

Energy Economy Perspectives in Iran-Russia Relations after the Ukraine War

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Abstract

Following Russia's invasion of Ukraine and the ensuing war, Russia lost a significant portion of its gas market in Europe. This market had been a crucial tool for bargaining and exerting pressure on the West, and it also brought substantial economic benefits to Moscow. This was especially true for gas exports to Germany, which had seen the construction of the Nord Stream pipeline, with plans for Nord Stream 2 also underway before the war began, leading to the halting of both projects. Consequently, energy relations between Russia and Europe deteriorated. Following the Ukraine war, Europe was compelled to secure its gas supply from the United States, despite incurring significantly higher costs. Currently, the U.S. is the largest supplier of gas to Europe. This process led Russia to seek alternative markets for its gas exports. China and India, two major global consumers, are markets Russia is eager to capture. Currently, Russia is China's largest supplier of gas. Although a large gas pipeline already delivers Russian gas to China, Moscow isn't content with this alone and aims to diversify its methods of product delivery. Iran is a crucial option for Russia to transport gas, as it is close to India and can also meet some of China's needs. Furthermore, Russia is considering physically connecting its economic interests with the Arab countries of the Persian Gulf, particularly the UAE, Bahrain, Qatar, and Saudi Arabia. Russia believes that by doing so, it can establish a major gas economic bloc and become a counterweight to competitors, especially the United States. From this perspective, it could be argued that the Iran-Russia gas pipeline is, in fact, a replacement for Nord Stream and could transform Iran into a regional energy hub. This article aims to explore the possibility of Iran becoming a regional energy hub through economic cooperation with Russia in the energy sector, thoroughly examining the opportunities and challenges involved. The research method employed was SWOT analysis.

Keywords: Iran, Russia, Economic Outlook, Bilateral Relations, Energy Hub

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1. Introduction

From a geopolitical perspective, the connection of gas pipelines between Iran and Russia, extending to Iran's southern coasts, holds immense significance for Iran and can significantly enhance its regional and economic standing. Although Iran is one of the world's largest gas producers, it has fallen behind in meeting its domestic gas demands due to Western, particularly U.S., sanctions. As a result, the country is in dire need of investment and special attention in this sector. The construction of the Iran-Russia gas pipeline can not only meet a significant portion of the Islamic Republic of Iran's energy needs but also substantially contribute to strengthening Iran's regional position.

Iran is already a gas exporter to neighboring countries such as Iraq and Turkey and has signed important agreements with Oman and Pakistan for gas transmission. With the inflow of Russian gas into Iran, not only can Iran increase its export capacity to neighboring countries, but it may also gain access to new markets.

The integration of Iranian and Russian gas networks—an idea that predates the Islamic Revolution and now urgently requires expansion—can bring considerable benefits to Iran that must not be overlooked. At a time when the country faces intense pressure from the United States and its European allies, with a clear Western agenda to isolate Iran and exclude it from global trade corridors, such opportunities must be seized to counteract this imposed isolation.

The first signs of divergence in the energy arena between Iran and Russia emerged after the Cold War, particularly over the selection

of routes for oil and gas pipelines from the Caspian Sea and Central Asia. While the United States strategically sought to prevent any new pipelines from passing through Russia or Iran, Russian interests, aligned with U.S. policies, also aimed to sideline Iran. The issue of gas transmission from Iran to Europe has been one of the most significant sources of competition and divergence in energy diplomacy.

Russia, leveraging its economic capabilities and energy infrastructure, has successfully met a substantial portion of Europe's gas needs. By capitalizing on sensitive political and economic moments and the dependency of consumer countries, Russia has managed to raise and stabilize gas prices in several phases. Russian energy diplomacy pursues this approach from both strategic and economic perspectives.

However, in pursuit of its national interests and energy diplomacy goals, Iran is striving to access European markets and utilize its potential capacity to compete with Russia. The Nabucco pipeline, planned to stretch 3,300 kilometers and with clear economic justification for routing through Iran, would enable the annual transportation of 31 billion cubic meters of gas from Azerbaijan and Iran to Central Europe. The realization of this project would present a significant challenge to Russia's energy diplomacy in Europe and impact its dominance in the Turkish, Balkan, and Eastern European markets.

