



# After the sanctions: Policy challenges in transition to a new political economy of the Iranian oil and gas sectors<sup>☆</sup>

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## ABSTRACT

This article discusses the prospects of Iranian domestic energy sector by focusing on the latest political and economic developments taking place in connection with the hydrocarbon industry. Although after partial lifting of the sanctions, substantial changes in the Iranian energy sector may present a new, favorable environment for international investments, the political economy of hydrocarbon management in Iran plays a significant role in the definition of current and prospective stakeholders, their aims and interests. This paper analyses existing policies and policy challenges of hydrocarbon management by contextualizing them with historical and political factors.

Considering the recent prospects in the Iranian hydrocarbon sector, it is worth keeping only the lower expectations concerning the production boom of the Iranian hydrocarbon industry: due to external market trends (low oil price, oversupply in the market) and a long redistribution process, the most probable scenario proposes a slow and continuous transformation in the oil and gas sectors of the Islamic Republic. In practice, it means that both the extension of export capacity and the involvement of international companies will take place in a gradual, regulated way, in which all the interests of major Iranian political and economic stakeholders have to be considered.

## 1. Introduction

This article discusses the prospects of Iranian domestic energy sector by focusing on the latest political and economic developments taking place in connection with the hydrocarbon industry. Although after partial lifting of the sanctions, substantial changes in the Iranian energy sector may present a new, favorable environment for international investments, the political economy of hydrocarbon management in Iran plays a significant role in the definition of current and prospective stakeholders, their aims and interests. This study only deals with oil and natural gas issues within the energy sector. In this respect, my aim is to analyze the economic and political opportunities offered by the partial elimination of the sanctions against Iran at the beginning of 2016 together with the expansion of Iranian oil and natural gas industries. In this article, there is no coverage on the technical details of these topics unless they are indispensable for understanding the political economy of oil and gas issues in Iran. Renewable energy sources do not have this political and geopolitical impact, therefore they are not addressed in

the text<sup>1</sup> and the environmental issues are for now out of scope as well.<sup>2</sup> Similarly, any prospects concerning coal and nuclear energy and all their political implications will not be discussed in this article.

The importance of oil and gas resources in the Iranian energy policy is based on two factors. On the one hand, Iran gains almost all its energy from hydrocarbons,<sup>3</sup> on the other hand, oil and gas by their nature connect Iran to the international community, to the regional and the global market. This interconnection has become particularly significant during the sanctions regime showing that changes in these sectors were not only had an influence on the domestic affairs, but it determined the international status of the country as well. Oil and gas as significant profitable raw materials are not only the basis of the economy in Iran, but they constitute strategic and political instruments that interact with the Iranian domestic and foreign policy and are often utilized in diplomacy by the policy makers. Since the strategic sectors (military, energy) and their development are concentrated in the hand of the political leadership of Iran, the interrelations between politics and hydrocarbon management cannot be exaggerated. Hydrocarbon revenues

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<sup>1</sup> For further details: al-Monitor (2016a) and Tabatabaei et al. (2017).

<sup>2</sup> For further discussion, see Talaei et al. (2014), Eshraghi and Ahadi (2016) and Tabatabaei et al. (2017).

<sup>3</sup> Out of the total energy mix of Iran oil has 37%, natural gas has 61% share, while nuclear and water power constitute only 1–1% (Rzayeva, 2016).

### Nomenclature

bcm	Billion cubic meters
bpd	Barrel per day
CNPC	Chinese National Petroleum Company
EU	European Union
GDP	Gross domestic product
JCPOA	Joint Comprehensive Plan of Action (nuclear agreement)

LNG	Liquified natural gas
LPG	Autogas
MENA	Middle East and North Africa
NIOC	National Iranian Oil Company
OPEC	Oil and Petroleum Exporting Countries
SWIFT	Society for Worldwide Interbank Financial Telecommunication
USD	United States dollar

are often used for a dual, contradictory, target by the governments: first, to accomplish economic and social transformation (industrialization, modernization), second, to maintain the status quo in the domestic power relations (Smith, 2007). The strong ideological commitment of the leadership, the politically influenced economy and the fact that the overall economic performance depends on the effectiveness of the hydrocarbon sectors make the analysis of the political sphere even more relevant in the case of Iran.

