US-Iran Relations

Implications for Iran's Oil Policy

By Hooshang Amirahmadi

The world demand for oil will continue to increase considerably, with Asian demand growing the fastest. Given that the growth of Non-OPEC oil supply will be trivial, the call on OPEC oil will increase substantially. Yet, given the declining per capita oil revenue of OPEC, member countries may not be able to make timely investments in required upstream projects. If this happens, the supply constraint will lead to higher prices and intensified international competition for Persian Gulf oil. Thus, foreign investment will be increasingly needed in OPEC countries if prices are to remain stable and international competition manageable. Yet, there are geopolitical and institutional barriers to foreign investment in many OPEC countries. Therefore, it is imperative that major players in the world oil market cooperate to reduce such barriers on time to ensure a stable world oil market.

Iran and the United States are among such major players and have a responsibility in seeing that the world oil supply increases in response to the increase in world oil demand so that producers and consumers are both protected in terms of oil revenue and price. Yet, the two countries are caught in a spiral conflict that threatens to escalate beyond redemption. President Clinton's recent executive order bans all American trade with and investment in Iran. It is particularly unfortunate that the United States' new pressure policy should target the Iranian oil industry in an attempt to prevent the country from expanding its oil production capacities. It is also ironic that the United States should use the so-called oil weapon to punish Iran. Sadly, under the conditions that will soon prevail in the world oil market and geopolitics of oil in the Persian Gulf, both countries will suffer from the lack of cooperation between Tehran and Washington.

Dr. Hooshang Amirahmadi chairs the Department of Urban Planning and Policy Development, and is director of Middle Eastern Studies at Rutgers University. Dr. Amirahmadi has published numerous books and journal articles on the Middle East.

Iran's Oil Policy

Recognizing the significance of oil for the economy and national security, the late shah adopted what I wish to call a linkage policy, whereby his government linked oil, regional politics, and economic growth within a single policy framework. Oil was used to finance both economic growth and a military build-up, which in turn were used to sustain sizable oil exports and near-dominant leadership within OPEC and in regional security affairs. Iran's friendship with the United States and the accommodation of oil companies and the shah's carrot-and-stick policy toward the Arab states contributed to the success of this linkage policy approach.

Upon assuming power in 1979, the Islamic government in Tehran changed this policy and instead adopted a combative approach based on the primacy of ideology and revolutionary zeal. This de-linking approach, along with the war with Iraq and the American hostage episode, soon led to economic and military decline, and brought the Islamic Republic in direct conflict with all major players in the oil and regional security markets. As a response to these and other regional developments, the Islamic regime gradually moved away from its initial ideologically-based oil and security policy toward a more pragmatic and depoliticized one. This trend was accentuated in the period following the cease-fire with Iraq in August of 1988 and Ayatollah Khomeini's death in June of 1989, when post-war reconstruction became a priority.

However, a major shift in policy occurred after the 1991 Persian Gulf war. The war radically changed the Islamic Republic's perception of its security, making it keener toward developing a deterrent military force. Thus, as was the case under the shah, oil revenues are being used to spur economic growth and military strength in order to ensure a leading role for the Islamic Republic within OPEC and in regional security matters.

Oil revenue predictability and price stability became important for the Islamic Republic, and these factors could only be brought about under a condition of sustained producer-consumer cooperation. Thus, regional political stability and good neighborly relations became a pre-requisite. In 1988 an international conference on the Persian Gulf was organized to underline Iran's quest for friendship with its Arab neighbors on the other side of the Gulf.

The new oil policy is also based on a new marketing strategy. In particular, the government is now eager to enter into markets that are growing and stable rather than selling oil in spot markets or markets with less predictability of demand. It also prefers to sell oil for hard currency. Western markets are still given priority. According to Gholamreza Aghazadeh, Iran's oil minister, the Islamic Republic now has two channels for exporting its oil: Kharg and Rotterdam.

