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# THE NATIONAL IRANIAN OIL COMPANY IN IRANIAN POLITICS

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## ABOUT THE POLICY REPORT

### *THE CHANGING ROLE OF NATIONAL OIL COMPANIES IN INTERNATIONAL ENERGY MARKETS*

Of world proven oil reserves of 1,148 billion barrels, approximately 77% of these resources are under the control of national oil companies (NOCs) with no equity participation by foreign, international oil companies. The Western international oil companies now control less than 10% of the world's oil and gas resource base. In terms of current world oil production, NOCs also dominate. Of the top 20 oil producing companies in the world, 14 are NOCs or newly privatized NOCs. However, many of the Western major oil companies continue to achieve a dramatically higher return on capital than NOCs of similar size and operations.

Many NOCs are in the process of reevaluating and adjusting business strategies, with substantial consequences for international oil and gas markets. Several NOCs have increasingly been jockeying for strategic resources in the Middle East, Eurasia, and Africa, in some cases knocking the Western majors out of important resource development plays. Often these emerging NOCs have close and interlocking relationships with their national governments, with geopolitical and strategic aims factored into foreign investments rather than purely commercial considerations. At home, these emerging NOCs fulfill important social and economic functions that compete for capital budgets that might otherwise be spent on more commercial reserve replacement and production activities.

The Baker Institute Policy Report on NOCs focuses on the changing strategies and behavior of NOCs and the impact NOC activities will have on the future supply, security, and pricing of oil. The goals, strategies, and behaviors of NOCs have changed over time. Understanding this transformation is important to understanding the future organization and operation of the international energy industry.

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# THE NATIONAL IRANIAN OIL COMPANY IN IRANIAN POLITICS

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## INTRODUCTION

### *Basic Information*

The National Iranian Oil Company (NIOC), the national oil company of the Islamic Republic of Iran, manages and exploits an estimated 132.5 billion barrels of oil and 296 trillion cubic meters of gas in proven reserves. This makes Iran the second in the world in both products.<sup>1</sup> Ranked among the top two or three largest oil companies in the world, in 2006 NIOC generated some \$46.9 billion in oil export revenue, comprising 80-90 percent of Iran's total exports and 40-50 percent of the government's budget.<sup>2</sup> In

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<sup>1</sup> "Iran," *International Petroleum Encyclopedia 2006* (Tulsa: PennWell, 2006).

<sup>2</sup> Iran Country Analysis Brief, Energy Information Administration, <http://www.eia.doe.gov/emeu/cabs/Iran/Background.html> (accessed December 29, 2006).

general, the government underwrites any debts NIOC incurs and allocates NIOC's operating budget through legislation. However, during the 1980s and 1990s the Iranian government occasionally used NIOC's capital as collateral by making advanced sales of oil.<sup>3</sup> Today, 'buy-back' contracts—details of which are discussed below—also involve pre-payment for product, but on a much more limited basis.

NIOC has three sister organizations that are technically independently incorporated under the Oil Ministry, but function as NIOC affiliates handling gas, petrochemicals, and refining.<sup>4</sup> Estimates on the number of employees range from 120,000 to 180,000.<sup>5</sup> NIOC is internally organized into numerous subsidiary organizations. Five are charged with managing specific geographic regions or fields.<sup>6</sup> Others have functional expertise in drilling, exploration, terminal management, general contracting, and engineering.<sup>7</sup> Three subsidiaries are based overseas and charged with sales and procurement.<sup>8</sup> NIOC board consists of the chairman, Oil Minister Seyed Kazem Vaziri Hamaneh, the managing director, Gholamhossein Nozari, the director of corporate planning, Abdol-Mohammad Delparish, the managing director of the National Iranian South Oil Company, Seifollah Jashnsaz, the director of finance, Abbas Allahdad,

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<sup>3</sup> *Middle East Economic Survey* (MEES), December 25, 1989.

<sup>4</sup> I.e., National Iranian Gas Company, National Petrochemical Company, and National Iranian Oil Refining and Distribution Company.

<sup>5</sup> Reza Bayegan, "Iran's New Oil Disorder: An Interview with Dr. Parvin Mina," August 4, 2004, <http://bayegan.blogspot.com/2005/08/irans-new-oil-disorder-interview-with.html> (accessed December 30, 2006); "Excerpts from the Presentation of H.E. Eng. Behrouz Boushehri, Advisor to the Petroleum Minister, President of the NIOC Pension Fund," Iran Energy Forum, 27-28 May 2002, <http://www.ibchamber.org/Magazine%206/pensionfund.htm> (accessed December 30, 2006).

<sup>6</sup> I.e., National Iranian South Oil Company, National Iranian Offshore Oil Company, National Iranian Central Oil Fields Company, Khazar Exploration and Production Company, Pars Oil and Gas, Pars Special Economic Energy Zone.

<sup>7</sup> I.e., National Iranian Gas Export Company, Petroleum Engineering and Development Company, National Iranian Oil Terminals Company, National Iranian Drilling Company, Ahwaz Pipe Mills Company, PetroPars, Iranian Fuel Conservation Organization, National Iranian Tanker Company, Exploration Service Company.

<sup>8</sup> I.e., Kala Naft London, Ltd., Kala Naft Canada, Ltd., and NaftIran Company

the director of exploration, Seyed Mahmoud Mohaddes, the director of administration, Mohammed Sadegh Bakhsian, the director of legal affairs, Seyed Mustafa Zeynodin, the director of research and development, Mohammed Ali Emadi, and the head of the pension fund, Mr. Karbassian.<sup>9</sup>

By 2004 estimates, NIOC infrastructure includes thirty-three onshore and thirteen offshore oil fields. NIOC and its affiliates also operate nine refineries, six crude terminals, a tanker fleet, and a nation-wide distribution system.<sup>10</sup> Due to deterioration in the oil fields, Iran's oil productivity is in general decline. A bright spot for NIOC is the discovery of the mammoth South Pars gas field, connected to Qatar's North field, which has yielded gas for domestic usage, for export, and for use in re-injection.<sup>11</sup> Much of NIOC's strategic planning in the last five years has focused on three priorities: recovering and rejuvenating older oil fields, maximizing the potential for gas, and increasing refining capacity to meet domestic demand. Nevertheless, NIOC's efforts have consistently fallen short of its production goals and remain strapped by increasing demands for domestic consumption. According to one recent analysis, Iran will no longer be able to export oil by the year 2015.<sup>12</sup>

### *The Political Economy Approach to NIOC*

Since its establishment during the Mossadeq crisis of the 1950s, NIOC has faced two often contradictory demands: On one hand, oil is a fungible economic commodity

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<sup>9</sup> "Members of the Board," <http://www.nioc.com/members/index.html> (accessed December 29, 2006).

<sup>10</sup> Estimates come from *Arab Oil & Gas Directory, 2005*. For a table showing major oil fields and refineries, see Appendix.

<sup>11</sup> For estimated size of Iran's gas fields, see Appendix.

