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Interviews

Virtual Dialogue: Aftermath of Iranian Presidential Elections

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What has been the overall impact of the presidential elections crisis on the stability of the Iranian political system? Is the crisis over?

Maloney: The Iranian political system has experienced a profoundly destabilizing shock. The decision to rig the outcome of the 12 June presidential elections in favor of President Mahmoud Ahmadinejad and all that has followed in its wake has transformed Iran's political system, reshaped the political jockeying of its elite decision makers and intensified the dissatisfaction of millions of its citizens. The regime is now dealing with an almost unprecedented array of challenges, both on a street level and within the corridors of power. The passionate, disciplined street demonstrations that peaked in the days after the election continue to percolate and – with further provocations and/or coherent direction – could evolve into a powerful and even a revolutionary force.

This is a truly significant development. In addition, the surprisingly bold defiance of regime stalwarts such as Mir Hossein Mussavi, Mehdi Karrubi, Mohammad Khatami and Ali Akbar Hashemi Rafsanjani suggests that a crucial component of Iran's elite has begun to separate itself from the regime to promote the opposing agenda of a nascent mass-based movement. At this stage, it is impossible to predict precisely where, when and how Iran's current power struggle will end. In the immediate term, the Islamic Republic will likely survive this crisis with its governing system and leadership largely intact, thanks to the same tactics that have preserved it for the past 30 years: behind-the-scenes deals and mass repression. However, the regime's internal challenges have already intensified beyond what most analysts anticipated a mere six weeks ago, and at some point the discord may begin to transcend Tehran's capacity to navigate.

Ehteshami: Iran's post-election crisis is increasingly less about the disputed poll itself and more about the very nature of power in Iran and the exercise of power. As such, the crisis is about the balance of power in Iran, the legitimacy of the ruling regime, political and revolutionary identity, the ideology of the state, the republic's political culture, foreign relations, and Iran's place in the Muslim world.

Leveretts: The Islamic Republic remains fundamentally stable in the wake of the 12 June presidential election. Since its founding 30 years ago, the Islamic Republic has always been a political order characterized by competition among various personalities, factions and formal and informal power centers. Nevertheless, the system has survived daunting challenges, including:

- A bloody and damaging eight-year war with Saddam Husain's Iraq.
- The death of Ayatollah Khomeini, the Islamic Republic's "founding father", and his replacement by Ayatollah Ali Khamenei under controversial circumstances.
- Presidential transitions in which particular political factions transfer power to their most ardent opponents.

At bottom, the controversy surrounding the 12 June election reflected the unhappiness of parts of the power structure with President Ahmadinejad's polarizing political and management style, which sometimes upsets the consensus-oriented dynamics of the Islamic Republic's "high politics." But the controversy was never a real "crisis," as none of the major protagonists has any interest in bringing down the system.

Because of the consensus-oriented nature of the system, Iranian politics will – for the next several months and even years – place a premium on post-election reconciliation. The figures who, by virtue of their positions, personalities and agendas, can put themselves forward as national conciliators are likely to include:

- Ayatollah Khamenei.
- The current parliament speaker Ali Larijani.
- Former President and current head of the Expediency Council and the Assembly of Experts Ali Akbar Hashemi Rafsanjani.

How damaged – if at all – is Mr Ahmadinejad's and more importantly Ayatollah Khamenei's legitimacy by the aftermath of the elections? How is that likely to affect the Islamic Republic's foreign relations?

Maloney: The manipulation of the election and the protests that erupted in its wake have fatally undermined the legitimacy and credibility of the current Iranian system. Historically, representative institutions and popular participation in the voting process constituted a critical dimension of the authenticity and legitimacy of that system. However, for Iran's hard-liners, the regime's stability ultimately does not require this kind of legitimacy, and when they believed the system was under threat from within, they willingly sacrificed its popular legitimacy to preserve it. These actions have narrowed the regime's base of support and ultimately weakened it in the long-term. In the short term, however, the Islamic Republic will probably survive, and its foreign policy will be influenced by countervailing imperatives. Iran's leadership will be focused inwardly for the foreseeable future, as the domestic tumult will distract Tehran from initiating any major new foreign policy ventures. However, it is not inconceivable that the regime would seek to shore up its domestic base of support and rally the nationalist sentiments of Iranians by manufacturing a foreign policy crisis.

Ehteshami: Of the many problems befalling the regime post-election, the crisis of legitimacy facing the ruling establishment is perhaps the most important, perhaps second only to regime security. It was Grand Ayatollah Hossein Ali Montazeri who early on stated that confronting protesters threatened the legitimacy of the Islamic Republic because it was no longer representing the people. Significantly, other clerics followed suit: Ayatollah Jaleedin Taheri (the former Friday prayers leader in the city of Isfahan), went on record describing the re-election of Mr Ahmadinejad as "illegitimate" and "tyrannical." Voices from Qom have reported that "with the exception of a few clerics who have ties with the government, the majority of clerics have not issued any statements in support and confirmation of the election results. Ayatollah Safi, Ayatollah Makarem Shirazi, Ayatollah Zanjani and Ayatollah Montazeri and other figures have not only not confirmed the election results, but also have made explicit or implicit comments and expressed their protests." Mr Ahmadinejad is increasingly a minor figure in the battle for the soul of the revolution, though clearly his powerful backers in the Revolutionary Guards and sections of the clerical establishment are trying very hard to keep his ship afloat.