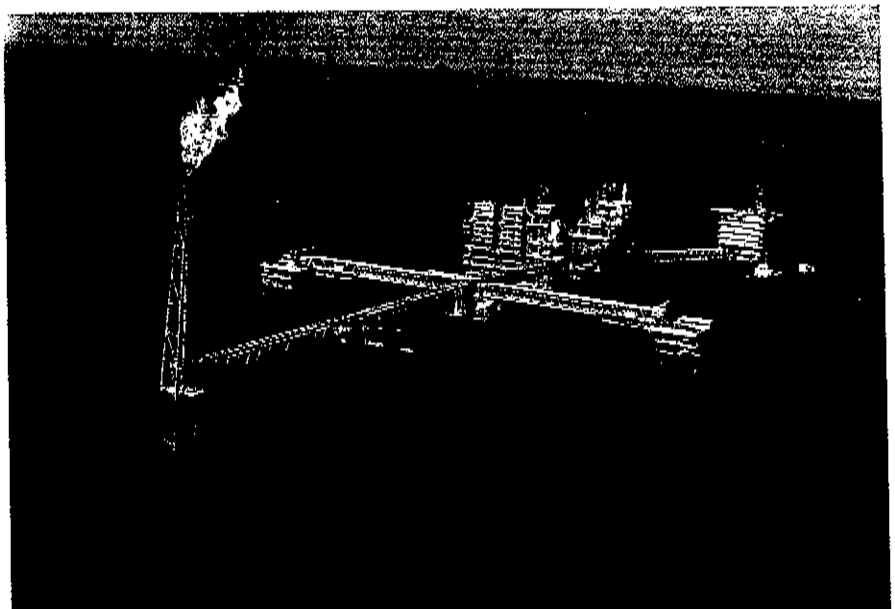
Up until the Clinton Administration's actions in mid-1995, Iran was also active in the American market. By 1992, Exxon had become the largest US buyer of Iranian crude, purchasing about 250,000 barrels a day, which would be worth $1.8 billion on an annual basis. Costal was the second largest with half Exxon's purchases. Mobil, Texaco, Chevron, and Caltex were buying an average of 50,000 barrels a day. Phibro Energy A.G. of Salomon Brothers was also purchasing an unknown quantity.

Iran now directly sells 25 percent of the country's oil. It has diversified its trading partners and created more links in the world oil market. Iran has been able to quickly find customers for the 500,000 b/d of oil previously purchased by large American oil companies. It has also been increasingly looking to East Asia, China in particular, for future oil markets. In may 1995, China agreed to triple its oil imports from Iran, from 20,000 b/d to 60,000 b/d. In April 1995, President Rafsanjani paid an official visit to India during which he signed seven memoranda of understanding with Indian authorities covering a range of economic and cultural projects including "a joint venture in the petrochemical sector for oil and gas exploration and production," an area in which they have been cooperating for some time.

Implications for US-Iran Relations

World oil demand is rising. Although world proven reserves continue to expand as technology develops, this does not automatically translate into increased production capacity. Proven oil reserves now stand at an all-time high, yet the global utilization rate of available production capacity is close to 95 percent. Higher oil prices will induce investors to take on major production projects. However, there is usually a long lead time of some 10 years or so to develop the fields. There is a critical need for immediate investment in order to enable an uninterrupted flow of oil.

What makes the concern even more critical is the fact that the bulk of growth in world oil demand has to be



Iran's strategic importance derives in part due to the increasing world reliance on Persian Gulf oil, which is expected only to rise further in the future; Above, an oil rig in the Persian Gulf

met by production increases in OPEC countries, particularly those in the politically volatile Persian Gulf region. Yet, given financial limitations, it is difficult to believe that the OPEC governments can adequately respond to this call without assistance from countries and/or oil companies that control the needed technology and investment capital. With oil prices low, the mutual understanding and cooperation that is needed among major players in world oil markets may not automatically develop. A more conscious effort is needed. The first requirement would be a complete change of attitude among these players, from a zero-sum game to one of mutual benefits. The emerging multipolar world order should encourage this new approach by placing long-term mutual economic considerations above opportunistic political priorities or short-term economic gains at the expense of others.

Given OPEC's financial situation, capacity expansion will require foreign investment in OPEC countries by big oil companies. Such investments are particularly needed in Iran where economic conditions do not allow huge oil reserves to change into actual supplies. It is too early to assess the efficacy of President Clinton's total ban on trade with and investment in Iran. However, there is no evidence that it will cripple the Iranian economy, destabilize the regime in Tehran, or change its behavior. Rather, these actions may cripple the future world oil market.

Aside from satisfying congressional critics and the Israeli lobby, the new measures were intended to further isolate Iran. After the Halifax meeting it became clear that American allies are not convinced that Washington's unilateral approach to Iran is helpful. They have refused to join the embargo, arguing that constructive engagement is a better way of dealing with Tehran. Even more telling is the refusal of America's smaller friends in the Middle East and elsewhere in the world to support the embargo. Some, like Jordan, Pakistan, and Turkey, have even upgraded their relations with Iran since the trade ban. OPEC has also remained unanimous in rejecting US policy toward Iran. One OPEC minister was quoted as saying that the United States has imposed embargoes on Iran, Iraq, and Libya, all members of OPEC. He then went on to say that "the only question around OPEC now is who's next on the US sanction list."

