

# CRS Report for Congress

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## Iran: Relations With Key Central Asian States

(name redacted) and James Nichol  
Foreign Affairs and National Defense Division

### Summary

Iran sees the Central Asian region as an arena for reducing its own isolation. Hoping to make itself an attractive economic and political partner to these states, Iran has been cautious in supporting radical Islamic opposition movements in the region. Several Central Asian states are proceeding with or contemplating energy projects that transit Iran. These projects present the Administration and Congress with the dilemma of how to keep Iran's financial resources constrained while at the same time fostering economic and political development in Central Asia. Provisions in S. 2334, covering FY1999 foreign operations appropriations (S.Rept. 105-255), as well as in S. 1344, the Silk Road Strategy Act of 1997, appear intended to reduce Central Asian incentives to cooperate with Iran. This report will be updated to reflect legislative developments.

### Background<sup>1</sup>

Successive U.S. Administrations have identified Iran's support for radical Islamic movements as a key justification for containing and applying sanctions against Iran. During the 1980s, Iran attempted to "export" its Islamic revolution to Lebanon, Afghanistan, Sudan, Algeria, and the Persian Gulf states. During the 1990s, Iran has built ties to Palestinian Islamic movements opposed to the Arab-Israeli peace process. After the Soviet Union broke up in 1991, U.S. analysts and policymakers feared that Iran would attempt to use its varied ethnic, linguistic, religious, and cultural ties to Central Asia to cultivate pro-Iranian radical Islamic opposition movements in the region. Tajikistan, which does not border Iran but whose people are of Persian origin, and Azerbaijan, which shares with Iran the predominance of Shiite Islam, appeared to be natural targets for increased Iranian political and religious influence.

The worst fears of some in the United States and Central Asia about Iran's regional intentions apparently have not been realized. Iran's revolutionary purists, who wanted to take advantage of the Soviet collapse to push Iran's ideology, quickly lost out to Iranian pragmatists who saw Central Asia as an export market and a potential avenue to frustrate

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<sup>1</sup>In this report, Azerbaijan, Kazakstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan are considered as Central Asian states. Azerbaijan, Kazakstan, Russia, Turkmenistan, and Iran constitute the Caspian Sea littoral states.

U.S. attempts to isolate Iran. Iran's leaders apparently also believed that political meddling in Central Asia, which Russia considers its "sphere of influence," could jeopardize its ties to Russia. Russia has been a major supplier to Iran of conventional weapons, including submarines, tanks, and combat aircraft, as well as a nuclear reactor (under construction). In June 1998, Iran allegedly tested an intermediate-range missile of North Korean design, reportedly with Russian assistance.

Since 1992, Iranian leaders have been stressing to their Central Asian neighbors the economic benefits of dealing with Iran. Iran argues that it has the most developed transport network and well-equipped ports on the Persian Gulf and Sea of Oman, and that rail lines could be easily extended. Some in Central Asia have looked at Iran as a market for raw materials and industrial products such as cotton fiber. Currently, Iran still is a minor trade partner for the states of the region, but it has established economic commissions with most of the states to expand trade. Iran's emphasis on economic cooperation has been reinforced since the May 1997 election of a relative moderate, Mohammad Khatemi, as Iran's President.

Either by design or lack of opportunity, Iran has not developed significant political influence in the Central Asian countries. Iran provided some support to a coalition of Islamic and democratic movements that briefly seized power in Tajikistan (September - December 1992). Iran also has provided sanctuary to Tajik Islamic opposition leaders such as Akbar Turajonzada and reportedly has built up an intelligence network there.<sup>2</sup> At the same time, Iran has built ties to the government of Imomali Rakhmanov and helped broker a ceasefire (September 1994) and a further peace settlement (June 1997) in the internal conflict in Tajikistan. The United States accepted a statement in the communique of the P-8 summit in Denver in June 1997 praising Iran's mediation role in Tajikistan. Iran also has tried to mediate in the dispute between Armenia and Azerbaijan over the disputed Nagorno-Karabakh territory. Over the last few years, Iran has worked to improve often contentious relations with Azerbaijani President Heydar Aliyev, and has offered only minor support to a pro-Iranian Islamic Party in Azerbaijan.