The crisis in the Islamic Republic is also creating fresh anxiety regionally about Iran's foreign policy. The crisis of legitimacy for the regime could encourage further adventurism abroad and strengthen the hands of those who would like to return to 'exporting' the revolution as their first directive. It might seem prudent for some of the radical forces attached

to the security apparatus to seek to demonstrate their continuing power and influence by initiating subversive behaviour in neighbourhood. This kind of action can only further threaten the region's fragile security, of course, inevitably sucking in more external intervention. Such behaviour could also lead to immense pressure on Iran itself and its further isolation.

Leveretts: President Ahmadinejad's legitimacy has not been fundamentally damaged by the election controversy. We believe that he continues to enjoy majority support across most of Iran. But he is a polarizing figure, as was evident in the intensity of the effort to unseat him in the election and the intensity of the demonstrations in Tehran and a few other cities in the election's immediate aftermath. Mr Ahmadinejad's polarizing style also alienates some conservative figures. These actors, for the most part, supported the incumbent president in his re-election bid, but have already gone back to opposing him on specific personnel appointments and aspects of policy. We anticipate that this pattern will continue well into Mr Ahmadinejad's second presidential term.

We believe that supreme leader Ayatollah Ali Khamenei's political standing has actually been enhanced by the controversy. While some Western commentary focuses on instances of clerical criticism against the ayatollah since 12 June, it is important to remember that there has always been clerical grousing about the leader's exercise of authority – even Ayatollah Khomeini, faced this, as during his famous dispute with Grand Ayatollah Montazeri. The election controversy has underscored the leader's role as the ultimate arbiter of major political conflicts and disputes – even if some in Mr Mussavi's camp are unhappy about his decisions and actions in this episode.

The election controversy will affect Iran's foreign relations, but not in the way many Western commentators surmise. The controversy's chief foreign policy impact will not be on Iran directly, but rather on the US and other western countries, which will back off from engaging Tehran in a serious way and move instead toward more coercive policies. This is unfortunate, because Tehran is open to a comprehensive strategic dialogue with Washington that would address the Islamic Republic's core national security and foreign policy interests.

How would the post-electoral turmoil influence Mr Ahmadinejad's economic and energy policy? What would be the impact of its increased "risk premium" on Iran's ability to attract foreign investments?

Maloney: The unrest of the past six weeks will only aggravate Iran's economic dilemmas and put durable solutions to the perpetual problems of uncontrollable subsidies and unaccountable spending that much further out of reach. The crisis will likely persuade more Iranians who have the means and/or ability to leave the country to do so, exacerbating the persistent problem of the brain drain and related capital flight. Even in advance of any multilateral action on sanctions, the political risks and generally unpalatable nature of the new power structure will dissuade some investors. Should the political situation degenerate further, economic actions by the opposition such as strikes and mass boycotts could further paralyze the Iranian economy as a means of applying pressure to current decision-makers.

Ehteshami: In focusing on the post-election political crisis engulfing the Islamic Republic we should not lose sight of the many domestic and external challenges (discussed earlier) that continue to plague the government. The socio-economic situation remains perilous (inflation, unemployment and corruption continue to be serious handicaps), the crippling impact of the combination of US-UN-EU sanctions on Iran's financial and non-oil trade sectors has not been removed, soft oil prices will mean less spending power and budget deficits, and Tehran's influence in shaping the region's agenda is being moderated by forces beyond its control. Iran's macro-economic and energy policies are likely to remain uncertain for some time to come, and if further US/UN sanctions are introduced then clearly the finance and energy sectors will suffer even more. FDI is less likely to come with the threat of further sanctions and also political instability in the country. With soft oil prices Tehran also may not have the cash to provide premiums for foreign firms to enter the market.

Leveretts: We do not anticipate that Iran's economic and energy policies are likely to change fundamentally – that is, to become more "liberal" and, therefore, attractive to foreign investors – during Mr Ahmadinejad's second term, for two reasons. First, he displayed little interest in economic liberalization during his first term, so such a shift would go against historical precedent. Second, Iranian policies regarding foreign energy investment reflect a "balance of power" among major political factions and their competing agendas for Iran's hydrocarbon sector – economic nationalists, those who take a more technocratic approach, and those who want to use oil and gas development to build ties to strategically important countries. The main features of those policies – a reliance on the "buy back" system (with some limited modifications over time), emphasis on "local content," and growing interest in non-Western international partners – will continue until there is a significant shift in the "macro" configuration of political forces and players. We do not believe that Iran's post-election turmoil will produce such a shift.

The increase in Iran's "risk premium" is likely to lead to new deals and more business opportunities for those willing to pay that premium – ie Chinese and other non-western investors. For the first several years of this decade, Chinese energy companies signed MOUs and other preliminary agreements in Iran, but did not conclude actual investment contracts. Since the end of 2007, though, Chinese companies have been increasingly willing (for a variety of reasons) to

sign investment contracts. We anticipate that Chinese and other non-Western companies will undertake virtually all of the new foreign investment in the Islamic Republic's oil and gas sectors over the next few years. This will reinforce an already ongoing shift in Iran's plans to develop itself as a gas exporter away from LNG projects to a greater focus on pipeline projects.

What are the potential repercussions of Mr Ahmadinejad's re-election for the foreign policy of the Islamic Republic vis-à-vis Iraq and the Arab Gulf states?

