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# Moving (Slightly) Closer to Iran China's Shifting Calculus for Managing Its "Persian Gulf Dilemma"

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## MOVING (SLIGHTLY) CLOSER TO IRAN: China's Shifting Calculus For Managing Its "Persian Gulf Dilemma"

John Garver, Flynt Leverett, and Hillary Mann Leverett\*

Over the past quarter century, China has been challenged to balance a major interest in maintaining comity with the United States against its efforts to develop multi-dimensional cooperative relations with important countries in the Persian Gulf—including countries in policy conflict with Washington. This "Persian Gulf dilemma" in China's foreign policy first took shape—and has challenged decision-makers in Beijing most consistently—with regard to the Islamic Republic of Iran. Over the years, the Islamic Republic has emerged as the *de facto* leader of regional resistance to America's longstanding hegemonic position in the Gulf and the Middle East more broadly. As tension between Washington and Tehran has risen, U.S. demands on Beijing to cooperate with U.S. efforts to isolate and press the Islamic Republic have mounted. But, since the mid 1990s, China has developed an increasingly strategic energy relationship with Iran, reinforced by a variety of economic and technological cooperation agreements. And Tehran, for its part, has made China the focus of an emerging "Eastern orientation" in Iranian foreign policy.

Beijing's struggle to balance its interest in maximizing Chinese access to Iran's hydrocarbon resources against its interest in preserving good relations—and, above all, avoiding conflict—with the United States is, in many ways, the quintessential manifestation of China's Persian Gulf dilemma. China's leaders have been careful not to let their country's developing ties to the Islamic Republic be perceived in Washington as a direct

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challenge to America's hegemonic position in the Gulf. In coming years, China's foreign policy will almost certainly continue trying to balance between the two horns of the country's Persian Gulf dilemma. The prospective costs of coming down clearly on Washington's side or Tehran's are simply too great. But, while China will continue to avoid direct challenges to American hegemony in the Gulf, recent developments in Sino-Iranian energy relations indicate that governmental and corporate decision-makers in Beijing now calculate that China can "get away with more" with regard to energy investment in the Islamic Republic without provoking a serious U.S. backlash.

Given Tehran's increasing openness to expanded ties to China, Beijing's revised calculus for managing its Persian Gulf dilemma with regard to Iran is likely to lead to further growth in Chinese energy investment in the Islamic Republic. China's revised calculus for managing its Persian Gulf dilemma also suggests that Beijing is extremely unlikely to cooperate with Washington to impose anything approaching "crippling sanctions"—to use Secretary of State Hillary Clinton's phrase—on Tehran over Iran's nuclear activities. Among other things, that raises serious questions about the plausibility of the Obama Administration's preferred approach to the Iranian nuclear issue, which—much like the George W. Bush Administration's approach—emphasizes intensification of multilateral economic pressure to leverage Tehran's nuclear decision-making without putting positive incentives on the table that would address the Islamic Republic's most important strategic needs.

To develop these arguments, the present paper is organized in four sections. The first section examines the two horns of China's Persian Gulf dilemma in greater depth. The second section then outlines the emerging Eastern orientation in Iranian foreign policy, placing Tehran's approach toward China in the broader context of the Islamic Republic's foreign policy and national security strategies. The third section looks at recent

developments in Sino-Iranian relations in order to draw some conclusions about the shifting calculus of opportunity and risk that guides China's foreign policy "balancing act" between Washington and Tehran, especially in the context of the Iranian nuclear issue. Finally, the fourth section draws implications for U.S. policy.

### **Understanding Beijing's "Persian Gulf Dilemma"**

Over the last quarter century, China has faced an increasingly acute "Persian Gulf dilemma" in its foreign policy. During this period, Beijing has been compelled at least a dozen times to choose between cooperation with the United States over Persian Gulf issues, or cooperation instead with Persian Gulf states locked in various disputes with the United States (see Figure 1). Each time, China has had to decide how to respond: to cooperate with Washington; to reject Washington's invitations and oppose U.S. policy; to find some way of side-stepping the issue; or, to balance between Washington and America's regional rivals, giving each side part of what it desires without alienating either side.

Beijing's management of its Persian Gulf dilemma has entailed an ongoing effort to balance important but sometimes conflicting Chinese interests. On the one hand, Beijing has a major interest in maintaining comity with the United States; on the other hand, China seeks to develop robust and positive relations with important Gulf countries—including some at odds with Washington. This section explores in greater depth these two drivers of Beijing's Persian Gulf dilemma.

**Figure 1. Beijing's Choices in Managing its Persian Gulf Dilemma**

<u>Date</u>	<u>U.S. policy initiative</u>	<u>China's policy choice</u>
1982-88	Push for UN-sponsored arms embargo against Iran to push it to end war with Iraq	Rejected; served as Iran's major arms supplier
1982-97	Push to end anti-ship cruise missile sales to Iran	Seemingly accepted U.S. demands, but found ways to transfer capabilities to Iran
1987-88	Multilateral action to guard oil traffic during "tanker war"	Rejected; disassociated from action
1990	Report to UN and sponsor war to undo Iraqi annexation of Kuwait	Opposed, but abstained on Security Council vote
1997-2002	Air attacks to uphold sanction and inspection regime re Iraq	Opposed
1995-2002	Maintenance of tough sanctions regime against Iraq	Opposed, but let others take the lead in opposing
1996-	Block large foreign investment in Iran's energy sector	Opposed, but let others take the lead in opposing
1983-1997	End foreign assistance to Iran's nuclear program	Rejected for 13 years; agreed in 1997
1989-	End sale of dual-use technology to Iran	Rejected except Category I ballistic missile technology (substantially agreed 1997)
2003	War for regime change in Iraq	Opposed, but let others take the lead in opposing
2004-09	Democratization and reform in the Middle East	Rejected and opposed
2006-	Push for sanctions against Iran over nuclear program	Opposed, but reluctantly accepted symbolic sanctions

*Maintaining Sino-American comity.* For more than thirty years, Chinese foreign policy has linked positive relations with the United States to the imperatives of China's own economic development. The essence of Deng Xiaoping's foreign policy line, as defined *circa* 1978, was that Beijing should strive for comity with Washington so as to enable China to accelerate its development by drawing on the resources of a global system dominated, for better or worse, by the United States. Ever since, this proposition has been a foundational pillar of China's approach to the world, although the operationalization of Deng's concept in Chinese foreign policy has evolved considerably since he first expounded it. During the last decade of the Cold War, Beijing relied on common interests with the United States in countering the Soviet Union to stabilize Sino-American relations. With the end of the Cold War, Sino-American relations became more vulnerable to the sometimes negative influences of U.S. public opinion and interest groups.<sup>1</sup> In response, Beijing worked to recreate a strategic basis for China's vital relationship with the United States; by the mid 1990s, Chinese leaders were pushing for an explicit "strategic partnership" with America. In the late 1990s, maintaining a stable relationship with the United States was enshrined as one of the fundamental tenets of the "new diplomacy" that has been pursued with particular vigor following Hu Jintao's accession to China's presidency in 2003.<sup>2</sup>

This emphasis on preserving positive relations with the United States has had a substantial impact on China's approach to the Middle East. In private—and, almost certainly, in classified discussions—Chinese analysts, officials, and policymakers have long held a view of U.S. policy in the Middle

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<sup>1</sup> This is a major theme of James Mann, *A History of America's Curious Relationship with China, From Nixon to Clinton* (New York: Knopf, 1999).

<sup>2</sup> For an early assessment of China's foreign policy following Hu's accession to the presidency, see Evan Medeiros, and Taylor Fravel, "China's New Diplomacy", *Foreign Affairs* 82:6 (November/December 2003), pp. 22-35.

East as “hegemonism run amok”. But the same Chinese analysts, officials, and policymakers who criticize America’s drive to dominate the Middle East as part of a broader quest for global dominance have also made a pragmatic calculation that active opposition to U.S. hegemony in the region could be extremely costly for Sino-American relations.

As will be discussed in greater detail below, China is far from comfortable with the reality of American hegemony in the Persian Gulf—or elsewhere in the world. Most Chinese analysts of U.S. hegemony in the Middle East believe that what they see as Washington’s plans for domination of the region are bound to fail. Grandiose American ambitions to control the Middle East and its oil will collapse because arrogant and crude U.S. policies will generate a backlash, and the United States will be exhausted by the patriotic resistance of the region’s peoples. But, how long will U.S. hegemony last—in the Persian Gulf or elsewhere? Since 1997, Chinese leaders have increasingly acknowledged that U.S. hegemony may last longer than mainstream Marxist analyses had anticipated, and that China would therefore need to prepare to live in a world still dominated by U.S. “hegmonism”.

If American hegemony in the Middle East is to continue for a considerable period of time, then a more prominent Chinese role in the region could well be seen in Washington as a “challenge” by a “strategic rival”, potentially undermining Sino-American comity and threatening the macro-climate for China’s own development drive. But, if the United States is ultimately slated for defeat in the Persian Gulf, it also does not make sense for China to form a full-fledged regional partnership with what will turn out to be a losing power. Under these circumstances, it is better for China to remain largely disassociated from U.S. efforts in the Gulf, “watch the fire on the opposite bank”, and accumulate what influence it can with local victims of U.S. aggression, even while doing what is necessary to stay out of U.S. gunshots.

For these reasons, Beijing's public criticisms of America's Middle East policy have typically not been strident. Terms such as "hegemony" and "aggression" are used relatively sparingly in open commentary. More concretely, China has refrained from having People's Liberation Army Navy squadrons use ports in the Middle East; most strikingly, Chinese warships have not called at ports in Iran, even though the Islamic Republic has had close military-to-military ties to the PLA and China spoke loudly in the early 1990s (and more softly thereafter) in support of Iran's struggle against U.S. hegemony in the Persian Gulf.<sup>3</sup>

Likewise, over the last 20 years, China has been cautious in supporting Middle Eastern states entangled in policy conflicts and confrontation with the United States. Historically, China's Persian Gulf dilemma first emerged with the Iranian revolution of 1979 and the subsequent divergence of U.S. and Chinese policy toward the Islamic Republic. By 1993, the Clinton Administration's policy of "dual containment" *vis-à-vis* Iran and Iraq was paralleled by Beijing's efforts to expand multi-dimensional, friendly, and cooperative relations with both of Washington's Persian Gulf rivals. Since the U.S. invasion of Iraq and the rise of the Iranian nuclear issue to the top of America's foreign policy agenda, American pressure on Beijing to cooperate with Washington's policy goals in the Persian Gulf has escalated considerably. In this context, Beijing's dealings with Saddam Husayn's Iraq during the 1990s and its reaction to the U.S. campaign to remove Saddam from power offer numerous examples of Chinese sensitivity to being viewed in Washington as a patron of the Iraqi regime.<sup>4</sup>

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<sup>3</sup> Since the PLA Navy began visiting foreign ports in 1985, Chinese warships have visited Karachi in Pakistan, Colombo in Sri Lanka, Chittagong in Bangladesh, Sittwe in Myanmar, Lumut and Kelang in Malaysia, Mumbai and Cochin in India, and Dar es Salaam in Tanzania. Ports in the Middle East are conspicuously absent from this list.

<sup>4</sup> For example, in the fall of 2002, as Washington sought UN sanction for war to remove Saddam from power, France, Germany, and Russia voiced strong opposition. China also opposed U.S. war plans, but Beijing's statements of opposition during Security Council debates were less sharp, less verbose, less frequent, and came later in the Council's

As will be discussed below, Beijing's development of relations with the Islamic Republic of Iran since the late 1980s reflects a similar strategic caution.

