

Russia and Iran after the U.S. withdrawal from the JCPOA

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Abstract: The preservation of the Joint Comprehensive Plan of Action (JCPOA) will play a key role in Moscow–Tehran relations. Currently, Russia is looking for options to offset the negative effect of Trump’s decision on Iran and the tenuous future of the nuclear deal. When Iranian Foreign Minister Mohammad Javad Zarif visited Moscow on May 14, 2018, his goal was to discuss the future of the Iranian nuclear deal with his Russian counterpart, Sergey Lavrov. The men also used the meeting to discuss the wider agenda of their countries’ bilateral relations, but above all, Zarif confirmed that they seriously intended to continue economic cooperation despite new U.S. sanctions. However, Tehran would count on Russia as the last resort, he said. Moscow can offer Iran only diplomatic support and some marginal measures to mitigate the negative effect of American sanctions. This is largely explained by the lack of economic and political potential to help Iran, although, if it could, Moscow would definitely assist Tehran in sanctions evasion. One should expect that Moscow will make a lot of noise on the diplomatic track trying to mobilize the international community against the United States. Russian businesses, on the other hand, are choosing a wait-and-see strategy.

Introduction

Until May 2018 the Russian strategy of economic cooperation with Iran was based on the principle of patience. Moscow assumed that it should not hurry when dealing with Iran. Instead, the Kremlin carefully worked on the creation of a solid base for cooperation with Tehran. Yet, U.S. President Donald Trump’s decision to leave the JCPOA and restore/introduce new sanctions could change some of Moscow’s approaches.

The situation that existed in relation to Iran before May 2018 completely suited Russian interests. Tehran was cornered by the remnants of the sanctions regime of 2010–2015: these sanctions as well as Trump’s threats to impose new punitive measures against Tehran prevented Western investors from entering the Iranian economy. Yet, they were not a big obstacle for Russian business. As opposed to their Western rivals, Russian companies were among the first to trade Iranian oil after the nuclear deal was signed in 2015. Almost all Russian oil and gas majors negotiated participation in Iran’s hydrocarbon projects. By May 2018, the Kremlin was confident that Russia was not limited by time and that it need not be in a hurry when working with Iran, giving the Iranian leadership time to get use to the idea that there was no alternative to Russia. There were also no illusions in Moscow that Russian business could completely replace the Westerners. In other words, Russia aimed to fulfill those niches that it is interested in, but not to take over the whole economy. At the same time, the Kremlin was not interested in the strengthening of the U.S. sanctions regime above the existing levels. On the one hand, Russia was concerned that new U.S. sanctions can lead to the partial restoration of the pre-2015 sanction regime that could negatively

affect Iran's economy and thus lead to the socio-economic destabilization of the country. On the other hand, new sanctions could add pressure on Russian companies interested in Iran and make them withdraw from the country. Consequently, Moscow demonstrated a clear interest in securing the implementation of the JCPOA and motivating Iran to stay loyal to the deal.

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Initial reactions

Nevertheless, after recent statements by Trump, this negative scenario seems to be coming true. The tone of statements by Russian and Iranian officials on the prospects of bilateral cooperation under sanctions is differing. While the Russians appear cautious, the Iranians (for obvious propaganda reasons) are declaring the beginning of the new age of Russian–Iranian partnership determined by Trump's decision to leave the JCPOA that will naturally push Tehran towards Moscow.¹ Thus, they repeat the words of the Iranian ambassador to Moscow, Mehdi Sanaei, that the Russian oil majors are about to sign new contracts with Iran. As argued by Sanaei, Rosneft and Gazprom have reached serious progress in negotiations with the Iranian side. Gazprom intends to invest in the development of the Iranian LNG-producing capacities. Rosneft, in turn, has signed a cooperation road map with the National Iranian Oil Company that implies \$30 billion of investments in the oil and gas sectors of Iran (the total oil output of projects to be developed by Rosneft might reach 55 million square meters annually).² Currently, the sides are discussing technical details. Gazprom Neft provided the Iranian side with the technical plan to develop Cheshm-e Khosh

and Shanguleh oil fields. In early December 2017, it also stepped up with the proposal to develop the Iraqi Badr oil field and Iranian Azar oil field as a united cluster (obviously hoping to profit from Iranian intentions to develop border oil fields as a first step).

Yet, all these statements should be taken with a grain of salt. First of all, Iran is interested in demonstrating to the international community that Trump's actions are futile. By speaking about plans to become closer to the Russians, Tehran is trying to play on American worries, believing that U.S. policymakers would not like to see Iran and Russia forming a real alliance under the pressure of sanctions. Secondly, blunt statements on the bright prospects of the Russian–Iranian cooperation under sanctions are often made by the Iranian or Russian politicians who are not responsible for the practical development of these ties.³ Those who are responsible, on the contrary, are often modest in their statements. They probably understand that Trump's decision will not help to develop economic ties between the two countries.⁴ Thirdly, the Russian policy-makers and businessmen are obviously critical of the U.S. decision to restore sanctions, but, in a number of cases, this is determined not by compassion with Iranian problems but by a negative attitude towards sanctions as an instrument of political pressure as such. It is necessary to remember that Moscow is also living under U.S. sanctions and cannot afford to be silent on the issue of their use by the

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United States. The same goes for Russian businesses: on May 25, 2018, the managing director of Rosneft, Igor Sechin, heavily criticized the U.S. decision to use sanctions against Iran and Venezuela. Yet, if we read between the lines, his speech largely reflected the concerns of Russian businesses over the sanctions imposed on Russia.⁵

Who will leave first?