Among the other Central Asian states, Turkmenistan has developed the warmest ties with Iran. President Niyazov in June 1997 termed Iran the "closest friend and neighbor of Turkmenistan," and the two countries opened a major rail link in May 1996. Uzbekistan's relations with Iran, earlier cool, have warmed somewhat. Uzbekistan openly backed a May 1995 U.S. trade and investment ban on Iran. In 1997, after Iran's apparent good-faith mediation efforts in Tajikistan, Uzbekistan's President Islam Karimov said he supported expanded trade and transport ties with Iran. Kazakhstan and Kyrgyzstan have consistently been less concerned than the other Central Asian states about Iran's intentions in the region and have steadily broadened economic ties with the Islamic Republic.

## **Energy Relationships**

As it became apparent in the mid 1990s that the expected Iranian effort to gain "influence" in Central Asia was not materializing, the Central Asian states began to see Iran as a viable and desirable partner to help them exploit the resources they would need

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<sup>2</sup>Gertz, Bill. Intelligence Agency Highlights Threat of Anti-American Terror in Tajikistan. *Washington Times*, December 9, 1997.

to develop economically. According to the U.S. Energy Department, proven and possible oil reserves in the Caspian region are 171-191 billion barrels of oil and 564-665 trillion cubic feet of natural gas. Proven reserves are much smaller, but are still comparable to North Sea oil reserves and North American gas reserves. The landlocked Central Asian states were anxious to develop alternatives to Russia as a transit route for exporting their energy resources. Iran has argued that the shortest and least expensive route to export these resources runs through Iran. To bolster this view, and to discourage U.S. energy firms from proceeding with projects, Iran has maintained that exploitation of oil and gas resources in the Caspian Sea, and related uses, cannot move forward until the status of the sea is worked out. Azerbaijan has led objection to this position, in part because its Caspian Sea projects are more advanced than those of other littoral states.

Despite widespread concerns about Iranian foreign policy, Iran's political stability gives Iran an advantage in competing for projects over some regional countries, such as Afghanistan. Two energy teams<sup>3</sup> are vying for the right to build a gas pipeline from Turkmenistan to Pakistan, through Afghanistan. Although the Clinton Administration endorses such efforts, it admits that a trans-Afghan pipeline is unlikely as long as inter-factional strife continues in that country. Major energy projects that involve Iran and Central Asian states, either under way or planned, include those discussed below.

- In mid-1997, Kazakstan conducted a test swap of oil to Iran, under plans for Iran to use the Kazak oil in its northern refineries and to then export an equivalent amount of its own oil from Persian Gulf terminals in the south, crediting Kazakstan for the shipments. Technical and other problems, however, have put this project on hold.
- On December 29, 1997, the President of Iran, Mohammad Khatemi, and of Turkmenistan, Saparmurad Niyazov, inaugurated a 125-mile pipeline linking the two countries' gas transport networks. Initially, Iran will use the Turkmen gas in its northeast to offset the \$160 million Iran funded to construct the pipeline. Under a May 1997 memorandum of understanding between Turkey and Turkmenistan, the Turkmen gas will eventually be exported through Iran to Turkey when an Iran-Turkey pipeline, agreed to in August 1996 and now under construction, is completed.
- One day earlier, Khatemi and Niyazov were joined by Turkey's Prime Minister Mesut Yilmaz in endorsing a plan by Royal Dutch Shell to study the feasibility of a larger 940-mile gas pipeline from Turkmenistan to Turkey, through Iran. The energy firm envisions that pipeline as eventually transporting gas from Central Asia and Iran to Europe.
- Kazakstan is in discussions with Iran for the construction of an oil pipeline from Kazakstan's oil fields to Iran's Persian Gulf coast. Iran is offering to finance construction of that pipeline. For Kazakstan, the pipeline to Iran would cost a fraction of that envisioned in an alternate pipeline corridor, strongly backed by the United States, that would avoid Iran by running from Baku (Azerbaijan's capital)

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<sup>3</sup>One grouping competing for the project is led by the U.S. firm UNOCAL, the other is led by the Argentine company Bidas.

to Turkey's Mediterranean port of Ceyhan. To link this pipeline with Kazakhstan, tanker or undersea pipeline transport are contemplated. A provision of S. 2334, covering FY1999 foreign aid appropriations (S.Rept.105-255) requests an Administration report, by March 1, 1999, on the status of U.S. initiatives to promote financially the Baku-Ceyhan pipeline route.

