



AFTER THE DEAL: THE EU AND IRAN'S ENERGY PROMISE

Ozan Serdaroglu

The EU has played an instrumental role in negotiating the interim agreement on Iran's nuclear program. Ozan Serdaroglu argues that while the prospective lifting of sanctions under a final deal brings with it the potential for the EU to diversify its energy supply, uncertainties and challenges remain in tapping into Iran's huge natural gas reserves.

As the initiator of the negotiation process involving five permanent members of the UN Security Council (U.S., Russia, China, UK, and France – the “P5”) and Germany (“+1”) which led to the Joint Comprehensive Plan of Action (JCPOA) on Iran's nuclear program, the three key EU member states, assisted by EU institutions, have assumed a constructive role in contributing to resolving (albeit not finalized) a high-profile international issue: that of safeguarding the peaceful nature of Iran's nuclear ambitions. With the interim JCPOA agreement paving the way for the prospective lifting of sanctions under a final deal, the EU and Iran have an opportunity to look afresh at their relations, especially regarding their respective energy ambitions. Possessing the world's second-largest proven natural gas reserves, Iran has the potential to become a significant partner in diversifying the EU's energy supply away from its overdependence on Russia. However, as will be examined, the EU also faces significant obstacles in reaping the anticipated energy gains from its diplomatic success.

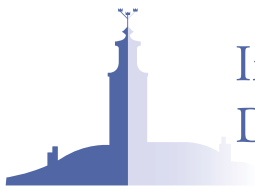
Europe's Stake in Iran's Opening

The interim JCPOA agreement introduces new scenarios regarding the normalization of relations with Iran and its reintegration into the world economy, even though a comprehensive deal is yet to be concluded by the June 30 deadline. The EU was Iran's biggest trade partner until the extension of sanctions under Council decision 2012/35/CFSP, which covered also the energy and financial sectors. Whereas the EU has since suspended restrictions on energy imports pending a final nuclear deal, bans remain on investment, technology, and provision of services to the oil and gas sectors. Rejuvenating this trade in the wake of

an agreement and lifting of sanctions would be an important development of mutual benefit to Iran and the EU. More importantly, Iran's re-opening would usher in new opportunities for trade in the energy sector, another solid pillar of pre-sanctions EU-Iran relations. Indeed, up until 2011, Iran was the EU's seventh-largest crude oil supplier; it possesses the world's fourth-largest crude oil reserves with 136 billion barrels. Moreover, the EU is the second-largest consumer market for gas with long-term demand expected to increase for external supplies as its own resources dwindle. With its approximately 30-35 trillion cubic meters of proven gas reserves, Iran is an obvious supplier.

The EU would benefit from the diversification of its sources of energy which Iran's economic reintegration would bring. Alleviating the heavy dependence on Russian energy has been an explicit priority for the EU, as Russia supplies around 40 percent of EU natural gas imports, with six member states being fully dependent on Russia. The EU's quest for energy supply diversification brought about the launch of the Southern Gas Corridor initiative in 2008, reflecting an overall strategy to supply additional infrastructure to carry Caspian gas to Europe, beginning with the resources at the Shah Deniz 2 field of Azerbaijan. The renewed 2009 gas crisis between Gazprom and Naf-togaz and the increasingly sour relations between Russia and the EU in light of developments in Ukraine have only intensified the EU's urge to diversify supply options.

However, Iran's huge potential as an energy exporter cannot be effectively exploited under ongoing international sanctions. Thus, while Russia's annual natural gas exports exceed 196 billion cubic meters, Teheran's supply amounts to only 10 billion, 95 percent of which goes to the Turkish



market, which has remained open amid sanctions. Iran also suffers from a lack of foreign investment to help improve its exploitation, production, and delivery capacities. In light of this, Teheran expects an end of sanctions to facilitate renewed Iranian access to Western markets and to receive the foreign investment required to improve its gas production.

Pipelines and the Turkey Connection

Encouraged by the EU's engagement in the JCPOA and perceiving its energy implications, Iran has been sending out signals about its enthusiasm to enter the European market through Turkey. The two highest authorities on the matter, President Hassan Rouhani and former Deputy Petroleum Minister for International Affairs Ali Majedi, have expressed their interest in the Southern Gas Corridor and its Turkish route. The JCPOA process is seemingly kindling similar aspirations on the EU side. The Climate Action and Energy Commissioner Miguel Arias Cañete specified in a meeting between EU energy ministers in Latvia that Europe would be interested in importing Iranian gas via Turkey after a final deal.