<sup>12</sup> Roger Stern, "The Iranian Petroleum Crisis and the United States National Security," *Proceedings of the National Academy of Science*, (2007) 104:1.

that must be traded to be valuable. NIOC must sell in the international market to generate revenue for the Iranian national treasury. The state can then use these funds as it sees fit. On the other hand, oil is an inalienable national patrimony, a symbol of Iran's national strength. In this regard, NIOC's role is to guard this patrimony, ensuring that it is only used to benefit the nation as a whole. Crass economic calculations must be abjured in favor of equality and social justice. This paper considers NIOC as an agent within Iran's political economy, buffeted between these two often irreconcilable imperatives. It explains the constraints and drivers of NIOC's behavior based on these historical circumstances.

The first section discusses the theory of how a national oil company (NOC), like NIOC, functions in such a political-economic nexus of high expectations and limited capability. As we shall see, NIOC is able to exploit ambiguities in the Iranian political system to forward its own institutional agenda, but remains bound by consideration of the stability of the entire system. The second examines the history of the oil industry in Iran, from its inception under the Qajar dynasty to its role as the buttress for Iran's heavily oil-reliant economy under Ayatollah Khomeini. The final section considers NIOC's role in the post-Khomeini era under Supreme Leader Ali Khamenei and the successive presidencies of Ali Akbar Hashemi Rafsanjani (1987-1996), Mohammed Khatami (1996-2005), and Mahmoud Ahmedinejad (2005-present). During this era, Iran has undertaken considerable, if sporadic, efforts at economic reform. These reforms entail a reduction of the size and scope of the public sector, curtailing subsidies, selling off state assets, and rationalizing foreign exchange practices. While private firms have entered both upstream and downstream oil markets, both NIOC and the regime itself have taken steps to

mitigate the possibility of real competition, moving the oil economy from a state-held monopoly to a state-sanctioned oligopoly. As a result of the transition to an even more complex form of state control, the opening of the oil sector to private investment has not yielded deeper political reforms. Rather, Iran's institutional system has provided for a privatization that protects the political elite and perpetuates their interests by informal means. This elemental fact of political life has several significant implications for the future not merely of NIOC, but for its wider role and position in Iran's political economy. As we shall see in the conclusion, political and economic reforms favored by NIOC and its partners enhance the durability and maneuverability of the Islamic Republic as a whole.

## **THEORY OF NOCS AS AGENTS IN A RENTIER ECONOMY**

Iran is often viewed as a prototypical rentier state.<sup>13</sup> In its most basic form, rentier state theory holds that the availability of outside rents—typically through the sale of a country's domestic natural resources in the international market—provides the state with enough financial autonomy to ignore demands for political reform emanating from its own society. Freed of the need to tax its populace, the rentier state skirts the painful political bargains that lead to the creation of representative political institutions. Instead, the national oil company (NOC) serves as an agent of the state, generating profits internationally that are then redistributed as rents domestically. In this way the state achieves a high degree of political autonomy, but paradoxically is economically

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<sup>13</sup> Hossein Mahdavy, "The Patterns and Problems of Economic Development in Rentier States: the Case of Iran," in M.A. Cook, ed., *Studies in the Economic History of the Middle East* (New York: Oxford University Press, 1970); Theda Skocpol, "Rentier State and Shi'a Islam in the Iranian Revolution," in *Social Revolutions in the Modern World* (New York: Cambridge University Press, 1994).

constrained because its legitimacy is now tied to providing economic benefits in return for the political quiescence of the population.<sup>14</sup>

There are both significant institutional similarities and differences among NOCs. Most face a conundrum similar to other state-owned enterprises (SOEs) in being subject to political dictates for full employment and cheap domestic supply that contradicts profit-maximizing strategies available to privately-held firms. These dictates often constrain the choice of buyers, vendors, and partners. Even though top officials and technocrats within the organizations recognize the need for reform, they are often unable to alter the NOCs' institutional features.<sup>15</sup> The state's capacity to monitor, tax, and distribute rents influences the roles NOCs are asked to play, as do popular expectations about the role of rent redistribution in society. In her comparative study of NOCs, Valerie Marcel notes that in Iran, NIOC "was created to become the national custodian of the [the country's] most prized and political commodity." Due to Iran's turbulent history, "in the Iranian oil industry, nationalism and the fear of renewed imperialism are more present than elsewhere in the region."<sup>16</sup> At every stage of its development, NIOC has faced popular demands for social justice and state demands for revenue, both of which have greatly constrained NIOC's business conduct.

Yet these goals are often mutually unobtainable. Over time, these contradictions have caused recurrent crises in the relationship between Iran's oil sector, the state, and society. Under Khomeini's leadership, the 1979 constitution of the Islamic Republic

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<sup>14</sup>"Comparative Reform Strategies in the Arab World" in Rex Brynen and Bahgat Korany, eds., *Political Liberalization and Democratization in the Arab World* (Boulder: Lynne Rienner Press, 1995).

<sup>15</sup> John Waterbury, *Exposed to Innumerable Delusions: Public Enterprise and State Power in Egypt, India, Mexico, and Turkey* (Princeton: Princeton University Press, 1993).

<sup>16</sup> Valerie Marcel, *Oil Titans: National Oil Companies in the Middle East* (Washington DC: Brookings Institution, 2006), 56, 42.

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officially enshrined the concept of public ownership and state administration of oil under state control, specifying that mineral wealth “be at the disposal of the Islamic government for it to utilize in accordance with the public interest.”<sup>17</sup> NIOC was the “golden goose” for the new regime’s aggressive plan to distribute rents to reward key constituencies like the traditional bazaar-based bourgeoisie. The organizational efficiency and sustainability of NIOC were tertiary and expendable so long as these goals were met.

As Iran experienced economic crisis in the late 1980s—a process deeply aggravated by its war with Iraq and decline in oil prices—it found it had to dismantle some of its statist infrastructure. Some degree of privatization—the removal of NIOC monopoly over upstream and downstream development—was necessary to secure investment for Iran’s most valuable economic sector. The ensuing privatization of some NIOC assets and the introduction of more private firms as partners of NIOC have strained the relationship between the firm and the state. On the one hand, as with any bureaucratic institution, NIOC was always differentiated by its specialized skills and knowledge-base, but until the early 1990s, it was an instrument under state control. On the other hand, pressures for privatization introduced ambiguity in the relationship between NIOC as agent and the state as principal, blurring the boundary between public and private interest. Today the state is not the sole claimant to NIOC’s allegiance. Rather, NIOC is a hybrid between an SOE and a private, domestically-owned firm.<sup>18</sup> Senior NIOC members, in alliance with other politically prominent figures and foreign

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<sup>17</sup> Hamid Algar, trans., *Constitution of the Islamic Republic of Iran* (Berkeley: Mizan Press, 1980), Section 3, Article 45.