- Azerbaijan has given Iranian firms 10% stakes in two consortia (out of seven) currently developing Azerbaijan's oil and gas resources. In June 1998, the main foreign oil consortium in Azerbaijan (Azerbaijan International Operating Consortium, AIOC), which includes some U.S. firms, acknowledged it had begun talks with Iran on oil swap arrangements.
- In June 1998, Iran solicited bids for a \$400 million oil pipeline from Iran's Caspian port of Neka to Iran's northern refineries. The plan is intended to encourage oil swaps between Iran and Caspian region oil producers and could eventually form part of a new energy route from the Caspian to Iran's Persian Gulf ports.
- Turkmenistan has transported some crude oil by road and rail through Iran to Persian Gulf ports. However, Asian economic turmoil has reduced this trade, and Turkmenistan has shifted to Western exports through Georgian and Russian ports.

## **U.S. Policy**

The financial attractiveness of energy export routes through Iran has run up against the commitment of the Administration and Congress to constrain Iran's financial and military capabilities. An April 1997 State Department report on Caspian energy development<sup>4</sup> stated that "the United States strongly opposes activities which significantly contribute to Iran's revenues and petroleum sector, increasing the funds available to support international terrorism and development of weapons of mass destruction." A chief congressional backer of this position has been Senator Sam Brownback, who said in a November 5, 1997, speech on Central Asia that "If the floodgates open through Iran, the eastern Caspian will certainly fall into the Iranian sphere of dominance and the South Caucasus will lose out on its opportunity to prosper." In October 1997, Sen. Brownback introduced a bill, the Silk Road Strategy Act of 1997 (S. 1344) that provides incentives for the Central Asian states to cooperate with each other and with the United States, rather than with Iran. The bill was reported to the full Senate on June 23, 1998.

While trying to persuade the Central Asian states to exclude Iran from major energy projects, the Administration apparently has sought not to interfere with the overarching objective of energy development in Central Asia. In May 1995, President Clinton imposed a U.S. ban on trade and investment with or in Iran and in any territory or marine area (apparently referring to portions of the Caspian) over which Iran claims sovereign rights or jurisdiction. However, the ban specifically allowed for licensing, on a case-by-case basis, U.S. participation in temporary market-based swaps of crude oil from the Caspian Sea Basin in support of energy projects in Turkmenistan, Azerbaijan, and

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<sup>4</sup>This report was requested by the conference report on FY 1997 foreign aid appropriations (P.L. 104-208).

Kazakstan. One U.S. firm, Mobil Corp., has already applied for a U.S. license to engage in oil swaps with Iran; no decision has been announced on that application.

Some observers believe the overarching goal of promoting Central Asian development -- coupled with a U.S. desire to reach out to the more moderate new President of Iran -- has made the Administration hesitant to apply the Iran-Libya Sanctions Act (P.L. 104-172, ILSA), to Central Asian energy projects that include Iran.<sup>5</sup> The ILSA law, signed August 5, 1996, requires U.S. sanctions on foreign firms that make substantial investments (over \$20 million in one year) in Iran's energy sector.<sup>6</sup> At a July 23, 1997 hearing of the House International Relations Committee, State Department officials said that the Iran-Turkey-Turkmenistan project discussed above was not sanctionable under that law because Turkey had agreed to purchase gas from Turkmenistan, not Iran. As currently constituted, Iran will earn only transit fees from the project. Whether or not it purchases Iranian gas, Turkey maintained that its pipeline with Iran was not sanctionable under ILSA because Iran and Turkey were each constructing portions of the pipeline on their respective sides of the border. Many outside experts agreed with the Turkish interpretation that this did not meet the definition of sanctionable investment stipulated by ILSA.