Maloney: Iran's foreign policy in its immediate neighbourhood is not likely to change in dramatic fashion in the aftermath of the election crisis. Hard-liners have long dominated its approach toward Iraq and have quietly supported the tense détente that has been achieved with its southern neighbours in the Gulf. Still, the relationship between Tehran and all of its neighbours improved under reformist leadership, and with those voices silenced or exiled from the inner circle of power, tensions may begin to intensify once again. The radicalism and in particular the embrace of messianic sentiments exhibited by Mr Ahmadinejad and other hard-liners have discomfited Gulf leaders in recent years, and there will no doubt be concerns about the revival of Iran's efforts during the 1980s to destabilize its southern neighbours. Paradoxically though some of the southern Gulf states will see a silver lining to the instability in Iran in terms of puncturing the aura of Iranian invincibility and undercutting Mr Ahmadinejad's popularity among their citizens, as well as the power of his rejectionist, anti-Israeli rhetoric. For some in the region, an Iran that is distracted by internal crises and further isolated from the world may represent an ideal outcome – distinctly preferable to an Iran with a burgeoning democracy, liberalizing leadership and an improving relationship with the international community and the US.

Ehteshami: Post-revolutionary Iran has left its mark on the region, and since the early 1980s the Islamic Republic has been a champion of radical Islamist currents and the 'resistance front.' Moral, political and financial support enabled it to develop a presence in the Levant and in the 1990s it was able to forge new links with such Islamist organizations as Hamas and Islamic Jihad. The shockwaves of the post-election crisis in the Islamist regime *par excellence* are likely to be felt across the region, just as the shockwaves of the 1979 revolution were felt well beyond Iran's borders. Political Islam will have to find ways of absorbing the blow to the credibility of the widely used slogan 'Islam is the solution.'

It patently is not in the world's only revolutionary Islamic state. The dynamics of Iran's relationship with Islamist forces may well be changing for the worse, and the damage to Iran's credibility as a just and accountable Islamic state model may become so great that it could find its voice weakened in all manner of Muslim settings. It will be in Iraq and the GCC states, with their own substantial Shi'a populations, that Iran's image will have been tarnished. Shi'a voices in the GCC have already criticised the government for its conduct and some in Najaf have drawn attention to the problem of mixing politics and religion in ways that the Iranians have done, to the detriment of their faith and their country.

Leveretts: Since Saddam's overthrow in 2003, Iran has pursued three major policy goals *vis-à-vis* Iraq: preserving Iraq's territorial integrity; establishing a political order in which Iraqi Shi'a exercise power commensurate with their demographic weight; and ensuring that Iraq will never again be used as a platform for attacking Iranian interests. These goals reflect a strongly held consensus across the Islamic Republic's power centers, and the direction of that policy is therefore unlikely to be affected by Mr Ahmadinejad's re-election or changes in individual leadership positions in Tehran. Indeed, virtually any Iranian leadership with even minimal domestic legitimacy would probably endorse these objectives.

The Islamic Republic supported virtually all of the Iraqi Shi'a Islamist parties (and their militias) formed in opposition to Saddam's regime during the 1980s and 1990s. As these parties have become the most important political forces in post-Saddam Iraq, Tehran has adroitly leveraged its support for them to consolidate multiple channels of influence there. As US forces in Iraq draw down, Iran's already considerable influence in the country will almost certainly grow stronger.

Presidents Rafsanjani and Khatami, Mr Ahmadinejad's two predecessors, both pursued rapprochement with the Gulf Arab states – in part, to reduce their inclination to use Saddam's Iraq to "balance" the Islamic Republic. Mr Ahmadinejad came to the presidency after Saddam's overthrow, and so has not felt the same strategic need to improve relations with Gulf Arab states. Iran continues to have an interest in becoming a gas supplier to Gulf Arab states, all of which, except Qatar, face looming gas shortages. But, while Mr Ahmadinejad has not re-launched Iran's campaign from the 1980s to "export the revolution" to Gulf Arab states, he has been more willing to assert Iranian influence in what the Saudis and other Arab leaders describe as "Arab affairs" – ie Iraq, Lebanon and Palestine – much to these leaders' dismay. This trend is likely to continue.

What are the potential consequences of Mr Ahmadinejad's re-election for the foreign policy of the Islamic Republic vis-à-vis Russia and China? Why did Russia and China appear to be supportive of Mr Ahmadinejad during his post-electoral showdown with Mr Mussavi?

Maloney: Russia and China have historically resented external interference in their internal affairs, and they apply this principle in their own foreign policy. Neither the spectre of a rigged election, nor the crackdown on peaceful protestors, are likely to generate much outrage among these countries' leaders or populations. For that reason, the recent developments within Iran have not proven nearly as troubling to Moscow or Beijing as to the US and Europe. Still, it is also likely that both countries are watching developments in Iran very closely and will calibrate their policies toward Tehran and their posture within the multilateral dialogue on Iran's nuclear program accordingly.

Neither government wishes to see Iran achieve an actual or even a virtual nuclear capability, and they will continue to have a crucial influence on future negotiations and/or intensified pressures on Iran. Experience suggests that both Russia and China will continue to veto more stringent sanctions as long as their leaderships are convinced that the threat is not urgent or that additional diplomatic initiatives from the west can contain its impact. If further American efforts at engagement are met with continuing stonewalling from Tehran, or if they sense that stability is slipping from the regime's grasp, Russia and China may yet pivot to adopt a harder line against Tehran. Both the Russians and Chinese will want to avoid the implication that they have been on the wrong side of history.