Beijing has also come to appreciate the importance of nonproliferation to Washington and, since the late 1990s, has seen little reason to rouse U.S. ire by thwarting American efforts to limit the spread of weapons of mass destruction (WMD) capabilities in the Middle East—especially with regard to Iran. Starting in the mid 1980s, China's cooperation with the Islamic Republic in the development of nuclear, cruise missile, and ballistic missile capabilities became an increasingly significant point of conflict in Sino-American relations. But, in 1997—as part of the negotiations over the terms of twinned U.S. and Chinese presidential visits in 1997 and 1998—Beijing agreed to suspend all nuclear and cruise missile cooperation as well as cooperation in the development of “Category I” (nuclear capable) ballistic missiles.<sup>5</sup> U.S. administrations have continued to complain about Sino-Iranian cooperation on dual-use technology with potential missile production

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discussions of the issue. Overall, China was careful to keep its opposition to U.S. moves several notches below that of France, Germany, and Russia. According to Chinese analysts interviewed in 2007, France asked China to speak more forcefully against the United States during Security Council deliberations on Iraq in 2002 and early 2003, but China demurred. Another Chinese analyst interviewed at the time of Secretary of State Colin Powell's February 2003 visit to Beijing—during which Powell sought Chinese support for the U.S. position in the Security Council—said that the Chinese leadership had determined by that point that Iraq was not worth a setback to the post-9/11 warming trend in Sino-American relations. Once Saddam had been removed from power, China played an important role in persuading France, Germany, and Russia to join a Security Council resolution giving a UN imprimatur to U.S. leadership of Iraq's reconstruction. The thrust of China's arguments to these other powers was suggested by China's then-UN ambassador, Wang Guangya: “You have to recognize that the U.S. is the biggest country in the world. If they do not want to participate at the UN, I don't think the UN will work effectively”. See “China's envoy defends UN deal on Iraq”, *The Financial Times*, October 19, 2003.

<sup>5</sup> For a discussion of this episode, see John Garver, *China and Iran: Ancient Partners in a Post-Imperial World* (Seattle, WA: University of Washington Press, 2006), pp. 221-228. Strikingly, Beijing's commitment in the nuclear arena went well beyond the requirements of the nuclear Non-Proliferation Treaty (NPT), which China had joined in 1992. The NPT permits nuclear cooperation between states under the supervision of the International Atomic Energy Agency. But, in 1997, China agreed to suspend *all* nuclear cooperation with Iran—including that which might be permitted under the NPT.

or biological and chemical warfare applications. These complaints notwithstanding, 1997 marked a major draw down of Chinese cooperation with the Islamic Republic on the most sensitive WMD capabilities.

This record of Chinese maneuver to avoid collision with the United States over various Middle East issues should not be taken to mean that Beijing has shifted course on each of these issues without obtaining some *quid pro quo* from the United States. In fact, Beijing has consistently bargained hard and frequently obtained U.S. concessions in return for Chinese restraint or modifications of policy in the Middle East. Thus, in 1997, China used its commitment to end cooperation with Iran on nuclear, cruise missile, and Category I ballistic missile capabilities to win an American commitment to high-profile presidential visits to Beijing and Washington in 1997 and 1998. Similarly, in the run up to the invasion of Iraq in 2003, China won both U.S. designation of the East Turkistan Independence Movement as a terrorist organization and, apparently, a U.S. commitment not to bomb North Korean nuclear sites in return for modulating its opposition to America's widely anticipated military action.

Nevertheless, in strategic terms, China has been careful not to "take the lead" in the Middle East because of the potential injury to Sino-American relations that might arise from policy conflicts in the region between Beijing and Washington. As the historical record summarized in Figure 1 suggests, even when China has opposed particular U.S. policy initiatives in the Persian Gulf or the "greater Middle East", it has not done so in a manner that was likely to be perceived in Washington as a direct challenge to America's longstanding hegemonic position in the region.

In recent years, Chinese leaders have reaffirmed Beijing's low-profile/low-risk approach to the Middle East. In the wake of the September 11, 2001 terrorist attacks in the United States and Washington's launching of a "global war on terror", China's leaders began a thoroughgoing review of their country's Middle East policy. This review was prompted, *inter alia*, by

China's skyrocketing need for imported oil, the role of the Middle East in supplying China's oil imports, and the growing number of Chinese businessmen and workers in the region. During the policy review, a number of arguments were advanced within Beijing's decision-making circles for China to become more active in the region. Some argued that, since oil is the vital "black blood" of the Chinese economy, China should even consider deploying naval forces to the Middle East to protect its oil supply. A more active role in the Middle East might also be necessary to protect its citizens and firms in the region. Furthermore, many Middle Eastern countries had enhanced petroleum revenues and ambitious development plans; Chinese machinery, equipment, engineering, and labor services were very competitive, creating potentially lucrative business opportunities in the region. An expanded Chinese role in the Middle East could help Chinese companies take advantage of these opportunities.

As China's leaders reviewed their country's Middle East policy, Beijing seemed to be moving in the direction of a larger role in the region. Following the 9/11 attacks, China appointed a "special envoy" to the Middle East, Wang Shijie, who made a number of multi-country visits to the region over the next several years. (According to a former Chinese ambassador to Iran, during Wang Shijie's travels, many Middle Eastern leaders lamented the absence of a countervailing power to the United States and expressed hope that China would play such a role.) In early 2006, China expressed interest in joining the Middle East "Quartet"; later that year, China committed 1,000 combat engineers to the United Nations Peace Keeping Operation in Lebanon.

But, according to Chinese analysts and officials, by the end of 2006, China's leaders had decided to draw back from deeper involvement and to continue keeping a low profile in the Middle East for some time to come. China's capabilities were still too limited, and too much ambition carried excessive risks. China's leaders recognized that China has interests in the Middle East—and that conclusion represents a major step in the evolution of

Chinese policy toward the region—but ruled out trying to protect those interests through a higher-profile Chinese role.<sup>6</sup> China would pursue its interests in the Middle East largely through cooperation with the other permanent members of the UN Security Council—including the United States—as well as through cooperation with Middle Eastern states.

*Developing ties to key Persian Gulf states.* Alongside the perceived imperative to maintain Sino-American comity, China has, since the late 1970s, developed increasingly important interests in its relations with various Persian Gulf countries—interests primarily (but not exclusively) focused on satisfying China’s burgeoning demand for imported hydrocarbons. According to the *CIA World Factbook*, China was the world’s second-largest consumer of oil in 2008, using roughly seven million barrels per day (bpd); by way of comparison, the United States consumed roughly 20.8 million bpd in 2008. Although China has significant oil reserves of its own, the country has been a net oil importer since the early 1990s. Assuring adequate energy supplies in coming decades is viewed in Beijing as essential to China’s continued economic growth and national security.

- Data from the Customs General Administration in Beijing indicate that China currently meets about half of its oil demand—that is, roughly 3.6 million bpd—through imports.<sup>7</sup>
- According to China’s Ministry of Commerce, just over half of these imports were sourced from the Middle East in 2008.<sup>8</sup> (The Middle East

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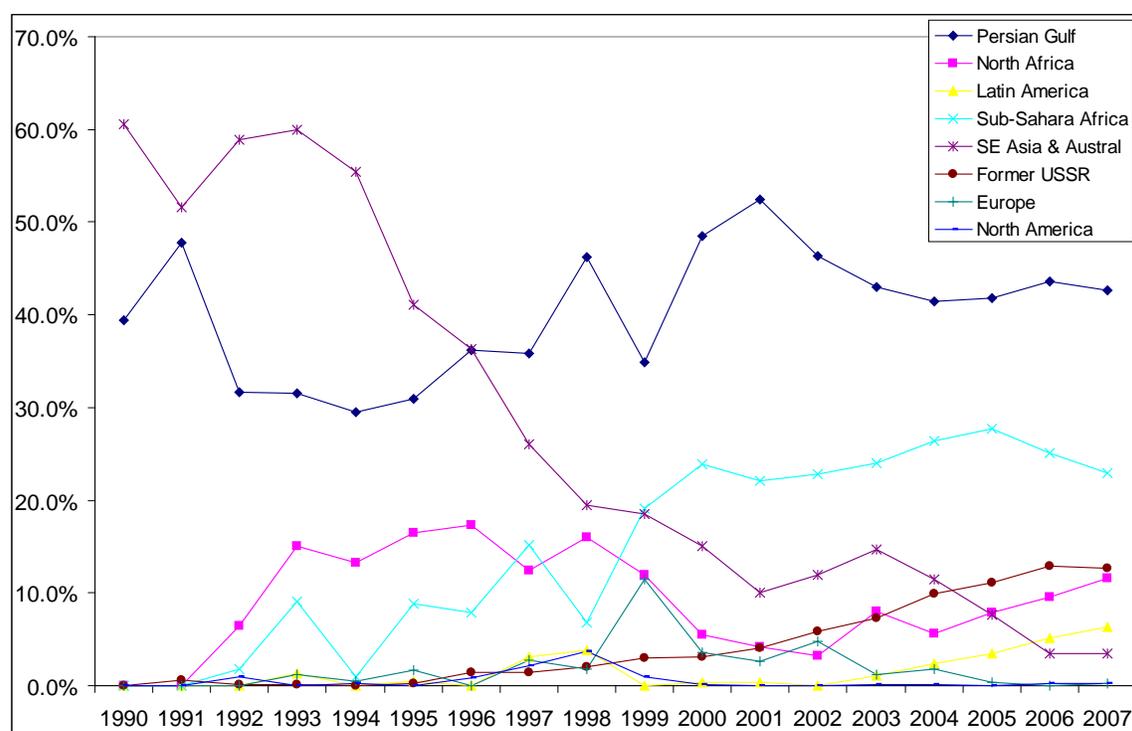
<sup>6</sup> Instead, state-run research institutions were directed to study ways of protecting China’s interests in the Middle East within the framework of “keeping a low profile”.

<sup>7</sup> See Winnie Zhu, “China’s 2008 Oil Imports Rise at Slowest Pace in 3 Years”, *Bloomberg*, January 13, 2009, which also contains a link to data from the Customs General Administration.

has been an important source of oil for the Chinese economy for more than 20 years and, in this decade, has consistently provided more than 40 percent of China's oil imports; see Figure 2.)

- As China's hydrocarbon imports grow in coming years, the Persian Gulf is likely to figure even more prominently in Beijing's external energy strategy.<sup>9</sup>

**Figure 2. Chinese Oil Imports, Sourced by Region**



Source: China Customs Statistical Yearbook [Zhongguo haiguan tongji nianjian] (Beijing: China Customs Bureau, data available through 2007)

<sup>8</sup> "China: 50 percent import crude oil originated from the Middle East", *E-to-China.com*, March 27, 2009.

<sup>9</sup> Although policymakers and strategic planners in Beijing routinely stress the importance of diversifying the sources and transport routes for China's hydrocarbon imports, private conversations with Chinese officials and energy executives suggest there is a widely held consensus in China anticipating that, in 2020, 50-65 percent of the country's oil imports will come from the Gulf.

Today, China accesses Persian Gulf oil largely through supply contracts of varying duration, although China's major national energy companies (NECs) are working to develop upstream equity positions in the region. Beijing has long recognized that, as it seeks to expand Chinese access to the Gulf's hydrocarbon resources, cultivating relations with regional states at odds with the United States—including Saddam Husayn's Iraq and the Islamic Republic of Iran—can be highly advantageous for China's interests.<sup>10</sup> In this context, Iran—which holds the world's second-largest proven reserves of both conventional crude oil and natural gas and is currently the world's fourth-largest oil exporter has come to occupy an especially significant place in China's external energy strategy, giving Beijing multiple motives for expanding its ties to the Islamic Republic.<sup>11</sup>

- China's oil imports from Iran have grown by orders of magnitude over the past 15 years. Beijing established the state-owned Zhuhai Zhen Rong trading company in 1994 to focus on procuring crude oil volumes from Iran; Zhuhai Zhen Rong has become the world's largest purchaser of Iranian crude by company. During the first quarter of 2009, China imported 484,093 bpd from the Islamic Republic—slightly more than a quarter of China's oil imports from the Middle East.<sup>12</sup> In recent years,

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<sup>10</sup> For example, China's first major involvement in an upstream oil project in the Middle East came in June 1997, when CNPC signed a \$1.2 billion agreement with Iraq's Oil Ministry to help develop the Al-Ahdab field in southern Iraq. To a considerable extent, Baghdad's award of this agreement to CNPC was a reward for China's previous opposition to the continuation of economic sanctions against Iraq.

