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The Iran-US Relations

Their Effects On GME & Asian-Pacific Energy

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Definitions: The Greater Middle East (GME) is an area extending from **Russia's** south-east of the Urals (including the Caucasus) all the way to **AfPak** (Afghanistan & Pakistan), from **China's Central Asian (including Caspian) borders to the Atlantic** (Morocco & Mauritania), and from Egypt down to the Horn of Africa (HoA). The rest of Africa's link to the GME means the Muslims there who are part of the **Muslim World** of about 1.6 billion people represented by the **Saudi-led Sunni front of rulers grouped in the 57-state Islamic Co-operation Organization** (ICO) whose general-secretariat is based in Jeddah and since January 2014 headed by a Saudi ex-minister. The **ICO** area extends from the **Balkan** to Asia and a part of the Pacific and to Africa. Iran is **the only Shi'ite member-state of the IOC which is a Safawi theocracy** (i.e., a theocracy having the 16th century AD ideology – known as Safawism (see Safawism in Google).

Asia/Pacific in this presentation covers India, the ASEAN countries, **East Asia** (including China, the two Koreas & Japan, as well as Russia's eastern Siberia and far eastern lands & waters up to the Arctic) and **South Asia**, as well as the Pacific area including Australasia and all other regions including the Canadian and US/Latin American west coasts.

Overview: What will happen to Iran-US relations, Russia-US relations and the US position in the Muslim world in the months and years ahead will have major effects on the global energy situation, particularly on the petroleum industry. **These three factors are inter-linked and, therefore, merit close monitoring by all strategists and investors** who have a stake in the global economy as well as in global politics which are inter-dependent.

This is just a paper for discussion. It will not provide the answers which the participants may want. It does, however, seek to un-lock clues that the participants may require for them to draw conclusions on any matter. Hopefully, this paper may help stimulate the discussion needed for the participants to formulate perspectives based on their own points of view. Thus said, the discussion – here now and elsewhere at other times - may help you share or exchange notes.

Iran's theocracy, whose constitution re-affirms the Safawi ideology but keeps this open to any version of it subject to the balance of power in the regime, **is split between a coalition of reformists and pragmatists wanting their country to have a "comprehensive" pact with the US including a nuclear weapon-free nation**, and extremists bent on keeping their axis of control in the GME functioning. This split raises the risks for Iran and Iraq, as well as for Iran's other client-forces such as those in Lebanon, Syria's 'Alawite regime and other countries in this vast part of the world.

The Iranian Risk & The Putin/Islam Factors; The Global Implications

The greatest risk for Iran will come if and when the two rival camps decide to defeat each other in a show-down over a "comprehensive" Tehran-Washington pact supposed to end the theocracy's nuclear and geo-political ambitions.

The Putin Factor: The global implications of Iran's split might include a **Russia-G7 cold war** – perhaps as dangerous as, if not more than, the one between the Communist and capitalist fronts

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that lasted from the close of World War-II to the collapse of the Soviet Union in late 1991. This factor, the product of Russian President Vladimir Putin, could be triggered by the combination of the Iranian split and the Ukraine crisis, if they both worsen.

The seeds of such global confrontation are Putin's East European ambitions, which are clear when one recalls his accusations in recent years that the West caused the collapse of the Soviet Union and its loss of East Europe. The Putin factor has triggered the Ukrainian crisis, which Moscow accuses Washington of having caused. Ukraine has been a political foot-ball kicked back and forth between Russia and the West; but now, this means East Europe.

To quote the Russian-born British TV producer and writer, Peter Momerantsev, "**there is a battle of ideas going on**". He says this is not between Communism and capitalism, or even conservatives and progressives, but "**between competing visions of globalisation, between the 'global village' - which feels at once nice, naff, and unreal - and 'non-linear war'**".

Momerantsev tends to back the theory Russian actions in Ukraine might be the beginning of Putin's "non-linear war", a term used in a short story written by a close Putin political adviser **Vladislav Surkov**, published under his pseudonym, **Nathan Dubovitsky** (you can use both names to get the full story through Google). Dr Surkov had his story published a few days before Russia's March 2014 annexation of Crimea. (**The more you read these few paragraphs the more clearly you will see the real implications of the Putin factor. Putin, incidentally, has his own taqiya which he frequently uses for both internal and external purposes**).