Ehteshami: Russia and China have always distanced themselves from domestic developments in Iran – one of their attractions as economic and military partners for Tehran. Given that the leader endorsed the outcome of the poll very early on, they had little incentive to question the regime's judgement. Since then, however, Russia has taken a small step back, and as Moscow's relations with the US improve – particularly over international security issues – there is room for further steps back for Moscow. But given their substantial interests in Tehran, I don't envisage 'de-linking' as a viable option for Russia. If Mr Ahmadinejad's new tenure turns out to be short-lived and someone like Mr Mussavi emerges as president, Russia's interests will be hit. Chants in recent rallies in Iran have for the first time been anti-Russian. China's situation is more straightforward as it has artfully turned 'non-interference' into a foreign policy strategy. To a large extent, then, what happens inside Iran is the Iranians' business and not the outside world's. But for both Russia and China, a new round of UN sanctions could weaken their ties, since Tehran would see their support for more sanctions as betrayal of their friendship.

Leveretts: Well before the election, the Islamic Republic was cultivating an "eastern option" in its foreign policy, forging closer strategic and economic relations with Russia and closer energy and economic ties to China. In the post-12 June period, this trend is likely to accelerate and intensify. Tehran views both Russia and China as counterweights to the US, able to provide political cover against US pressure on Iran because of their status as permanent members of the UN Security Council. Additionally, Russia has become a leading source of military and high-technology imports for Iran that Western countries largely withhold, and a geopolitical partner in combating the spread of Sunni fundamentalism in Central Asia while also working to reduce US influence in the region. China, for its part, has become the second-largest purchaser of Iranian oil exports and an increasingly important exporter of capital and manufactured goods to the Islamic Republic.

Moscow and Beijing both recognized Mr Ahmadinejad's re-election almost immediately after the election and welcomed him to the annual summit of the Shanghai Cooperation Organization (in which Iran has observer status) a few days later. Both Russia and China have significant strategic and economic interests in the Islamic Republic – for Russia, important export markets for military hardware and nuclear technology and a regional agenda which Tehran largely shares, for China, critical sources of oil and, potentially, natural gas. Both judged that those interests could be put at risk by instability in Iran. Moreover, both believed that Mr Ahmadinejad had actually won the election, and were receptive to charges from him and the leader that post-election protests were the cutting edge for a Western-supported "color revolution." Moscow and Beijing share a strong interest in preempting such a prospect in a strategically critical country bordering their perceived spheres of influence.

Some European states, most notably France, were more vocal over their negative reaction to the election results than the US. Given France's energy presence in Iran – via Total and to some minor extent via other companies – how do you explain President Sarkozy's personal criticism of the Iranian leadership?

Maloney: For a number of years, Europe and the US have cooperated reasonably well on Iran and coordinated their positions closely. This is especially true of the French and British, whose governments are probably closer to the American posture on Iran than any others at this time. European governments tend to be particularly sensitive to human rights issues, in line with their own domestic public opinion. At the same time, of course, the European states have always maintained a wider array of economic relations with Tehran, and traditionally were loathe to jeopardize those on behalf of broader strategic or human rights issues. Not so any longer, at least as far as the French and British are concerned.

In part this is a reflection of their calculation over several years that the political risks and bureaucratic headaches of doing business with Iran had diminished the allure of those trade relations. In parallel, increasing competition for Iranian

opportunities from India and China has reduced Tehran's sensitivity toward and interest in investment from Europe. It remains to be seen how far Europe as a whole or even individual states will be willing to go if Iran continues to defy UN sanctions and avoid serious talks with the international community on the nuclear program. Overall, though, many European companies – and in particular Total – have already limited their exposure in Iran and are mainly seeking to position themselves for the long term, when and if Tehran's internal governance and its relationship with the international community improves.

Ehteshami: France's growing influence and links with the Arab states have become more significant than its links with Iran in recent years, and as long as sanctions remain in force Paris will remain circumspect. It has had little reason to rush to the aid of a vulnerable energy partner, given the wider context. Also, the fact that France's European allies and the US had taken such a principled stance over the crisis in Iran meant that France had little option but to follow the line of the western alliance.

Leverretts: President Sarkozy has largely taken Iran policy away from professional diplomats at the Quai d'Orsay, running it instead from the Elysée. Mr Sarkozy's approach to Iran seems to be motivated by three major considerations. First, he came to office determined to repair France's relationship with the US, which he believed his predecessor had damaged. Moving France's Iran policy to the "right" has been an important part of that repair project for Mr Sarkozy, even at the expense of his country's energy and economic interests.

Second, there is speculation that Mr Sarkozy's approach to Iran may have been influenced by his experience as France's interior minister in 2005, when he led the government's response to riots in Parisian suburbs significantly populated by Muslims of Arab and African origin. In this regard, it has been suggested that he sees Islamic radicalism as an especially serious threat to France's national security, and looks at a number of Middle East issues – including Iran – through that prism. In particular, Mr Sarkozy's personal approach to Iran seems to reflect an assessment that, by being "tough" on Tehran over the nuclear issue, the West can forestall an Israeli military strike on Iranian nuclear targets. He has said that an Israeli attack on Iran would be an "absolute catastrophe," not least because of what many European officials believe could be a reactive backlash among Muslim communities in Europe.

Third, Mr Sarkozy's approach to Iran reflects the French President's strong pro-Israel inclinations. He has publicly refused to meet with Mr Ahmadinejad because of the Iranian President's rhetoric about Israel. Mr Sarkozy's criticisms of his Iranian counterpart's stance toward Israel are, in many respects, similar to his denunciations of Muslim intellectuals for what he characterizes as their "hostility" toward Israel and a more generalized anti-Semitism.

How would you grade President Obama's stance during the political crisis in Iran? What does it signify for the future of US-Iranian relations and the dynamics of a rapprochement during Mr Ahmadinejad's second term?

