Iran P5+1 Nuclear Negotiations and Outlook

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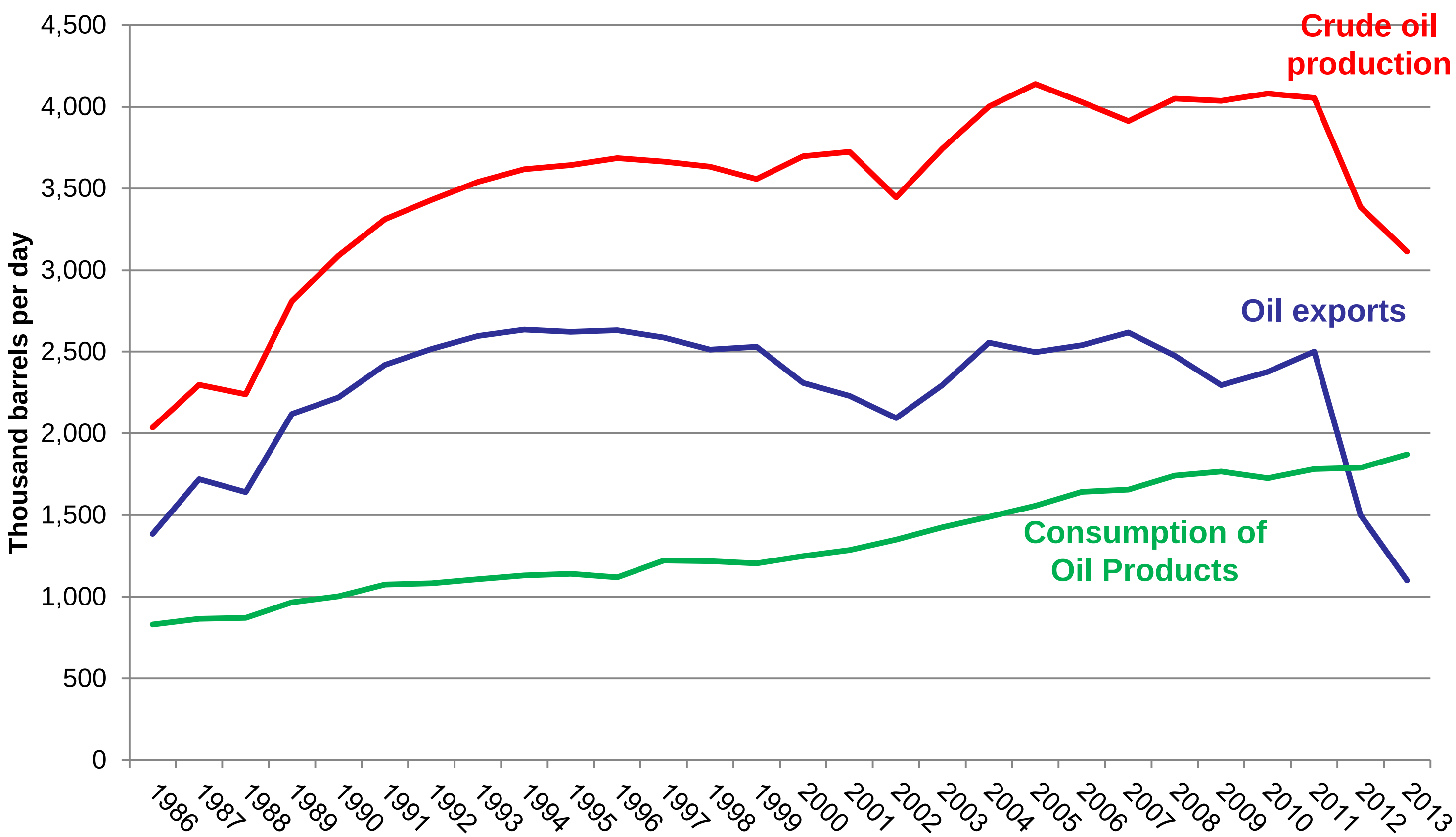
A decade of diplomatic frustration

- **2002 revelations of Iranian efforts, previously hidden, to master the full nuclear fuel cycle alarmed the world**
- **A year later, Tehran agreed to suspension of uranium enrichment & enhanced IAEA inspections**
  - Terms were renegotiated and broadened in 2004 as Paris Agreement
- **In 2005, Tehran abrogated its commitments and resumed uranium enrichment**
  - Reflected deep-seated frustration with the return on the deal
  - Decision commanded brought support across Iranian political spectrum
- **For next 8 years, Tehran's nuclear calculus appears unchanged by diplomacy or coercion**
  - Diplomacy: 2005 referral to UN Security Council; 2006 decision by Bush administration; 2009 fuel-swap proposal; 2010 mediation by Turkey & Brazil
  - Coercion: covert campaign vs. scientists; internet sabotage; sanctions