<sup>11</sup> For several years, the *Oil and Gas Journal* has listed Canada as holding the world's second-largest proven reserves of crude oil, estimated at roughly 179 billion barrels, ahead of Iran, with 136.2 billion barrels as of January 2009. However, the *Journal's* estimate of Canadian reserves includes 175 billion barrels of oil sands; thus, it is appropriate to state that Iran holds the world's second-largest proven reserves of conventional oil.

<sup>12</sup> "Iran's major oil customers and energy partners", *Alexander's Gas and Oil Connections* 14:10 (August 7, 2009).

the Islamic Republic has consistently been one of China's three leading suppliers of crude oil (alternating in and out of the top spot with Saudi Arabia and Angola). At least some players in Chinese energy circles anticipate that the Islamic Republic could assume a similarly prominent role in the future as a supplier of natural gas to China (although, as will be discussed below, there are considerable uncertainties associated with such a scenario).

- For senior Chinese military officers and intelligence officials focused on the security of China's energy supplies, Iran is also uniquely important for China's efforts to diversify transportation routes for its oil and gas imports. In this regard, Iran is the only major energy-producing state in the Persian Gulf whose geographic position would permit transport of oil and gas exports to Asian markets *via* pipeline as well as *via* sea routes—an important consideration for Chinese officials and strategic planners concerned about the possible interdiction of China's sea-borne oil imports as they pass through the Straits of Malacca.<sup>13</sup>
- And, by remaining relatively dissociated from the U.S. push for sanctions against Iran, China has been able to expand its own exports to Iran—to the extent of displacing Germany as the Islamic Republic's top trading partner in 2007. Effectively, these exports of machinery and equipment, engineering services, and manufactured products to Iran pay for China's burgeoning imports of Iranian oil.

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<sup>13</sup> As China's NECs—in particular, CNPC—move ahead with the development and expansion of transportation infrastructure to export hydrocarbons from Central Asia to China, the prospect of running pipelines from Iran to connect with Chinese pipelines in Kazakhstan and Turkmenistan is becoming more tangible. However, as will be discussed in the text below, it is not clear that Chinese NECs will make such projects a priority as they develop their own positions in Iran.

For Chinese NECs, Iran is attractive because it is one of the few places in the Gulf where foreign companies have the possibility to access upstream resources directly.<sup>14</sup> Indeed, U.S. and Western efforts to isolate the Islamic Republic mean that Chinese companies have prospectively greater opportunities to pursue business development opportunities there than in many other upstream sectors around the world.<sup>15</sup> Moreover, Chinese NECs may be better positioned than Western companies to operate within the fiscal and contractual regimes that govern foreign investment in upstream oil and gas in Iran. The Islamic Republic's "buy back" system for foreign energy investment will be discussed in the next section; at this point, it should be noted that Chinese NECs typically have lower capital hurdles than Western energy companies and often have access to financing on preferential terms for their overseas investments from state-owned banks in China. These factors

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<sup>14</sup> In this regard, Saudi Arabia and Kuwait continue to bar foreign companies from their upstream oil sectors; Saudi Arabia has allowed foreign companies only limited access to its upstream gas sector, to explore and produce some of the Kingdom's non-associated natural gas reserves. While there was considerable expectation in the industry that post-Saddam Iraq would be open for equity participation by foreign companies in upstream oil and gas projects, this has not materialized outside the Kurdistan Region; the only contracts concluded by foreign energy companies with Iraq's Oil Ministry since 2003 have been service contracts. This is certainly true with regard to CNPC's Saddam-era production sharing agreement to develop the Al-Ahdab field, which was recast last year by Iraq's Oil Ministry into a service contract; see Katherine Zoepf, "Iraq Signs \$3.5 Billion Deal for China to Develop Oil Field", *The New York Times*, November 12, 2008. CNPC's joint agreement with BP to help develop Iraq's Rumaila field, concluded with the Iraqi Oil Ministry in June 2009, is also a service contract; see Hou Lei, "CNPC-BP Consortium Wins Bid for Iraqi Oil Field", *China Daily*, July 1, 2009.

<sup>15</sup> U.S. energy companies are barred from working in Iran by executive orders issued by American administrations since the 1980s. European and other non-U.S. energy companies are not subject to these prohibitions; nevertheless, many of these companies have been constrained in the development of investment positions in the Islamic Republic by concerns over the threatened imposition of secondary sanctions against them by the United States, or by more generalized concerns about reputational risk and potential loss of business opportunities in the U.S. markets. And, as Western concern over Iran's nuclear activities has escalated in recent years, European companies, in particular, have come under mounting pressure from their own governments not to undertake significant new investments in the Islamic Republic's energy sector for the time being. Chinese NECs' efforts to develop business in the Islamic Republic is consistent with their penchant—demonstrated in Burma, Sudan, and elsewhere—for opportunistically pursuing upstream projects that Western companies find unduly risky on political and/or reputational grounds.

may make some upstream deals in Iran acceptable to Chinese NECs that would be rejected by their Western competitors. Impelled by these considerations, all three of China's major NECs have been working since the late 1990s to develop upstream equity investment positions in Iran.

Beyond these energy and economic interests, Beijing also has significant geopolitical interests at stake in its relationship with the Islamic Republic. In this context, Chinese perceptions of "U.S. hegemony run amok" in the Middle East are directly linked to China's strong preference for multipolarity over unipolarity in the international order. From the early 1970s, Beijing has regularly called for the development of a multipolar world order. Throughout the post-Cold War period, Beijing has decried American-dominated unipolarity and extolled the virtues of multipolarity. This conceptual framework helps to shape Chinese views of American hegemony in the Middle East and other regions where Beijing has important interests.

From a Chinese perspective, the Middle East has been a focus of America's drive for global dominance since the 1950s. During the Cold War, U.S. hegemony in the region was restrained by the existence of the Soviet Union. Since the end of the Cold War, however, an "imbalanced" international situation has existed, which has permitted the United States to drive ruthlessly to dominate not only the Middle East but also to expand its influence in Central Asia—where China has increasingly important security, economic, and energy interests and where, in the wake of 9/11, the United States sought to develop military platforms to support its global war on terror. More fundamentally, Chinese analysts and policymakers worry that, if the United States can take advantage of its hegemonic standing to consolidate control over hydrocarbon resources in the Persian Gulf and Central Asia, Washington could use this as leverage to pressure those dependent on access to these resources—Europe, Japan, India, South Korea, and, of course, China. This would move the United States substantially closer to its putative goal of world domination.

Given these concerns, Chinese analysts and the leaders they advise simply do not believe arguments advanced from Washington that American leadership in the Gulf and the “greater Middle East” has contributed to peace and stability in these critical regions. From a Chinese perspective, China’s interest in the stable and uninterrupted flow of Persian Gulf oil has more often been hurt, not helped, by the exercise of American power in the Gulf.<sup>16</sup> Over the years, U.S.-sponsored sanctions have further hampered China’s efforts to expand its share of Middle Eastern oil production *via* participation in upstream exploration and production projects in Iraq and Iran.

While, as was discussed above, Chinese leaders have judged it unwise to challenge America’s hegemonic position in the Persian Gulf directly, Beijing does have an interest in deflecting overly assertive exercises of U.S. hegemony in this critical region. China has long seen Iran as a putative regional power—not only in the Persian Gulf, but also in Central Asia. This makes the Islamic Republic—with its longstanding opposition to U.S. hegemony in both the Gulf and Central Asia—a potentially important ally to Beijing in both of these critical regions. If the U.S. drive for hegemony over these areas fails, that failure will almost certainly leave a regional power—most likely Iran—in a newly dominant position. If China had remained distant from failed hegemonistic efforts by the United States against Iran, and had perhaps subtly supported its resistance to U.S. hegemony, China might enjoy a relationship based on “a tradition of trust, mutual understanding, and cooperation” with that new, regionally-dominant power.

This is one of the reasons that China strongly disapproves of the American desire for—and, many in Beijing suspect, a *sub rosa* policy to

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<sup>16</sup> This is well illustrated, from a Chinese perspective, by the variability in Iraq’s oil exports to China. Following the U.S.-led war in 1991, China imported no oil from Iraq until 1996, when the UN’s Oil for Food (OFF) program began. China’s oil imports from Iraq rose to 3.2 billion tonnes in 2000 before falling to zero again in 2003 as a consequence of the U.S. invasion of Iraq. China’s imports of Iraqi oil have still not returned to their pre-invasion level. Chinese analysts believe that a U.S.-Iran conflict would severely restrict the flow of Iranian oil to China.

encourage—regime change in the Islamic Republic. Many Chinese analysts and diplomats feel that the overthrow of the Islamic Republic and the transformation of Iran into a Western-style liberal democracy is the ultimate, if also unstated, goal of U.S. policy toward Iran. Such a scenario raises deep concerns in Beijing. If a liberal and democratic Iran were joined to a stable, more-or-less democratic, and pro-American Iraq, the United States might actually realize its dream of hegemony over the entire Middle East—including effective control over the region’s oil. Moreover, Chinese analysts and officials are worried that, if Washington succeeded in bringing regime change to Tehran, communist-ruled China would become more vulnerable to U.S. and Western pressure over human rights.

Official Beijing firmly believes that a regional and international environment in which the United States is obliged to accept a diversity of political and social systems serves China’s interests. That perception further reinforces Beijing’s strategic ties to the Islamic Republic. In this context, it is hardly surprising that, following the Islamic Republic’s most recent presidential election on June 12, 2009, China was—even before Russia—the first major power to recognize the results and congratulate incumbent President Mahmoud Ahmadinejad on his re-election.

More symbolically, a certain measure of Chinese resistance to “U.S. hegemony run amok” in the Middle East is a significant element in China’s “soft power” appeal in the region. Frank expressions of Beijing’s dark analysis of U.S. purposes and policies make China popular in many quarters in the Middle East. Like diplomats everywhere, China’s representatives couch their arguments to suit their audiences. Middle Eastern governments and groups opposed to or skeptical about U.S. policies undoubtedly take heart from China’s views of U.S. policy expressed during a “frank exchange of views on international and regional issue of mutual concern”. Some Middle Eastern governments—including the Islamic Republic—see China as a potential counterweight to the United States. Even those regional governments that

understand China's reluctance to confront the United States—and, again, the Iranian government falls into this category—may hope that China's stance will change as its capabilities grow. From such a standpoint, investment now in cultivating China's goodwill may pay off later. Or, Beijing may use its leverage with Washington—perhaps as a result of U.S. needs for China's cooperation in the United Nations Security Council—to influence U.S. policy in ways mutually desired by Beijing and Tehran.

Additionally, the legitimacy of the Chinese Communist Party (CCP) at home depends to some degree on propagating a sinister and gloomy view of the world, especially regarding the aims of the United States in regions such as the Middle East. Currently, the CCP's most powerful source of legitimation is the argument that it is making China rich and powerful. The steady “rise of China” over recent decades has addressed a century-old longing of the Chinese people for high international status, and the CCP argues that China's current “rise” demonstrates the wisdom of CCP rule. But, as China has opened and reformed, there is an increasingly close link between putatively too weak diplomacy and domestic criticism.

Thus, perceived government weakness in dealing with Japan played a role in the student demonstration of 1986 that fed eventually into the student movement of 1989. Incipient student demonstrations in 1999, after news of the U.S. bombing of the Chinese embassy in Belgrade reached China, led the government to adopt a much harder position than initially planned. In the Middle East, China's decision to contribute 1,000 troops to the Lebanon PKO and the casualties associated with that deployment, its decision in 2007 to support the deployment of a hybrid African Union-UN peacemaking force to Sudan, and its endorsement of two Security Council resolutions (to be discussed below) imposing sanctions on Iran all precipitated criticism on Chinese websites.

In this context, propagation of a negative public image of U.S. policy in the Middle East serves to mobilize popular support for the CCP. The subtext

of this propaganda runs as follows: look how terrible and dangerous the United States is; if China is not vigilant and strong, if it is “divided” or not under the leadership of a tough-minded group like the CCP, it too will fall prey to U.S. “hegemonism”. An overly radical departure from China’s long tradition of independence from the United States and other foreign powers, or deviations from the principles of support for developing countries, support for non-interference in the internal affairs of other countries, and opposition to “hegemonism” in international affairs could leave the CCP leadership vulnerable to domestic criticism. (In the context, it is striking how many Chinese diplomats and CCP officials express satisfaction over the launch of *Al Jazeera*’s English-language network, AJE, which is available in China. From a Chinese perspective, it seems, AJE is seen as a preferable alternative to CNN.)

