
*Source: Turkish Ministry of Commerce*

Oil and gas, especially pipelined gas, account for a major share of Iran's exports to Turkey.

Energy interdependency has become a critical element in the regional interaction as can be seen in the following facts:

- Iran is importing gas from Turkmenistan, exporting gas to Turkey;
- It also exports gas to Armenia in return for electricity;
- Iran has a gas swap deal with Azerbaijan and Nakhchivan;
- Tehran has also connected its electricity grids to most of the neighbors and is exporting electricity to Armenia, Pakistan, Turkey, Iraq, Afghanistan, and Nakhchivan. Iran imports electricity from Azerbaijan, Armenia, and Turkmenistan. Talks have also been held to establish a circular power grid between Russia, Azerbaijan, Iran, Turkey, and Georgia.

**Map 1: Iran's Gas Pipeline Grid**



Furthermore, Tehran has announced ambitious plans to export natural gas to various destinations, from Persian Gulf littoral states to Central Asia. The country now has gas export contracts with the UAE and Pakistan pending implementation, is in gas export talks with Oman, Kuwait, and Bahrain and reached an agreement with Russia for gas swap. Tehran has proposed the following pipeline projects to further consolidate her regional role as a supplier of gas and energy to the region:

- Iran-Iraq-Syria pipeline with an outlook to export Iranian gas to Europe via the Mediterranean countries (this project has been dubbed “Islamic Pipeline” which can be understood as a competition to the various pipeline projects that are designed to export gas to Europe via Turkey);
- Tabriz-Ankara pipeline from Tabriz to Ankara;
- Baku-Tabriz pipeline from Baku to Tabriz;
- Iran-UAE pipeline to Dubai;
- Iran-Kuwait;
- Iran-Oman;
- Iran-Bahrain, from Iran’s Ferdows gas field in the Persian Gulf.

It remains to be seen which of these projects will materialize, especially in the light of regional tensions as well as developments in the oil and gas markets. However, what is clear is that energy

connectivity has been an important parameter in Iran's regional policies. So far, Tehran has not hesitated to invest in such infrastructure. For example, despite all the uncertainties in the plans to export gas to Pakistan, Iran has invested in building a pipeline to the Pakistani border. Such plans have also been facilitated by the fact that Iran has localized the technology to lay gas pipelines; hence, all such investments are reliant on local industries.

The above outline illustrates Iran's vision towards its immediate neighborhood. Tehran considers itself as a regional power and projects power through trade, investment, and energy interdependency. However, internal structural and economic deficiencies as well as external sanctions and pressure have undermined the overall potential of such regional cooperation. Even though Iran has made progress in developing good working relations with immediate neighbors, it is far from reaching its own objective to be the region's top economic and technological power by 2025. In fact, in terms of economic performance, Iran remains behind Turkey and Saudi Arabia. Furthermore, current regional tensions as well as external sanctions will continue to undermine Iran's economic potential as well as the development of its energy resources, which will both hamper Tehran's regional ambitions. Nonetheless, regionalism based on trade and energy cooperation will remain Tehran's best bet in offsetting the negative impacts of the current sanctions.

### **III. A Closer Look at Iran's Energy Sector**

Evidently, the success of Iran's regional and international policy will very much depend on the development of its energy sector. Over the past decade, many analysts predicted that over time Iran would become a net importer of energy due to its energy trajectory, i.e. marginal growth in production parallel to a massive rise in domestic consumption. However, the realities on the ground are more complex and one needs to understand three phenomena to gauge the future potential of the country's energy sector as an instrument of regional and international positioning. These are:

- The country's ability to maintain its oil production capacity in light of the current sanctions and sector realities;
- The future of gas production and the gas utilization strategy; and
- Trends in domestic energy consumption in light of subsidy reforms as well as a push towards greater energy efficiency.

Below we will dissect these three factors which can be summarized as follows:

- NIOC puts current oil production capacity at 4 million barrels per day (mbpd); however, experts believe that a sustainable capacity is around 3.6 mbpd.
- Gas production stands at 500 million cubic meters/day (mcm/d) and it will grow gradually as new phases of South Pars<sup>10</sup> come on stream;
- Growth in condensate production is making a major difference in the country's overall balance sheet;
- The main story on gas will be domestic consumption savings as a result of subsidy reforms (potentially up to 100 mcm/d);
- Another important outcome of the subsidy reforms could be that Iran would become a significant regional exporter of petroleum products.

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<sup>10</sup> The South Pars field is Iran's largest gas field in the Persian Gulf and adjacent to Qatar's North Dome. Iran has broken the huge field into 24 phases which are partly developed and partly under development.

## ***Oil Production***

Iran holds approximately 137.5 billion barrels of proven crude oil. These reserves are distributed between 40 onshore fields (83 percent of total production) located mainly in the south-western province of Khuzestan, along with 15 offshore fields (17 percent of total production) located in the Persian Gulf. Iran's top four producing on-shore fields include Ahvaz (Asmari and Bangestan formations), Maroun, and Aghajari, which are very old and need significant investments and gas-injection schemes to continue producing at high levels. Iran's highest producing offshore fields include Dorood, Soroush & Nowruz, Salman, and Sirri E.

Iran's current official production capacity is around 4 mbpd; however, experts argue that a sustainable capacity is closer to 3.6 mbpd. The International Energy Agency reports that production had dropped to about 3.45 mbpd in December 2011 with sustainable production capacity standing at 3.51 mbpd.<sup>11</sup> There are no expectations of achieving the planned production target of 5 mbpd by 2015, though the Iranian government is trying hard to attract foreign and domestic investment into the oil sector.<sup>12</sup> However, experts believe that the core issue in the Iranian petroleum sector is lack of needed technology, which is absent as a result of external sanctions. Right now, Iran is mainly relying on Chinese and Indian investors. Consequently, production is expected to fall to 3.1 mbpd by 2016 with revenue-earning exports suffering accordingly.

The eventual production capacity in 2015 will heavily depend on the ability of Iran to bring the current projects on stream in the next three years as well as on the outlook of sanctions. In August 2011, the *Middle East Economic Digest* predicted: "By 2015, crude oil production is expected to fall to 3.8 mbpd from 4.2 mbpd in 2010. Production capacity could fall faster if sanctions continue."

One of the techniques that Iran has utilized to recover falling oil production has been to inject vast amounts of natural gas into the declining oilfields to increase pressure. However, the prospect of that program will depend on the availability of excess gas in the country's gas sector (see below). According to the Energy Information Administration in the U.S., the share of injected gas will increase dramatically in the next few years.<sup>13</sup>

As mentioned earlier, one needs to evaluate the Iranian oil sector developments through the lens of export potential. The graph below shows the net export capacity of Iranian oil, which currently stands at about 2 mbpd. The future outlook of oil exports will be discussed in the section on domestic energy consumption.

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<sup>11</sup> . "OECD Stocks – Oil Market Report," *Organisation for Economic Co-operation and Development/International Energy Agency*, (10 February 2012), pp. 26-32.