Dr Surkov is credited with inventing the system of "**managed democracy**" which has dominated Russia in the 21st century, and his new portfolio focuses on the Kremlin's foreign policy. This time, he sets his new story in a what is now called "**dystopian future after the fifth world war**". In that Dr Surkov (**Dubovitsky**) wrote the following:

"It was the first non-linear war. In the primitive wars of the 19th and 20th centuries it was common for just two sides to fight. Two countries, two blocks of allies. Now four coalitions collided. Not two against two, or three against one. All against all".

To Surkov, this is a world where the old geo-political paradigms no longer hold. As the Kremlin faces down the G7, it is gambling that old alliances like the EU and NATO mean less in the 21st century than the new commercial ties it has with nominally Western companies such as BP, Exxon, Mercedes, and BASF. And, while Western powers welcome corrupt financial flows from the post-Soviet space; it is part of the G7's economic models, and not one many want disturbed.

Momerantsev says **Putin's gamble seems to be paying off**, with financial considerations helping to curb sanctions. Part of the rationale for fast-tracking Russia's inclusion into the global economy was that inter-connection would be a check on aggression. But **Putin thinks this can be flipped: Inter-connection also means Russia can get away with aggression**.

Dr Surkov adds: "A few provinces would join one side, a few others a different one. One town or generation or gender would join yet another. Then they could switch sides, sometimes mid-battle. Their aims were quite different. Most understood the war to be part of a process. Not necessarily its most important part".

In this, Momerantsev says one can see a similar thinking by Putin as he "toys with Eastern Ukraine, using indirect intervention through local gangs, with a thorough understanding of the interests of...local power brokers" like Donetsk tycoon **Rinat Akhmetov** (Ukraine's richest man) or **Mikhail Dobkin**, the former head of the Kharkiv Regional Administration and now a presidential candidate.

Though these local magnates make occasional public pronouncements supporting Ukraine's territorial integrity, their previous support of ousted President Victor Yanukovich makes them wary of the new government in Kiev. Momerantsev adds: "Just the right degree of separatism

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could help guarantee their security while ensuring that their vast financial global interests are not harmed”.

Although there is no direct link between what will happen in Iran and the current East-West tensions over Ukraine, **the Putin factor and a deep split in the Muslim world can connect these dangers: the split in Iran and the split between the Muslim world’s militants in political Islam, led by Iran’s theocracy, and the promoters of non-political Islam led by Saudi Arabia, which can potentially become a connecting factor just as powerful.** Political Islam consists of radicals from the Sunni majority and the Shi’ite minority. The Sunnis claim to constitute over 94% of the Muslim world, with the Shi’ites accounting for the rest.

So the effects of the cold war and the Iranian show-down could be a chaotic global energy situation. But this will be temporary: Global markets are free and have self-adjusting mechanisms to bring about a manageable balance. Yet there will always be winners and losers.

At this point, it is important to take into account **the possibility of the Obama administration allowing the export of American crude oil to all markets outside the US** – i.e, ending a ban on such exports imposed in the 1970s by the Nixon administration. It is also expected to allow the export of US natural gas in the form of LNG. The results would be a fall in world oil and LNG prices to a new balance which will not be too low – still high enough to keep investment going to oil and gas E&P (including non-conventional petroleum) across the globe.

The US-led international sanctions against Iran since the 1990s have caused Iran’s economy to begin imploding and thus raising the risks of a popular revolution against the entire theocracy. Khamenei knows this, the reason why he has allowed Rowhani’s government, through its US-educated **Foreign Minister and chief nuclear negotiator Dr Muhammad Javad Zarif**, to bring about both the pact with Washington and the proposed de-militarisation of the nuclear plan. **Zarif now says his negotiators with the 5+1 powers are in the process of drafting a final agreement.**

The final nuclear agreement may even be signed before July 20, the end of a six-month trial deal signed in Geneva on Nov. 24, 2013. This should be followed by a comprehensive pact with the US – both possible only if Khamenei accepts them.