### **Tehran’s “Eastern Orientation”**

As China has worked to balance its posture in the Middle East and, more specifically, toward Iran between the two horns of its Persian Gulf dilemma, the Islamic Republic has made China the centerpiece of an increasingly prominent “Eastern orientation” in its foreign policy. Against a backdrop of disappointment with Tehran’s efforts since the end of the Cold War to cultivate diplomatic openings with the United States and Europe, Iranian foreign policy in this decade has turned increasingly toward the cultivation of strategic relationships with rising Asian powers—China first among them.

The emergence and evolution of an Eastern orientation in Iranian foreign policy needs to be understood in the broader context of the Islamic Republic’s diplomatic strategy. Fundamentally, the conceptual frameworks for Tehran’s foreign policy and national security strategies are grounded in perceived imperatives associated with Iran’s geostrategic location. Iran shares territorial boundaries with seven states (Pakistan, Afghanistan, Turkmenistan, Azerbaijan, Armenia, Turkey, and Iraq), maritime boundaries

with six others (Kuwait, Qatar, Bahrain, the United Arab Emirates, Saudi Arabia, and Oman), and boundaries cutting across the Caspian Sea with Russia and Kazakhstan. And, according to an assessment that is widely shared among elites across the Islamic Republic's political spectrum, not one of these 15 "neighbors" is a natural ally of Iran.

Since the end of the Iran-Iraq war in 1988 and the death of Grand Ayatollah Ruhollah Khomeini, the Islamic Republic's "founding father", in 1989 (ironically, on the same night that Chinese military forces moved to crush the Tiananmen demonstrations in Beijing), this assessment has moved Iranian foreign policy in a progressively less ideological and more interest-based direction. As one of the Islamic Republic's most prominent scholarly commentators on international affairs (and a former Deputy Foreign Minister) has written, "Following the war with Iraq, the urgent need for reconstruction and the necessity of social and economic development to meet the needs of a young population led policymakers to focus more on material national interests in all areas. In foreign relations this was expressed in an emphasis on expanding trade and attracting investment through the development of mutually beneficial state-to-state relations and integration into the global economy."<sup>17</sup>

In practical terms, the shift toward greater pragmatism in Iranian foreign policy has had two important consequences: 1) a stronger emphasis on building strategic relationships with "great powers" outside the Middle East, and 2) greater attention to improving relations with states in Iran's immediate neighborhood. Both of these developments have helped to shape the Eastern orientation in the Islamic Republic's foreign policy, especially with regard to China. In seeking to cultivate closer ties to Beijing, Iran has relied, first of all, on its potential to supply oil and natural gas to meet China's burgeoning energy demand. Secondarily, Tehran has sought to

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<sup>17</sup> Abbas Maleki, "Iran's Regional Foreign/Energy Policy", *POLITIKA*, 2007.

leverage its potential to act as a partner to Beijing as China seeks to protect its expanding interests in regions where the Islamic Republic has significant influence—most notably, in Central Asia.

*“Great power” relations.* Since the early 1990s, the Islamic Republic has placed a higher priority on forging positive ties to “great powers” outside the Middle East—countries that could support Tehran’s efforts at postwar reconstruction, long-term economic development and modernization, and realizing Iran’s enormous potential as an exporter of oil and natural gas. Positive relations with such countries could also help the Islamic Republic address its core national security challenges.<sup>18</sup>

In this regard, the Soviet Union’s demise in 1991 had deprived Tehran of the option of “balancing” between the two Cold War superpowers—at precisely the point at which, from an Iranian perspective, American policy toward the Islamic Republic became increasingly hostile.<sup>19</sup> During the presidencies of Ali Akbar Hashemi Rafsanjani (who served for two terms, from 1989 to 1997) and Mohammad Khatami (who also served two terms, from 1997 to 2005), the Islamic Republic intermittently pursued a diplomatic opening to the United States, but these efforts were almost wholly unsuccessful, in any strategically meaningful sense.<sup>20</sup> Consequently, under Rafsanjani and Khatami, Iran sought a separate diplomatic opening to Europe (and to Japan as well); while this effort was somewhat more successful, it did not, in the end, result in the consolidation of a strategically

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<sup>18</sup> In this context, Anoush Ehteshami usefully refers to the “three Gs” of Iran’s post-Cold War foreign policy—“geopolitics, geostrategic instabilities, and globalization”; see Ehteshami, “The Foreign Policy of Iran” in Raymond Hinnebusch and Anoush Ehteshami, eds., *The Foreign Policies of Middle Eastern States* (Boulder, CO: Rienner, 2002).

<sup>19</sup> On this point, see Maleki, “Iran’s Regional Foreign/Energy Policy”.

<sup>20</sup> For discussion of these efforts, see Flynt Leverett, *Dealing With Tehran: Assessing U.S. Diplomatic Options Toward Iran* (New York: The Century Foundation, 2006).

and economically productive partnership between Europe and the Islamic Republic.

These outcomes have given Iran an ever more urgent interest in forging strategic relationships with “alternative”, non-Western powers. To that end, Tehran began cultivating an increasingly strategic relationship with Moscow in the late 1980s—even before the final collapse of the Soviet Union—and continued doing so after the Soviet Union had given way to the Russian Federation. When Russia began to experience challenges from separatist movements in Chechnya and elsewhere, Iran—in contrast to other major Islamic countries such as Saudi Arabia—took a “pro-Russian” line, consistently describing the war in Chechnya as an “internal” Russian affair.<sup>21</sup> Likewise, Iranian foreign policy turned toward the cultivation of strategic relationships with rising Asian powers, with a special focus on China.

For Iran, the prospective strategic, political, and economic advantages of closer ties to China are significant. Even before the “pragmatic turn” in Iranian foreign policy described above, the Islamic Republic began developing its relations with China in the 1980s, when China was one of the few external powers willing to supply Iran with weapons and equipment. (Of course, China also supplied Iraq with weapons and military equipment during the war.) China remains Iran’s second-largest military supplier, after Russia, providing the Islamic Republic with a wide range of ordinary and advanced conventional weapons and military equipment. And, while China has become less willing to supply sensitive military technology to Iran, as was discussed in the preceding section, Tehran almost certainly calculates that Beijing might play such a role again.

As Tehran has come under increased international pressure over its nuclear activities and other issues, the support of a permanent member of the

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<sup>21</sup> On Iranian policy regarding the Chechen conflict, see, *inter alia*, William Samii, “Iran and Chechnya: Realpolitik at Work”, *Middle East Policy* 8:1 (March 2000) and Clément Therme, “Tehran and the Chechnya Question”, *Caucas.com*, September 26, 2006.

UN Security Council could provide much needed international political cover, especially *vis-à-vis* the United States. Looking ahead, Iranian elites clearly see China as a rising power—indeed, as perhaps the only rising power that might eventually be able to displace the United States from its current hegemonic position in international affairs. Beijing’s longstanding preference for a multipolar international order and emphasis on sovereignty and non-interference in states’ internal affairs make China a relatively attractive strategic “pole” for the Islamic Republic.<sup>22</sup>

On the economic front, China has become and is highly likely to remain the most important marginal market for Iran’s exports of crude oil during the next quarter century. Iran’s top four export markets for its crude oil production are all in Asia—Japan, China, India, and South Korea, in descending order (see Figure 3). While, for now, Japan remains the Islamic Republic’s leading market for oil exports, it is widely anticipated in Iranian energy circles that demand growth in China will eventually push China ahead of Japan as the biggest purchaser of Iranian crude. (As was noted in the preceding section, China has already surpassed Japan to become the world’s second-largest oil consumer, after the United States.)

**Figure 3. Iran’s Leading Oil Export Markets, 2009 (Q1)**

<u>Country</u>	<u>Oil Purchases from Iran (bpd)</u>
Japan	519,518
China	484,093
India	426,360
S. Korea	244,989

Source: “Iran’s major oil customers and energy partners”, *Alexander’s Gas and Oil Connections* 14:10 (August 7, 2009)

<sup>22</sup> On these points, see also Afsaneh Ahadi and Nasser Saghafi Ameri, *Iran and “Look to the East” Policy* (Tehran: Center for Strategic Research, 2008).

Furthermore, China has the wherewithal to inject sorely needed investment capital into the expansion and modernization of Iran's upstream oil and gas sectors, as well as other sectors of the Iranian economy. As was noted in the preceding section, the Islamic Republic holds the world's second-largest proven reserves of both conventional crude oil and natural gas. According to the *CIA World Factbook*, Iran produces roughly 4.7 million bpd, making it the world's fourth-largest crude oil producer.<sup>23</sup> From that production, Iran exports roughly 2.8 million bpd, making it the world's third-largest oil exporter.<sup>24</sup>

However, when Iran's current production levels are measured against the country's resource base, it is hard to avoid the conclusion that the Islamic Republic is "underperforming" as an oil and gas producer.

- The National Iranian Oil Company (NIOC) is struggling to maintain its current levels of oil production. The International Energy Agency and a range of industry experts estimate the natural rate of decline in Iran's crude oil production at 8-11 percent per year.<sup>25</sup> In recent years, as various phases of Iran's mammoth South Pars gas field have been commissioned, the NIOC has captured more condensates from natural

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<sup>23</sup> To compare Iran's production of 4.7 million bpd against the output of the world's top three oil producers, Russia currently produces almost 10 million bpd, Saudi Arabia produces around 9.2 million bpd (Saudi production has dropped below that of Russia as a result of OPEC production cuts), and the United States produces almost 8.5 million bpd. The fifth-largest oil producer in the world is China, which produces approximately 3.7 million bpd.

<sup>24</sup> To compare Iran's oil exports of 2.8 million bpd against those of the world's top two oil exporters, Saudi Arabia currently exports roughly 8.2 million bpd and Russia exports roughly 5.2 million bpd. The fourth-largest oil exporter in the world is the United Arab Emirates, which exports roughly 2.7 bpd.

<sup>25</sup> See International Energy Agency, *World Energy Outlook 2008* (Paris: International Energy Agency, 2008). For a representative view from an industry consultant, see Fereidun Fesharaki, "Outlook for Global Oil Markets After the Great Recession, With Perspective on China and Iran", Presentation to the Center for Strategic and International Studies, Washington, DC, September 16, 2009.

gas production, enabling the Islamic Republic to keep its overall level of “liquids” production (including both crude oil and natural gas condensates) relatively steady.

- Iran currently produces roughly 112 million cubic meters of natural gas per year, making it the world’s fourth-largest gas producer. However, the country uses large amounts of its gas production for re-injection into its aging oil wells to slow the ongoing decline in crude oil production from its older oil fields, and domestic demand for natural gas has been rising rapidly in recent years. Consequently, the Islamic Republic is, today, a net importer of natural gas.

For at least a decade, Iranian officials and energy planners have announced ambitious plans to raise the Islamic Republic’s production of crude oil and natural gas, establish Iran as a major exporter of natural gas through both pipelines and maritime shipments of liquefied natural gas (LNG), expand Iran’s petrochemical sector, and develop a wide range of gas-based industries. To accomplish these objectives, however, Iran will need substantial infusions of capital and technology from beyond its borders.<sup>26</sup> In this regard, a combination of sub-optimal Iranian policy regarding foreign investment and challenges imposed from abroad has severely retarded the flow of foreign capital and technology into the Islamic Republic’s oil and gas sectors.