<sup>18</sup> Erika Weinthal and Pauline Jones Luong, “Combating the Resource Curse: An Alternative Solution to Managing Mineral Wealth,” *Perspectives on Politics*, 4:1 (2006); Pauline Jones Luong, “Rethinking the Resource Curse: Ownership Structure and Institutional Capacity,” Paper prepared for the Conference on Globalization and Self-Determination, Yale University, New Haven, May 14-15, 2004.

investors, exploit this ambiguity to pursue business strategies that benefit them individually and NIOC institutionally. This, however, often comes at the expense of NIOC's larger state-sanctioned mandate to serve the general populace—especially during periods of declining revenue or economic mismanagement, a point to which we shall return below.

NIOC and its various overseas subsidiaries have two unique capacities or avenues to forward their agenda. First, since NIOC is an incumbent firm with established ties to the state, it can influence laws to ensure its corporate interests are served using formal avenues such as testimony to the Parliament (*Majles*) and contact with ministries and other state officials. Secondly and more importantly in recent years, NIOC has captured certain properties of the state. It can entice public officials to cooperate with its plans by offering preferential contracts and other forms of non-transparent payments. By these two means, NIOC has been able to shape the formation of basic laws, rules, decrees, and regulations that would affect its future competitiveness.<sup>19</sup> Reciprocally, Iran's political elite, both inside and outside the oil sector, have ensured that "opening" the economy to foreign influence does not destabilize the regime, even as the state haltingly recedes from some aspects of Iran's economic life.

## **BUILDING THE IRANIAN RENTIER STATE, 1872-1989**

The early interactions between the Iranian state, society, and oil companies set the parameters for the future dealings between NIOC and IOCs. From the very beginning, these interactions were characterized both by high expectations about what Iran could achieve with its oil wealth and by great distrust of international investors who would

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<sup>19</sup> J. Hellman, G. Jones, and D. Kaufman, "Seize the State, Seize the Day: State Capture, Corruption and Influence in Transition" World Bank Policy Research Working Paper, No. 2402, Washington DC, 2000.

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swindle Iran of its national patrimony. This hostility to foreign intervention in Iran's internal affairs precipitated the establishment of NIOC and was immediately reinforced when Western powers deposed the chief architect of oil nationalization. These lessons derived from Iran's national history carry over and continue to influence NIOC today.

In the late 19<sup>th</sup> century, when interest in petroleum as an industrial-grade fuel first emerged, Iran under the Qajar dynasty was in economic and political disarray. Externally, Iran was beset on the north by an increasingly hostile Tsarist empire and on the east by British India. Internally, Iran's ruling shahs enjoyed fragmented authority over a disparate population that was falling ever further behind the West economically and technologically. In a search of capital, they resorted to monopoly concessions, but this only alienated nationalists who feared Iran was succumbing to the hegemony of non-Muslim powers.<sup>20</sup>

Iran became a new arena for competition in the "Great Game" between Britain and Russia for geo-strategic control of Asia. In 1901, the British millionaire William Knox D'Arcy gained a concession from Mozzaffar ed Din Shah for oil exploration. D'Arcy agreed to pay 20,000 pounds sterling up front, the value of 20,000 pounds sterling in stock, and 16 percent of future profits to Iran, in return for the exclusive rights to explore and exploit oil in the southern provinces. British agents campaigned for D'Arcy in the Shah's court and tried to outmaneuver Russian objections and several courtiers accepted bribes in return for supporting the British bid.<sup>21</sup> By the eve of the World War I, however, insecurity about the availability of petroleum supplies prompted the British government to move from being a sponsor of D'Arcy's Anglo-Persian Oil

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<sup>20</sup> Nikki Keddie, *Qajar Iran and the Rise of Reza Khan, 1796-1925* (Costa Mesa: Mazda, 1999).

<sup>21</sup> For the early history of negotiations, see R.W. Ferrier, *The History of the British Petroleum Company* (New York: Cambridge University Press, 1982), Volume 1.

Company (later re-dubbed Anglo-Iranian Oil Company, AIOC) to a full-fledged partner. To guarantee the security of its energy supply, Britain, at the urging of the first lord of the admiralty, Winston Churchill, purchased equity interest in the AIOC. In return for greater capitalization, the Royal Navy received reduced-price petroleum.

From the Iranian perspective, the AIOC's transition from a privately-held IOC to a British NOC contradicted Iranian national interests. Iran suspected the AIOC of using accounting schemes to hide profits and reduce its royalty payments, but lacked the ability to effectively audit the company. Furthermore, under advice from the British government, the AIOC increasingly diversified its interests in explorations outside of Iran, in effect raising the global supply of oil and depressing the price Iran received from its own oil. The AIOC refused to grant any share of its global profits beyond what was generated from the sale of Iranian petroleum.

Antipathy toward the AIOC and the oil concession grew steadily among the Iranian people as well. While the AIOC's British staff lived in luxurious European-style housing, the company's Iranian laborers and the surrounding communities rarely shared in the benefits of improved wages and living conditions. The AIOC allied with local tribal leaders in Ahwaz to control labor and break strikes. Iranians complained that the AIOC did not contribute enough to train locals for managerial positions or to improve educational, health, and other infrastructure. This hostility became more intense during the First World War, when British and Russian forces occupied Iran, effectively using Iran's own natural resources to fuel their invasion.<sup>22</sup>

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<sup>22</sup> On British policy and labor unrest in Ahwaz, see Shahbaz Shahnava, *Britain and the Opening of South-west Persia, 1880-1914: A Study in Imperialism and Economic Dependence* (New York: RoutledgeCurzon, 2005) and Ervand Abrahamian, *Iran Between Two Revolutions* (Princeton: Princeton University Press, 1982).

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The meteoric rise of Reza Khan to the position of Shah in 1925 brought the first significant challenge to the AIOC from within Iran. Following the example of Mustafa Kemal in Turkey, Reza sought to modernize Iran by seizing control of the economy. In 1929, Iran demanded a renegotiation with the AIOC on the basis that the original concession lacked the necessary approval by the Majles and was illegitimately acquired from a corrupt and decrepit Qajar regime. After unsuccessful negotiations, Reza unilaterally abrogated the concession. The matter quickly escalated, as the British government came to defend the company and warned of dire consequences if its activities were hindered. The Shah maintained his determined posture, increased his purchase of military hardware and threatened to destroy the oil installation should Britain intervene militarily. During the ensuing arbitration in the League of Nations, Iran raised what was to become a central rallying cry and core tenet for the later nationalization: that control of oil was a core component of Iran's sovereignty.

Still, the connection between Iran's oil and Iran's sovereignty was never fully tested. Before a ruling came in international court, the AIOC and Iranian government agreed to limit the scope of the concession and guarantee Iran a greater share of the profits in return for extending the duration of the terms. The 1933 revisions, then, met the interest of the state for increased revenue, but did not address the issues of national sovereignty and independence crucial to so many Iranians. In effect, the 1933 agreement satisfied the state but not the people.