Maloney: The Obama administration has demonstrated considerable dexterity in navigating this very tumultuous period of Iranian history. President Obama avoided putting Washington at the center of Iran's post-election controversy by modulating his rhetoric, explaining clearly his justification for doing so, and placing the emphasis on universal rights and values. Consistent with its original justification for engagement – which was never predicated on the palatability of the Iranian leadership but on the urgency of US concerns about Iranian policies – the administration has also wisely resisted some domestic political pressures to revise its policy hastily in response to the violence deployed by the Iranian regime. Still, the reality is that the violence and continuing turmoil has made it almost impossible to envision a successful negotiation with Tehran in anywhere near the time frame that the president and others have suggested is necessary to avert Iran's nuclear ambitions.

Direct diplomacy with the Islamic Republic has never proven simple or easy, but the aftermath of the presidential election has intensely complicated the one factor over which Washington has almost no influence: the posture of the Iranian leadership. Tehran is currently defensive, distracted, and dominated by hard-liners with an innately conspiratorial view of the world and of American intentions. Engagement remains the appropriate stance for Washington, in the unlikely event that the Iranians can transcend their own power struggle to advance their national interest in developing. Given the improbability of that success, Washington and the international community will also need to work aggressively to develop alternative options for dissuading Iran from continuing along its current course, and containing the repercussions of the worst case scenario.

Ehteshami: Mr Obama has been exemplary in his treatment of the crisis, criticising the regime on humanitarian and international law grounds while also leaving the door open for dialogue. But given the current state of affairs in Tehran, the future of US-Iranian relations remains rather dim. But a weakened Ahmadinejad and a vulnerable Ayatollah Khamenei may provide the formula for Iran to try and strike the illusive 'grand bargain' with the US which would not only provide the weakened regime with a greater degree of security, but also buy it some legitimacy at home for having

reached an accord with the US. Is this likely? Very hard to say with any certainty, but how many of us would have expected the outcome of the presidential poll to generate such a crisis of legitimacy for a regime that until 11 June 2009 was not only sure-footed but positively cocky about its place in the world?

Leveretts: Even before the Iranian presidential election, we were worried that divisions over Iran policy within the Obama administration were undermining the chances that the administration would pursue successful diplomatic engagement with Tehran. While some of President Obama's initial rhetoric about Iran was well-received in Tehran, his administration did not follow up on that rhetoric with well-crafted policies and strategically-grounded diplomatic initiatives aimed at achieving "Nixon-to-China" type of rapprochement with the Islamic Republic. Given the profoundly negative characterizations of the Iranian election in the western media, the chances that the Obama administration will be able to develop coherent and effective policies to realize the president's professed interest in putting US-Iranian relations on a more positive trajectory are now even more compromised. Unfortunately, we believe that the odds are against a strategically meaningful opening between the US and the Islamic Republic during the next few years and that the prospects for US policy toward Iran to turn in a coercive direction are growing.

Analyses

*Iraqi Oil Capacity: Political Risks**

By Walid Khadduri

To the surprise of both Iraqi oil officials and industry observers, the result of the bid round that would have provided for the re-entry of international oil companies (IOCs) to Iraq for the first time since the 1972 nationalization was a disappointment. Only one consortium (BP with China National Oil Corporation – CNPC) was awarded a long-term production technical service contract for the giant Rumaila field. The proven reserves of Iraq are conservatively estimated by the Ministry of Oil at around 115bn barrels, with more oil expected to be discovered as exploration resumes in earnest after three decades of wars and international sanctions. The Ministry of Oil projected that in the event that all six service contract bids for oil producing fields were concluded, the country's oil production capacity would increase from the current 2.5mn b/d to 6mn b/d within three years using conventional recovery methods and to 8mn b/d in six years' time with the use of enhanced oil recovery (EOR) techniques.

There is considerable doubt that Iraq could actually reach this level of production capacity in such a short period of time. These doubts relate not to Iraq's geology but to the political and security challenges that the country is facing, which constitute formidable obstacles to the development of the oil industry and stable relations with the IOCs. A major challenge facing the country's oil industry is "Iraqi oil nationalism," the result of the troubled history of the IOCs in Iraq, the deeply-held belief among influential segments of the Iraqi public that the country should rely on its own resources rather than the IOCs in developing its oil industry. This picture has been further complicated since 2003 by the fact that the IOCs were invited back while the country was still occupied and the state was almost non-existent. Since the sixties Iraqi politics have been dominated by a commitment to "direct investment" by the national oil companies (NOCs), as well as by suspicion of the IOCs, which were seen as agents of their governments who kept Iraqi production capacity down in order to favor other producing countries.

While there has been little public debate about oil policies since the seventies due to the dictatorial nature of the regime, the memory of the IOCs in Iraq remains very much part of the country's political culture, both because the government ensured that the public remained aware of the history of IOCs in the country and because of the success of the NOCs in implementing major projects and successfully marketing crude oil in international markets despite the volatile politics of the eighties and nineties.

However, because of the lack of public debate there was little awareness outside the upper echelons of government of the damage to the productivity of the giant fields at Kirkuk and Rumaila caused by two problems. First, the Iraq-Iran war in the eighties and international sanctions in the nineties meant that normal oil field management and maintenance practices were not followed. Second, the government ordered maximum production from the two fields despite the obvious need to curtail production in order to prevent damage to their reservoirs.

The resulting need for enhanced oil recovery (EOR) was the reason post-2003 officials cited for inviting the IOCs to return to Iraq to work in already producing fields instead of undertaking exploration and production (E&P) in discovered but undeveloped fields first – a less controversial approach.

* Dr Walid Khadduri, MEES consultant, presented this paper on 30 July at the 31st Oxford Energy Seminar of St Catherine's College, Oxford University.