Domestically, the biggest obstacles to foreign investment in Iranian energy projects are rooted in the Islamic Republic’s so-called “buy back” system. Under this system, the contracting company typically funds all investments to develop a new or existing field and is compensated through a

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<sup>26</sup> The International Energy Agency has estimated that Iran will need to attract at least \$160 billion of investment capital into its upstream oil and gas sectors during the next quarter century.

share of the field's production that is supposedly sufficient to give the contract a guaranteed rate of return on its investment. Once the contract is completed, operation of the field passes back to the NIOC.<sup>27</sup> Although buy back arrangements are supposed to provide incentives to attract foreign energy companies to invest in Iran, European and other non-U.S. energy companies involved in negotiations with the Islamic Republic's Ministry of Petroleum and the NIOC over the past decade and a half identify a number of problems in the system that have helped to limit inward flows of investment. These problems include the relatively short duration of buy back contracts, which undermines long-term investment planning; foreign companies' status as service providers to the NIOC under buy back contracts, which means that they usually cannot report any of the oil and/or gas deposits they are developing as "booked" reserves; and obligations to give local Iranian contractors 30 percent or more of the total contract value, which reduces total returns for the contracting company.

Iran's strained international position also acts to deter potential foreign investors in Iranian energy projects. As was noted in the previous section, many European and other non-U.S. energy companies have been reluctant to develop investment positions in the Islamic Republic by concerns over possible imposition of secondary sanctions by the United States or more generalized concerns about reputational risk and potential loss of business opportunities in the U.S. market.<sup>28</sup> These considerations have been reinforced more recently by direct exhortations from European governments

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<sup>27</sup> The buy back system grows out of the Islamic Republic's constitution, which explicitly prohibits foreigners from holding ownership rights to Iranian oil or gas reserves. This constitutional provision has, from early on, been interpreted to mean that foreigners could not be offered production-sharing agreements or other forms of "risky" investment contracts as the basis for their participation in monetizing Iranian hydrocarbon reserves. The buy back system is an attempt to square Iranian constitutional provisions with the imperatives of attracting foreign investors into the Islamic Republic's energy sector.

<sup>28</sup> See footnote 15.

to European energy companies not to undertake substantial new investments in the Islamic Republic for the time being.

Under these circumstances, Iran has been able to attract only a fraction of the foreign investment it needs to optimize its energy sectors' performance. Since the Islamic Republic opened its oil and gas sectors to participation by foreign energy companies in the early 1990s, within the parameters of the buy back system, it has attracted only \$15-\$20 billion in investment from Europe and Japan into Iranian energy projects. Moreover, as the nuclear issue has heated up, prospects for increased Western investment have virtually evaporated for the foreseeable future. These conditions have prompted a growing sense in Iranian decision-making circles that, as a senior Iranian diplomat said privately, Tehran cannot "wait on the West" forever.<sup>29</sup> And that is making Chinese NECs increasingly attractive prospects to partner with the NIOC in various Iranian energy projects.

To be sure, this has been a controversial issue within Iranian policymaking circles. Policymakers and energy planners with a more technocratic perspective are skeptical about the technical sophistication and experience of Chinese NECs; for example, no Chinese company is able at this point to develop LNG trains, which have been a key part of Tehran's plans for the Islamic Republic to emerge as a major gas exporter. This more technocratic camp would prefer for the NIOC to work with Western, and especially American, partners. But that would require an opening to the West of a scale and scope that does not seem likely in the foreseeable future. Over time, policymakers and energy planners with more nationalist and/or strategic perspectives have had greater political "space" to argue for expanding the NIOC's partnerships with Chinese (and other non-Western) energy companies.

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<sup>29</sup> See Flynt Leverett, "The Race for Iran", *The New York Times*, June 20, 2006.

On balance, the trend within Iranian policymaking circles is one of ever greater willingness for the NIOC to work with Chinese NECs. Indeed, there are indications that Tehran is now prepared to offer Chinese companies somewhat better terms than those traditionally contained in the NIOC's buy back contracts; these better terms reportedly include more flexibility in fiscal terms, shorter payback periods, and a slightly higher rate of return for contractors.<sup>30</sup> (As will be discussed in the next section, this trend toward greater willingness to work with Chinese NECs appears to be associated with other significant shifts in the Islamic Republic's long-term strategy for monetizing its hydrocarbon reserves—e.g., moving away from large LNG projects as the principal vehicle for establishing Iran as a major gas exporter and instead focusing on the development of pipeline projects.)

*Regional relations and Central Asia.* As was noted above, in working to forge closer ties to Beijing, Iran has relied primarily on its potential to meet China's expanding energy needs to draw China into a deeper relationship. But Tehran has also sought to leverage its influence in Central Asia to bolster cooperative links with Beijing. Since the end of the 1980s, Tehran has placed a higher priority on improving relations with potentially problematic states in Iran's immediate neighborhood—including the Caucasus and Central Asia.<sup>31</sup> In Central Asia, the improvement in Iran's

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<sup>30</sup> On this point, see Fesharaki, "Outlook for Global Oil Markets After the Great Recession, With Perspective on China and Iran".

<sup>31</sup> On this point, see, *inter alia*, Maleki, "Iran's Regional Foreign/Energy Policy" and Kayhan Barzegar, "The Geopolitical Factor in Iran's Foreign Policy", *Viewpoints: The Iranian Revolution at 30*, Special Edition (January 2009). At the same time that Tehran has pulled back from campaigns launched during the 1980s to "export" the Islamic revolution to other countries in Iran's neighborhood, it has made the cultivation of ties to political factions (in many cases, with associated militias) in neighboring states—so as to give Iran "proxies" through which to influence political and security decision-making by these states—a cardinal tenet of its national security doctrine. On this point, see Hillary Mann Leverett, "Think Again: Talking With Iran", *Foreign Policy.com*, February 2009 and "Iran and Thou: Productive Dialogue with Iran is Possible", *The National* (Abu Dhabi), February 13, 2009.

relations with other regional states has cut across both economic and political issues. A focus on improving relations with Central Asian states is further reflected in Tehran's emphasis on regional multilateralism. This multilateral impulse is manifested in Tehran's prominence in the Organization of the Islamic Conference—where, among other things, Iran has staked out a relatively moderate position on the Chechnya conflict. It is also manifested in Iran's advocacy for greater regional economic cooperation, including Tehran's leadership in 1992 to bring Azerbaijan, Afghanistan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan into the Economic Cooperation Organization (ECO, which was founded in 1985 by the Islamic Republic, Pakistan, and Turkey).

Additionally, Iranian officials and foreign policy strategists have been concerned about threats to the Islamic Republic's interests emanating from the relative weakness of most states in the Caucasus and Central Asia<sup>32</sup>, as well as by the dissemination of radicalized Sunni extremism that threatens Shi'a interests in the region at least as much as it threatens U.S. interests. Thus, during the 1990s, Iran was one of the principal supporters of Afghanistan's Northern Alliance in its struggle to fend off the expansion of Taliban control there. At the same time, Iran cooperated with Russia to ensure that the United States and its partners were not able to take advantage of the Soviet Union's demise to establish a strategic foothold in these regions; Tehran also worked, in a non-ideological and interest-driven way, to support Armenia in its conflict with Azerbaijan over Nagorno-Karabakh and mediate Tajikistan's civil war.<sup>33</sup> And, while Iran was not

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<sup>32</sup> These threats include not only the potential for regional states to be used as platforms by the United States and its Western allies to press Iran, but also the risk of intra-state conflict and associated humanitarian crises, the danger that nationalist sentiment among the region's many ethnic minorities could influence some of Iran's own minority communities, the spread of armed criminal networks, and narcotics trafficking.

<sup>33</sup> On these episodes in Iranian foreign policy, see, *inter alia*, Kaveh Afrasiabi and Abbas Maleki, "Iran's Foreign Policy After 11 September", *Brown Journal of World Affairs* 9:2

included among the founding members when the Shanghai Cooperation Organization (SCO) was established in 2001, it obtained observer status in the SCO in 2005 and has applied for full membership.<sup>34</sup>

These developments have made the Islamic Republic a significant actor in Central Asia's regional affairs, with a policy agenda emphasizing opposition to efforts by extra-regional powers—e.g., the United States—to consolidate hegemonic influence in the area. This posture has given Tehran a geopolitical “card” to “play” in forging closer relations with Beijing—alongside Iran's massive hydrocarbon reserves.<sup>35</sup> Iranian diplomats believe that Tehran's approach to Central Asian issues gives the Islamic Republic a “soft power” edge over other major Persian Gulf energy producers—especially Saudi Arabia, with its long record of support for the dissemination of an intensely *salafi* form of Sunni Islam—in cultivating links to China. (Such an approach to Islam is supposedly more likely to spark politically-oriented Islamist movements.) And, in this regard, Tehran's overriding respect for Russia's sovereignty and territorial integrity in defining its policy on the Chechnya conflict, for example, is positively viewed in Beijing. Similarly, the Islamic Republic's pullback from earlier efforts to “export” the Islamic revolution to other Muslim countries contrasts favorably, in Beijing's eyes,

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(Winter/Spring 2003) and Abbas Maleki, “Iran's Asian Identity” in Amrots Novikova, ed., *Regional Security Issues* (Yerevan: Amrost Group, 2007).

<sup>34</sup> The SCO was originally founded by Russia and China, along with Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan. In addition to these six core members, four other states—India, Mongolia, and Pakistan, as well as the Islamic Republic—now have observer status. Current and former Iranian diplomats say that participation in the SCO is important to the Islamic Republic's interests for at least three reasons: 1) a regional security framework for Central Asia that excludes the United States is consistent with longstanding Iranian objectives; 2) participation gives Iran a channel through which to ensure that its interests and perspectives on regional security and stability are taken into account in the SCO's deliberations; and 3) participation reduces Iran's international isolation in a high-profile way that underscores America's diminishing influence in part of the Islamic Republic's “neighborhood”.

<sup>35</sup> Of course, Tehran “plays” its Central Asian “card” with Moscow, as well.

with Saudi Arabia's ongoing funding of Wahhabi proselytization throughout the Muslim world—including Central Asia.

*Developing the Eastern orientation.* A policy of forging better relations with Beijing has enjoyed consistent support from the Islamic Republic's foreign policy decisionmakers, under President Rafsanjani, President Khatami, and, now, President Ahmedinejad. Indeed, for Ahmadinejad—who seems to disdain Europe almost as much as the United States and has spoken openly about the imperative for Iran to forge strategic alliances with strong, non-Western countries—the “China option” in Iranian foreign policy seems especially attractive. And, of course, the cultivation of closer ties to China has been backed by Ayatollah Ali Khamenei, the Islamic Republic's Supreme Leader since Khomeini's death in 1989.

Overall, the trend has been and continues to be toward ever greater prominence for the Eastern orientation in Iranian foreign policy—to a point where Ahmadinejad's appointee as Foreign Minister, Manouchehr Mottaki, stated early in his tenure that Iran's foreign policy now seeks to define an “Asian identity” for the Islamic Republic. Given the prospective strategic, political, and economic benefits associated with an opening to China, Iran will keep following an Eastern orientation in its foreign policy for the foreseeable future. To what extent and at what pace Sino-Iranian relations develop will largely be a function of decision-making in Beijing.

### **Striking a Balance—China and the Iranian Nuclear Issue**

Over the years, Beijing has attempted to downplay the tensions between its interest in maintaining Sino-American comity and its interest in developing closer ties with Persian Gulf states by taking what Chinese officials describe as a “principled stance”. In Beijing's representations, China's links with Persian Gulf states—and with other “third world” or “developing” countries—are independent of China's ties to the United States. China seeks to make

friends, its representatives say, with *all* countries—including the United States and Persian Gulf states that might be in conflict with Washington. It is not fair for Washington to insist that China pick sides in conflicts between the United States and America's regional rivals in the Gulf, Beijing argues. China's relations with various Persian Gulf states should be based on the interests and views of the governments of China and those Gulf states, not on the interests and views of the U.S. government. Thus, conflicts between particular Persian Gulf countries and the United States should not hinder the development of friendly and mutually beneficial economic cooperation between China and those countries.

Of course, this argument both reflects and serves China's interest in avoiding overly stark choices between the two horns of its Persian Gulf dilemma. But the argument will work only if Americans can be persuaded to accept it. The problem for China is that the strategic stakes in the Gulf for both Beijing and Washington have risen to a point where the Chinese argument of "making friends with all countries" is becoming less and less persuasive to U.S. policymakers, particular when "friendly cooperation" entails Chinese ties to U.S. rivals like the Islamic Republic of Iran.