<sup>12</sup> In March 2012, the Iranian Parliament passed a new petroleum law which is designed to make investments in the petroleum sector more attractive.

<sup>13</sup> EIA Report, 17 February 2012.



**Iranian Total Oil Production and Consumption, 1977-2010**



Source: U.S. Energy Information Administration

### ***Gas Production***

With 28.1 trillion cubic meters of proven natural gas reserves (15.5 percent of the world total), Iran has the second largest gas reserves after the Russian Federation. Current gas production stands at 500 mcm/d and it is projected to increase to 1,480 mcm/d by 2015. Although, similar to the oil sector, real gas production will be lower than expected.

However, Oxford Analytica's assessment, which states that "[the] oil and gas sector will continue to stall amid mismanagement, corruption, sanctions and lack of technical expertise,"<sup>14</sup> is not accurate, because gas production will expand in Iran, though at a slower pace than anticipated.

Iran's gas production capacity is about 530 mcm/d; however, the actual balance between production and consumption (summarized in Table 2 below) shows some new trends.

As can be seen, the volume of gas being injected into oil fields has almost doubled and the current savings emerging from subsidy reforms (see below) are allowing Iran to inject more gas and also look for further opportunities to export natural gas.

Nonetheless, Iran has not yet become a major exporter of gas as most of the gas that is being exported to Turkey originates from Turkmenistan.

<sup>14</sup> Oxford Analytica, 5 September 2011.

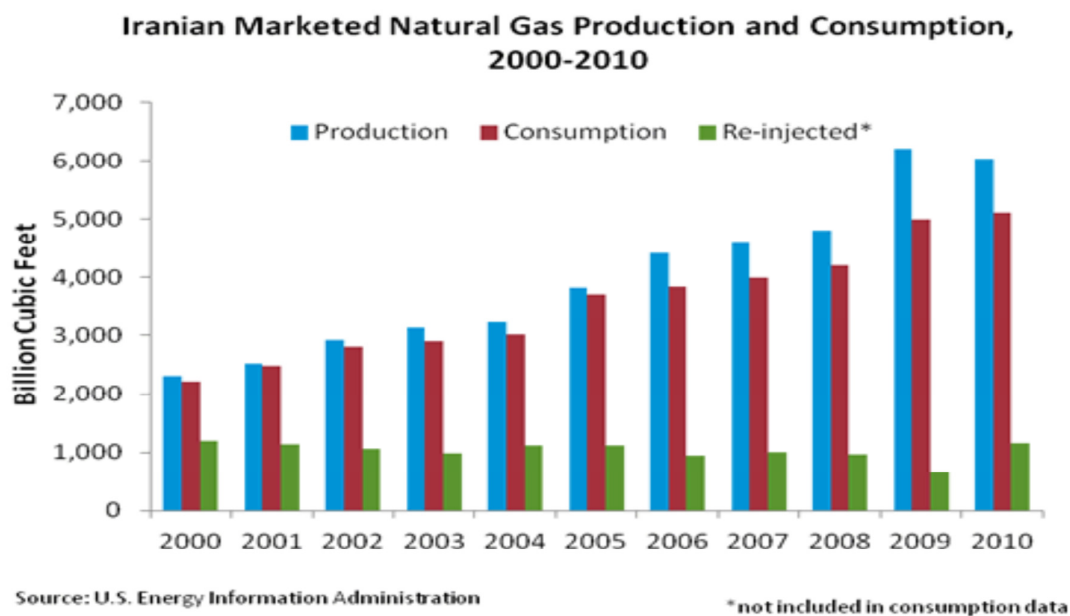
**Table 2: Iran's gas summary sheet (2010-2011)**

Description	Average (Mar. 2010 – Sep. 2010)	Average (Mar. 2011 – Sep. 2011)
Total Daily Gas Production	418.5	403.3
Gas Depletion	8.5	8.37
Treatment Plant Fuel	10.5	8.78
<b>Total Output of treatment plants</b>	<b>399.6</b>	<b>386.16</b>
Imports	18.3	25.66
<b>Total gas supply to gas network</b>	<b>417.5</b>	<b>411.82</b>
Export	22.85	23.81
Injection	6.9	11.89
Gas pressure station fuels	2.95	2.73
Other	0.5	0.5
Ethane recovery	13	11.87
LPG (equivalent)	1.6	1.86
<b>Total gas supply to domestic consumers</b>	<b>370.1</b>	<b>359.99</b>

*Sources – National Iranian Gas Company Management Reports*

### ***Overall Domestic Energy Consumption***

The following graph summarizes the overall trend in gas production and consumption in Iran from 2000 to 2010, i.e. before the implementation of subsidy reforms in December 2010.<sup>15</sup>

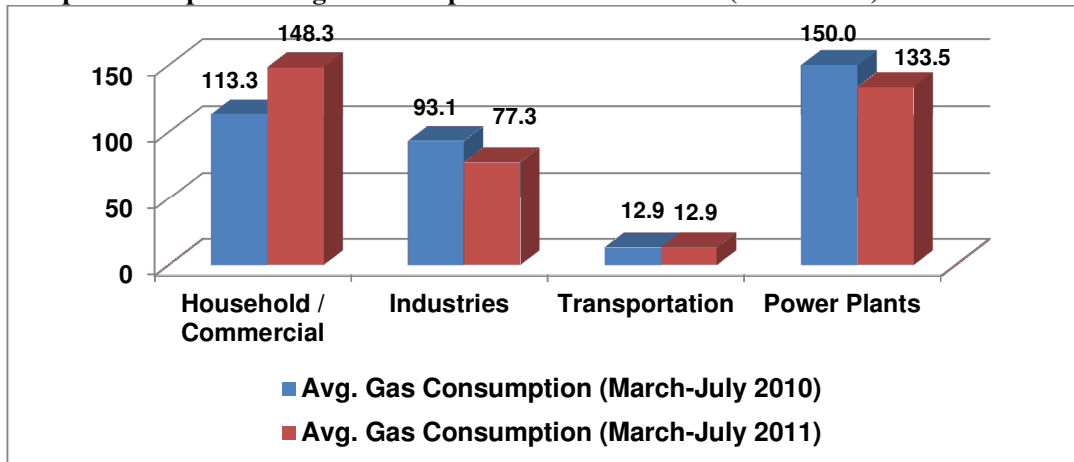


<sup>15</sup> The government introduced subsidy reforms by lifting the indirect subsidies on food and energy prices, hiking fuel prices in return for offering cash handouts to lower income classes.

As can be seen in the above graph, annual production grew from some 2,200 billion cubic feet (about 62.3 billion cubic meters) in 2000 to some 6,000 billion cubic feet (about 169 billion cubic meters) in 2010. Considering the high level of domestic consumption, the volume of gas injected into oil fields remained low. However, the introduction of subsidy reforms in December 2010 paved the way for some gas savings, which could now be injected into oil fields.