In practice, Russian business seems to be ready to adopt a wait-and-see tactic and, if necessary, to get prepared to step back from Iran in certain areas. There has already been one case of a Russian company's withdrawal from Iran, allegedly under the influence of the U.S. sanctions. In May, Russko-Blizhnervostochniy Eksportniy Tcentr, which belongs to Russian businessman Igor Chayka (the son of Russian attorney-general Yuri Chayka) declared its decision to leave Iran.⁶ Previously, this company had agreed to build desalination facilities in Iran. However, for now, Chayka's case was an exception. As argued by some market analysts, even before Trump's decision, the company had problems with the implementation of the project and used Trump's intentions to press Iran harder as a pretext to leave: the U.S. sanctions had never been completely lifted and the company could not buy necessary equipment for the construction of the desalination plants.⁷ In general, Russian business is still interested in continuing its efforts to enter the Iranian market.⁸ However, there is a clear understanding that Trump's decision to withdraw from the JCPOA has made this task more risky and challenging. Although the Kremlin is trying to ensure their Iranian partners remain ready to continue business with Tehran, the continued Russian presence in this country will probably depend on two factors:

A) The behavior of the Europeans: Moscow will look to see whether EU politicians will support their statements on their

readiness to secure their ties with Iran in practice. Moreover, Russia will even try to urge the Europeans to be more decisive in its confrontation with the United States on the sanctions issue. Thus, on May 10, 2018, Russian MFA Sergei Lavrov, during a meeting with his German counterpart, emphasized that Trump's decision to leave the JCPOA was unfair towards the other participants of the deal as it was not taking into account their economic interests.⁹

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B) Trump's determination to restore sanctions and implement new measures against Iran: Moscow's leverage over U.S. behavior is negligible (if not nil). This has been recognized officially; in early May, Lavrov argued that Russia could do nothing about the new sanctions that will be imposed by Trump.¹⁰ The Kremlin is not ready to fight seriously for Iran alone, either. If it sees that the situation is not developing in Iran's favor and the Europeans have failed to carry out proper resistance to the Americans, the majority of Russian oil and gas companies will probably put cooperation with Tehran on hold, or at least reassess their strategies in Iran. Yet, this will not mean the complete disruption of cooperation, as this will inevitably backfire in terms of the political narratives of the two countries, a situation which Moscow would also like to avoid. In the worst-case scenario (the Europeans leaving Iran and the U.S. putting additional secondary sanctions on it) the area of cooperation will probably shrink and be limited by the number of projects actively protected by the Russian government or those in the areas not covered



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by sanctions such as the construction of the Bushehr nuclear power plant, the building of the Sirik power plant and maybe the Russian Railways Company's (RZD) projects. Government oil companies may also try to stay in Iran, but not all of them, and probably they will just keep a ghost presence in Iran, hoping to secure their share of the Iranian market until better times.

Even in the worst-case scenario, there will also be no immediate flight of Russian companies. In most cases, they will prefer to freeze their presence in Iran, but not to cut it completely. Zarubezhneft has already signed a contract on the development of the two oil fields in Iran and will probably seek to remain. In early May, it already signed another agreement with Petropars for the geological study of several oil and gas fields.¹¹ If successful, they will provide the National Iranian Oil Company with suggestions about the development of these fields. Gazprom and Rosneft enjoy government support and will also still try to develop cooperation with Iran. Moreover, as demonstrated by the Venezuela experience, Rosneft's behavior is not always determined by economic logic, but by the geostrategic plans of Moscow. Currently, Russia is interested in keeping Iran in its sphere of its influence. This, in turn, might compel Rosneft to stay in order to help the Russian government to pursue its goals. Tatneft and Lukoil might be more vulnerable and more determined to leave Iran.¹² Both companies enjoy less government support, are more driven by a cost-benefit approach, and have not had much success in their progress in terms of negotiations over potential investment projects with Tehran.

Although Lukoil posits Iran as one of its main areas of activity in the Middle East, in the past it had negative experiences of working with the country, and it also recently lost its bid for the development of the Mansuri oil field. This may encourage it to stop dealing with Iran if the United States continues to sustain its current level of confrontation with Tehran.