Iran continued to complain about the AIOC's 'overproduction' and its unwillingness to invest enough in improving Iran's own human and physical infrastructure, but Britain remained intransigent. During World War II, Britain and the

Soviet Union again invaded Iran to prevent its oil fields from falling into Axis hands. By the late 1940s, however, the international and domestic arena had changed significantly to favor Iran's demands. Around the world, oil producing states had gained new power over their natural resources.<sup>23</sup> In Iran, the deposition in 1941 of Reza Shah in favor of his son Mohammed Reza Shah opened the door to greater democratic freedoms in Iranian politics.

At the fulcrum of the many disparate movements clamoring for reform was Dr. Mohammed Mossadeq, scion of an aristocratic family and long-standing opponent of the Pahlavi monarchy. Mossadeq assumed the prime ministry in 1951 with the promise of restoring Iran's honor and dignity by eliminating the AIOC concession. As in Mexico, Mossadeq proposed a national company to assume control over oil wealth on behalf of the Iranian people. Mossadeq cemented the link between Iranian oil and Iranian nationalism, transforming oil from a fungible commodity to a political symbol. As Fakhreddin Azimi observed,

[t]he oil issue was a tangible instrument around which popular demands and national aspirations could be focused... the National Front [Mossadeq's political party], moreover, perceived the nationalization of the Anglo-Iranian Oil Company as a goal which symbolized the real decolonization of Iran, and an ideal inseparable from the consolidation of constitutionalism.<sup>24</sup>

Previous negotiations had focused on the purely financial arrangements of finding a more equitable division of profits between the AIOC and the Iranian state. But Mossadeq now

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<sup>23</sup> Stephen J. Kobrin, "Diffusion as an Explanation of Oil Nationalization: Or the Domino Effect Rides Again," *Journal of Conflict Resolution* 29:1 (1985).

<sup>24</sup> Fakhreddin Azimi, "Musaddiq: The Reconciliation of Ethics and Politics, Nationalism and Democracy," in James A. Bill and William Roger Louis, eds., *Musaddiq, Iranian Nationalism and Oil* (Austin: University of Texas Press, 1988), 53.

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told his British counterpart that henceforth “we value independence more than economics.”<sup>25</sup>

In April 1951, the Majles abrogated the concession, nationalized the AIOC’s properties and infrastructure, and established NIOC as its successor. Mehdi Bazargan, a French educated engineer and close ally to Mossadeq, became the managing director.<sup>26</sup> (Twenty eight years later, Bazargan was appointed by Ayatollah Khomeini as the first prime minister following the fall of the shah). Britain rejected the legitimacy of nationalization, despite Iran’s offers to compensate AIOC shareholders. Britain and the U.S. saw Mossadeq’s move as a threat to their commercial interests, and they feared that Mossadeq’s alliance with the Tudeh Party would lead to a communist take-over of the country. American and British IOCs, working with the consent of their respective governments, colluded to block any firm from doing business with NIOC, starving the Iranian economy of \$200 million of oil revenue annually. Again, the dispute proved irresolvable in bilateral negotiations and ultimately reached the International Court of Justice. Britain contested Iran’s right to unilaterally abrogate its commitments to the AIOC; Iran questioned the jurisdiction of an international court to interfere in a commercial dispute between a sovereign state and private company.

During the nearly two year stand-off, Mossadeq was fairly successful in staving off the economic collapse that many predicted would result from the international boycott. But he failed to sustain a broad political coalition that spanned from the Tudeh party to conservative Shi’i jurists.<sup>27</sup> Meanwhile, Britain and the U.S. conspired to oust

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<sup>25</sup> R.W. Ferrier, “The Anglo-Iranian Oil Dispute: A Triangular Relationship,” in Bill and Louis, 180.

<sup>26</sup> Mostafa Elm, *Oil, Power, and Principle: Iran’s Oil Nationalization and Its Aftermath* (Syracuse: Syracuse University Press, 1992), 95, 118.

<sup>27</sup> Ferrier, “The Anglo-Iranian Oil Dispute,” 190.

Mossadeq. On August 19, 1953, Iranian military officers working with British and American intelligence agencies arrested Mossadeq and brought Muhammed Reza Shah back from Rome, where he had fled.

With Mossadeq gone, negotiations between Iran and Britain secured NIOC's position in the Iranian oil industry. A new consortium of American and French IOCs was admitted alongside the British. These IOCs were now designated agents of NIOC. NIOC split 50 percent of the profits from sale of Iranian crude with the agent consortium, received 12.5 percent of the oil to sell under its own name, plus fuel at a reduced rate for use in the domestic market. Iran extracted a vague promise that the IOCs would hire more Iranian nationals to managerial positions. NIOC assumed full financial responsibility for improvements in general infrastructure, sanitation, housing, etc. for industrial workers. The parameters of the concessionary area were again adjusted in Iran's favor, but the term extended for 25 years.

While this agreement was an improvement over the 1933 concession, it again failed to live up to Mossadeq's promise that securing control of Iran's own oil meant controlling its own destiny. It was obvious that NIOC still did not have total control over output or marketing. The long-reviled British and newly-despised Americans were still meddling in Iran's domestic politics. Most importantly, the fact that the agreement was accepted by an increasingly autocratic and unpopular Shah, rather than Mossadeq, meant that what could have been considered a triumph for Iran was perceived rather as a humiliation.<sup>28</sup>

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<sup>28</sup> Mary Ann Heiss, *Empire and Nationhood: The United States, Great Britain, and Iranian Oil, 1950-1954* (New York: Columbia University Press, 1997), 209-20.

## **National Iranian Oil Company**

NIOC steadily grew as a player in the global oil market and a symbol of Iranian national pride. In 1957, for example, the Majles empowered NIOC to take over all Iran's dealing with IOCs as well as to undertake ventures outside of Iran. NIOC developed several different types of contracts with which to attract foreign investors, including joint ventures between itself and IOCs and service contracts in which foreign firms served as contracting agents for the Iranian government, with payment coming either before or after fields came online.

NIOC immediately found an Italian bidder from outside the consortium to enter a joint venture with NIOC that paid Iran 75 percent of the profits. Such an agreement clearly threatened the existing consortium, as NIOC received a string of bidders offering better terms than the consortium. In the ensuing years, Japanese, Dutch, Danish, and Soviet-bloc firms all entered Iran under similar terms. It also expanded its operations to gas, petrochemicals, and domestic refining, and launched a number of overseas joint-ventures. These aimed to improve the firm's in-house technical expertise and decrease its reliance on IOCs. The establishment of OPEC in 1960—of which Iran was a founding member—further turned the tables in favor of producer countries. Securing Iran's position at the head of the international oil market, a position it had lost between 1951 and 1953, was a crucial point of pride for the Shah. By 1973, the old consortium had officially dissolved, leaving NIOC free to contract with any firm it chose. As the Shah told steel workers in Isfahan, the Western firms had “surrendered totally... [and] handed over to us total and real operations of the oil industry of Iran with ownership of all

installations.”<sup>29</sup> NIOC was a testament to that victory, a tangible symbol of Iranian people’s control of their own economic destiny.