The following graph indicates the changing pattern of gas consumption in the country after the subsidy reforms. It should be noted that the growth in household consumption is not reflective of higher per capita consumption, but is related to a larger number of households and towns being connected to the country's gas grid.

**Graph 2: Comparison of gas consumption in various sectors (2010 - 2011)**



Sources – National Iranian Gas Company Management Reports

Looking at other fuels, Iran currently consumes 1.7 million bpd or 2.2 percent of total global crude oil production.<sup>16</sup> The majority of crude oil is either refined into gasoline to fuel automobiles<sup>17</sup> or converted to gasoil for transportation and electricity generation and heating oil for areas where natural gas infrastructure has not yet been built. Iran refines the mentioned crude in nine refineries. Furthermore, Iran plans to add around 985,000 barrels/day of refining capacity by 2014, mostly through expansions and upgrades for gasoline production from current levels of 46 million liters per day to 160 million liters per day. Hence, by 2014, Iran will not need to import any gasoline and may well be an exporter thereafter depending on the patterns of growth in domestic consumption. Iran's gasoline demand is unlikely to grow much due to the price elasticity resulting from subsidies being lifted.<sup>18</sup>

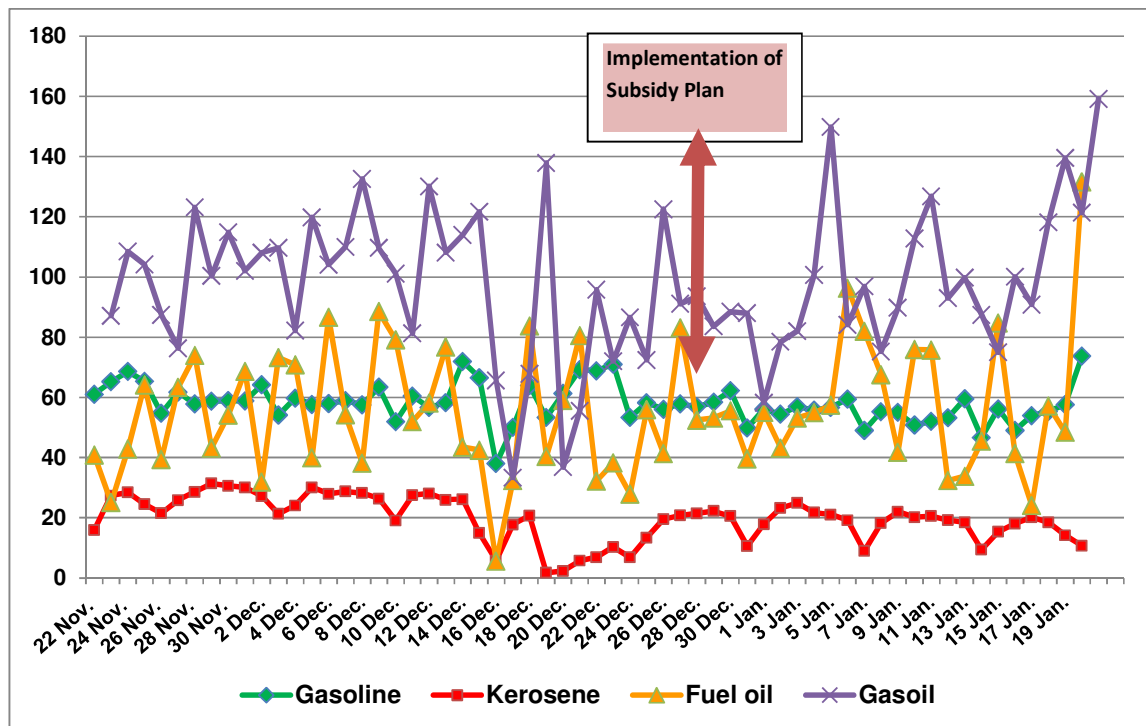
When analyzing the consumption of various fuels (see graph below), it is interesting that the overall pattern has not changed much. However, it should also be considered that once these figures are seasonally adjusted (i.e. considering the fact that January 2011 was a winter month), one can identify a decline in domestic consumption of fuels.

<sup>16</sup> BP Statistical Review of World Energy," (June 2010), p. 11

<sup>17</sup> Although a gasoline rationing system was introduced in June 2007, this policy has curbed Iran's petrol imports to some extent.

<sup>18</sup> Fuel prices will continue to rise in different stages until they reach 90 percent of international fuel prices.

**Graph 3: Consumption of oil products from 22 November 2010 to 20 January 2011 (million liters/day)**



Source: National Iranian Oil Products Distribution Company Report

All in all, Iranian officials underline that there have been considerable savings. According to Nasser Sajjadi, the deputy director of the National Iranian Oil Products Distribution Company (NIOPDC), the consumption of four highly-consumed fuels in Iran has declined noticeably since implementation of the reform plan. Another NIOPDC official, Jalil Salari, stated that the consumption of LPG, gasoline, kerosene, and diesel had declined between 4 and 19 percent.<sup>19</sup>

Finally, looking at electricity and water consumption, according to Majid Namjoo, Iran's energy minister, the country has saved some \$8.1 billion and \$400 million in water and electricity consumption respectively since subsidy reforms started in December 2010.<sup>20</sup>

Considering all of the above savings in diverse energy sectors, experts opine that Iran has managed to save an average daily volume of gas of 80 mcm in 2011 compared to 2010.<sup>21</sup> This means that the country will have the ability to export natural gas to neighboring markets and also inject more gas into oil fields.

## IV. Gas Export Plans

Although gas export ranks as the last priority (behind domestic consumption, injection, and gas-based industries) when it comes to gas allocations, it is valid to argue that Iran is seriously contemplating long-term plans to fulfill the objective of joining the global gas export market. Indeed, for Iran the

<sup>19</sup> "Subsidy Reform Plan saves Iran \$5.3b in fuel consumption," Tehran Times – Economic Desk. 12 January 2012.

<sup>20</sup> "Subsidy Cuts Savings," Kayhan International (6 February 2012).

<sup>21</sup> Based on calculations by Siamak Namazi of ACG Dubai – presentation at MEGAS Conference in Dubai in October 2011.

objective of joining this market goes beyond economic considerations and it has become part of the country's international relations strategy.

Considering the views of key domestic players in the context of the country's actual challenges (especially in the field of attracting needed investments, creating jobs, etc.), one can identify a pattern focusing on the development of gas-intensive industries as opposed to the export of gas. Key parameters in this strategy would be:

- Creation of a number of special zones for the development of gas-intensive industries (e.g. the Jask Region at the Sea of Oman);
- Promotion of gas-based industries such as petrochemicals, cement, aluminum, steel, etc.;
- Promotion of integrated gas projects, which could help rectify some of the shortcomings in the upstream-only buyback projects;
- A diversification policy (i.e. diverse industrial approaches) could also allow the gas pricing and rates of return to vary depending on industrial sector.