In reality, China has been and will continue to be compelled to strike a balance in its foreign policy between an interest in maintaining Sino-American comity and the development of its relations with Iran. This reality has important implications for the manner in which China has developed its relationship with the Islamic Republic. In the early 1990s, for example, China declined invitations to work with Tehran to play a more prominent role in checking U.S. influence in the Middle East. At a time when Sino-American relations had hit a post-Tiananmen low and China was actively helping Iran develop nuclear, cruise missile, and ballistic missile capabilities, Iranian leaders proposed that Tehran and Beijing work together to push the United States from the Persian Gulf and East Asia. Beijing gently indicated its disinterest in this proposal. Similarly, Tehran urged China to use its

Security Council seat to support the Palestinians against Israel and the United States, even to the extent of seeking Israel's expulsion from the United Nations. China declined and, in 1992, recognized Israel.<sup>36</sup>

Overall, Chinese leaders have been careful not to let their cultivation of better relations with Iran put China in the position of appearing to challenge America's regional hegemony directly. Since the turn of the millennium, however, three developments since the turn have made China's "balancing act" regarding its relations with Iran ever more challenging.

- China's national power—in the most comprehensive sense of the word—has grown rapidly during this decade. That has engendered a sense of greater urgency, in Beijing and Washington alike, about the critical importance of long-term Sino-American cooperation across a wide range of economic, political, and strategic arenas.
- At the same time, the George W. Bush Administration's invasion of Iraq in 2003 seemed to mark a turn toward increasingly direct, costly, and risky confrontations by the United States with its Persian Gulf rivals. This turn was associated with both an elevation in the perceived risk of U.S. military action against Iran and heightened U.S. elicitation of Chinese support for American policy goals in the region.
- Additionally, China's own involvement in the Gulf—as both a consumer of the region's oil and a trading and development partner for various Gulf states—has increased dramatically since the beginning of this decade. This has deepened Chinese awareness of China's independent interests in the region, at a time when China's relative power *vis-à-vis* the United States is increasing in a number of arenas.

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<sup>36</sup> On these episodes, see Garver, *China and Iran*.

Increasingly, the force of China's Persian Gulf dilemma with regard to the development of Sino-Iranian relations is focused on the Iranian nuclear issue. As this issue has risen in salience, Beijing has balanced cooperation with Washington to pressure Tehran over its nuclear activities with support for Tehran against U.S.-led international pressure. This mix of support for and opposition to U.S. moves reflects the mix of China's interests regarding the Iranian nuclear issue. On the one hand, there are at least three important Chinese interests that impel Beijing toward cooperation with the United States on this issue:

- *Preventing the proliferation of nuclear weapons.* As was noted in the first section, Beijing has increasingly understood the importance of non-proliferation to Washington. Moreover, as one of only five nuclear weapons states under the NPT, China's elite status would be diluted by the proliferation of nuclear weapons to more states.
- *Securing international recognition as a responsible power upholding international regimes.* Beijing recognizes the widespread international support for the NPT regime and appreciates that being perceived as a responsible power upholding rather than undermining that regime will help China accrue greater international respectability. Securing such recognition from Europe and the Asia-Pacific community is perhaps as important for China as recognition by the United States.
- *Expanding strategic cooperation with Washington to stabilize the Sino-American relationship,* thereby solidifying a favorable macro-climate for China's development drive.

On the other hand, while Beijing and Washington both oppose the proliferation of nuclear weapons in the Middle East, this objective is far less weighty for Beijing than it is for Washington. The potential effects of nuclear proliferation in the Persian Gulf on Chinese interests and on American interests are, in fact, quite different:

- *China, unlike the United States, does not have any allies in the Middle East.* The United States has security obligations to many Middle Eastern states—Israel, Saudi Arabia, Kuwait, Jordan, Egypt, Bahrain, and Turkey. Not only could these U.S. allies be threatened by Iranian possession of nuclear weapons, but U.S. obligations to these countries might draw America directly into a conflict. China, on the other hand, has carefully avoided extending deterrent support to its Middle Eastern friends. (Pakistan—not really a Middle Eastern state—is the only partial exception to this generalization.) This also means that China, unlike the United States, does not have a military presence in the Middle East that might become the target of nuclear-armed states in the region.
- *China, unlike the United States, has consistently enjoyed good relations with Persian Gulf states aspiring to nuclear weapons—e.g., Iraq under Saddam Husayn and the Islamic Republic of Iran.* China has not become entangled in bitter conflicts with Iraq, Iran, or any other Middle Eastern state that might aspire to nuclear weapons. Whereas the United States has been locked in deep conflict with Iran since 1979, and with Iraq between 1990 and 2003, China has sustained friendly, cooperative relations with these and all other Middle Eastern regional powers.

- *China has not undertaken to guarantee the uninterrupted flow of oil from the Persian Gulf—a responsibility that the United States has assumed since the promulgation of the Carter Doctrine in 1979.*

Regarding a guarantee for Persian Gulf security, China's declared preference is that regional powers, not extra-regional powers, should handle the matter.

The argument here is not that Beijing would welcome or actively seeks the emergence of a nuclear-armed Iran, but, rather, that Beijing does not feel compelled to act as forcefully as Washington to prevent the Islamic Republic from acquiring nuclear weapons. For Washington, preventing the proliferation of nuclear weapons in the Persian Gulf is a very important objective. For Beijing, it is desirable, but far less vital. The prospect of a nuclear-armed Iran is simply not as gloomy and frightening for Beijing as it is for Washington.<sup>37</sup> And that leaves China free to balance its interest in maintaining Sino-American comity (including through cooperation with the United States on non-proliferation) against other interests at stake in its relationship with the Islamic Republic.

Thus, China's decisional calculus regarding the Iranian nuclear issue is complex, balancing a range of potentially conflicting interests over multiple time frames. Chinese diplomats and Party officials describe Beijing's policy on the Iranian nuclear issue as seeking to balance six different interests: regional stability, a secure supply of oil, securing China's northwest border (meaning Xinjiang province), the development of Sino-American relations, the development of Sino-Iranian relations, and the positions of Europe and

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<sup>37</sup> Arguably, a nuclear-armed Iran could even offer geopolitical benefits to China. Assuming that Iranian nuclear weapons would deter or constrain the U.S. use of military power against Iran, a nuclear Iran would weaken the U.S. position *vis-à-vis* the Islamic Republic, thereby reducing America's ability to control Persian Gulf oil. If a nuclear-armed Iran emerged as the dominant power in the Persian Gulf and achieved that position with a degree of Chinese support and understanding, Beijing could find itself a friend that newly-dominant power.

Russia.<sup>38</sup> To understand the evolution of China's balancing act on this issue, it is useful to divide the historical record into two periods: 2003-2007 and 2007-present.

*China and the Iranian nuclear issue, Stage I: 2003-2007.* In the first few years after the Iranian nuclear issue rose to the top of America's foreign policy agenda, Beijing's efforts to balance the various interests at stake in its decisional calculus produced a number of discernible patterns in Chinese policy:

- China consistently questioned allegations that the Islamic Republic is actually seeking to develop nuclear weapons.
- China consistently defended Iran's right to peaceful applications of nuclear energy.
- China consistently emphasized the importance of, and its own commitment to, the peaceful resolution of disputes.
- China consistently tried to retard, but not necessarily to block, the application and escalation of multilateral pressure on Iran over its nuclear activities.
- China consistently worked to keep the Iranian nuclear issue within multilateral fora—first, the International Atomic Energy Agency (IAEA), and, later the United Nations Security Council—where Beijing's influence would be enhanced.

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<sup>38</sup> For additional discussion of China's multi-tiered calculation about the Iranian nuclear problem, from a prominent Chinese analyst, see Dingli Shen, "Iran's Nuclear Ambitions Test China's Wisdom", *The Washington Quarterly* 29:2 (Spring 2006).

- China generally was content for Russia to be “in front” in resisting specific measures proposed by the United States and its European partners (although, as will be discussed below, Beijing has become increasingly willing to come out from under Russia’s political “cover” to defend particular Chinese interests that could be adversely affected by international sanctions).

As U.S. concern about Iran’s nuclear activities has intensified in recent years, the Iranian nuclear issue has become an increasingly salient issue on the Sino-American diplomatic agenda. During the George W. Bush Administration’s second term, Chinese cooperation on the Iranian nuclear issue quickly became a central element in U.S. proposals put forward in the so-called “Senior Dialogue” that was launched in August 2005.<sup>39</sup> In a speech delivered to the National Committee on U.S.-China relations in New York the following month, Deputy Secretary of State Robert Zoellick placed U.S. calls for expanded cooperation with China in a broader historical and policy context.<sup>40</sup> The “essential question for the United States and the world”, Zoellick said, was “how will China use its influence”. Would China become a “responsible stakeholder” in the international system? “We need to urge China to become a responsible stakeholder” and use its growing influence to “strengthen the international system that has enabled its success” at development. Turning more specifically to the Iranian nuclear issue, Zoellick said, “China’s involvement with troublesome states indicates at best blindness to consequences and at worst something more ominous...China’s

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<sup>39</sup> In the fall of 2005, when Presidents Hu Jintao and George W. Bush met at an APEC summit, Hu suggested high-level discussions regarding the strategic framework for Sino-American relations. The idea for an ongoing “Senior Dialogue” evolved from Hu’s original proposal.

<sup>40</sup> Robert Zoellick, “Whither China: From Membership to Responsibility?”, National Committee on U.S.-China Relations, September 21, 2005, New York City.

actions on Iran's nuclear program will reveal the seriousness of China's commitment to non-proliferation".

The second Senior Dialogue met in Washington three months after Zoellick's New York speech, in December 2005. Vice-Minister of Foreign Affairs Dai Bingguo and Zoellick sought to "identify mutual interests and guide" cooperation in a number of areas; Iran was one of the challenges discussed. The two sides discussed their "overlapping interests" in, *inter alia*, "preventing the proliferation of nuclear weapons and building energy security".<sup>41</sup> Zoellick continued his solicitation of increased Chinese cooperation during talks in Beijing in January 2006. Zoellick advanced "some ideas" regarding Hu Jintao's forthcoming visit to the United States, noting that the United States "has been obviously very involved with a strategic challenge through the broader Middle East". "I wanted to come to China to discuss how...China [could] play a very positive role in the international system, from issues dealing with nonproliferation to energy security", Zoellick said. The "challenge we face in Iran" was among the topics he discussed with his Chinese interlocutors.<sup>42</sup> At their summit meeting in Washington in April 2006, Presidents Hu and Bush also discussed the Iranian nuclear issue.

The Bush Administration's initial engagement with Beijing regarding the Iranian nuclear issue induced some movement in Chinese policy. In early 2006, China agreed to "report" the Iranian nuclear file—rather than "refer", as Washington had initially insisted—from the IAEA to the Security Council.

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<sup>41</sup> Deputy Secretary Zoellick Statement on Conclusion of the Second U.S.-China Senior Dialogue, U.S. Department of State, December 8, 2005.

<sup>42</sup> Robert Zoellick, Deputy Secretary of State, "Press Conference in China", U.S. Department of State, January 24, 2006.

China also agreed to a non-binding Security Council Presidential Statement in March 2006 that called for Iran to suspend nuclear enrichment activities.<sup>43</sup>

But Beijing was not prepared to support a Security Council resolution citing Chapter VII of the UN Charter—which would identify the Iranian nuclear issue as a challenge to “international peace and security”, a legal and political necessity for the authorization of mandatory international sanctions against the Islamic Republic—in the absence of U.S. support for more robust diplomatic engagement with Tehran. To avoid a “train wreck” in the Security Council, the Bush Administration agreed in May 2006 to the creation of the so-called “P-5+1” mechanism—including the five permanent members of the Security Council and Germany—to deal with the Iranian nuclear issue. Shortly thereafter, in July 2006, China supported the adoption of Security Council Resolution 1696, which invoked Chapter VII and threatened sanctions if Tehran did not suspend its fuel cycle activities, but stopped short of actually authorizing multilateral sanctions.<sup>44</sup> China’s *volte face* on this resolution reflected, in part, Beijing’s interest in keeping Washington and its European partners from trying to impose sanctions on Iran over its nuclear activities through a “coalition of the willing”.