The administration's policy also failed to gain support among an absolute majority of the people in Iran. Most view the embargo as a direct challenge to Iran's sovereignty. Even the Islamic regime's opposition was not unanimous in its response to the new trade ban. Except for a few royalist groups and the Iraq-based National Council of Resistance, the opposition criticized the embargo for its likely disastrous effect on the Iranian masses. They rightly pointed out that hardly any trade embargo in modern times has changed regimes or their behavior.

The Islamic regime's low-key approach and controlled reaction to the Clinton Administration's harsh measures and pronouncements, and Iran's active diplomacy in recent weeks have helped diffuse a possible show down between the two governments and have been instrumental in isolating Washington. However, it is the dual containment's obliviousness to Iran's domestic dynamics, particularly developments in the civil society, and the reality of a global economy in a multipolar world that has caused its failure to isolate Iran.

If the containment policy has not yet produced its intended results, it does not mean that it will have no impact on the Iranian society in the long run. Even its immediate effects have at times been noticeable. A case in point is the sharp drop in value of the Iranian rial, a development that forced the government to place control on foreign exchange markets, thus reversing a major reform course for liberalizing the economy. The United States is also in a position to delay the much needed development of Iranian oilfields. The United States has already forced Iran to reschedule its debts under unfavorable conditions. There are many other means that the United States can actually use to hurt the Islamic regime.

But, the United States is also losing in the process, as is the world oil market. In particular, the embargo is certainly hurting major American businesses. The United States is seen to use oil as a political weapon, while its corporations lose credibility as reliable suppliers in the world market. American oil companies will have to find new oil suppliers; they will need to modify their refineries to new crude; and they will suffer from a loss of competitive edge and future business opportunities, as happened in the Vietnam case. Meanwhile, thousands of American jobs will be lost.

The emerging multipolar world order should encourage [a] new approach by placing long-term mutual economic considerations above opportunistic political priorities or short-term economic gains at the expense of others

The political impact of this new approach will be even more harmful to larger American interests as it will strengthen radical Islamic forces in Iran at the expense of positive trends evolving in the country's domestic politics and international relations. Despite its many ills, Iran is one of a few states in the region with an elected parliament and president. The Islamic Republic has given rise to a vibrant public sphere and a plurality of voices. Intellectuals discuss Foucault and Marx in widely-read journals, and the public openly criticizes government policies. In respected journals the clergy are advised to return to mosques and to recognize a separation of mosque and state.

The main flaw in imposing sanctions and taking the political hard line toward Iran is that these measures will merely add legitimacy to anti-Western Islamic hardliners and nip Rafsanjani's liberalizing initiatives in the bud. If sanctions weaken the state in Iran or bring radicals to power, the government will become more oppressive at home and more adventurous abroad.

Demonizing Iran is premised upon the belief that Iran has lost its strategic significance to the United States. Yet, the transformations that have followed Desert Storm and the break-up of the Soviet Union have created a new regional order in which Iran has become the meeting place of the Middle East, Central Asia, and the Caucasus. Iran owes its current and growing strategic significance to the precarious future of democracy in Russia, the fragility of the Arab-Israeli peace process, latent instability in the Persian Gulf, and the increasing reliance of the world economy on Persian Gulf oil. Iran's population of 63 million has potential as a vast consumer and investment market, and the country has one of the most diversified economies in the region.

If Iran's Russian-sponsored nuclear program is any indication, Moscow is in an expansionist mood. Pressuring Iran will drive it further into Russia's orbit. Meanwhile, the uncertain future of Iraq, the Gulf's escalating arms race, and China and India's emerging role in the geopolitics of Persian Gulf oil make the region's future potentially volatile.

Because no one government can optimize its national interest by pursuing the current spiral conflict, the dialogue option must remain open. If past history is any indication, the two countries will at some point in the future resolve their differences. The longer they wait, the more they lose, and the more difficult it becomes for them to amicably resolve their differences. Fortunately, Iran has recently shown interest in the possibility of dialogue. It would greatly serve US national interests to reciprocate and talk to Iran. The constructive engagement of North Korea and Syria has made great strides in bringing them into line with the international community. Iran, which is an even more strategically important state, should be viewed as no exception. ■