Turkey's entry into the calculation stems from its strategic position. Presently the sole westward pipeline from Iran is the Tabriz-Ankara system serving Turkish consumers. Significantly, however, this pipeline has the potential to connect with the Trans Anatolian Pipeline (TANAP) which is currently being constructed as part of the Southern Corridor framework, comprising also the Trans-Adriatic pipeline between Greece and Italy and the South Caucasus Pipeline (SCP) which already carries Azeri gas to Turkey. TANAP is expected to function as a bridge between these two pipelines, and, according to Taner Yıldız, the Turkish Minister of Energy, Teheran is ready to buy shares in this Turkish route, but is awaiting the ending of sanctions.

Supplementing TANAP with Iranian gas will be essential for the EU as only 10 billion cubic meters of Azeri gas can flow to Europe annually with the completion of the above ongoing projects by 2020. Such an amount would allow Russia to retain its dominant position. Additionally, with its much richer gas reserves compared to Azerbaijan's proven gas reserves of 0.9 trillion cubic meters, Iran's reserves hold greater promise for the EU in terms of diversifying supplies in the longer term. Moreover, Iranian ambitions do not only involve simply selling their gas, but they are also aspiring to become a hub between Turkmen and Azerbaijani supplies

and the EU, again via TANAP.

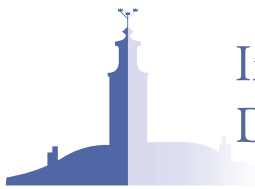
Challenges

Notwithstanding, Iran's involvement remains uncertain for several reasons. The most significant issue is the U.S.'s skepticism toward Iran and its commitment to its regional allies Israel and Saudi Arabia who are worried by Iran's "empowerment." The Obama administration is contemplating additional mechanisms to swiftly re-enact sanctions in case of disagreements after a final deal. While EU sanctions apply only to its own jurisdiction, the U.S. sanctions have a more universal character and apply to any person or government involved in business with Iran, whether it is based on U.S. territory or not. Even if Brussels intended to define a more autonomous policy on Iran, continued U.S. sanctions would undermine the viability and confidence in investing in Iran's energy sector.

Meanwhile, Russia's immediate reaction to the JCPOA indicates that it will continue to invest in "special" relations with Teheran; Moscow has already declared it will lift an embargo on deliveries of S-300 missiles and started an oil-for-goods swap. In the face of a possible U.S.-led "diplomacy of ambiguity" toward Iran, Russia would remain as Iran's most reliable backer. Furthermore, it would be in Moscow's interest for Iran to pursue an energy policy aimed at controlling and manipulating the European market and its supply system through cartelization, where the conditions for commercializing Iran's natural gas would be set according to immediate Russo-Iranian interests.

Considering such latent distortions on eventual energy cooperation with Iran, the EU would need to elaborate new regional policies from a broader perspective beyond the constricted P5+1 setting. Firstly, the mutual declarations could be bolstered by an explicit energy partnership with clear goals and commitments. The EU would therefore need to implement an official "energy dialogue" with Iran along the same lines as with its other suppliers, including Russia. This entails a long-term roadmap, thematic expert groups, and an advisory gas council composed of both EU and Iranian representatives. Such a policy structure would allow reliable scenarios and analyses to be made regarding juridical, economical, and infrastructural conditions for the production and transportation of the Iranian gas.

Secondly, the EU may have to assume a more mediatory role between Iran and any skeptical U.S.-led "coalition" that



will likely be more circumspect over Iran's reintegration. In this regard, the important role already played by key EU members and institutions in the JCPOA talks clearly indicate that a more proactive European diplomacy can yield results.

Conclusion

With the ongoing projects regarding the Southern Gas Corridor and the JCPOA talks boosting expectations of Iran's reintegration, Iran stands to potentially become a significant supplier of natural gas to the EU. However, there are still many uncertainties, not least whether a comprehensive deal will be signed by June 30. In any case, the two sides would need to engage in a long-term relationship where they would jointly plan, invest, and administer a large-scale gas supply system. Such an engagement would also entail navigating and mediating probable continuing tensions and skepticism regarding Iran's reintegration.

Dr. Ozan Serdaroglu is a Visiting Research Fellow at ISDP and a frequent contributor to international news portals/websites on Euro-Mediterranean affairs and the Middle East.

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