So far, as can be seen in the above table, Iran has remained a net importer of gas and it has mainly played the role of a "regional gas hub" as opposed to being a gas exporter. However, increased future gas production will allow Iran to export energy in different forms including:

- Pipeline gas;
- Electricity (mainly produced in gas-fuelled power plants); and
- Products of gas-based industries (steel, aluminum, cement,<sup>22</sup> petrochemicals,<sup>23</sup> etc.)

The above combination of exports is also a reflection of the general mood among the key stakeholders in Iran with regard to gas exports. In fact, domestic opponents of gas exports believe that export of gas in its raw form is equal to export of development potential. This group, led by some prominent MPs and former government officials, believes that priority should be given to gas injection into oil fields as well as industrial and petrochemical sectors. What facilitates the export of energy in the form of electricity is the fact that Iran has indigenous capabilities in constructing power plants. This means that in the process of adding value to gas to produce electricity, Tehran is not dependent on foreign technology. This is also the case when it comes to constructing domestic and export pipelines. However, when one considers other forms of adding value to gas (petrochemicals, liquefied natural gas or LNG, gas to liquids or GTL as well as other gas-based industries) Iran would be dependent on foreign technology, which is not widely available under the current sanctions regime.

Furthermore, production and political difficulties aside, Iran's presence in the regional and global gas market faces political barriers, especially external sanctions<sup>24</sup> due to the country's nuclear program. External sanctions and their consequences have both hampered Iran's plans in the field of gas and energy exports, but they have also compelled Tehran to become more pro-active in using the country's main competitive advantage (vast hydrocarbon resources) in consolidating regional relations.

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<sup>22</sup> According to domestic industry sources, Iran is already the world's fourth largest manufacturer of cement, which is one of the main export items to regional markets (especially Iraq, Afghanistan, and Qatar).

<sup>23</sup> Iran's annual petrochemical output stands at 47 million tons (below the installed capacity of 54.5 million tons) with annual exports reaching about US\$12 billion.

<sup>24</sup> Iran's energy sector has been subject to sanctions imposed by U.S. Presidential Executive Orders since 1995 and also a number of laws passed by the U.S. Congress (laws originally known as ILSA and later IFA). In recent years, there have been additional sanctions related to Iran's nuclear program initiated by the U.S. and also by the UN Security Council.

This phenomenon will be seen when we look more closely at the country's relations with Russia and Turkey.

## **V. Regional Policies Towards Russia and Turkey**

In light of the above outline of Iran's regionalism as well as energy sector realities, the country has developed specific approaches to key countries. Below we will have a closer look at Tehran's relations with Moscow and Ankara:

### **Iran-Russia Relations**

Russia and Iran have had a long history of parallel rivalry and occasional cooperation throughout the past few centuries. Though occasionally a tactical ally, for Russia (and also the Soviet Union), Iran was never a close ally or a client state (such as Egypt was in some stages of the twentieth century). In turn, Tehran has never been able to trust its northern neighbor to the degree that it would call Russia a strategic ally or a partner. Nonetheless, partly due to physical and geographical proximity and partly due to the fact that the two countries have been the principal powers of key regions such as Central Asia, the Caspian, and the Caucasus, they have experienced multiple ups and downs including wars and partnership pacts throughout the past 200 years.

Defying history, at present, Russia and Iran are trying to foster a close relationship. Russia has been building Iran's nuclear power plant at Bushehr and is engaged in extensive trade and investment in Iran. Tehran is also seeking full membership in the Shanghai Cooperation Organization, which would pave the way for closer relations.

Since the collapse of the Soviet Union, there have been serious attempts on both sides to deepen the state-to-state relationship. However, the long history of competition and distrust has undermined the creation of a deeper strategic relationship. Below, we will examine the drivers as well as the obstacles to the emergence of such a strategic partnership, which are partly rooted in history and partly in current geopolitical and geostrategic realities and interests.

### ***Main Issues in Iran-Russia Relations***

Historically, Iranian experts have always analyzed Tehran's relations with Moscow in a broader strategic context rather than in a bilateral nature. Both consider themselves important and independent regional and international players. Consequently, the two parties' interests are divergent in several key areas, including the development of energy resources and export routes, the territorial division over the Caspian Sea as well as general regional interests. The complexity of Tehran-Moscow relations is reflected in the fact that while they should have a mutual interest in counterbalancing America's influence in the Caspian region, their competition for the same clients has blocked co-ordination of policy. Therefore, one key issue in the divergence between these powers is how they position themselves towards international and regional players. For example, Moscow's geostrategic aspirations in the Middle East have undermined stronger ties between Iran and Russia. Moscow had stronger ties with Saddam Hussein's Iraq than with Iran during the Soviet era, and this dynamic still seems intact, i.e. the potential of better Russia-Iraq ties as opposed to Russia-Iran ties. The contrast is best seen in the energy sector: The Iraqi government has offered extensive opportunities to Russian energy and construction firms, while in Iran, Russian participation in the energy sector is minimal and the presence of Russian technicians is mainly limited to those engaged at the construction of the Bushehr nuclear plant.

Below, we will look at the key areas that drive a wedge between Russian and Iranian interests:

### *Caspian Legal Regime and Security*

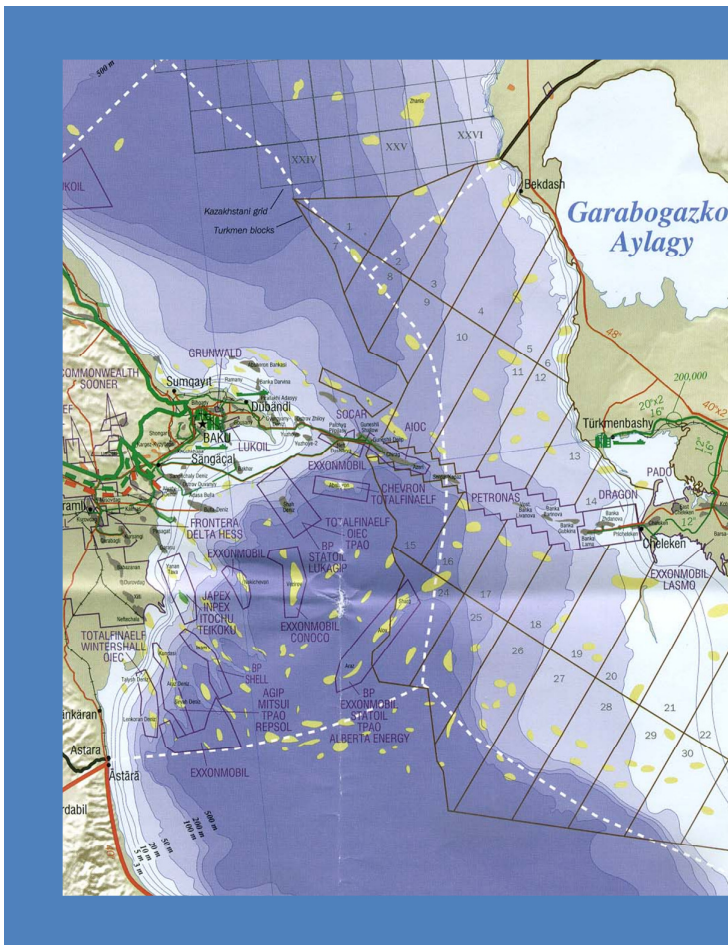
Russia and Iran continue to dispute legal ownership of the Caspian Sea including subsea mineral rights. While Russia has been successful in bringing two other Caspian littorals, Kazakhstan and Azerbaijan, around to its preferred median-line solution, it is finding it difficult to win round Iran and Turkmenistan.