Iraqi Oil and Politics

A common feature of modern Iraq has been the zero-sum nature of its politics. There have been very few opportunities for opposing views to be aired or for compromise, and members of the opposition have habitually been jailed or executed, mostly without due process of law. Another feature is the central role of oil policy in the country's politics, in particular relations with the IOCs. This began with the drive to increase revenues from the Iraq Petroleum Company (IPC) in the early fifties and continued with the protracted negotiations in the early sixties that took back unexplored and undeveloped land from the IPC concession in accordance with Law No 80 (1960), and then with the 1972 nationalization of IPC. Since then, Iraq's oil industry has been operated by national oil companies with the support of technical service agreements with foreign engineering firms when necessary.

One of the objectives of the 2003 invasion was to open the way for IOCs to operate in the country once again. However, the occupation authorities ignored the depth of "Iraqi oil nationalism," which not only caused a majority of Iraqi oil officials in exile to oppose this policy, but also prompted oil executives working in state-owned companies – particularly the most important firm in Iraq, the South Oil Company (SOC) – to sign public petitions and testify before parliament against the Ministry of Oil's policy.

Various criticisms have been levelled against current oil policy. The main target has been the narrow and prejudicial interpretation of the controversial 2005 constitution by the Kurdistan Regional Government (KRG), which assumes that the provinces have all the necessary authority to negotiate and conclude contracts with IOCs with no need even to consult the federal Ministry of Oil.

Accordingly, the KRG has not only proceeded with its own negotiations with IOCs, but has even signed a number of contracts without consulting the federal Ministry of Oil. It has also exercised its influence in the federal parliament to delay a vote on the draft oil and gas law that was submitted by the cabinet in February 2007. The Ministry of Oil for its part has banned any IOC operating in the Kurdish region from working in the rest of Iraq. However, a compromise was reached in early 2009, whereby crude oil produced in the Kurdish region by Norway's DNO and Switzerland's Addax can be exported through the federally owned Kirkuk-Ceyhan pipeline, with Iraq's State Oil Marketing Organization (SOMO) marketing the crude and depositing the revenue with the federal authorities.

On the face of it, the compromise provided a win-win situation for both parties. Baghdad needed more oil revenue, while the Kurds needed to assure the firms working in their region that they would be able to export their oil. However, a problem arose as to who is responsible for paying the exporting firms. Baghdad's position has been that since the contracts were signed exclusively between the KRG and the IOCs, without consultation with or the knowledge of the federal Ministry of Oil, it is the KRG's responsibility to meet its obligations towards the IOCs, while the federal treasury will continue paying the KRG 17% of the country's gross oil revenue, calculated on the basis of the Kurdish percentage of the population.

This compromise did not end the problems between Baghdad and the KRG, since the conflict between the two is not limited to oil but extends to other issues as well, such as: the territorial claims of the Kurdish region; the terms of reference of a federal regime; the distribution of oil revenue; the role and status of the Iraqi armed forces in the federal regions; and the function of the Kurdish militia (the Peshmerga).

The 1st Permit Round

The Iraqi Ministry of Oil held a public ceremony in Baghdad on 30 June 2009 attended by Prime Minister Nuri al-Maliki and Oil Minister Husain al-Shahristani. Around 22 IOCs participated in the round that included six producing oil fields (the southern fields of Rumaila, West Qurna-1, Zubair, and the cluster of Misan fields and the two northern fields of Kirkuk and Bai Hasan), as well as the two discovered but non-producing gas fields of 'Akkaz and Mansuriya.

The six oil fields on offer have estimated reserves of around 58bn barrels, or more than 50% of the country's proven reserves, and account for 90% of Iraq's current production. The high profile ceremony marked the first public oil bidding process in Iraq. Ostensibly, this was to show the Iraqi public the "transparency" of the process. In fact, it was a direct response to the many criticisms levelled against federal oil policy by the KRG. This was made clear by Dr. Shahristani at the opening ceremony when he said that "we plan to open the bids in front of the media so that the Iraqi people will be assured that we are not forfeiting their rights, and to provide an opportunity for a real competition to achieve high production levels and at the lowest cost for the incremental barrel."

Dr. Shahristani answered further criticisms of his policy by the KRG by saying that "Iraq is attempting through this round to increase production to 4mn b/d in accordance with service contracts and not production-sharing agreements." Only one bid met the Ministry of Oil's terms, from a consortium led by BP (66.67%) with China's CNPC (33.33%) for the

Rumaila field (16bn barrels of proven reserves). The consortium initially offered a remuneration fee of \$3.99/B, but finally compromised and accepted the Ministry's maximum remuneration fee of \$2/B. The commitment is to increase the field's capacity from 957,550 b/d to a minimum plateau production level of 2,850,000 b/d.

A second bid for Rumaila by ExxonMobil (80.1%) with Malaysia's Petronas (19.1%) failed to win. There were no bids for the Mansuriya free gas field in Diyala province. The field's estimated production capacity is around 300mn cfd. The western 'Akkaz field (capacity 400mn cfd) received a non-confirming bid by France's Total as well as a second bid by a group led by Italy's Edison (30%) with Petronas (17.5%), CNPC (17.5%), CNOOC (17.5%) and Turkey's TPAO (17.5%).

No awards were made for the Zubair field, which received four bids: (a) from India's ONGC (51%), with Russia's Gazprom (24.5%) and Turkey's Petrocorp (24.5%); (b) from CNPC (66.67%) and BP(33.33%); (c) from a consortium led by Italy's ENI (30%) with China's Sinopec (25%), Occidental of the US (25%) and Korea's Kogas (20%); and (d) from ExxonMobil (65%), Shell (20%) and Petronas (15%).