Relying on the now bountiful oil rents, the Shah believed he could radically transform Iran from a predominantly rural country into a global power in less than a generation. The Shah spent billions to launch a ‘white’ revolution in 1963, entailing massive projects of land-redistribution, industrialization, and social secularization. The details of the social dislocation and resistance this engendered are not directly relevant to this study.<sup>30</sup> However, part of the subsequent popular discontent followed from the perception that Iran’s oil wealth was being squandered or abused. With oil wealth came rampant corruption among politicians and bureaucrats, misappropriation of funds, plus the Shah’s penchant for extravagant personal vanity. Despite public sympathy with the Palestinian plight and a sense of Muslim solidarity, the Shah continued to maintain an alignment with the U.S. and Israel. In 1973, Iran defied the Arab oil embargo. Thus, again, Iranian oil flowed into the hands of foreign states whose interest were seen as inimical to the good of Iranians.

Throughout the 1970s, the Shah raised the hope that every Iranian could enjoy the benefits of the nationalized oil wealth, yet many Iranians saw their economic and social conditions deteriorate. NIOC improved its technical competence, expanded its operations, and gained more favorable terms from investors. But the failure to deliver the promises of economic prosperity and what many Iranians assumed were the promises of political independence contributed directly to the 1978-1979 Revolution. Violent

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<sup>29</sup> Cited in Robert B. Stobaugh, “The Evolution of Iranian Oil Policy, 1925-1975,” in George Lenczowski, ed., *Iran Under the Pahlavis* (Hoover Institution Press: Stanford, 1978), 220.

<sup>30</sup> Rouhollah K. Ramazani, “Iran’s ‘White Revolution’: A Study in Political Development,” *International Journal of Middle East Studies*, 5:2 (1974).

opposition to the Shah sprung up in many quarters, including among students and socially conservative religious camps. Many anti-regime guerrillas assimilated quasi-Marxist theories. They believed that oil actually retarded and distorted Iran's growth by forcing it to remain an exporter of raw material and importer of finished ones. Eying Mossadeq as a role-model (although not an untarnished one), some revolutionaries even advocated an 'oil-free' economy in which Iran's energy was only used to fuel domestic industrialization, not for export. A consensus aroused across the revolutionary spectrum that reform in the oil industry and a more just distribution of oil rents was necessary.<sup>31</sup>

After the 1979 Revolution, the new regime immediately revised the terms of the relationship between the state and NIOC. Article 44 of the new revolutionary constitution officially reserved oil, along with other significant sectors of the Iranian economy, to be "publicly owned and administered by the state." In a largely symbolic gesture, on February 28, 1979, the revolutionary government unilaterally abrogated the remnants of the concessionary agreement. NIOC would now market all of Iran's oil itself and hire contractors directly. Hassan Nazih, an outspoken civil rights lawyer, was appointed as the new managing director of NIOC. In addition to replacing NIOC's director, the new regime also created a new oil ministry to increase oversight. Nazih hoped to reduce foreign involvement in Iran's oil industry and lower production in order to reduce depletion of reserves. While a considerable number of NIOC management staff fled Iran preemptively, Nazih tried to protect the core of NIOC technocrats from political

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<sup>31</sup> Shaul Bakhash, *The Politics of Oil and Revolution in Iran* (Brookings Institution: Washington DC, 1982), 4-6; Ervand Abrahamian, *Khomeinism: Essays on the Islamic Republic* (Berkeley: University of California Press, 1993).

interference. In fact, Nazih's administration of NIOC was consistent with many of the policies adopted during the Shah's last years.<sup>32</sup>

However, as the revolution unfolded, Ayatollah Khomeini and the radical clerics turned on Nazih, purging him along with many other technocrats. Clerics with little experience in the industry or even management joined NIOC to oversee the staff. Instead of focusing on long-term contracts with the major IOCs, NIOC integrated Japanese, Pakistani, Turkish, and Soviet Bloc firms into its customer base. It sold on the spot and short term market and even bartered. This marketing practice was clearly intended to reduce Iran's susceptibility to boycott by Western oil producers and to diversify the Islamic Republic's political and economic connections. But this approach only undercut the credibility of the OPEC price fixing mechanism and damaged NIOC's credibility as a reliable and professional organization.<sup>33</sup>

The outbreak of the Iran-Iraq War in 1980 and the 1980s oil glut, however, forced Iran to back away from its more aggressive policies. Iran's oil output plummeted to 2.2 mb/d by July 1982.<sup>34</sup> NIOC faced a number of different challenges during this period. Iraqi attacks damaged much of the oil infrastructure in Ahwaz and threatened Iranian shipping in the Persian Gulf. The withdrawal of Western investment caused a further decline in the quality of Iran's fields. NIOC technocrats tried to compensate for the lack of Western technology by devising their own solutions to production problems.<sup>35</sup> At the same time, though, politics compromised NIOC's professionalism. NIOC offices were used as fronts to circumvent the Western arms embargo, essentially bartering oil for

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<sup>32</sup> Bakhsh, 7-8.

<sup>33</sup> Ibid, 9-12.

<sup>34</sup> Ibid, 34-7.

<sup>35</sup> Marcel, 215-6.

weapons. The opacity of these types of negotiations invited abuse, embezzlement, and other financial irregularities both in Iran and in the West. Thus in the late 1980s and early 1990s Hashemi-Rafsanjani and his relatives and Iranian third party agents in Dubai secretly negotiated with Western companies trying to secure access to drilling equipment and other hardware, treating NIOC revenues as a slush fund.<sup>36</sup> Such actions, committed by a powerful businessman, long time Khomeini ally and future president, left a debilitating legacy by associating NIOC with patterns of rent seeking and corruption that in the ensuing years were regularly “exposed” in a succession of internal power struggles.

Despite the revolutionary government’s inclination to reduce reliance on oil, the costs of war, deteriorating economic conditions, and a population boom resulted in Iran becoming ever more oil dependent. Under the new provisions set out in the 1979 constitution, the state assumed responsibility to provide all citizens with basic necessities and life-time employment. Large sectors of the industrial, mining, and banking sector were nationalized. Run as state-owned enterprises, they typically incurred heavy debts and bloated pay-rolls, and provided a host of services and subsidies, from education to food to fuel, at virtually no cost. Outside of the state’s direct control, but still aligned with the Supreme Leader, religious foundations called bonyads, expropriated vast sums of property from wealthy exiles and other royalists. Many members of the bazaar, the traditional merchant class, gravitated to the bonyads as an extension of their service as financiers of Iran’s religious establishment. Some bonyads becoming multi-functional conglomerates in construction and housing, tourism, real estate, agriculture, and other fields, holding properties in the name of the disenfranchised. By the early 1990s, the

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<sup>36</sup> Andrew Gowers, “Why All’s Well in the Arms Bazaar,” *Financial Times*, August 15, 1987; Ibid., “Iraq Claims Iran is Still Buying Arms in London,” *Financial Times*, December 18, 1987; “Irangate Themes Repeated in Iranian Oilfield Purchasing,” *Mideast Markets*, April 13, 1987.

largest bonyad, Mostazafin va Janbazan (MJF), controlled hundreds of companies, employing 50,000 workers. Due to their status as religious charities, however, these bonyads were free from government audit or taxation. Through the course of the Iran-Iraq War, the bonyads built strong connections with the Pasdaran (Islamic Revolutionary Guard Corps), the Basij paramilitaries, and other branches of the security establishment. Each owed a similar allegiance to the Supreme Leader.<sup>37</sup> In the coming decades, each of these groups would aspire to enter the oil market as partners of the privatizing NIOC.