Russia has formally ruled the Caspian since 1828 when it gained full control of the inland sea under the Treaty of Turkmenchaisk. After the demise of imperial Russia in 1917, the Soviet Union granted Iran limited control over a small part of the sea (13 percent) in the Soviet-Iranian Treaties of 1921 and 1940. But with the break-up of the Soviet Union, and the creation of three newly independent Caspian littoral states (Kazakhstan, Azerbaijan, Turkmenistan), Russia has promoted a median-line solution equidistant from each state's coastline, with disputed fields to be developed jointly. As this solution gives Kazakhstan, Azerbaijan, and Russia the greatest share of the Caspian, unsurprisingly, they are supporters of this approach (see map).

Iran has not accepted the median-line solution and has consistently held out for an equal share Caspian solution giving every littoral state a 20 percent sector, regardless of length of coastline. This approach gives Iran a 7 percent share increase. As Caspian development projects have proceeded, it is clear the northern Caspian basin is more prolific than the southern basin. Thus, Iran's only hope of gaining a larger share of Caspian wealth is by extending its sector size. Also developing offshore southern basin reserves will be more costly for Iran as they are located in 600-800 meters of water versus 10-50 meters in the north Caspian. Tehran continues to insist that all five littoral states must agree demarcation before joint exploration-development projects can proceed.

Paradoxically, while Russia and Iran diverge on how the Caspian Sea should be split, they are united in their opposition to Kazakhstan's plans to build a subsea trans-Caspian pipeline to ship Kazakh, and potentially Turkmen and Uzbek, gas exports to Europe. Both oppose construction of pipelines across the Caspian seabed until demarcation of the sea has been agreed among the littorals. They are agreed that in having lost market share due to BTC<sup>25</sup> and Shah-Deniz transport systems, they are not eager to see additional bypass outlets take shape in the Caspian.

Security represents another contentious issue between Russia and Iran in the Caspian Sea, particularly over control of surface waters.



<sup>25</sup> Baku-Tiblisi-Ceyhan pipeline.



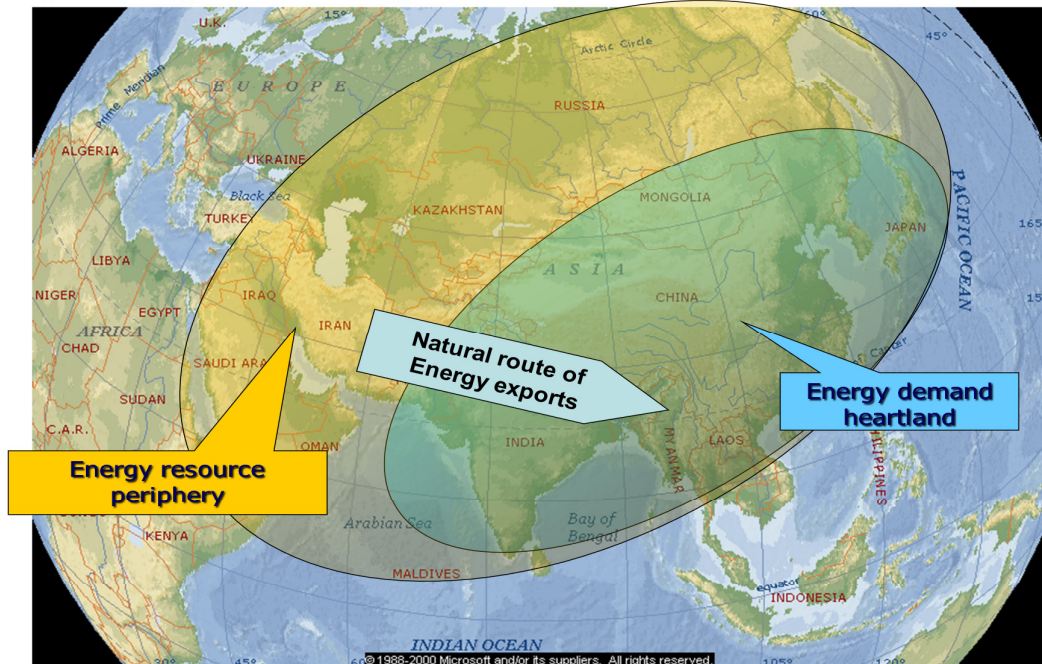
## ***Role in Energy Markets***

Russia and Iran very often clash over energy issues. While both states envisage themselves as major global energy players, there has been more rivalry between them than collaboration. Their enormous hydrocarbon potential and the fact that those reserves are firmly under state control, as well as the willingness of both states to affect energy policy for wider geopolitical purposes, could have paved the way for a coordinated energy policy, but so far it has only caused more rivalry.

Interestingly, Iranian strategists argue in favor of cooperation between Iran and Russia in developing the energy interdependency between Euro-Asian hydrocarbon producers and the Asian markets (see map below). Nonetheless, this cooperation has not emerged yet, mainly due to the competition between Iran and Russia over other major markets such as Europe, Turkey, and the Balkans.

Though currently hampered by sanctions and international issues, Iran as well as Caspian gas reserves could potentially change the gas dynamics in Europe by creating a viable competitor for Russian gas exports to the European Union. In fact, Iran is not only a potential exporter, but also a key transit country in transferring Turkmenistan's gas to Europe. Therefore, the competition over gas supplies to Europe will remain a key issue in Iran-Russia relations.

**Map 2: Interdependency of Energy Producers and Asian Energy Demand**



Nonetheless, Russia and Iran, the world's first and second leading gas reserve holders, were instrumental in the creation of the "Gas Exporting Countries Forum" (GECF), which now boasts a status similar to that of OPEC as it tries to coordinate efforts between gas-producing states. Tehran views the GECF as an opportunity to coordinate efforts between gas producers; however, many Iranian stakeholders view GECF as an organization that will be dominated by the Russian agenda to reduce competition among key producers in targeted geographical markets. As long as Iran remains more focused on Asian markets, there will be no major clash between the two big reserve holders, but the dynamics can change once Iran becomes a serious exporter of energy to Europe.