The Options For Japan’s Energy Supply Security – Oil & LNG

To begin with, there will be no problem for the security of Japan’s energy supply, particularly for its crude oil and LNG imports. There will be plenty of energy supplies from the GME and other sources which in the coming years will include crude oil and LNG from the US and Canada. One option the Japanese government has taken is a set of agreements with major crude oil suppliers in the Middle East for the latter to locate a part of their strategic reserves in this country.

There is no major change in the petroleum policies of the GCC states. With the exception of Saudi Arabia and Kuwait which are not offering PSAs to the IOCs, the other four GCC members are competing with one another in offering attractive PSA terms. All the six GCC states have pragmatic oil and LNG export pricing policies. But with the GCC’s LNG exporters insist on their prices to remain indexed to oil market values. I shall answer any questions on this matter in the Q&A section.

As for major Japanese oil companies, **hedging against energy price risks is an important option. The same is true in the case of companies trading in LNG, both exporters and suppliers.** Learning the tricks – or ups and downs – of hedging through trading via futures exchange markets or any other forward markets – is an important option to reduce the risks of price volatility. Crude oil and spot LNG price volatility in the coming years will be an important development. This is because energy prices will become more volatile in the years ahead,

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especially because the volumes of LNG and crude oils – as well as refined oil and natural gas products like GTL – will be increasing in the Asian/Pacific markets.

Global environmental politics will become much more effective in the years ahead. Even China, recently classed as becoming the world's largest economy in 2014 by a controversial calculation that I strongly doubt – **will have increasingly more influential environmentalists due to excessive pollution in its booming coastal provinces.**

Already climate changes around the world have begun to alarm those who for years had doubted what the environmentalists used to say. So, for example, **GTL-sourced fuels could become more and more popular, even in China and other emerging economies around the world – apart from those of the developed economies.**

Another major issue is the option for Japan, in an increasingly more globalised economy, to be able to reduce – and eventually to totally eliminate – the price premium which this country's crude oil and LNG importers pay for their supply requirements. This option is for Japan to help develop a combination of market mechanisms as follows:

1. Asian/Pacific spot crude oil and refined products markets to be established anywhere from Tokyo to Singapore, with both to be based on price markers or price benchmarks.
2. A Tokyo futures trading mechanism for crude oil, refined products and LNG – with the price marker contract for LNG to be based on the average in spot markets for natural gas (not for LNG) in Asia to be established as well as in Europe and the US. The price basis for the marker LNG futures contract is favoured by the importing countries to be the Henry Hub spot price of American natural gas, rather than crude oil.
3. Establishing an Asian spot market for natural gas – both the gas fed into LNG plants and the re-gasified fuel – to be based either in Japan or in China (Shanghai).

I have based this third requirement on a thorough study by APS Energy Group of **China's future needs of energy – other than over-dependence on coal, including imported Chinese coal imports since 2008.** China's demand for LNG could eventually over-take that of Japan. The future Asian/Pacific LNG requirements will include foreign natural gas by pipeline and liquid methane. This is in terms of volume of both in-land consumption through re-gasification and direct use by the shipping sector and other potential direct users of liquefied methane in this vastest part of the world by population and surface. LNG is used directly in North America.

The Tokyo stock exchange is to have a futures trading mechanism for LNG in 2015. I have read several reports indicating that. METI has been involved in this effort, having recently begun issuing releases about the average spot prices of LNG based on actual transactions made; and this has helped reduce spot prices for supplies reaching Japan.

Indeed, there have been a lot of discussions of this issue in LNG-related conferences held in Japan, with the IEEJ being among the main participants or organisers in this effort.

The issue of the premium Asian/Pacific importers pay for their term-LNG supply requirements has begun to be even more serious, now that the cost of LNG export projects in Australia, Canada and the US have risen sharply. For example, **Canadian LNG export project-promoters are planning to seek oil-indexed prices with a delivered cost to Asia/Pacific of at least \$2 per million BTUs more than the price US export project-promoters are willing to accept for their LNG supplies.** So the Canadian promoters say Asian/Pacific LNG buyers would have to pay more than \$20/million BTUs for their supplies.

Does The US Energy Diplomacy Need A Japanese Equivalent?

