

RUSSO-IRANIAN ENERGY RELATIONS: NAVIGATING THE TENSION BETWEEN COMPETITION AND COOPERATION

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Abstract

Western pressure has necessitated Moscow to restructure its energy exports towards Asia. This development has revealed a weak point in its relations with Tehran: the two are in fact competing for consumers in a geographically restricted market. A superficial glance at the situation might indicate that Moscow is paradoxically strengthening its economic competitor but other factors may suggest otherwise. Russia is investing in Iran's oil and gas sector in an attempt to decrease antagonistic potential in their bilateral relations driven by the competition for shared export markets. Furthermore, concerns that Europe may substitute Russia with Iranian energy exports have driven Moscow to pursue a hedging strategy. Moreover, the Kremlin considers Iran a suitable partner for swap deals. Last but not least, Tehran's decades-long experience in circumventing sanctions proves beneficial for Russia.

Keywords

Energy, Russia, Iran, investments, resources.

In recent years, bilateral relations of the Russian Federation and the Islamic Republic of Iran have steadily improved as their geopolitical goals have proven to be compatible. Both are trying to resist US hegemonic behavior while striving towards a multipolar world order. Bilateral cooperation in the political, security and economic spheres has rapidly increased, especially since February 2022. In light of unprecedented sanctions and pressure from the West, both Moscow and Tehran are doubling down on their economic cooperation. Trade turnover in 2022 jumped by 20% to 5 billion dollars and keeps growing [1]. Exports of goods from Iran to Russia rose by 30% year on year [2]. According to Iran's Finance Minister, Russia has become the largest foreign investor in the Iranian market, even exceeding China [3]. Furthermore, the Deputy Governor of Iran's Central Bank stated that the two countries connected their bank communication systems to support bilateral trade and financial transactions [4].

Importantly, Russo-Iranian cooperation in the energy sector is growing with a marked increase in infrastructure development investments. Prior to the deterioration of relations between Russia and the West, Moscow was already interested in Iran's energy sector but moved cautiously to not damage its economic ties with the West [5]. Cooperation remained limited and Russian investments in the energy sector were modest at best. Western pressure against Russia, however, has presented a renewed impetus for Moscow to expand its energy ties with Tehran without reservation for it has nothing left to fear from sanctions. In July 2022, Gazprom signed a memorandum with the National Iranian Oil Company (NIOC) worth around 40 billion dollars: the deal encompasses the development of various gas and oil fields, Liquefied Natural Gas (LNG) projects, the construction of gas pipelines as well as the exchange of petrochemical and gas products [6].

The European Union's attempt to «wean» itself off from Russian energy has necessitated Moscow to restructure its energy exports towards Asia. This development has revealed a weak point in its relations with Tehran, the two are in fact competing for consumers in a geographically restricted market. A superficial glance at the situation might indicate that Moscow is paradoxically strengthening its competitor, but other factors may suggest otherwise.

Moscow is investing in Iran's oil and gas sector in an attempt to decrease antagonistic potential in their bilateral relations driven by the competition for shared export markets. In its attempt to weaken Russia, Europe and the US imposed drastic sanctions targeting the backbone of the Russian economy - its gas and oil industry. With Russia cut off from Western markets and now turning East, it is inevitable for Moscow and Tehran to compete for market share of energy exports in Asia. These developments have led to pricing conflict and efforts to undercut each other's market position. Notably, because of the lack of secondary

sanctions imposed against buyers of Russian fossil fuels and Moscow's enticingly high discounts, Tehran has been greatly disadvantaged [7]. Reportedly, Russia is selling its crude with a 30 dollars discount to Brent, while Iran has sold its products with only a 20 dollars discount [8]. As Beijing and other customers increase their imports of discounted Russian oil and gas, Iran is forced to give up on profit and lower prices to stay competitive. Already in May 2022, Hamid Hosseini, chairman of the Iranian Oil, Gas and Petrochemical Products Exporters' Union, complained that due to massive Russian discounts on gas, prices in the region have fallen significantly [9]. He also acknowledged that the flow of Russian oil towards China «is a huge potential threat» [10]. As mutual dependence increases, Moscow seeks to balance the negative developments for Tehran with investments into Iran's energy industry. The gas industry in Iran is underdeveloped, makes losses and is suffering from the tough sanctions against the export of technology [11]. Hence, Moscow's support is of great interest for Tehran as the astonishingly vast investment projects combined with Iran's resource potential could enable the Islamic Republic to revive the flagging gas industry and increase its competitiveness. Iran needs investments which no one else but Russia is willing to provide. Tehran therefore sees Russia's attempts to undercut its energy exports as a necessary short-term loss to gain the capacity to be competitive later on.