Nonetheless, the two sides signed an agreement in January 2008 to cooperate in developing some of Iran's vast oil and natural gas reserves.<sup>26</sup> Furthermore, in January 2009, Tehran and Moscow signed an agreement to trade natural gas in order to increase their export efficiency and increase profits. Russian Energy Minister Sergei Shmatko announced in July 2009 that Russia is eager to help Iran with the development of oil and gas fields in the Islamic Republic.<sup>27</sup>

### ***Geopolitical Interests***

There is no doubt that Tehran and Moscow consider themselves partners and allies in some areas, but they are also clear competitors in others. One element influencing Russian-Iranian bilateral relations is sanctions policy towards Iran. Russia and Iran both seek to assert their independent foreign policy as a counter to U.S. policy. Nonetheless, so far, the western bloc has managed to maintain Russia in a coalition of states that have put pressure on Iran regarding the nuclear file. In fact, Russia's political behavior, especially its occasional siding with western powers in sanctioning Iran, has irritated Iranian politicians, leading to increased distrust of Russian motivations. In recent years, Iranian analysts have argued that Moscow has used the nuclear issue as a bargaining tool to win concessions from the West, while simultaneously convincing Iran that it has prevented the 5+1 from passing severe sanctions against it. In short, Moscow has exploited the nuclear crisis to obtain economic and political benefits from both Iran and the West. However, it should also be noted that the most serious proposal that could lead to a resolution of the Iranian nuclear issue (the so-called step-by-step proposal) has been drafted by Moscow.

Evidently, both countries are subject to a multiplicity of dynamic and complex political, geopolitical, and international challenges and the mutual relationship will fluctuate for some time to come.

There is no doubt that in the absence of western companies, Russian firms would be able to benefit from Iran's economic and infrastructure prospects. But the volume of investment and foreign trade is small compared to so many other trade relations that Tehran nurtures (see the section on trade above). Nonetheless, in nuclear and military sectors, Iran has been a very profitable market for Russia. For Iran, its dependence on Russian arms is growing; it is now Russia's third largest arms buyer. Since 1991 Russia has sold Iran missiles, tanks, and armored battle vehicles—all critical components for the Iranian military. Russia also plans to undertake a \$5 billion project to build five nuclear reactors in Iran.

Further, security, military, and economic interactions between Iran and Russia could open the door for the Russians to step into the warm waters of the Persian Gulf, a traditional sphere of U.S. interest and influence.

Interestingly, in spite of relatively minor economic interests, Moscow has a direct interest to preserve Iran's territorial integrity. In fact, Russian analysts believe that any process that could lead to Iran's fragmentation (such as military action) would in turn destabilize Russia's southern regions.

Therefore, Moscow's top priority in its assessment of Iran will focus on Iran's stability and territorial integrity. In return, Tehran will look at Russia as a source of technologies that are not available elsewhere and a tactical partner in international relations. However, the existing mistrust and other practical differences will impede a deeper strategic relationship.

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<sup>26</sup> Mansour S. Kashfi, "Did Caspian summit share the sea or Iran's oil riches?" *Oil & Gas Journal* (28 January, 2008).

<sup>27</sup> Ariel Farrar-Wellman, "Russian-Iran Foreign Relations," *Iran Tracker* (2 August 2010).

## ***Energy and Trade***

While competition on international gas markets represents a point of divergence, Iran and Russia have convergence on development opportunities in Iran's upstream sector. Moscow is unhappy with the low level of Russian involvement in upstream activities in Iran. Russian upstream participation has so far included Gazprom's participation in South Pars 2 and 3;<sup>28</sup> Lukoil's interest in Anaran<sup>29</sup> and Rosneft, and Zarubezhneft role in Azadegan. Furthermore, recently GazpromNeft signed an MoU with NIOC regarding the development of the Azar field. But for the Kremlin, expanding holdings in the Iranian upstream remains a major priority, which could also help ensure that future Iranian gas exports do not undermine Russian energy markets in Europe and Asia.

Tactical moves, especially in the light of western sanctions on Iran, can also be registered regularly. For example, in July 2010, just two weeks after a new round of EU sanctions on Tehran, Russian Energy Minister Sergei Shmatko announced, "active cooperation between Russian and Iranian companies in the oil, gas and petrochemical sectors, which are developing and widening in their joint work."<sup>30</sup> Later that month, Russian companies agreed to export gasoline to Iran in defiance of EU and U.S. sanctions.<sup>31</sup>

Furthermore, both sides have agreed to trade in their local currencies, defying banking sanctions imposed by the U.S. and the EU.

## ***Outlook for Iran-Russia Relations***

To summarize the main interests from both parties:

Russia's national interests relating to Iran are to:

- Maintain security in Russia's southern regions, especially in regard to preventing potential instability in Iran impact the stability of the region;
- Persuade Iran to join the Russian position on Caspian Sea demarcation and common access to its surface waters;
- Secure export outlets for expanding Russian oil and gas volumes;
- Monitor OPEC, of which Iran is a member, to prevent adverse impacts of its decisions on Russian exports and maintain price stability;
- Secure the Turkish and southeast Europe gas markets from Iran among others;
- Protect the lucrative export potential of arms and nuclear technology to Iran;
- Ensure participation of Russian firms in Iranian energy, infrastructure, and industrial projects;
- Cooperate with Iran to halt the flow of Sunni Wahhabi Islamic fundamentalism into southern parts of Russia;
- Partner with Iran to promote a longer-term Asia-to-Europe trade and transportation corridor to rival the Suez Canal.

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<sup>28</sup> Though the South Pars project has been completed, Gazprom still has an office in Tehran and is pursuing other oil and gas projects.

<sup>29</sup> In 2011, Lukoil decided to withdraw from Iran in accordance with the latest sanctions on the country.

<sup>30</sup> Andrew E. Kramer, "Russia Plan to Help Iran Challenges Sanctions," *New York Times* (July 14, 2010),

<sup>31</sup> Lucian Kim and Stephen Bierman, "Iran May Get Gasoline from Russia State Companies Next Month," *Bloomberg*, (July 29, 2010).

Iran's interests as they relate to Russia are to:

- Counter U.S. and western pressure on Iran, especially in the nuclear field;
- Expand its oil and gas production capacity and develop its offshore gas fields in the absence of major western oil and gas companies;
- Promote security and cooperation in Central Asia and the Caucasus;
- Secure access to technologies (especially in the fields of military and nuclear) that Iran cannot obtain from western producers;
- Secure a larger share of the Caspian Sea oil and gas reserves and counter Russian hegemony of the Caspian surface waters;
- Become a major oil and gas transit route between the Caspian countries of Kazakhstan, Azerbaijan, Turkmenistan, and Asia-Pacific consuming nations.

The sustainability of Russian-Iranian relations remains to be seen. Moscow is becoming increasingly dependent on its economic and energy relations with the West, and is thus gradually becoming vulnerable to western pressures in trying to curb its ties with Tehran. Iran has also expressed its unhappiness with the repeated delays by Russia in finishing the Bushehr nuclear power plant as well as the cancellation of the delivery of the S-300 missiles in light of UN sanctions.