The field that received most bids was West Qurna-1, but none met the Ministry's requirements. These came from: Total (Chevron was expected to partner the French firm but decided not to participate in the bidding round); Russia's LukOil (66.40%) with ConocoPhillips (33.60%); Spain's Repsol (40%) with Norway's Statoil (30%) and Denmark's Maersk (30%); Exxon Mobil (80%) and Shell (20%); and CNPC (46.7%) with Petronas (33.3%) and Japan's Japex (20%).

Only one bid was made for the three Misan fields, by two Chinese firms, CNOOC (80%) and Sinochem (20%). Once again, no award was made. (CNPC is already working on the al-Ahdab field in the same province, in accordance with a revised-1997 contract.) The northern fields included in the first bid round were Kirkuk (currently producing 400,000 b/d), which received one bid from a consortium led by Shell (40.2%) with Sinopec (24.9%), CNPC (24.9%) and Turkey's TPAO (10%); and Bai Hasan, with proven reserves of 2.2bn barrels, which was bid on by Conoco Phillips (50%) with Sinochem (30%) and CNOOC (20%). No award was made for either field.

It is scarcely surprising that IOCs were reluctant to invest in these two fields, since in early June 2009 the KRG authorities warned IOCs that they would be "ill-advised to enter into such contracts with the Ministry of Oil, without the involvement of the KRG." KRG Natural Resources Minister Ashti Hawrami also stated in early June 2009 that he expected companies to consult the KRG before signing any contracts and warned IOCs planning to work in the Kirkuk field that they would "require KRG protection."

Some 22 IOCs participated in the first bid round for six oil fields and one gas field, but none of the 15 initial bids for the projects came close to matching the Ministry of Oil's threshold for incremental barrels produced. China showed the most interest in entering the Iraqi upstream, with four Chinese firms (CNPC, Sinochem, CNOOC, and Sinopec) participating in eight of the 17 bids presented. Only one received an award (CNPC in partnership with BP for the Rumaila field). There was only one bid for the cluster of three Misan fields, from CNOOC and Sinochem. Three US firms, ExxonMobil, ConocoPhillips and Occidental, submitted four bids as members of consortiums. None won an award. China's CNPC was the most ambitious firm, participating in five bids, followed by Malaysia's Petronas, which made four bids.

The Oil Ministry's conditions included the following terms: a remuneration fee for incremental production; a plateau production target, to be sustained for a minimum of seven years; cost recovery that begins after a 10% rise in production or 36 months, whichever comes first; and repayment of the recoverable signature bonuses to begin after two years.

A principal feature of the service contracts is the establishment of joint ventures between the NOC firm which is already operating the fields and the IOC selected, with the Iraqi share in the joint company not exceeding 25%. After a one-year transitional period, the joint venture will manage the fields for 20 years. The IOC will finance development and operations and recover its costs from the oil produced, as well as receiving a fee of \$2/B for incremental oil.

Post-2003 Politics and Oil

The 2003 US invasion and occupation of Iraq has injected new complications into the Iraqi oil scene, specifically:

- The lack of a clear legal framework for concluding contracts with IOCs, compounded by controversies over the interpretation of the 2005 constitution due to the confusing and contradictory nature of its federal and hydrocarbon articles.
- Renewed suspicion about the real objectives of the invasion and foreign attempts to control Iraqi oil resources.
- The unprecedented corruption which has infected the decision-making process.
- The collapse of domestic public services such as the supply of petroleum products and electricity.

- Unresolved political and security issues even after the redeployment of US troops from major cities to their bases on 30 June 2009. These include the possibility that religious and sectarian conflicts may reignite, the lack of reconciliation between the ruling parties, the absence of an agreement on the legal status of Kirkuk, and Kurdish territorial claims in the governorates of Diyala and Ninevah.
- The adoption of sectarianism as the basis of the country's political system.

Nabucco Intergovernmental Agreement Boosts Pipeline's Chances: Questions On Viability Remain

By Theodoros Tsakiris

At a ceremony in Ankara on 13 July attended by officials from more than a dozen different countries and the prime ministers of four EU member states and Turkey, the intergovernmental agreement (IGA) establishing the Nabucco International joint venture company (JVC) was initialled. According to the President of the European Commission, Jose Manuel Barroso, "the signature of the Nabucco agreement is a concrete step in realising the Southern Corridor concept and its vision of deeper cooperation on energy to the benefit of consumers, producers and transit states alike, as expressed by the Prague Summit on the Southern Corridor in May 2009."

The 23-page agreement, which can be accessed via the website of the Hungarian Ministry of Foreign Affairs, (<http://www.mfa.gov.hu>), creates a common tax regime (Article 11) and a unified tariff setting mechanism (Annex, Articles 4.1-4.2) for the entire 3,300km pipeline, while acknowledging (Article 3.2) that it can also be used "to the extent that is technically feasible and economically viable" in a reverse flow capacity so as to allow for imports of gas from Europe to Turkey in case of a severe supply disruption. More importantly the IGA stipulates that the Nabucco shareholders (each with a 16.67% equity) – Turkey's Botas, Bulgaria's BEH, Romania's TransGaz, Hungary's MOL, Austria's OMV and Germany's RWE – will have the right to reserve 50% of the pipeline's capacity on a first come first served basis. As Article 3.3 notes, "fifty percent of the maximum available total technical capacity in the Nabucco Project, but not more than 15 bcm/year, shall initially be offered to and if accepted, reserved by the shareholders, or their affiliates or transferees provided that the remaining capacity will be offered in a transparent, objective and non-discriminatory procedure."