The international energy community was further encouraged by a May 18, 1998 U.S. decision not to sanction a September 1997 deal between Iran and Total SA (France, Gazprom (Russia), and Petronas (Malaysia) to develop Iran's South Pars gas field. The Administration judged the deal to meet the criteria for ILSA sanctions, but it waived the sanctions on national interest grounds, and indicated that similar deals by EU firms would also receive waivers. Many experts viewed the Administration waivers as an effort not only to avoid trade frictions with the EU, but as part of a U.S. effort to signal positively toward Iranian President Mohammad Khatemi. Some observers believe that imposing sanctions under ILSA could undermine the more moderate Khatemi as he is attempting to consolidate his position in Tehran.

In late 1997, and especially following the May 18 ILSA waivers, the Administration has sought to counter the widespread interpretation that it is softening its position on Central Asian energy routes through Iran. apparently recognizing the widespread interpretation of U.S. policy, the Administration sought to articulate more clearly its policy on energy projects that transit Iran. On October 23, 1997, in testimony before the Subcommittee on International Economic Policy, Export and Trade Promotion of the Senate Foreign Relations Committee, Under Secretary of State Stuart Eizenstat said, "Let me be clear... We do not support any pipelines through Iran carrying either Iranian oil and gas to Western markets or that of any other country." Referring to the July 23 testimony about the Iran-Turkey pipeline, Eizenstat said, "This announcement has been widely misinterpreted to mean that the [United States] has approved a pipeline across Iran. This is definitely not the case...should we find evidence of investment activity which could enhance Iran's ability to develop its own petroleum resources, we will take appropriate actions under ILSA."

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<sup>5</sup>U.S. firms were already banned from making such investments in Iran under the May 1995 executive order discussed above and a March 1995 executive order.

<sup>6</sup>U.S. firms were already banned from making such investments in Iran under a March 1995 and a superseding May 1995 Executive order.

In November 1997, Energy Secretary Federico Pena visited Turkey and the Caspian region in an attempt to build support for a trans-Caspian pipeline route rather than one that transits Iran. President Clinton pressed that same agenda during a visit to Washington in mid-November 1997 by Kazakhstan's President Nursultan Nazarbayev. He reportedly told President Clinton he would support that route over one that transits Iran if the United States could arrange financing for the trans-Caspian route by October 1998.<sup>7</sup> During Turkmen President Saparmurad Niyazov's April 1998 U.S. visit, the Administration similarly advocated alternatives to trans-Iranian oil and gas shipments, and proffered some study aid, but Niyazov reportedly reiterated his support for Iran as one of multiple transshipment routes contemplated for large-scale Turkmen energy exports.

On June 3, 1998, two weeks after the ILSA waivers, Under Secretary of State Eizenstat testified before the House International Relations Committee that the United States "remain[s] strongly opposed to oil and gas pipelines which transit Iran and that, as a policy matter, we will continue to encourage alternative routes for the transport of Caspian energy resources, such as trans-Caspian pipelines and the Baku-Ceyhan route....We will carefully examine any proposals for trans-Iranian pipeline construction for possible implications under ILSA, and any other relevant laws, and take appropriate action. In view of our strong opposition to such pipelines, we intend to continue to challenge them."

Despite the strong Eizenstat and other U.S. statements, many in the oil industry continue to believe that U.S. resolve to press for routes that exclude Iran is weakening. They received some support for their analysis from a June 18 State Department press briefing by Department spokesman Jamie Rubin. In answering reporter questions, Rubin suggested that the United States opposed *reliance* on Iran as an export route, saying that, the United States does not "believe it is in any country's best interest to have Iran as the *only* transit corridor for Caspian oil and gas." The statement left open the possibility that the United States might acquiesce to the development of some routes than transit Iran. Some U.S. officials stress that the Eizenstat and other statements are more a *u t h o r i t a t i v e* statements of U.S. policy, while others believe the Rubin characterization represents an effort to signal a gradual change in U.S. policy on this issue.



Prepared by CRS for FAND.

<sup>7</sup>Ottaway, David and Morgan, Dan. U.S. Backs Non-Iranian, 'Eurasian' Corridor West for Caspian Sea Oil. *Washington Post*, November 20, 1997.

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