Where most analysts are in agreement is that Moscow's relationship with Tehran is opportunistic rather than geopolitical. As long as U.S.-Iranian hostilities persist, Moscow can continue to pursue its lucrative business dealings with Tehran. However, should Tehran and Washington mend fences at some point, Tehran would reassess its relationship with Moscow.

In the meantime, closer cooperation with Russia in nuclear and military sectors will continue out of necessity and not out of strategic deliberations. Within that context, Iran will most likely commission further nuclear power plants to Russian companies. Moscow will further encourage Russian companies to position themselves in the Iranian market in the absence of western competition—a process that has already led to Russian investments in sectors such as automotive, construction, and infrastructure.

### **Iran-Turkey Relations**

Tehran and Ankara have historically had a good relationship supported by cultural and religious affinities between the two nations. Like any other neighboring states that have regional and international ambitions, Iran and Turkey have also had their share of regional competition, but compared to other bilateral relations in the Middle East, this relationship has been a robust one. In recent years, this phenomenon has been supported through the fact that an Islamist government has been in power in Ankara since 2002.

Occasional tensions and disagreements, such as the current discord over the future of Syria, have never been strong enough to shake the foundation of a relationship based on mutual respect and geostrategic calculations. In the past decade, the core of the relationship has been based on strengthening trade and energy relations. In fact, Iran-Turkey trade reached U.S.\$16 billion in 2011 (up from \$1.2 billion in 2002), which makes Turkey one of the most significant trading partners of Iran (see section on trade above). In fact, during an official trip to Iran in February 2011, Turkish President Abdullah Gul signed an MoU in which the two sides committed to increase their bilateral trade to \$30 billion per annum by 2015. Also, politically, Turkey and Iran are very close. Both countries follow a foreign policy of sustained engagement and close relations with immediate neighbors and from an Iranian perspective, Turkey is an ideal ally/trading partner as it appeals to the majority of the mindsets and political factions in Iran. In other words, Turkey combines some of the key characteristics that Iranian stakeholders are looking for: it is a Muslim country; it is one of Iran's strategic neighbors; and, its economy can offer Iran technological and financial assistance in Iran's projects.

Considering the potential in trade between the two countries, the \$30 billion goal is feasible due to these reasons:

- a) As a result of subsidy reforms and lower domestic consumption, Iran's gas export volume to Turkey could theoretically double in the next five years, adding a potential \$5 billion in new Iranian exports to its western neighbor;
- b) Iran is quickly shifting its import routes to replace the UAE with Turkey as a third country location for re-exports to Iran. The volume of re-exports through UAE to Iran reached some \$16 billion in 2010/11 (see trade statistics above), which could be shifted to Turkey; and
- c) Growing presence of Turkish companies in growth sectors such as construction, agriculture, and energy.

In recent years, Turkey has increasingly positioned itself not only as a market and a transit outlet for Iranian gas, but also as a potential key player in developing Iran's upstream sector. Turkish Prime Minister Recep Tayyip Erdoğan had discussed these issues during his October 2009 visit to Tehran. MOUs signed on that occasion include exploration, production, and transportation of Iranian natural gas, notwithstanding U.S. sanctions in that sector.<sup>32</sup> Interestingly, Ankara has increased its reliance on importation of Iranian crude oil as 51 percent of Turkish oil imports came from Iran in 2011. Turkey is also interested in receiving future Turkmen gas production volumes via Iran, irrespective of the situation with trans-Caspian transportation and potentially to that project's detriment. In light of Iran's growing gas potential, Turkey may well move ahead and conclude significant upstream and pipeline contracts in Iran despite U.S. opposition.

### ***Iranian Perceptions of Turkey***

Decision-making in Iran is influenced by diverse mindsets. The different mindsets have varying and sometimes competing views on how Iran should develop and with which countries Tehran should develop closer ties. There are few countries that appeal to all of these mindsets—Turkey is one of them, as it combines the following characteristics that attract dominant Iranian mindsets:

- It is a leading Muslim country, which is in line with the core values of the ideologically motivated mindset;
- Turkey offers major commercial and investment opportunities to Iran and it has good relations with other key players such as the U.S., and is therefore highly respected by pragmatists in Iran;
- Turkey has invested in Iran and continues to look for further capacity building potential in Iran, which is appealing to the revolutionary nationalists in Iran;
- Finally, directly or through joint ventures with western companies, Turkish businesses can offer Iran access to various technologies, which appeals to the technocrats who seek technology to spur Iranian development.

All in all, Iranian perceptions towards Turkey are very positive and the bilateral relations between the two countries would be very sustainable over time and also through potentially shifting political preferences in Tehran.

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<sup>32</sup> "Turkey determined to enhance ties with Iran: Erdogan," *Tehran Times – Political Desk*, (28 October 2009).

### ***Motivations for Growing Iranian Trade and Investment in Turkey***

One of the important phenomena in Iranian-Turkish bilateral relations is the growing investment activity of Iranian companies in Turkey. The main motivations for such investments are twofold:

- Iranian companies' desire to become regional entities and to learn from the experiences of Turkish companies who have successfully expanded regionally and internationally; and
- The fact that utilizing Turkish entities helps Iranian companies manage the threat of sanctions. Though the UN Security Council has introduced a framework for sanctions against Iran, the detailed implementation of sanctions is left to the member states. Turkey has so far decided not to go beyond the basic sanctions, which target the military and nuclear sectors in Iran. Turkish officials have stated that Turkish companies will remain free to make their own decisions about whether to comply with U.S. and EU sanctions. It is clear that by operating from Turkey, Iranian companies can continue their international business with less risk emanating from international sanctions.

Another facilitator in this regard is the fact that most international companies are using Turkish banks for major transactions with Iran, as Turkish banks are operating fully in Iran in defiance of U.S. sanctions. Furthermore, Turkey and Iran have signed a double taxation treaty, as well as an investment protection treaty, and are also leading members of two trade-based alliances:

- Economic Cooperation Organization (ECO), which is a regional trade and investment community; and
- D-8, which is an alliance of the 8 leading and populous Islamic countries including Iran, Turkey, Malaysia, Indonesia, Egypt, Nigeria, Pakistan, and Bangladesh.

It should also be noted that the Central Bank of Iran is currently holding accounts in Turkey to manage international financial transactions. To understand the impact of this decision, one can look at the trade balance sheet between the two states:

Iran exports to Turkey the following:

- Pipeline gas (quantities fluctuate based on gas availability, but assuming 8 bcm of gas per annum @ 50.5 cents per cm) = about U.S.\$4 billion per annum;
- Crude oil (@ about 220,000 barrels per day) = about \$8 billion per annum at current prices;
- Other goods (light industrial products, etc.) = about U.S.\$1 billion per annum

In return, Iran imports some \$3-\$4 billion of goods from Turkey annually, and the rest of the funds are used for paying for Iranian imports from other countries. Considering the fact that Iran is trying to use Turkey as an intermediary country for indirect imports (a role that Dubai used to play in the past), it is conceivable that Turkey will remain the main financial hub for Iran's international transactions.