The Bush Administration continued its engagement with Beijing over the Iranian nuclear issue, hoping to win China’s support for an intensification of multilateral economic and political pressure on the Islamic

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<sup>43</sup> See S/PRST/2006/15, adopted on March 29, 2006.

<sup>44</sup> See S/RES/1696 (2006), which was adopted by the Security Council on July 31, 2006. Specifically, Resoluton 1696 cites Article 40 of the United Nations Charter (one of 13 articles contained in Chapter VII) to mandate Iran’s compliance with previous calls from the International Atomic Energy Agency for Tehran to suspend activities related to the enrichment of uranium. The text indicates the Council’s willingness to consider taking “appropriate measures” against Iran under Article 41 of the Charter (another of the articles contained in Chapter VII referring to diplomatic and economic sanctions and other measures not entailing the use of force) if Tehran does not comply with the suspension requirement. However, Resolution 1803 does not authorize sanctions, noting explicitly that implementation of sanctions would require “further decision” by the Security Council. Moreover, Resolution 1803 does not mention Article 42, which empowers the Council to authorize the use of force “to maintain or restore international peace and security”.

Republic. Iran was on the agenda of the third Senior Dialogue between Undersecretary of State for Political Affairs Nicholas Burns—who had emerged as the Bush Administration’s “point man” on Iran-related diplomacy—and Vice-Minister for Foreign Affairs Yang Jiechi, held in Beijing in October 2006. In December 2006, China endorsed Security Council Resolution 1737, which cited Chapter VII of the UN Charter to mandate an initial application of international sanctions against Iran for its continued fuel cycle activities. The sanctions authorized, however, were rather weak—in no small part, because of Russian and Chinese opposition to tougher measures.<sup>45</sup> In March 2007, China supported Security Council Resolution 1747, which authorized a marginal expansion of the sanctions previously imposed against the Islamic Republic by Resolution 1737. Once again, China had been among those resisting proposals for broader and more severe measures that had been advanced within P-5+1 discussions and in the Security Council.<sup>46</sup>

Thus, in its handling of the Iranian nuclear issue during 2003-2007, China sought to balance the two horns of its Persian Gulf dilemma (see Figure 4). On the one hand, Beijing never allowed a rupture in its relations with Washington over the issue. China ultimately acceded to the Bush Administration’s most fundamental demands (sending the Iranian nuclear

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<sup>45</sup> See S/RES/1737 (2006), which was adopted by the Security Council on December 23, 2006. Specifically, Resolution 1737 calls on all states to restrict the transfer of technologies and provision of other types of support that would contribute to development of Iran’s capabilities for uranium enrichment, reprocessing of spent nuclear fuel, heavy-water reactor operation, its development of nuclear-weapons delivery systems. However, the resolution leaves it to individual states to determine which technologies meet these criteria. The resolution also authorizes states to freeze the assets of small number of designated individuals and entities deemed to be closely associated with Iran’s nuclear and ballistic missile programs, and encourages states to exercise “vigilance” over the travel of designated individuals.

<sup>46</sup> See S/RES/1747 (2007), which was adopted by the Security Council on March 24, 2007. Specifically, Resolution 1747 expands the application of measures authorized in Resolution 1737 by designating an additional eight persons and ten entities judged to be involved in Iran’s nuclear and/or ballistic missile programs and three entities and seven persons associated with the Iranian Revolutionary Guards Corps.

file from the IAEA to the Security Council and passing Chapter VII resolutions mandating international sanctions against Tehran). But, on the other hand, Beijing worked, along with Russia, to “water down” the sanctions that were actually imposed on Iran, keep the Iranian nuclear issue in the Security Council, oppose any use of force against Iran by the United States, and allow China’s economic cooperation with the Islamic Republic to proceed more or less without interference.

The perceived requirements of China’s balancing act on the Iranian nuclear issue also affected the pace and manner in which the Chinese government and China’s three major NECs proceeded in forging concrete energy links with Iran during 2003-2007. As was noted in the previous section, during the early years of this decade, all three of China’s major NECs—China National Petroleum Company (CNPC), China National Petrochemical Company (now known as Sinopec), and China National Offshore Oil Company (CNOOC)—worked to lay the groundwork for the eventual development of upstream equity positions in Iran.

**Figure 4. Dual Aspects of Beijing’s Handling of the Iranian Nuclear Issue, 2003-07**

Cooperate with U.S. Initiatives

Oppose proliferation of nuclear weapons, “noting” Iranian assurances that its program is purely non-military

Eventually agree to “report” issue to Security Council after minimizing Chapter VII references

Eventually agree to two Security Council resolutions threatening and then imposing sanctions

Urge Iran to suspend enrichment to win international trust

Urge Iran to “cooperate fully” with the IAEA to win international trust

Urge Iran to sign, implement, and ratify the Additional Protocol

Slow down on Yadavaran and other big upstream projects

Maintain close consultation with the United States

Support Iran Against U.S. Initiatives

Support for Iran’s NPT “right” to the peaceful use of nuclear energy

Opposition to “referral” from IAEA to Security Council, opposition to sanctions and actual/threatened use of force

Water down sanctions to maximum extent possible

Support Russian and European efforts at negotiation in the face of U.S. calls for tougher sanctions

Delay and draw out process, winning time for Tehran

Continue to expand economic and trade relations with Iran

Maintain close consultation with the Islamic Republic

- Sinopec was the first Chinese NEC to undertake upstream exploration projects in Iran, taking the lead in exploring the Zavareh-Kashan block in 2001 and the Garmsar block in 2005. (Neither block has yet been deemed viable for commercial development.) Sinopec moved on to sign a memorandum of understanding (MOU) with the NIOC in 2004 to participate in developing the Yadavaran oil field and buy 10 tons of liquefied natural gas (LNG) per year from Iran for a 25-year period. At the time of its signing, this MOU was prospectively valued at \$70-100 billion. (On the downstream side, Sinopec is also working with the NIOC to expand one of Iran's domestic refineries—which is important to Tehran's ongoing efforts to reduce the Islamic Republic's dependence on imports of gasoline and other refined products.)
- CNPC, China's largest NEC, launched operations in Iran in 2004, signing a service contract with NIOC to take over development of the aging Masjid-i-Suleiman oil field. The following year, the company commenced exploration of Iran's Kudasht oil block. More significantly, in 2007, CNPC signed a MOU with NIOC to participate in upstream development of Phase 14 of the South Pars gas field as well as development of the Pars LNG project.
- CNOOC, for its part, signed an MOU with the NIOC in 2006 to participate in upstream development of Iran's North Pars gas field as well as the development of an affiliated LNG project. CNOOC executives say that, in 2008, the company finalized a development plan for North Pars.

These initiatives notwithstanding, as the Iranian nuclear issue rose to the top of America's foreign policy agenda after 2003, the need to balance

China's U.S. interests against its Persian Gulf interests prompted Beijing to take a slower approach toward building energy ties to Iran than might otherwise have been the case. Specifically, Chinese NECs were free to carry out exploration and service contracts and conclude MOUs presaging upstream investment in Iran; however, until the end of 2007, the Chinese government was not prepared to let Chinese NECs move ahead with investment contracts which might be subject to secondary sanctions under U.S. law.<sup>47</sup> On the corporate side, conversations with senior executives at all three major Chinese NECs indicate that, as the perceived risks of U.S.-Iranian military confrontation appeared to grow during 2005-2007, Chinese companies were deeply reluctant to expand their positions in what they believed might become the Middle East's next "war zone".

*China and the Iranian nuclear issue, Stage II: 2007-present.* Since the end of 2007, Beijing's decisional calculus regarding the Iranian nuclear issue has shifted in subtle but important ways. China remains disinclined to challenge American hegemony in the Gulf directly, and that disposition continues to condition Beijing's approach to Iranian matters. For example, since 2006, Russia has championed the extension of full membership in the SCO to the Islamic Republic. China, however, has politely declined to support this proposal, saying that the SCO, as presently constituted, does not have a mechanism for taking in new members and that the issue needs further

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<sup>47</sup> Since 1996, U.S. law has authorized the executive branch to impose a range of secondary sanctions against third-country entities and individuals determined to have invested \$20 million or more in the development of Iran's energy resources. The sanctions authorized include denial of U.S. Export-Import Bank credits for the export of any good or service to a sanctioned entity; denial of export licenses for shipments of controlled items to a sanctioned entity; a ban on U.S. government procurement of goods and services from a sanctioned entity; a prohibition on U.S. banks from lending a sanctioned entity more than \$10 million in a 12-month period; restrictions in imports from a sanctioned entity; and, if a sanctioned entity is a financial institution, a prohibition on that entity serving as a primary dealer in U.S. government debt instruments and from serving as a repository of U.S. government funds.

study. Privately, senior Chinese military intelligence officers say that Beijing does not want Iran to become a full member because such a development would strain the credibility of Chinese arguments that the SCO is not a military alliance directed against a particular country (e.g., the United States).

With regard to the Iranian nuclear issue more specifically, China's declaratory posture has not changed significantly. Beijing continues to insist on a peaceful resolution of the issue. It encourages all parties to resume talks as soon as possible to find a negotiated solution and to show flexibility in pursuing such a solution. Likewise, Beijing continues to support Iran's right to the peaceful use of nuclear energy, while stressing the need for all countries to fulfill their obligations under the NPT and encouraging Tehran to address the concerns of the international community about its nuclear program so as to restore international confidence in Iranian intentions. In March 2008, China supported the adoption of Security Council Resolution 1803; in no small part because of Chinese resistance to tougher measures favored by the United States, Resolution 1803 only marginally expanded the scope of multilateral sanctions authorized by previous resolutions.<sup>48</sup> Six months later, China also endorsed the adoption of Security Council Resolution 1835. This measure imposed no new sanctions on the Islamic Republic; the text merely calls on Iran "to comply fully and without delay" under previous resolutions and "to meet the requirements of the IAEA Board of Governors".<sup>49</sup>

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<sup>48</sup> See S/RES/1803 (2008), which was adopted by the Security Council on March 3, 2008. Specifically, Resolution 1803 makes mandatory a travel ban on five individuals subjected to discretionary travel limitations in Resolution 1737 and Resolution 1747. Resolution 1803 also extends the asset freeze on individuals and entities identified in the two previous resolutions to cover 13 additional individuals and 12 additional entities. Additionally, Resolution 1803 bans the transfer of specified dual-use items to Iran, but the list of specified items does not go significantly beyond items already subject to control by other multilateral export regimes.

<sup>49</sup> See S/RES/ (2008), which was adopted by the Security Council on September 27, 2008.

However, governmental and corporate decision-makers in Beijing are becoming more assertive in advancing China's energy and economic interests in Iran—even as American concern over the nuclear problem continues to intensify. U.S. and European diplomats involved in P-5+1 discussions on the Iranian nuclear issue in recent years say that China has become increasingly willing to stand on its own—that is, without necessarily having political cover from Russia—in opposition to specific measures proposed by the United States to raise international pressure on Tehran. In particular, Beijing has made clear that it will not endorse any measure that would seriously impede China's access to Iranian hydrocarbon supplies or Chinese energy companies' potential to pursue upstream positions in Iran. (Such measures include proposed bans on Iranian hydrocarbon exports and new foreign investment in Iran.) It is also highly unlikely that China would go along with a ban on Iranian imports of refined petroleum products—a measure that is currently under consideration by the Obama Administration.

Furthermore, governmental and corporate decision-makers in Beijing now calculate (for reasons that will be explained below) that China can “get away with more” with regard to energy investment in the Islamic Republic without provoking a serious U.S. backlash. As a consequence, Chinese energy companies have begun to develop actual investment positions in Iran.

- In December 2007, Sinopec concluded its first investment contract based on the company's 2004 MOU with NIOC—a contract for first-phase development of the Yadavaran field. While, publicly, the U.S. State Department says that it is continuing to investigate this contract to determine whether it meets the conditions spelled out in U.S. laws for the application of secondary sanctions, State Department officials say privately that the deal is almost certainly “sanctionable” under U.S. law.

- In 2008, CNOOC signed an upstream contract to develop the North Pars gas field, while, in January 2009, CNPC signed a contract with NIOC to take the lead in developing the North Azadegan oil field; it seems that both of these contracts—like Sinopec’s contract on Yadavaran—would also, in principle, be “sanctionable” under U.S. law.