Therefore, Russia is seeking to prevent the development of the Nabucco pipeline through various strategies, including bilateral agreements with transit countries like Hungary and expanding the "Blue Stream" pipeline, while

proposing alternative pipeline projects. In this context, Iran, besides attempting to play a role in the Nabucco pipeline, has also proposed alternative initiatives, such as the "Persian Pipeline," and has taken practical steps in that regard.

The routes envisioned for Iran's natural gas exports, which constitute a significant component of the country's energy diplomacy, are designed in three main directions:

The first route is towards Europe, passing through Turkey and then via Greece to countries such as Italy, Switzerland, Austria, and Germany.

The second route targets Asia, transmitting gas from the South Pars field to Pakistan, and potentially to India and China.

The third route focuses on the Persian Gulf states, including Oman, the United Arab Emirates, Bahrain, Kuwait, as well as Iraq and Syria.

2. Competition Between Iran and Russia in the Energy Sector

Iran and Russia have long maintained a complex relationship of both competition and co-operation, driven by their abundant oil and gas resources. The establishment of the Organization of the Petroleum Exporting Countries (OPEC) in 1960 created a control mechanism to stabilize oil prices among major players, somewhat framing this competition within certain limits, but did not eliminate it. Both countries have continued to seize every opportunity to increase their oil sales, even at the cost of lowering prices.

When Iranian oil came under sanctions, Russia expanded its oil exports to fill the gap left by Iran and capture a larger market share. China also fully capitalized on the opportunity, even after sanctions were imposed on Russia. According to Vandana Hari, founder of the Singapore-based firm Vanda Insights, by importing more than 1.1 million barrels of oil monthly from Russia, China has emerged as the winner in the oil price competition between Iran and Russia.

To maintain its position in the oil market, Iran has been forced to offer its oil to China at double the previous discounts. This is because, despite Russian oil being of higher quality than Iranian crude, Russia's aggressive pricing strategy causes Iranian sales to decline, putting Tehran at risk of losing its most important energy market—Beijing. Bloomberg reported that in August 2022, Iranian oil was priced nearly \$10 per barrel lower than Brent crude. In contrast, before Russia's military operations in February, Iran typically offered a discount of only 4-5% per barrel (Hashemi Movahed, 2022: pp. 12-13).

Another source of divergence between Iran and Russia in the energy sphere is their disagreement over the legal regime and ownership of the Caspian Sea's seabed resources. Due to Russia's resistance to establishing a legal framework in the Caspian Sea, the prospects for agreement and cooperation among the littoral states on oil-related issues have become minimal.

Iran insists that the resources of the Caspian Sea be divided based on the proportional length of each coastal country's shoreline. Under this model, Iran's share would increase to 20%. However, Russia, Azerbaijan, and

Kazakhstan oppose this and have proposed an alternative plan that would limit Iran's share to a maximum of 13% of the seabed resources (Eslami, 2012: pp. 214-215). These negotiations have yet to result in a collective agreement.

Despite these differences, Iran and Russia share a common stance against the construction of any oil or gas pipelines under the Caspian Sea. Although both countries cite environmental concerns as a reason for this opposition, their coordinated efforts to prevent oil transport from the Tengiz and Kashagan fields and block the connection of new pipelines to the Baku-Ceyhan line more accurately reflect their strategic intent.

Energy swaps—especially involving oil, gas, and electricity via Iran—also represent a potential arena for competition and divergence in the energy diplomacy between Iran and Russia (Eslami, 2012: pp. 216-217).