### ***Other Phenomena in Bilateral Relations***

Transit is playing increasingly important role in bilateral relations. Especially with the imposition of sanctions on shipping to and from Iran, a growing segment of the western exports to Iran are transited by land through Turkey. In fact, Turkey is the key transit country for Iranian imports from European countries (a role formerly played by Dubai).<sup>33</sup>

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<sup>33</sup> According to Maku News (Farsi news agency – 19 February 2012), the number of trucks entering Iran from Turkey has increased by 4% in 2011 compared to 2010. The growth rate in the same period for trucks exiting Iran to Turkey stands at 17%.

As for Iran, the country is an important outlet for connecting Central Asia to international markets. In 2011, Iran transited 10 million tons of goods, which represents an increase of 6 percent compared to 2010.<sup>34</sup> According to Shahryar Afandizadeh, Iran's special representative for transit affairs, main transit goods via Iran are fuel products, construction materials, vehicles, foodstuff, and fertilizers.<sup>35</sup> Afandizadeh also confirmed that Iran was seeking to accelerate the expansion of transit lines by developing road and railway links across the country, especially in the border provinces. Given its unique geographical position, Iran could potentially transit a minimum volume of 40 million tons of goods annually. Though Turkey is not the only outlet for exporting Central Asian exports to western markets, a large segment of the transited goods find their way to Turkey due to the already existing flow of trucks and trains from Turkey to Iran. In other words, the growing flow of goods via Turkey to Iran has created the capacity for an increasing transit of goods in the reverse direction.

Another important phenomenon in Iran-Turkish relations is the role of Iranian tourism in Turkey. In fact, Turkey has become a country of choice for Iranian tourists, not just because Iranians do not require a visa to travel there, but also due to geographical and cultural affinity as well as the greater availability of flights as well as other means of transportation (trains and bus connections). Turkish and Iranian airlines fly between major cities in both countries (including direct flights from cities like Mashad, Tabriz, Isfahan, and Shiraz to Istanbul, Izmir, and Ankara). Furthermore, during peak seasons (Iranian New Year and summer), there are many chartered flights to tourist destinations such as Antalya, Bodrum, and Kuşadası. According to the Turkish tourism ministry, the surge in Iranian visitors to Turkey is derived from "visa-free travel, the greater availability of flights, diversification into mountain holidays, health and cultural tours, and its own advertising campaigns."<sup>36</sup>

### *Sources of Divergence*

As mentioned earlier, Tehran and Ankara experience occasional setbacks in their relationship. Some areas of competition that need to be considered are:

- Regional developments, especially events in Syria, have led to tensions in the relationship. Ankara's success in serving as a role model to the new regimes of Egypt, Libya, and Tunisia has irritated many Iranian stakeholders and will remain an issue until a new balance of power is established in the region. It should be noted that it is not the first time that Tehran and Ankara end up in a competition—they were engaged in a similar competition in Central Asia and the Caucasus after the collapse of the Soviet Union, which did not hinder the overall positive trend in the relationship;
- Tehran desires to export gas to the EU and to become one of the "energy brands" in the EU (similar to the Russian strategy). Turkey's ambitions to highlight its role as a transit country for gas exports to the EU are in direct competition with this Iranian objective. Consequently, Tehran has developed an alternative route (the so-called Islamic pipeline going through Iraq, Syria, and the Mediterranean). This conflict of interest could undermine future energy relations, though it is a marginal factor at the current juncture;
- One major source of tension that could emerge between Tehran and Ankara is if the current unrest spreads to the Caucasus and Central Asia. For example, if the regime in Baku falls, there will be competition between the two powers on controlling future developments there. Such competition could result in short-term irritations in the relationship, but it will be difficult to shake the core foundation.

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<sup>34</sup> Tabnak (Farsi website), 6 February 2012

<sup>35</sup> "Transit goods via Iran reaches 5.5 million tons in 7 months," *English.news.cn*, (3 November 2011).

<sup>36</sup> Ayla Albayrak, "Iran's Tourist Invasion of Turkey," *Institute for War & Peace Reporting*, IRN Issue 75 (24 March 2011).

## VI. Conclusions and Outlook

Regionalism and energy interconnectivity are two important parameters in Iran's international relations and Russia and Turkey both occupy an important place in Iran's regional and international strategy. This will remain the case as long as external pressure, especially U.S. hostility, continues to influence Iranian decisions. Undoubtedly, an opening in the relationship with western countries would change the dynamics for Iran enormously. In the meantime, the outlook for a strategic relationship between Tehran and Ankara is much more positive compared to a strategic axis between Iran and Russia.

Evidently, economic and energy interests can drive key regional countries to push forward an agenda of cooperation. However, political risks and uncertainties will remain significant impediments in the short to medium term.

For the time being, the future outlook of Iran's regional strategy will depend on a number of strategic factors that need to be analyzed further. These are:

- The future outlook of nuclear negotiations will have a direct impact on Tehran's ability to achieve its own plans in the region. While a negotiated settlement is feasible, it remains to be seen whether the key stakeholders in the nuclear stand-off have the political will to resolve this issue or whether a successful outcome will be undermined by marginal interests;
- Further escalation in Iran's external relations will also affect the overall dynamics of the country's regional strategy. Increased pressure will push Iran to become more and more inward-looking and less and less cooperative with the international community;
- Another process that can change the dynamics of Iran's strategy is the generational shift taking place in Iranian politics. While the first generation of post-revolutionary leaders were from the clerical and merchant networks, the new leaders belong to the war generation organized around the Revolutionary Guards. The new generation has a different world view and is more interested in Iran's technological progress rather than the country's strategic positioning. This does not mean a change of overall strategy, but a potential shift of tactical approaches leaning much more towards technological aspects rather than religious and cultural affinities. While Turkey has been a more trusted strategic ally, the new generation of Iranian leaders may prefer Russia over Turkey in real terms;
- The actual outcome of the Arab Spring will be significant for the future dynamics in the region as well as for Iran's national strategy. Tehran's general analysis is that U.S. influence will decline in the Middle East and North Africa, which is seen as an opening for a greater Iranian presence in the region, supported by trade, energy relations, and investment. However, the final outcome of the processes in Arab countries is yet to be determined. The potential emergence of revolutionary governments and potential disintegration of some states can change dynamics unexpectedly;
- The country's gas strategy will also influence the ability to implement the regional strategy outlined above. Clearly, the growing emphasis on gas-based industries does not mean an end to the planned pipeline projects and gas exports, but the consolidation of this policy will address some of the domestic Iranian concerns in the utilization of the country's gas potential. Eventually, Iran will be able to achieve its goals including gas exports, but the timeline for this process will be much longer than anticipated.

The resource base and international demand are in place to realize Iran's macro strategy. Many other obstacles (domestic politics, international relations, regional shifts, lack of investment, etc.) will need to be resolved over time and current political realities suggest that these impediments are unlikely to be resolved quickly.