## **NIOC IN THE ERA OF ECONOMIC LIBERALIZATION**

### **1989-PRESENT**

The Khomeini era left Iran with a political system riddled with contradictions.<sup>38</sup> On one hand, the constitutions endowed the judiciary, legislature, and executive with real powers and responsibility in ways that created a measure of checks and balances. On the other hand, the Supreme Leader and his clerical allies could abrogate almost any policy using both constitutionally-enshrined powers and informal networks connecting religious authority with the bazaar and the Pasdaran. Economically, too, Iran displayed a schizophrenic tendency, at once heavily statist and redistributive, while also protective of the para-statal economic sphere where the bonyads and other quasi-governmental

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<sup>37</sup> Ali Rashidi, "The Process of De-Privatisation in Iran after the Revolution of 1979," in T. Coville, ed., *The Economy of Islamic Iran: Between State and Market* (Tehran: Institut Francais de Recherche en Iran, 1994); Ali A. Saeidi, "The Accountability of Para-governmental Organizations (Bonyads): The Case of Iranian Foundations," *Iranian Studies*, 37:3 (2004); Suzanne Maloney, "Agents or Obstacles? Parastatal Foundations and Challenges for Iranian Development," in Parvin Alizadeh, ed., *The Economy of Iran: Dilemmas of an Islamic State* (New York: I.B. Tauris, 2000).

<sup>38</sup> Daniel Brumberg, *Reinventing Khomeini: The Struggle for Reform in Iran* (Chicago: University of Chicago Press, 2001).

agencies functioned under the direct oversight of the Supreme Leader, but not the civil authority of the Majles and the ministries.<sup>39</sup>

Like the Shah before him, Khomeini established high expectations about the wealth Iran's oil was capable of generating, combined with an abiding disappointment as to what was actually accomplished. The constitution of the Islamic Republic committed the state to use the mechanisms of a command economy to redistribute wealth to the underprivileged and ensure full-employment and social welfare.<sup>40</sup> Iran became even more dependent on oil as a source of government revenue. While this system did provide some boon to the lowest income sectors, it also yielded increased unemployment and marked decline in the industrial and service sectors, as well as in per capita GDP.<sup>41</sup>

In the wake of Khomeini's death in 1989 Iran's competing factions lost the charismatic leader who had previously arbitrated their disputes. As a result, both old and new political constellations competed in ways that frayed the old revolutionary consensus over economic and political policy. Each of these factions claimed a facet of the Khomeini legacy as their own. The cleavages between them existed on both the socio-political and economic issues. The continuum of socio-political views spanned from 'reformists' who sought to introduce greater political and civil liberties to Iran to 'radicals' who demanded a social conservatism and a harsher stance against un-Islamic sentiment. Divergent views about economic reforms cut across each of these camps, however. For analytic purposes, we can divide Iran into three loose poles or camps of

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<sup>39</sup> Mehran Kamrava and Houchang Hassan-Yari, "Suspended Equilibrium in Iran's Political System," *The Muslim World*, 94:4 (2004); Mehran Kamrava, "The Politics of Weak Control: State Capacity and Economic Semi-formality in the Middle East," *Comparative Studies of South Asia, Africa, and the Middle East*, 22: 1-2 (2002).

<sup>40</sup> *Constitution of the Islamic Republic of Iran*, Article 43-55.

<sup>41</sup> Adnan Mazarei, Jr., "The Iranian Economy under the Islamic Republic of Iran: Institutional Change and Macroeconomic Performance (1979-1990)," *Cambridge Journal of Economics*, 20 (1996).

political orientation: the populists, associated with Ahmedinejad, the culturally conservative bazaar, associated with Rafsanjani, and the reformists, associated with Khatami.<sup>42</sup>

The power of each of these political groupings is contingent on the power and objectives of Supreme Leader Ayatollah Khamenei. Khamenei is responsible for protecting and perpetuating the Islamic republic. He is thus authorized to intervene in nearly any aspect of political, economic, or cultural life and routinely balances among factions to ensure the stability of the system. Each political faction vies for the Supreme Leader's favor; it is his responsibility to prevent any side from gaining too much power and thus leading to fissures in the revolutionary consensus.

Ahmedinejad came to the presidency in 2005 on a platform of economic populism. His primary support comes from the urban and rural poor, who feel entitled to a high level of state welfare support and are suspicious of corruption and manipulation by the upper class, particularly those who might divert the benefits of oil from public to personal use. Many Ahmedinejad supporters are also veterans or connected to the Pasdaran and Basij. As Ahmedinejad said during the run-off election, "I will cut off the hands of the mafias of power and factions which have a grasp on oil... People must see their share of oil money in their daily lives."<sup>43</sup> This class suspicion, combined with a strong nationalism and religious conservatism, makes the populists deeply skeptical of attempts by foreigners to enter the Iranian oil market. But even more, it makes members of the other two factions suspicious of him and his intentions.

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<sup>42</sup> This classification draws on Matthew Wells, "Thermidor in the Islamic Republic of Iran: The Rise of Muhammed Khatami" *British Journal of Middle Eastern Studies*, 26:1 (1999) and W. Buchta, *Who Rules Iran?* (Washington: Washington Institute for Near East Policy, 2000).

<sup>43</sup> Cited in MEES, July 4, 2005.

Ahmedinejad's closest rival in the election was former president Rafsanjani, who represented another important constituency of the Islamic republic. The core of Rafsanjani's support comes from the bazaar, which is culturally conservative but economically laissez faire. They support economic liberalization both as a means to improve Iran's general economic performance but also to gain privileged access to foreign capital and hard currency for themselves.<sup>44</sup> Some prominent members of the bazaar had played a role in NIOC's marketing division throughout the 1980s, but in general NIOC tried to maintain an arm's length relationship from the bazaar and the bazaar-dominated bonyad. For the bazaaris, however, NIOC remained an alluring partner for projects designed to attract foreign investment.

The final pole is the reformists, epitomized by President Khatami. The reformists have the most ambiguous attitudes toward economic reform.<sup>45</sup> Many reformists came from an Islamic leftist background and were suspicious of the private sector. After assuming power in the 1990s, though, some have come belatedly to embrace the free market as necessarily concomitant with political reform, but there remains no clear consensus among reformists about economic issues. During the final years of Khatami's second administration (2000-2005), these fissures within the reformist camp, combined with the resistance of conservatives in the Guardian Council and elsewhere, stymied most efforts of the reformist program.