The price premium issue I have mentioned above is part of the pan-Asian/Pacific concern about the region's future energy supply security. This is not new for the US State Department, which

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has a special mechanism already involved in dealing with the matter of viable energy supply for various parts of the world. What is not yet clear is whether or not METI's energy supply/demand policy department, or other department, is sufficient to match that of the US State Department. Of course, you know best about what Japan needs. But I am not aware that Japan's Ministry of Foreign Affairs' Economic Cooperation division (or department) is also involved adequately in energy supply security for this country. I know the Japanese ambassador to Beirut is quite active in this regard, being keen on Japanese involvement in Lebanon's offshore petroleum resources.

MOFA is needed simply because it has highly-respected embassies world-wide. But in most cases, METI's representatives in such embassies are not as active – or as effective - as their US counterparts are at American embassies in the present time.

The State Department's **Bureau of Energy Resources** (ENR) is most potent among the soft-power tools – or weapon - of the US energy diplomacy. As a weapon, this is being used for Europe's future energy supply security. Its aim is to gradually reduce the EU's dependence on Russian natural gas and oil supplies. **As President Obama is preparing to shift the US geo-strategic focus from the GME to Asia/Pacific**, a process to be completed after the US/NATO have withdrawn from the AfPak front in 2014, this energy tool or diplomatic weapon can be used in any part of the world.

Set up in November 2011 and headed by **Carlos Pascual** - who was the American ambassador to Ukraine in 2000-03 - the ENR has a highly-skilled staff of 85 persons. Pascual is also the State Department's "Special Envoy and Coordinator for International Energy Affairs". I wonder whether Japan has a counterpart to Mr. Pascual; I simply do not know.

It was the then Secretary of State Mrs Hillary Clinton who appointed Mr Pascual to this position, effective from May 18, 2011. The ENR says it will ensure that all US diplomatic relationships advance "Washington's global interests in having access to secure, reliable, and ever-cleaner sources of energy".

The establishment of ENR was a direct result of the Quadrennial Diplomacy and Development Review (QDDR – see this in Google). **The ENR has three core objectives:**

Global Energy Diplomacy: To manage the geo-politics of the current energy economy through re-invigorated energy diplomacy with the world's major producers and consumers.

Energy Transformation: To stimulate the world market forces which will sustain transformational energy policies in terms of alternative energy, electricity, development, and re-construction.

Energy Transparency & Access: To expand good governance, increase transparency, and improve commercially viable and environmentally sustainable access to the 1.3 billion people across the world who are without energy services.

In this capacity, Mr Pascual advises the secretary of state (now John Kerry) on global energy issues, ensuring that energy security is advanced at all levels of US foreign policy. Before, Mr Pascual served as the US ambassador to Mexico (2009-11) and was vice-president and director of the Foreign Policy Studies Program at the Brookings Institution (2003-09). Just reflect on his profile. During his extensive career in public service, Mr Pascual held positions in the State Department, the White House's National Security Council (NSC) and the US Agency for International Development (USAID). He served as co-ordinator for re-construction and stabilisation at the State Department, where he led and organised US government planning to help stabilise and re-construct societies in transition from conflict or civil strife in various parts of the world. So **he is a multi-disciplinary person**. (See in Google his Sept. 25, 2013, speech to Columbia University. Its title was: "The Geopolitics of the Global Energy Revolution").

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For example, **ENR in 2012 began to focus more on Israel's offshore gas resources and to develop a diplomatic offensive to promote quiet contacts between the Jewish state and each of Egypt and Jordan – as well as Kuwait and Saudi Arabia.** By March 2014, ENR's efforts had succeeded in establishing secret contact between Israel and these Arab states. Already, the former chief of Egypt's armed forces (EAF) and now presidential candidate, rtd **Field Marshal 'Abdul-Fattah al-Sissi** had been in contact with Israeli intelligence officials since the time he headed Egypt's military intelligence. Once Sissi was Egypt's military attaché in Riyadh. Sissi is expected to win the presidency in late May 2014.

In parallel with ENR's efforts is the role of the State Department's bureau helping resolve territorial disputes around the world. This works closely with the ENR. It focuses on petroleum-rich areas. **In co-ordination with the ENR, it is working on settling a dispute between Lebanon and Israel concerning offshore oil and gas. One option is for Tokyo to get this bureau and the ENR to be involved in settling the Japan-China dispute over the petroleum-rich Senkaku islands and waters.** Thank you.