Concerns that Europe may substitute Russia with Iranian energy exports has driven Moscow to pursue a hedging strategy. Although, it is unlikely that Iran will replace Russia in meeting Europe's energy demand in the near future due to the West's lackluster willingness to allow Iranian imports in the midst of Washington's maximum pressure coupled with the stalled negotiations on the nuclear issue. However, in the medium to long term a rapprochement between Iran and the West cannot be excluded. In the event of a new nuclear deal, Europe might be eager to import cheap Iranian fossil fuels. Yet, a renegotiated nuclear deal does not preclude Europe's search for alternative fossil fuel taps as Brussels could attempt importing Iranian gas via Oman. Nikita Smagin, expert at the Russian International Affairs Council (RIAC) and analyst at the Carnegie Endowment for International Peace, outlined that Iran could use Oman's spare capacity in LNG to send its resources to Europe. By doing so, Europe could keep up the appearance of boycotting Iran and would technically not violate sanctions. By being invested in the Iranian energy industry, Moscow could ensure it remains a relevant stakeholder, albeit one «behind the scenes».

Despite their concerns of mutual competition, additional shared interests might help to soothe and override potential friction. Russia considers Iran a suitable partner for swap deals enabling Moscow to sell its gas via Iran as an intermediary. Deputy Prime Minister Alexander Novak stated in February 2023 that the technological possibilities

of a potential swap agreement on oil and gas supplies between Iran and Russia are already being addressed and that it would be a «promising project» [12]. According to Novak, an initial stage of such a deal could allow for a swap of up to 10 billion cubic meters of natural gas and 5 million metric tons of oil [13]. Moscow could profit from these arrangements by supplying India as well as supplying Europe through Iran and then Oman.

Moreover, Tehran's decades-long experience in circumventing sanctions has enabled it to attain niche products that Moscow no longer has access to. For example, Russian Energy Minister Nikolai Shulginov announced in December 2022, that Moscow is keen to work with Iranian counterparts on gas turbine technology as well as joint manufacturing [14]. Shortly before this, Iran agreed to provide forty gas turbines to Russia. Although Russia can independently produce small and medium power gas turbines, high-capacity turbines have been provided by Siemens, a German company no longer operating in and with Russia, but Iran has the capabilities to manufacture these turbines and is willing to fill this gap [15].

Moscow and Tehran are seeking to balance the growing American influence in the energy markets, an endeavor they can only realize through strategic cooperation. As an important energy producer and exporter, the influence of the US is growing and the strategic interests of Russia and Iran are aligning [16]. By forming a «gas cartel», Moscow and Tehran would be able to balance American influence in the energy market [17]. Also, considering that Russia has the world's largest and Iran the second-largest natural gas resources, this alignment could put Russia and Iran in a position to wield immense pressure on the world energy market and use it as a trump card in its relations with third countries.

However, obstacles remain that must be overcome in order to achieve a lucrative and meaningful cooperation. The effects of Western sanctions and the lack of technological capabilities might be a difficult gap to bridge. Some analysts argue that Moscow is not able to fulfil its promises and leverage Iran's energy industry to a new level simply because the country itself does not have the required technology to do so. According to Smagin, projects in South Pars and Kish might not be feasible due to the absence of material that neither Russia nor Iran produce. Due to sanctions, imports from producing countries are impossible [18].

Moreover, there is an opinion that a potential swap mechanism directed for Europe is unviable due to the non-existing infrastructure. To export via Oman to supply Europe would require a new pipeline for which deep-water technology is required, which currently neither Iran nor Russia have access to [19]. There are additional doubts in regard to a swap arrangement involving India, who has rapidly increased its energy

imports from Russia since February 2022. A possible pipeline would have to go through Pakistan, India's foe, which might not be in the interest of New Delhi.

Moscow and Tehran have shown significant inventiveness in the face of economic sanctions imposed on them by the West. Their ability to exploit loopholes in spite of sanction regimes, cooperate with other non-western states and advance their technological domestic sector showcase their resilience and adaptability. Even if restrained by technological difficulties for now, it might be only a matter of time before the two will adjust to the new geopolitical environment. Both states have shown that they are not isolated from the rest of the world, and it would be a mistake to underestimate the potential support which Russia and Iran could receive from third countries in circumventing the current technological barriers. For example, China might be a willing provider as it looks for energy sources to satisfy its growing demands.

Russia and Iran look at the energy partnership not solely from an economic perspective but from a geopolitical perspective as well. For them, it is not just about revenue but about balancing the growing US influence in the energy market. It is a mistake to assume that Moscow is acting illogical when investing in its competitor. For Russia, it might be an opportunity to transform competition into cooperation by retaining influence in future Iranian energy deals while simultaneously reducing the potential effects of conflict of interests in bilateral relations.

Considerable potential exists for a win-win situation in the energy partnership between Iran and Russia. The two nations can build a strong energy partnership that contributes to future influence in the global energy market. Both Tehran and Moscow are well-equipped to gain from a symbiotic partnership as they explore opportunities to use the strengths of each other. One development seems to be obvious: relations between the Islamic Republic of Iran and the Russian Federation have reached an unprecedented level and the joint efforts in the field of energy are an essential part of it. If the Russian and Iranian calculations turn out to be correct, they have the potential to stay among the decisive players in the energy market, despite the implementation of vast international sanctions and pressure from the West.

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