However, Article 3.3 does not clarify what its provisions mean for Turkey's demand to access 15% of Nabucco's throughput capacity at reduced prices, a demand that has been deemed unacceptable by both Azerbaijan and the EU. And even if Turkey's reservations are fully addressed, Nabucco will still have to face the difficult reality of having to fill a 31 bcm/year pipeline with gas from a variety of sources. Azerbaijani Energy Minister Natic Aliyev, who attended the Ankara ceremony, was quoted as saying on 13 July that "Azerbaijan encourages diversity of hydrocarbon sources and supply routes" and that his country would choose from a "plethora of alternative projects" that included Nabucco, the Interconnector Turkey-Greece-Italy (ITGI), the Trans-Adriatic Pipeline and Gazprom. Statements by Iraqi Prime Minister Nuri al-Maliki that Iraq could supply Nabucco with up to 15 bcm/year by 2020 are considered to be irrelevant to the project's materialization in the short-to-medium term. Egypt has also been suggested as a reliable supplier, but an extension of the Arab Gas Pipeline (AGP) to Turkey via Syria would be unable to export Egyptian gas to the Turkish system before 2015-16, since most of what could reach the Turkish market would go to meet rising domestic demand in Syria.

Necdet Pamir, a Turkish energy expert with extensive experience in Turkey's state gas company, told *Dow Jones* on 13 July that "Azerbaijan has insufficient gas for Nabucco. Iraq is unstable, and it is not known when it will start exporting its natural gas to Europe. As for Iran, its involvement in the project is not considered possible until relations with the US have been settled." Turkmenistan, Russia and Iran are the three remaining gas suppliers who could have a major impact of the realization of the project. Even though the Nabucco partners would welcome Russian gas, Russia sees Nabucco as economically unfeasible and commercially redundant, given the launching of the South Stream line. Iran might like to help Nabucco out, but it will probably be excluded due to American opposition. Ambassador Richard Morningstar, the US special envoy for Eurasian Energy diplomacy, told a press conference following the Ankara agreement that "we don't believe today that Iran should be a part of the project." He also underlined the serious challenges that still lie ahead for Nabucco, saying that "there has to be a determination on how it will be financed, clarification on where the gas will come from and we look forward to agreement between Turkey and Azerbaijan on pricing and transit."

Turkmenistan is the most important element after Azerbaijan as far as the Nabucco project is concerned, and on 10 July Turkmen President Gurbanguly Berdimukhamedov declared that "Turkmenistan, consistent with the principles of diversifying its energy transport network on world markets, is considering all existing possibilities to participate in major international projects, such as for example the Nabucco project." On 13 July Stefan Judisch, the CEO of Germany's RWE

Supply and Trading, claimed that Mr Berdymukhamedov would support the export of 10 bcm/year via Nabucco, noting that "the 10 bcm/year could even be available for the first phase of Nabucco in 2014." RWE signed an agreement last April to prospect for gas in Turkmenistan's offshore.

Turkmenistan certainly has the capacity to commit up to 10 bcm/year to Nabucco, but there is no infrastructure linking Turkmenistan to Azerbaijan or Turkey. Any trans-Caspian pipeline between Azerbaijan and Turkmenistan would take at least two-to-three years to construct, and a decision to begin construction cannot be considered to be imminent, given the tensions in bilateral relations over the ownership of the offshore Serdar/Kypaz oil field.

In an unexpected move that ended approximately 16 months of bilateral negotiations between Azerbaijan and Turkmenistan over the ownership of the Sardar/Kypaz field, Mr Berdymukhamedov announced on 24 July that he would take the dispute with Azerbaijan to the International Court of Arbitration (ICA), saying that "I have ordered the foreign minister, Rashid Meredov, to engage leading international experts to study the legality of Azerbaijan's claims to the disputed deposits...and then submit the documents for examination by the International Court of Arbitration."

Turkmenistan's attempt to resolve the dispute via international litigation does not bode well for the construction of a Trans-Caspian gas pipeline that would link Turkmen gas exports to European markets via the Nabucco and/or ITGI pipeline projects. Turkmenistan decided to pursue the dispute at the ICA unilaterally, and the ICA does not have the authority to examine the issue unless Azerbaijan agrees. *MEES* understands that this is unlikely.

In 1992 Turkmenistan and Azerbaijan unilaterally delimited their sea borders along Turkmenistan's Block 3, almost midway between Baku and Turkmenbashi. The Azeris drew the line east of Block 3 in a way that included Turkmenistan's Serdar field, while the Turkmens drew the border line west of Block 3, thereby effectively claiming ownership of the Azeri-Chirag-Guneshli fields that constitute the backbone of Azerbaijan's oil production. In effect Turkmenistan is claiming that Azerbaijan's state firm Socar and Azerbaijan International Operating Company (AIOC) have been developing Turkmenistan's oil resources for the better part of 15 years.

For their part the Azeris have been claiming ownership of Serdar, which they call Kyapaz. Buried Hill Energy, a Canadian independent, has an agreement with Ashgabat to develop the field, but operations have been hampered by Azeri protests. The most likely outcome of an ICA process would be the delimitation of the maritime borders along the principle of the median line, which would recognize Azeri sovereignty over ACG and Turkmen sovereignty over Serdar/Kypaz. If Azerbaijan does not accept the arbitration process, the ICA could take up to five-to-seven years to issue a verdict which would not in any case be legally binding on Baku.