It is in this context of competing power structures, mediated by the nearly all powerful position of the Supreme Leader, that NIOC's wider relevance to the political system must be understood. NIOC's continues to serve as a fount for the state-oriented

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<sup>44</sup> Maloney, 166.

<sup>45</sup> Sohrab Behdad, "Khatami and His 'Reformist' Economic (Non-)Agenda," *Middle East Report*, May 21, 2001, <http://www.merip.org/mero/mero052101.html> (accessed December 29, 2006).

and redistributive political economy. NIOC was responsible for three distinct forms of subsidization: First, NIOC directly administered a significant program subsidizing domestic consumption of fuel for the entire country. As argued below, the burden of refining and distributing reduced price fuel has proven prohibitively expensive to NIOC.

One of NIOC's main focuses in its drive for economic liberalization, therefore, has been to shrink the size and scope of these subsidies. Less visible but still important is NIOC's role as a provider of generous wages and benefits to its tens of thousands of employees and their families. Given Iran's highly protective labor laws and NIOC's civil service mentality, it is highly probable that many positions with NIOC, both white and blue collar, are superfluous or redundant. However, maintaining the bloated rolls is another way for the state to pay its citizens indirectly.<sup>46</sup> Furthermore, since one of the many complaints about NIOC's predecessors was that they failed to invest in Iran's human capital, downsizing NIOC workforce is nearly impossible. Finally, NIOC is the cash cow for the entire structure of the Iranian welfare state. Nearly all government spending, from the military to education to food subsidies, is ultimately derived from money NIOC remits to the national treasury. NIOC thus enjoys limited political autonomy but extremely high economic value.

NIOC has two methods to influence policy decisions in Iran. First, like nearly every specialized government bureaucracy, NIOC has technical expertise and can offer advice to policy-makers. In interviews, Marcel was told by NIOC officials that the firm is responsible for executing policy, not for setting NIOC's larger strategy, yet, as Marcel

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<sup>46</sup> Hen-Tov observes that since 1979, NIOC employment rolls have grown 300 percent while oil production declined by 33 percent. This is somewhat misleading, however, since it does not account for the growth of gas, the embargo of advanced technology, and the requirement for NIOC to make up for foreign staff that left after 1979. Elliot Hen-Tov, "Understanding Iran's New Authoritarianism," *Washington Quarterly* 30:1 (2006): 170.

observed, the boundary between these two facets of control is often blurry.<sup>47</sup> The Oil Minister and his deputies submit recommendations to various decision-making bodies on such things as optimal production levels. The extent to which such formal channels are effective is not entirely clear.

At the same time, NIOC can also in join political alliances with the prominent political faction described above. The key to the success of this strategy is to appease Khamenei, who makes the ultimate decisions about the good of the country. At the moment, NIOC can be seen as a bridge between the reformist and conservative bazaari camps, both of whom oppose the massive expansion of welfare state advocated by Ahmedinejad and the populists. As an organization, NIOC had much to gain from economic reform. This would relieve some of NIOC's responsibilities to subsidize fuel and open up the oil market to investment. During the 2005 presidential campaign, Oil Minister Bijan Zanganeh was widely perceived to be a key Rafsanjani partisan, having been first appointed energy minister by Rafsanjani in the 1990s.<sup>48</sup> It is not surprising that key NIOC officials came to be closely associated with both the bazaar and those reformists who supported the economic liberalization project. The limits of this association vary, however, depending on the specific policy under consideration and the tone of the immediate political environment.

This section examines three crucial and interrelated fields of policy-making to evaluate the way NIOC can influence and is influenced by Iranian politics. The first field is in state-firm relations, defining the formal relationship between the government and NIOC. The second is in influencing Iran's foreign policy decision-making. The final

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<sup>47</sup> Marcel, 77.

<sup>48</sup> MEES, June 4, 2005.

field is in promoting economic reform. In some areas NIOC indeed does possess some capacity for autonomous, self-interested actions that prioritize the firm's profitability over the state's demands. In other areas, however, NIOC has been more a consistent servant and agent of the state that remains institutionally embedded and attached. Below we shall see NIOC's autonomy is contingent upon the approval of the Supreme Leader and the need to stabilize the entire system of the Islamic Republic.

### *Shifting Terms of State-Firm Relations*

Like many firms from Rafsanjani's era of liberalization, NIOC used public funding to create enterprises with no clear affiliation, with ministries and state agencies deliberately holding minority shares. These semi-public firms were able to pursue profit-making outside the purview of state monitors and regulations.<sup>49</sup> Through this opaque structure NIOC produced rents that benefited figures across the Iranian political spectrum through side payments, but avoided seconding these rents formally to the state.

NIOC answers to numerous authorities, but it also has numerous avenues by which to build political and economic alliances. The Oil Ministry, intended to monitor NIOC, has actually developed a symbiotic relationship in which the two are intertwined and nearly indistinguishable. The Minister often holds the post of NIOC chairman but there seems little change in the bureaucratic core of NIOC. The role of watch-dog over NIOC has largely fallen to the Majles, particularly to the Economics and Energy Committees. Majles members have often politicized issues of oil management and use charges of corruption to block some of NIOC's objectives. Kemal Daneshyar, chairman

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<sup>49</sup> Akbar Karbassian, "The Islamic Revolution and Management of the Iranian Economy," *Social Research*, 67:2 (2000): 636-7.

of the Majles energy committee, has proven to be one of NIOC strongest critics. As one NIOC official retorted, “in parliament people think the resource belongs to the people. They are not thinking of the economy.”<sup>50</sup>

Iran’s multi-level, multi-polar political system allows indirect recourse to the popular will, but maintains decision making power in a fairly small circle dominated by clerical authorities. At the center of this system is the Supreme Leader (*rahbar*) and his office (*bayt-e rahbar*), which consists of nearly 300 policy-experts, often former ministers and senior military personnel. This office is endowed with decision-making authority over all “key” policies regarding the preservation of the Islamic Republic. Outside his official position as head of state, the Supreme Leader is also the chief spiritual leader of Iran and thus has para-statal connections to the heads of the bonyad and to senior commanders in the Pasdaran. The office of the Supreme Leader typically receives a tithe of 15 percent from the largest of these bonyads.<sup>51</sup>

Under the Supreme Leader, redundant and overlapping institutions ensure that decisions are made by consensus. The President is the head of the government and chief of the executive branch. Within the executive is a panoply of autonomous organizations, like the Industrial Development Reconstruction Organization (IDRO) and the State Planning Organization (since renamed the Management and Planning Organization), and a host of policy committees, all of which contribute to formulating economic policy.<sup>52</sup>

Among those with the most direct impact on NIOC are:

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<sup>50</sup> Marcel, 102, 90.