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Finally, Moscow might be tempted to profit from the situation developing around the JCPOA. Russia is extremely opportunistic and Moscow's opportunism sometimes compels the Russian officials to make controversial and not-always-well-considered statements. Thus, while the Russian MFA criticized Trump's decision, to applause from Iran, Russian oil minister Novak, on the contrary, declared Russian readiness to compensate for the decrease in global oil supply if it were caused by a fall in Iran's oil exports due to new U.S. sanctions.¹³ This statement echoed declarations made by the Saudis and was determined by the pure pragmatism of Novak, who was much more concerned with the supply and demand in the oil market than about the situation with the Russian–Iranian partnership. This, in turn, found no understanding in Tehran. Russia was not criticized directly for these words, but OPEC's intentions to use the situation in its favor was condemned by Tehran.¹⁴

Moscow will try to help

Yet, all what was said above does not mean that Russia will stay completely idle and will not try to protect Iran from external



pressure. As was stated on May 17 by vice-prime minister Dmitry Kozak, Russia foresees difficulties for its companies in Iran, including some caused by the use of the dollar for financial transactions.¹⁵ Yet, Russia will also seek to minimize the negative effect on bilateral relations. First of all, Moscow might return to the situation of 2012–2015 when the lion's share of business between the two countries was carried out in a gray area by small and medium enterprises that could not be affected by sanctions (for some of them, Iran was the only external market). Secondly, Russia can try to create legal means to avoid U.S. sanctions. Thus, Trump's sanctions can boost the use of national currencies in bilateral trade. For instance, Novak argued that local currencies can be used by Russia in oil deals with Iran, although he emphasized that this will require the creation of certain administrative mechanisms.¹⁶ Currently, Russian and Iranian businessmen are opening correspondence accounts in Russian and Iranian banks. Moscow also plans to establish direct connections between the Russian and Iranian banking systems including the use of the Russian 'Mir' payment system (the Russian alternative to VISA) in Iran (which is planned to be set up in Iran by the end of 2018).

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It is also important to remember that in November 2017, Russia and Iran launched the 'oil-for-goods' program that represented the purchase of Iranian oil in exchange for Russian machinery and investments. This initiative had been discussed since the early-2010s. Initially, it was supposed to help Iran to evade the oil trade embargo imposed by

the US, EU, and their partners. This program was intended to save Iran's economy from collapse and provide Russian companies with additional oil reserves to trade abroad. After the adoption of the JCPOA, the discussion of this deal was naturally postponed but, then, once again renewed. This time, the 'oil-for-goods' program was expected to compensate for the lack of financial reserves in Iran which did not allow Tehran to pay for the imports of Russian equipment in hard currency. Yet, if the U.S. tries to persuade the buyers of Iranian oil to find alternative suppliers, the oil-for-products program can be used for the needs it was initially supposed to satisfy. Moscow has already confirmed in 2018 that it plans to continue the implementation of this program. It is expected that Moscow will annually buy 5 million tons of oil from Iran. In exchange, the Kremlin plans to supply Iran with goods worth \$45 billion.

Thirdly, on May 17, the Eurasian Economic Union and Iran signed a temporary agreement on the creation of a free trade zone that implied the lowering of existing trade tariffs and custom duties.¹⁷ Russia is expected to ratify this agreement until the end of the year. This move will not be sufficient to have a global positive effect on Iran's economy. The overall volume of trade between the Eurasian Economic Union and Iran is \$2.7 billion (the share of Russian-Iranian trade is \$1.7 billion), and there are no reasons to think that it will dramatically rise anytime soon. The immediate positive effect is also questionable: according to Kozak, Russian business will be able to earn additional \$150 million.¹⁸ Yet, this free trade zone will create certain loopholes for sanctions evasion and still help to develop Russian–Iranian economic relations under sanctions. Between 2012–2015, Iran was also actively using post-Soviet space as a territory from which it could get access to technologies and funds as well as even reaching the international financial system.¹⁹



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Russia is also trying to mobilize the international community against Trump's decision to leave the JCPOA. In service of this goal, it is trying to use all the regional and international platforms it has access to. The topic of Iran occupies first place in Moscow's negotiations with the EU. Russia is also expected to discuss the situation surrounding the JCPOA at the BRICS ministerial meeting. According to the head of the BRICS desk at the Russian MFA, Mikhail Kalugin, this topic will be one of the main questions of discussion

between the members of the BRICS at the meeting at Pretoria on June 4, 2018. According to the official, all members of the BRICS have strongly developed ties with Iran and want to protect them.

Will all these steps help Iran?

Unfortunately, not much. Tehran should count on Russia only as a last resort. Moscow can offer Iran only diplomatic support and some marginal measures to mitigate the negative effects of American sanctions. The latter is largely due to the lack of economic potential to help Iran, although, if it could, Moscow would definitely assist Tehran in sanctions evasion. One should expect that Moscow will make a lot of noise on the diplomatic track trying to mobilize the international community against the United States. Russian businesses, on the contrary, are choosing a wait-and-see strategy (i.e. no flight of Russian companies is expected until the end of the 120-day period that Trump gave to Iran before sanctions are restored). Russia does not want to leave Tehran, but it will have to do limit its presence if the U.S. pressures it hard via secondary sanctions. Finally, it is also important to keep in mind that for Russia the current tensions around the JCPOA are not only the story about Iran and sanctions. The Kremlin can look at this situation as an opportunity to restore the dialogue with the EU by playing on the idea that Trump's decision has challenged both European and Russian interests. On the other hand, Moscow might also use this situation as a way to create a split in the Western camp, seeing this as a way to weaken the 'anti-Russian' coalition.



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