It seems highly likely that Chinese NECs have additional investment contracts on Iranian energy projects in the works. In June 2009, CNPC signed a preliminary agreement to undertake upstream development for Phase 11 of the South Pars field; this puts CNPC in position to displace Total, which had originally been slated to oversee both upstream development and downstream exploitation—primarily through the Pars LNG project—of South Pars Phase 11. CNOOC is continuing to negotiate with NIOC on downstream exploitation of North Pars—which had also been anticipated to include developing LNG trains. And, Sinopec appears to be positioning itself to take a 20 percent stake in the Persian LNG project—for which Royal Dutch Shell and Repsol are already partners, and which is set to draw on gas produced from Phases 13 and 14 of South Pars.

Looking ahead, it seems highly probable that China will not only continue to import significant amounts of oil from Iran, but that Chinese NECs will become increasingly involved in the Iranian upstream. On their own, the Yadavaran and Azadegan oil fields have the potential to become major producing assets for Sinopec and CNPC, respectively. As Chinese NECs become more involved in Iran’s upstream gas sector, some companies—e.g., CNOOC—may continue to hold on to ambitions to become involved downstream in the development of LNG trains. But it is likely to take many years before a Chinese NEC would be able to realize such ambitions without Western partners. Thus, it seems more probable that upstream gas projects involving Chinese NECs will ultimately be tied to meeting Iran’s internal demand for gas and/or to pipeline export projects. And, at this point, it seems

reasonable to anticipate that pipelines from Iranian gas fields that may be developed by Chinese NECs will be directed toward regional markets—e.g., on the Arab side of the Gulf—rather than linking up with pipelines that CNPC is developing in Central Asia.

We believe that four factors are contributing to Beijing’s increased assertiveness on behalf of Chinese energy and economic interests in Iran and the greater willingness of the Chinese government and Chinese NECs for the NECs to take actual investment positions there. First, since the end of 2007, both the government and the companies have judged that a number of developments have reduced the risks of U.S.-Iranian military confrontation and the application of U.S. secondary sanctions against Chinese NECs.

- The publicly released December 2007 U.S. National Intelligence Estimate (NIE) on the Islamic Republic’s nuclear program was widely perceived in Beijing as having significantly lowered the chances of U.S. military action against Iranian nuclear targets, at least in the near term. It is in this context that Sinopec concluded its December 2007 investment contract to develop Yadavaran—in the immediate aftermath of the NIE’s release.
- The U.S. reaction to Sinopec’s contract on Yadavaran—namely, a seemingly open-ended “investigation” by the State Department which has yet to reach a conclusion whether the deal qualifies as an “investment” that could be sanctioned under U.S. law—raised Chinese confidence that, in the end, Washington would not actually impose secondary sanctions against a Chinese NEC over investment in Iran’s energy sector.<sup>50</sup>

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<sup>50</sup> This is actually a well-established pattern for Washington’s response to investments by third-country entities in Iran’s oil and gas sectors. Since Iran-related secondary sanctions were first authorized in U.S. law in 1996, the U.S. government has formally determined that one third-country investment in an Iranian energy project—a joint undertaking by Total,

- Interestingly, CNPC timed the conclusion of its January 2009 investment contract to develop the North Azadegan field so as to avoid U.S. attention and minimize the risk of a negative reaction from Washington. Specifically, the contract was signed on January 15, 2009—before the incoming Obama Administration had been inaugurated, and at a time when the outgoing Bush Administration retained only skeletal staffing and had no time in which to consider responding to CNPC’s action.

Second, in an environment conditioned by Chinese perceptions of reduced risks of U.S.-Iranian military confrontation and imposition of secondary sanctions by Washington, the Chinese government is more willing to let Chinese NECs take advantage of opportunistic openings to develop upstream positions in Iran.

- In this regard, CNPC’s decision to conclude its June 2009 contract for the upstream development of South Pars 11 reflected the Chinese company’s willingness to move ahead where Western competitors—in this case, Total—were unwilling to tread.
- In the wake of the controversy surrounding the Islamic Republic’s June 12 presidential election—which has only increased the reluctance of many European energy companies to consider new investment

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Gazprom, and Petronas to develop Phase of the South Pars gas field—qualified as an investment subject to U.S. sanctions; in 1998, the Clinton Administration Since then, in order to avoid the domestic political controversy associated with waiving the imposition of secondary sanctions on non-U.S. companies investing in Iran’s oil and gas sectors, both Clinton and George W. Bush administrations opted not to bring to closure any of the State Department investigations into roughly a dozen other Iranian energy projects involving foreign energy companies.

commitments in Iran—China’s NECs are likely to have additional openings for opportunistic business development.

Third, Chinese decision-makers now judge that Beijing has largely weathered the international storm of criticism generated by China’s engagement—including substantial investments by CNPC—in Sudan. Indeed, China’s position in Sudan has made Beijing an increasingly important player in recent efforts by the international community to deal with complex Sudanese challenges, including ameliorating horrific humanitarian and security conditions in Darfur and implementing the 2005 agreement ending the north-south civil war.

Fourth, since the outbreak of the global financial crisis last summer, China has been generally more willing to assert its own economic interests *vis-à-vis* the United States. This development has multiple manifestations; China’s increased willingness to pursue its own course regarding energy investments in Iran is one. China will continue to pursue policies regarding Iran and the Middle East more generally that avoid the extremes of confrontation with the United States or full partnership with the United States. But the precise balance that Beijing strikes between these two extremes is shifting in a direction that supports more focused pursuit of China’s economic and energy interests in this critical region.

### Implications for U.S. Policy

In light of these considerations, it is highly unlikely that China will support a dramatic intensification of multilateral economic pressure on Iran later this year if nuclear diplomacy with Tehran does not get off the ground or fails to produce an agreement regarding the future course of the Islamic Republic's nuclear activities. Beijing may, in the end, agree to a relatively marginal expansion of existing sanctions against Iran, to keep the nuclear issue in the Security Council. But China will not be prepared to support the implementation of anything approaching "crippling" sanctions—to use Secretary Clinton's phrase—against the Islamic Republic.

Expectations of this sort on the Obama Administration's part reflect a serious misunderstanding of China's approach to managing its Persian Gulf dilemma where Iran is concerned. Such misunderstanding is also reflected in an idea floated by Dennis Ross, the senior National Security Council adviser at the White House on the "Central Region". Ross has proposed that Washington ask Saudi Arabia to approach decision-makers in Beijing and propose that, if China will cut off its energy ties to the Islamic Republic, the Kingdom would provide for all of China's incremental oil demand in the future. It is not germane to this paper to evaluate Ross's idea in terms of its plausibility *vis-à-vis* Saudi decision-making. With regard to Chinese decision-making, it is extremely unlikely that Beijing would accept such a proposal.

- Among other things, China has a long tradition of straddling Persian-Arab and Israeli-Arab divides in its effort to "make friends with all countries" in the Middle East. It is very unlikely that Beijing would abandon this approach and come down firmly on one side or the other of those divides.

- In addition, it is highly unlikely that China would agree to such a significant reduction in the diversity of its oil supply sources in the Persian Gulf. Likewise, Beijing would almost certainly not abandon its interest in Iran as potential supplier of natural gas to international markets—a role that Saudi Arabia will not be able to assume.

More broadly, the foregoing analysis raises serious questions about the plausibility of the Obama Administration's preferred approach to the Iranian nuclear issue. This approach—President Obama's early expressions of interest in diplomatic engagement with Iran notwithstanding—has come to resemble the George W. Bush Administration's Iran policy, emphasizing the “ratcheting up” of international economic pressure to leverage Tehran's nuclear decision-making. Unfortunately, the Obama Administration's approach also resembles the Bush Administration's approach in its reluctance to put positive incentives on the table—e.g., a comprehensive agenda for resolving the major differences between the United States and Iran, linked to the prospect of a U.S. guarantee not to use force to change the borders or form of government of the Islamic Republic—that would address Iran's most fundamental strategic needs.

The Obama Administration might instead consider an approach that one often hears broached in Beijing: the United States should approach the Islamic Republic of Iran rather like President Richard Nixon approached the People's Republic of China in 1971, as a major regional power with interests of its own that would need to be addressed and accommodated to some degree in the context of bilateral rapprochement.<sup>51</sup> There are, of course, many and

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<sup>51</sup> This is also an approach that Flynt Leverett and Hillary Mann Leverett have recommended in their previous work on U.S.-Iranian relations. See Flynt Leverett, *Dealing With Tehran: Assessing U.S. Diplomatic Options Toward Iran* (New York: The Century Foundation, 2006); Hillary Mann Leverett, “U.S. Diplomacy With Iran: The Limits of Tactical Engagement” and Flynt Leverett, “All of Nothing: The Case for a U.S.-Iranian ‘Grand Bargain’”, Testimony to the Subcommittee on National Security and Foreign Affairs, U.S. House Committee on Government Oversight and Reform, November 7, 2007; Flynt

important conflicting interests between the United States and the Islamic Republic. There is also no single issue dominating strategic reflection in Tehran and Washington about a prospective realignment of U.S.-Iranian relations like the common Soviet threat faced by Beijing and Washington in 1971. But, in the wake of 9/11, both sides recognized a common threat in the sort of violent Sunni extremism embodied in *Al Qa'ida*. Moreover, there are important convergent interests between the United States and the Islamic Republic: consolidating a new and still democratic (and, thus, Shi'a-empowering) state in Iraq, preventing a Taliban return to power in Afghanistan, countering the drift of Pakistan toward a Wahhabi-style *salafi* state, guaranteeing the uninterrupted flow of oil to global markets from the Persian Gulf, and even, as this paper has suggested, creating conditions for the large-scale flow of foreign investment into the development of Iranian oil and gas resources to increase supplies on international markets.

It may even be that Iranian leaders recognize an interest in preventing a nuclear arms race in the Middle East—if Iran's security interests can be accommodated *via* a strategic understanding with the United States. A major factor driving Iranian policy is a desire for recognition as a major power. There is no intrinsic reason why the United States should not seek to accommodate that desire—if U.S. interests (including the security of America's regional allies) can be satisfied *via* a strategic understanding with Iran. The United States and the Islamic Republic are not fated to be enemies any more than the United States and Mao's China were fated to be enemies. A prerequisite for reconciliation is for both sides to set aside ideologies and build on their convergent interests.

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Leverett and Hillary Mann Leverett, "How to Defuse Iran?", *The New York Times*, December 11, 2007; Flynt Leverett and Hillary Mann Leverett, "Time for a U.S.-Iranian 'Grand Bargain'" in *Big Ideas for a New America* (Washington, DC: New America Foundation, 2008); Flynt Leverett and Hillary Mann Leverett, "The Grand Bargain", *The Washington Monthly* (August/September/October 2008); Hillary Mann Leverett, "Interview—U.S. Should Seek Comprehensive Accord With Iran", Council on Foreign Relations ([www.cfr.org](http://www.cfr.org)), February 4, 2009; and Flynt Leverett and Hillary Mann Leverett, "Have We Already Lost Iran", *The New York Times*, May 24, 2009.

The stakes for the United States in such reconciliation are high indeed. At this point, Washington will not be able to achieve any of its high-priority policy goals in the greater Middle East—with regard to Iraq, Afghanistan, the Arab-Israeli arena, nonproliferation, and fighting terrorism—without a more positive and productive relationship with Tehran. Furthermore, how the United States deals with Iran over the next few years will significantly influence Iran's alignment over the next half century of China's rise to global power. China is positioning itself to be Iran's good and reliable friend as China grows ever stronger. Realistic calculations of power are at the base of this approach. If the United States uses military force—or perhaps even if it condones another power's use of military force—against Iran, it is likely to find itself burdened by an albatross even weightier than its involvement in Mossadeq's overthrow in 1953. China is convinced that U.S. power politics and ethnocentric arrogance will, sooner or later, mobilize the peoples and countries of the Middle East against the United States. Sooner or later the United States will have to abandon its effort to reshape or dominate the Middle East. China is positioning itself to pick up the pieces when that happens.