After 30 years, sanctions began to bite

- **US measures date back to November 1979, with varied bases**
  - » First measures initiated after Embassy seizure, then eased after hostages freed
  - » Racheted up significantly in 1983; 1987; 1995 / 1996
- **9/11 transformed US sanctions policy, slowly turned vs. Tehran**
  - » US designations of Iranian banks and other entities for WMD/terrorism
  - » Reputational campaign waged to persuade businesses to leave
  - » Shift in European response to extraterritoriality
- **Since 2009, sanctions have gone on steroids**
  - » Four UN Security Council resolutions, culminating in UNSCR 1929 (June 2010),
  - » Subsequent US measures targeted Iran's refined petroleum imports; petrochemical exports; transportation and insurance; precious metals; Central Bank; autos; more
  - » Follow-on measures from "like minded states" included EU assets freeze; ban on energy investments; crude boycott; ban on SWIFT access, precious metals trade
- **Efficacy ensured by a constellation of factors, possibly unique**
  - » Mahmoud Ahmadinejad
  - » 2009 elections upheaval and subsequent repression
  - » Changing energy markets

Sanctions slashed oil production, exports



Iran’s 2013 presidential election

- **2009 post-election upheaval and subsequent repression set low expectations for 2013 ballot**

- **Long-time power broker Rouhani ran a savvy campaign, benefitted from cross-factional support**
  - » Reformists banded together with traditional supporters of the Islamic system in final days of the race
  - » Deliberate cultivation of youth, disaffected produced surprisingly strong mandate

- **Regime is more stable today than in recent memory**
  - » Rouhani’s mantra is prudence and balance; he leads a national unity government which has moved carefully to avoid exacerbating Iran’s debilitating factional competition.

November 2013: a breakthrough deal

- **Rapid progress underscores two important realities:**
  - » Washington’s commitment to a diplomatic resolution
  - » Tehran’s endurance has limitations
- **Deal froze major aspects of Iran’s nuclear program**
  - » More comprehensive confidence-building gesture than previously contemplated
  - » First successful negotiations between Washington and Tehran since 1981
- **These concessions came cheap; Iran received only modest sanctions relief**
  - » $4.2 billion in Iranian overseas assets repatriated
  - » 6-month holiday for petrochemicals, automotive sector
  - » Designations/enforcement of existing measures unaffected
  - » Sanctions relief has proven to be less rather than more than bargain

Stalemate at the first deadline (July 2014)

- **Extension of the talks for four months prolongs process, nets Tehran $2.8 billion in relief, but expectations lowered**
  - » Khamenei delivers defiant speech formalizing red lines of nuclear establishment → insistence on maintaining current enrichment capacity
  - » US Sec State acknowledges that a formula for a final deal remains elusive
- **Differences are technical, not a function of domestic politics**
  - » Distance between the two sides on key technical issues was not unanticipated, but tended to be obscured by optimism attendant with early progress
- **P5+1 cohesion remains strong but Ukraine, regional context intensify uncertainty**
- **Sanctions relief plans are part of the mix but do not appear to present a major obstacle**

Scenarios

• **(Another) November Surprise**	*30 percent*
• **No Deal; Diplomatic Pause**	*50 percent*
• **Diplomacy Craters; Military Strike**	*10 percent*
• **Inadvertent Escalation**	*Wild card*

Iran’s no-deal sanctions exit strategy

- **Denial**
  - » Self-sufficiency
  - » “Resistance economy”
- **Mitigation**
  - » Alternatives: condensate exports; electricity exports
  - » Creative financing arrangements: local currency, barter, oil swaps
  - » Reforms: TSP; privatization; revision of investment framework
- **Evasion**
  - » Smuggling
- **Retaliation**
  - » Threats intended to deter implementation of sanctions and/or raise the price of oil
- **Moral suasion**
  - » Pharmaceuticals; airplane safety
- **Bandwagoning with Russia**

Implications for Iranian Energy

- **Sanctions create severe limitations on financing, technology**
- **Tehran has quietly boosted output exports under interim deal, but 2015 crude exports & revenues are subject to considerable uncertainty due to likelihood of new Congressional measures**
- **Technocrats, led by Oil Min Zanganeh, are back in charge, but political & technical challenges remain**
  - » Aging oil sector generates massive gas reinjection needs, now in greater competition with domestic consumption and transportation needs
- **Remaining foreign investors – particularly China – have hedged; domestic substitutes often merely Potemkin players**
- **Intensity of sanctions enforcement, – together with problematic business environment and expectations of continuing external regulatory obstacles to trade and investment – continues to deter early movers**
  - » Even best-case – a deal – will only entail gradual, reversible sanctions relief
  - » Little to no prospect of significant new change in accessibility for US firms