This paper is organized as follows: after the section on literature review and methodology, the basic data on the existing resources of oil and natural gas are provided (economic aspect). Then, the historical developments of the hydrocarbon sector are summarized in order to understand the “package” of traditions influencing current policy-making and the Iranian political and economic elite (historical aspect). The economic sanctions imposed by the international community make the case of Iran unique: their effects are addressed before the discussion of the current governmental perspective on the domestic hydrocarbon industry (subsidies, monopolies) (political and legal aspect). The relevant events and data of the post-sanctions period lead the discussion to the political, economic, financial and legal background of investment opportunities in Iran. The penultimate section of this paper evaluates the latest trends of the oil, gas and petrochemical industries offering opportunities for further development. The article closes with conclusions and policy recommendations concentrating on the political and economic policy factors that would enhance the implementation of a more effective system.

## 2. Literature review and aim of this research

Recently, there have been a number of studies that have investigated several specific energy policy areas and technical issues of energy in Iran such as the gasoline consumption in the transportation sector (Jafari and Baratimalayeri, 2008), the impact of feed-in tariff policy (Tabatabaei et al., 2017), the practical application of the buy-back service contracts (Ghandi and Lawell, 2017), or the latest reform attempts in the electricity industry (Yousefi et al., 2017). Beyond these particular studies, the seminal work of Elham Hassanzadeh (2014) provides a comprehensive picture of the domestic and international challenges of the natural gas sector in Iran in the period of sanctions.

Another part of the literature provides different scenarios for the future production of oil and gas in Iran by the intensive use of production and consumption data, therefore putting rather less emphasis on the political aspects of supply and demand management (Abbaszadeh et al., 2013; Azadi and Yarmohammad, 2011; Kiani and Pourfakhraei, 2010). Some of the recent literature (Jalilvand, 2013; Vakhshouri, 2017) deals with the international prospects of the oil and gas policies of Iran, but they also contain relevant data on the development of the domestic energy policy. For example, Esen and Oral (2016) analyzed four countries having the largest natural gas reserves in the world (Russia, Iran, Qatar, Turkmenistan) from political and economic perspective putting emphasis on the international context, its differences and similarities. The approach used here is different in a sense that the focus is only on Iran and the interconnection of political and economic issues in the domestic arena. My main contribution is to reemphasize the importance of the political and economic

“embeddedness” of Iran concerning its hydrocarbon management policies. Compared to these studies, this article extends the research to the post-sanctions era as well and provides the latest data on the issues discussed here. Moreover, this paper analyses existing policies and policy challenges of hydrocarbon management by contextualizing them with historical and political factors. Beyond the “traditions” of oil and gas sectors influencing energy choices, understanding organizational dynamics and the role of domestic political “powerhouses” in economic decision-making strengthens the “human elements” of energy policy analysis (Sovacool, 2014). These “human elements” consist of legal, political, economic, and historical variables.

In the following sections, my aim is to provide a reliable assessment for policy makers and all interested parties on the domestic prospects and challenges of the post-sanction Iranian hydrocarbon sector. With this overview, it will be possible to identify the present state and the future needs of the Iranian hydrocarbon industry as well as its energy consuming sectors. The significant social and economic changes such as industrialization, modernity, population growth and the widespread use of information and communication technologies offer a new picture on the internal dynamics of the Islamic Republic (Social Change, 2013). Given the current circumstances provided by the partial elimination of the sanctions, the necessity of a comprehensive assessment on the performance of the Iranian hydrocarbon sector appears relevant.

## 3. Natural gas and crude oil resources in Iran – data

From an international perspective, Iran is a significant player due to its notable oil and natural gas resources. According to BP plc (former British Petroleum), Iran disposes of 158 billion barrels proven oil reserves and 33.5 trillion cubic meter natural gas reserves (BP, 2017). Now, Iran ranks in the 4th place with regard to the size of oil its reserves, while standing on the first position in terms of its gas reserves (closely followed by Russia). Iranian crude oil constitutes 10%, natural gas 17–18% of total reserves of the world. This huge amount of hydrocarbon wealth means that potentially there is no chance for these resources to be exhausted in the medium term (Fig. 1a, b, c and d).

Compared to its excellent physical attributes as Table 1. shows, the Iranian oil exports rank only third place internationally, considerably lagging behind Saudi Arabia in first position. In this sense, the natural gas potential is also underutilized, partly because internal consumption uses up the whole production capacity making the exports of natural gas to regional and world markets difficult. However, Iran ranks third in natural gas production (behind Russia and the USA). To discuss the issue of this discrepancy between potential and reality, this article relies on historical data and analysis of economic policies beyond sheer economic reasoning in order to comprehend the internal and external factors that play roles in the relative under-performance of the Iranian hydrocarbon sector.

### 3.1. Past tendencies in the management of oil and gas sectors

In Iran, the first oil exploration started in 1901 (at that time, it was known as Persia) followed by the decision of the shah of the Qajar dynasty, Mozaffar al-din (1896–1907) who—unaware of the strategic importance of oil—provided the British investor William Knox D’Archy

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