3. The Lack of Industrial Economy and the Reliance of Iran and Russia on Raw Material Exports

Undoubtedly, non-oil exports are among the most critical factors in generating foreign currency and contributing to national income. In summary, the necessity and significance of non-oil exports include: escaping from single-product oil exports that are vulnerable to political and economic fluctuations; funding public services across government, cooperative, and private sectors through foreign currency revenue from non-oil exports; fulfilling the country's import needs; creating new opportunities and increasing employment across various fields; preventing the excessive

migration of border-region villagers, farmers, and artisans to cities by absorbing their production and meeting their economic needs; and improving the quality of the domestic output (Hosseini Mirza, 2007).

Achieving non-oil export growth and transitioning away from a single-product economy requires industrialization, foreign investment, and access to advanced technologies. However, neither Iran nor Russia has been able to achieve this crucial transformation. The bulk of Russia's economy and exports are based on energy and, to a lesser extent, agricultural products. Over the past two decades, Russia has been the most significant energy supplier to European countries and a key global exporter of agricultural goods.

An overview of Russia's 2022 export list reveals that energy and its byproducts dominated the country's export portfolio. According to data extracted from relevant websites, Russia's total exports in 2022 amounted to \$486 billion, with crude oil accounting for 27.3%, natural gas for 14.7%, refined oil products for 13.9%, and coal for 7.51%—meaning roughly 64% of Russia's exports came from the energy sector. Metals such as gold and iron, as well as agricultural products like corn, wheat, and oilseeds, ranked next. There is no significant indication of industrial or technological products in Russia's exports.

Similarly, Iran's economy lacks the characteristics of a traditional industrial economy and relies heavily on crude oil and petroleum by-products, such as polymers. Furthermore, Russian exports to Iran primarily consist of agricultural goods, including apples, pears, grapes, vegetables, dried fruits, and nuts.

Thus, both countries have economies heavily dependent on raw materials.

In contrast, the products imported by both Iran and Russia are primarily industrial in nature. This mismatch has negatively affected their economic cooperation, as the absence of an industrial base and advanced technology in both countries limits their ability to meet each other's import needs.

4. Lack of Export Policies Aligned with Russia's Economic Needs

Given that Iran's domestic market has traditionally been the primary target of domestic production, Iranian manufacturers have not designed their goods with export markets in mind, focusing instead on the volume and quality of their products. Although Iran has had relatively successful trade experiences with countries like Iraq and Afghanistan, Russia has a mature and sophisticated economy that cannot be approached using the same model. The Iraqi and Afghan markets are characterized by simple and outdated structures, whereas the Russian market is developed and complex. As such, trade with Russia requires organized state support. Governmental and quasi-governmental companies in Iran should lead the way in entering the Russian market, paving the way for other Iranian traders (Jafari, 2021: p. 10).

To this end, having an export strategy tailored to the Russian market, accompanied by a clear roadmap and appropriate planning, with state backing, foreign investment, use of National Development Fund resources, and issuance of insurance and guarantees by banking or insurance institutions, could help increase Iran's

share in this market. By leveraging new opportunities through professional business entities and a well-structured export plan, products such as decorative stones, mineral and chemical products, petrochemicals, various polymers, and pharmaceuticals (especially biotech drugs) could be added to Iran's export portfolio (Jafari, 2021: 11).

5. Missed Export Opportunities

At various points in time, golden opportunities have arisen for expanding Iran-Russia economic relations, yet Iran has largely failed to take advantage of them. For example, following the Western sanctions imposed on Russia after the annexation of Crimea, as well as the downing of a Russian fighter jet by Ankara, Russia's relations with the European Union and Turkey became severely strained, and those countries lost access to the Russian market. During that period, given Iran's geopolitical position and its diverse domestic production, particularly in agriculture, Moscow sought Iran's support. However, Iran did not respond actively, and as a result, other foreign players seized the opportunity and outpaced Iran.

6. Weakness in Marketing Strategy

One of the significant challenges and threats to the expansion of Iran-Russia trade relations is the mutual lack of understanding of each other's capacities, needs, consumer preferences, and standards in goods and services. The absence of comprehensive, practical information for producers and exporters in both countries has posed a serious obstacle to

expanding economic exchanges. The failure of relevant institutions to identify these capacities has further exacerbated this information gap.

