



Iran: A Challenge for Polish Diplomacy and Energy Companies

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After recent elections in Iran, President Hassan Rouhani has secured power. His re-election means Iran will continue the policy of breaking out of its economic isolation and luring Western investment, especially in oil and gas exploration and production. On the other hand, Iran's actions and the tensions with the U.S. increase investment risk, which must be considered by European companies, including Polish ones.

Sanctions and Politics. U.S. and EU sanctions imposed in 2012 in connection to the Iranian nuclear programme targeted the country's oil sector. They forbade oil exports, using the international banking system to finance oil purchases, and barred foreign companies' involvement in Iran. After the sanctions were imposed, oil production in Iran dropped from 4.2 million barrels per day (bpd) in 2011 to 3.5 million bpd in 2012. In the same period, oil exports dropped from 2.5 million bpd to 1.5 million bpd. Since the deal known as the Joint Comprehensive Plan of Action (JCPOA) was reached between Iran and the U.S., UK, France, Germany, China, and Russia in 2015, Iran has limited its nuclear programme and the sanctions were lifted in 2016. Production rose to 4.2 million bpd last year and in the beginning of 2017, more than 2.4 million bpd were exported. That change in oil revenue resulted in GDP growth in Iran of more than 12% last year.

The agreement, however, did not abolish all the sanctions. There remain some imposed unilaterally by the U.S. in 1979. The EU also has extended to 2018 some sanctions related to human rights violations, but they do not cover the energy sector (they forbid, for example, exporting technologies that could be used to spy on citizens). Iran has received harsh criticism from the Trump administration, which has said it still supports terrorism. Iranian ballistic missile tests prompted the U.S. to impose new sanctions, though they do not impact the energy sector. In addition, President Donald Trump's first foreign visits were to Saudi Arabia and Israel—Iran's regional rivals—and he described Iran as a "hostile regime".

These factors mean Western companies' investments in Iran are connected to high risk. Iran tries to attract investments from EU countries since U.S. companies still cannot invest and trade with Iran freely on a regular basis (except for food, medical drugs, and civil aviation). The European companies, seeking opportunities, have targeted oil and gas exploration and production licenses by signing memorandums of understanding with the Iranians, but they are mostly waiting on an improvement in U.S.-Iran relations before signing final agreements, hence lower risk. The necessity to bypass the American financial system makes their ventures more difficult, on the one hand, and makes them highly cautious, on the other, because of the potential of U.S. Treasury fines if they breach the sanctions, which are extraterritorial, meaning any company in the world has liability. One company that has not waited is France-based Total, which signed a preliminary deal for the development of the giant oil and gas field at South Pars (China's CNPC also is involved in this area). However, any escalation in U.S.-Iran tensions could hit such European ventures, including Total's.

Iran's Investment Potential and Internal Challenges. Iran holds the world's second-largest reserves of natural gas and fourth-largest reserves of oil. However, the technical and financial involvement of foreign companies is necessary to increase its hydrocarbon output. Around half of Iranian oil is produced from fields that have been explored for around 70 years. They require investments to improve the recovery rate. According to the International Energy Agency, further investment could increase the amount of oil produced from the Iranian fields by 30-70% by 2040. The lack of gas infrastructure means Iran burns the gas recovered with oil (associated petroleum gas) instead of capturing it. Iranian gas transmission infrastructure and gas storage facilities require investments as well. Rouhani's cabinet's ambition is to increase Iran's share of the global gas trade by investing in LNG. The lack of technology in the country is what prompts Iran to cooperate with a foreign partner. Total is interested in this project and natural gas for an LNG terminal could be produced from the South Pars field.

According to official estimates, Iran aims to attract around \$85 billion in investment in its hydrocarbon-producing sector by 2021, while its domestic energy sector needs around \$185 billion worth of investments. At the beginning of 2017, Iran announced it had signed oil, gas, and petrochemical deals worth around \$35 billion. In August, Iran announced plans to attract \$15 billion worth of foreign investments in its oil and gas industry within nine months. The Iranians are currently reforming domestic regulations regarding foreign investments, which so far have forbidden foreign companies from extracting oil and gas, holding shares in fields or in Iranian companies. Despite the potential benefits, the risk to investors stems not only from international issues but Iran's internal affairs as well. The country was ranked 131st out of 176 in Transparency International's latest Corruption Perception Index.

Another factor is the Islamic Revolutionary Guard Corps, which has huge influence over the country's oil and gas sector. Before the nuclear programme dispute was settled, it pressured foreign companies operating in Iran. This might not end and could lead to more unpredictability when conducting business in Iran.

Opportunities for Poland. Polish energy companies are already benefiting from the opening of the Iranian energy sector. Oil imports from Iran allows them to diversify suppliers of Polish refineries: currently around 90% of oil comes from Russia. The first deliveries of Iranian oil were concluded in 2016, and Polish companies want to negotiate new contracts. Iran has one of the lowest breakeven costs on oil production in the world, at just \$12 per barrel (second only to Saudi Arabia), which means it can sustain production even when oil prices remain low. Poland could also benefit from Iran's plan to increase natural gas exports to 60-80 bcm by 2021. In the longer run, gas can be shipped not only as LNG but also via the planned Southern Corridor to Europe, which would diversify the EU's gas sources (the latter option, however, poses greater political risk).

Polish companies can see further opportunities from the Iranian energy sector. Polish state-owned PGNiG is among 29 foreign companies certified to bid for oil and gas projects in Iran. Another Polish company, Grupa Azoty wants to invest in modernisation of Iran's petrochemical sector. Poland's government has named Iran one of the five most prospective markets for Polish companies. In 2015, its Ministry of Economy started the "Go Iran!" programme, which encourages investment and exports. This year, an office of the Polish Investment and Trade Agency was opened in Tehran.

Conclusions. Polish plans for imports from Iran and investments in the country must consider the strong political risk, mainly the possibility of an escalation of U.S.-Iran tensions. Along with the overall rising tensions, the potential that the Trump administration might pull out of the JCPOA cannot be ruled out (plus the factor of the ongoing criticism of it by the U.S. president¹). The possibility that sanctions could be re-imposed in the future on the Iranian oil sector could hit Polish oil imports. At the same time, the EU and Poland have very limited influence on U.S. policy on Iran, which could strike European import and investment plans.

Poland can still benefit from Iran's return to the global oil market (and possibly in the future also its LNG exports). However, the U.S.-Iran tensions must be carefully considered when planning future cooperation with Iran. If those relations worsen, Poland, as well as other EU countries, must have precisely calculated their interests and relations, not only with Iran but with the U.S., Israel, and Saudi Arabia. The latter has recently begun its first oil exports to Poland and the U.S. is not only Poland's close ally, but also a potentially significant exporter of natural gas and oil to Poland.

¹ M. A. Piotrowski, "U.S. Policy toward Iran and Prospects for the Nuclear Deal," No. 74 (1014), 2 August 2017.