Although a joint database has been created to provide market information to both parties, this platform lacks up-to-date content and critical data. It fails to include essential information such as active companies engaged in Iran-Russia trade, details about market capacities, key export indicators for Iranian goods to Russia, relevant statistical data on target demographics for both Iranian and Russian products, and strategic export plans. Without such vital and practical insights into the Russian market, Iranian traders often face difficulties in meeting their trade objectives (Jafari, 2021: p. 10).

7. Shared Capabilities in the Energy Sector

Iran and Russia are both key players in global geopolitics and, in various ways, significantly influence the global energy landscape. After Saudi Arabia, Russia is the world's largest producer and exporter of crude oil. Both Iran and Russia possess the largest natural gas reserves in the world, offering them substantial opportunities to participate in global energy and gas markets. According to statistics, Iran and Russia together hold over 37% of the world's gas reserves. Russia, with 35 trillion cubic meters of gas, has more than 19% of the world's reserves. Iran follows with 33 trillion cubic meters of proven reserves, accounting for 17.1% of the global total and placing it in second position (SHANA, 2023: p. 1).

According to the Oil & Gas Journal, as of January 2018, Iran possessed approximately 157

billion barrels of proven crude oil reserves, accounting for around 10% of global reserves and about 13% of those held by OPEC members (Shahnazizadeh, Keshishian Siraki, & Khodaverdi, 2019, p. 90). Moreover, Central Asian oil and gas are also exported to Europe via Russia. Iran, ranking second globally in natural gas reserves after Russia, has sought to capitalize on these resources over the decades by accessing global gas markets. Consequently, analyzing Iran-Russia relations since the collapse of the Soviet Union is incomplete without considering the critical role of energy. The influence of energy, both positively and negatively, on the behavior of both countries has been increasingly significant (Bahman, 2017, p. 127).

Iran and Russia, with their abundant oil and gas resources, each have the potential to become a central force in the global energy market. Although specific strategies, such as their shared interest in exporting gas to Europe, may position them as competitors, regional and international realities have shown that countries rich in oil and gas often suffer more from rivalry than they benefit from it. Thus, Iran and Russia need to define themselves as partners in the energy sector to enhance their influence on global markets. What drives both nations towards a cooperative strategy in this field is their shared threats and interests, especially regarding the decline in energy prices. Coordinating their efforts to influence international markets and raise oil and gas prices can provide a solid foundation for strategic cooperation between Tehran and Moscow.

A prime example of this collaboration is the formation of the Gas Exporting Countries Forum (GECF), initiated and pursued jointly by Tehran and Moscow. Moreover, bilateral

cooperation in the energy sector has twice helped reset global markets: first, in the aftermath of 9/11, when oil prices had dropped significantly, and second, during the 2016 OPEC agreement with non-OPEC producers, in which both Iran and Russia played pivotal roles (Bahman, 2017: pp. 129-130).

Despite an increase in Iran-Russia cooperation in many areas after the Soviet collapse, their relationship regarding global energy supply has remained shaped by a strategic and natural rivalry. Although Russia continues its Eurasian policy and seeks to maintain its traditional dominance in the region, Iran is seen as a potential competitor. Nevertheless, there are still possibilities for cooperation, especially in energy transport routes. Russia's strategy to access Asian markets such as India and Pakistan, and Iran's geographical proximity to these countries, make this cooperation feasible.

Furthermore, given Russia's significant and constructive role in forums like the Gas Exporting Countries Forum and OPEC+, especially amid U.S. sanctions on both Iran and Russia, enhancing convergence and collaboration becomes even more crucial. In recent years, Russia has strategically shifted its oil-based economy towards gas development, adopting policies that have helped it circumvent certain sanctions. Given the shared concern over sanctions and oil-dependent economies, Iran should study and apply Russia's strategic policies in the energy domain.

Although the Ukraine crisis has led Europe to diversify its sources of gas, Russia still accounts for a substantial portion of European gas imports. This dependency has resulted in minimal yet ongoing cooperation between Europe and Russia. Iran could benefit from this

situation: Tehran may leverage Europe's diversification policy on one hand, and Russia's advanced energy technology and expertise on the other (SHANA, 2023: p. 1).

8. Areas of Cooperation Between Iran and Russia

Overall, there are at least five key areas for cooperation between Iran and Russia in the energy sector:

Cooperation in energy and the construction of new nuclear power plants in Iran;

Trade in oil, gas, and energy production equipment and technologies;

Direct Russian investment in Iranian oil and gas fields;

Bilateral and multilateral cooperation in constructing energy transmission pipelines;

Investment and collaboration in building power plants (Bahman, 2017: pp. 130-131).

9. Diversification and Expansion of Energy Cooperation

Given Iran and Russia's extensive experience in the energy sector and their abundant energy resources, the utilization of energy-related equipment and services presents a significant comparative advantage, providing a strong foundation for cooperation. Energy-related goods include various types of heating and cooling devices, turbines, and a wide range of refining and petrochemical products (in line with each country's production strengths).

This also includes the development of swap exchanges in the mentioned areas.

In terms of energy services, there is a wide range of potential areas for cooperation, including energy audits, energy system design, financial and investment management, implementation and commissioning, operations and maintenance, training, monitoring, and validation. ESCOs (Energy Service Companies) not only guarantee a certain level of energy savings, but their rewards are also tied to the efficient performance of the energy projects (IRAS, 2023, p. 1).

Leveraging the available potentials in both countries, in terms of both material resources and their geopolitical and political positions, can greatly facilitate joint production, exports, and investment within either country or even in third-party countries. Establishing joint venture contracting companies to streamline bilateral production and trade would be highly effective.

10. Conclusion

Trade agreements between Iran and Russia play a significant role in facilitating the export process. These agreements can include tariff reductions, ease the entry of goods, and create new opportunities for commercial cooperation. Exporters must be thoroughly familiar with the provisions of these agreements to benefit from them fully. Leveraging these agreements can reduce export costs and ease market entry into Russia. Additionally, familiarity with specific terms and regulations stipulated in these agreements can help exporters operate within legal frameworks and benefit from necessary support.

To improve market access and increase product sales in Russia, establishing and developing local distribution networks is essential. Exporting companies can work with local distributors and Russian firms to market their products more effectively. Such cooperation may involve using local agents, establishing distribution centers in various Russian regions, or even setting up regional branches. By building these networks, exporters can move closer to Russian customers, provide better after-sales service, and strengthen their relationships with the Russian market. Local distribution networks also improve delivery speed and efficiency, boosting customer confidence.

One of the serious barriers to expanding trade between Iran and Russia is the high tax burden on exporters. Iranian traders must pay approximately 28% in taxes when exporting directly to Russia. As a result, most exports are routed indirectly through countries such as Armenia and Kyrgyzstan before re-exporting to Russia. Therefore, offering a package of financial and export incentives can facilitate exports to Russia, contribute to expanding economic exchanges, and help reduce the trade imbalance with the country.

Moreover, the rise in exchange rates and instability in the currency market, primarily due to sanctions, have created significant challenges for various sectors of Iran's economy. The export sector has not been spared from the impact of currency fluctuations. Since rising exchange rates increase production and packaging costs, they inevitably raise the final cost of exported goods. Thus, to mitigate the impact of currency volatility on exports, particularly to Russia, the government must consider and implement two specific policies:

Adopt appropriate measures to reduce fluctuations in the free market nominal exchange rate from its equilibrium level.

Use monetary and financial tools to provide risk coverage for exporters.

Regarding the first measure, strategies such as clarifying the government's exchange rate

policies and obliging policymakers to implement and monitor these policies effectively can be helpful. Given that exchange rate fluctuations in the free market are heavily influenced by government policies, risk coverage methods could include the development and expansion of forward exchange markets and foreign currency deposit schemes within the banking system.

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