<sup>51</sup> Interview with M.S.; Interview with A.M.

<sup>52</sup> An interviewer noted that of the High Council of Industries, Money and Credit, Banking, Security, and Administration, all chaired by the president, could play a role in setting state economic policy. Interview with M.S.

- *NIOC General Assembly.* This body sets NIOC’s general policy and approves its budget. The members of the General Assembly are the President of the Republic, the Vice President, the Oil Minister, the Energy Minister, the Labor and Social Affairs Minister, the Industries and Mining Minister, the Economy Minister, the Finance Minister, and the Director General of the Management and Planning Organization.<sup>53</sup>
- *The Supreme Economic Council.* The Supreme Economic Council was founded by Khatami to centralize economic decision making. Khatami chaired the council. This council has final word on most development contracts in the oil sector and approves contracts between SOEs and private companies, including foreign direct investment. The council is also responsible for ensuring that state subsidies are appropriately administered. All of NIOC proposed contracts must be approved by this body.<sup>54</sup>
- *The Petroleum Council.* In early 2006, Ahmedinejad, seeking greater control over the oil sector, established the Petroleum Council, to “protect national interests” and to supervise the awarding of oil contracts. The Council consists of the President, the Oil Minister, Minister of Finance Davoud Danesh-Jafari, Head of the State Planning Organization Farhad Rahbar, the Governor of the Central Bank Ibrahim Sheibani, and the Chief of the Presidential Office.<sup>55</sup>

There are several institutions charged with mediating between the clerical and civil authority:

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<sup>53</sup> NIOC webpage, [http://www.nioc.com/sub\\_Companies/index.html](http://www.nioc.com/sub_Companies/index.html) (accessed December 27, 2006)

<sup>54</sup> Email correspondence, A.M, August 16, 2006.

<sup>55</sup> MEES, January 16, 2006.

- *The Guardian Council.* The Guardian Council represents the bastion of clerical authority. The Guardian Council is a constitutionally-enshrined body responsible for ruling on the constitutionality of the laws passed by the Majles. If a law is vetoed by the Guardian Council, it is passed back to the Majles for revision. Six members of the Guardian Council are directly selected by the Supreme Leader and six are nominated by the head of the judiciary (himself appointed by the Supreme Leader), subject to Majles approval. The Guardian Council also vets candidates for the Majles and the presidency. Under Khatami, the Guardian Council blocked several proposals for privatization and economic reform and launched an independent probe of irregularities in NIOC and Oil Ministries. As one interviewee notes, however, the Guardian Council “can interpret articles in whatever way they want,” and are thus free to approve or reject almost any interpretation of constitutional law.<sup>56</sup>
- *The Expediency Council.* The Expediency Council was established in 1989 through a constitutional amendment. Its role is to adjudicate the increasing number of disputes between the Guardian Council and the Majles. It has twenty-seven members. In 1998, Supreme Leader Ayatollah Khamenei appointed President Rafsanjani as head of the Expediency Council. Under Rafsanjani, the Expediency Council has several times overruled Guardian Council vetoes to move forward economic liberalization programs.<sup>57</sup> The Expediency Council is also responsible for formally advising the Supreme Leader on policy.

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<sup>56</sup> Interview with M.S.

<sup>57</sup> Azadeh Moaveni, “Shadowy Rafsanjani,” *Al-Ahram Weekly*, February 13-20, 2000, <http://weekly.ahram.org.eg/2000/469/re7.htm> (accessed December 29, 2006).

Immediately upon Ahmedinejad's election in summer 2005, the Majles initiated legislation calling for NIOC and its subsidiaries to submit a new charter for the company, clarifying and codifying the dimensions of the state-firm relationship. Such a charter would establish the rules under which royalties were secreted and taxes allocated and the level of political independence NIOC would enjoy. This move was part of Ahmedinejad's anti-corruption drive. As Ahmedinejad said in his campaign, "the atmosphere ruling over our deals, production, and exports is not clear. We should clarify it."<sup>58</sup> Majles-member Shokrollah Attarzadeh remarked that

[t]he structure of the National Oil Company at the time of its establishment was designed in a way that allowed the former monarchic regime to freely use its resources for the royal family's endless and extravagant expenses, without any parliamentary oversight...At the present time, the National Oil Company's incomes and expenditures are not transparent. So the statute of the National Oil Company has to be changed to prevent any misappropriation by certain groups in the Oil Ministry.<sup>59</sup>

At first, NIOC resisted the Majles' demands by temporizing, avoiding compliance until after a new Oil Minister was appointed.<sup>60</sup> While the new minister, Vaziri Hamaneh did eventually offer his plan, there remains doubt as to whether the Majles can ever exercise effective control over the oil sector.<sup>61</sup> At this date, the new charter has still not even had a hearing in the Majles, although one is planned for the coming months.

Beyond the bureaucratic capability to prevaricate, NIOC's level of technical specialization and skill also insulates it from effective oversight and provide opportunity for profit-seeking. While the firm is obliged to give over 25 percent of its profits from crude and (when prices are high) a deposit to the oil stabilization fund, NIOC keeps for

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<sup>58</sup> Cited MEES, July 4, 2005.

<sup>59</sup> Iranian Deputies Offer Ideas To Reform National Oil Company Statute Report by the economic desk: "Oil Ministry Emerges From the Shadows," *Siyasat-e Ruz*, June 24, 2006 T06:05:10Z, FBIS NewsEdge Document Number: 200606241477.1\_525901bc7ea4b36d

<sup>60</sup> MEES, July 19, 2005.

<sup>61</sup> *Siyasat-e Ruz*, op cit.

## National Iranian Oil Company

itself revenues derived from petrochemicals, gas, domestic sales of gasoline, and can make use of gas for re-injection to revive older fields.<sup>62</sup> This type of arrangement provides NIOC with ample incentive to continue to work on diversifying Iran's petroleum industry, as any improvement in non-oil capability will benefit NIOC directly. However, it also has the potential for long-term conflict between state interests in maximizing the revenue from oil, and NIOC preference to focus on gas and petrochemicals as more lucrative ventures. NIOC's internal division into both territorial subsidiaries, like the National Iranian South Oil Company, and functional subsidiaries, like the Exploration Service Company or the National Iranian Gas Company, each with its own board of directors, makes it easier to keep profits inside the company rather than secrete them to the state, since one branch of NIOC can hire another branch as a sub-contractor for projects at an elevated rate.

NIOC also has semi-formal or informal avenues with which to protect its revenue. NIOC owns a Jersey-based trading firm, NaftIran Company (NICO), which is wholly immune from the national government's taxation and regulation. Using NICO as an intermediary for foreign investment allows NIOC to establish a 'back-to-back' line of credit, so that NICO can purchase oil from NIOC and then sell it at a premium to an international investor overseas, keeping the margin for itself. Furthermore, by granting contracts to politically-favored firms, including the bonyad and the Pasdaran, NIOC can reward its key supporters with access to foreign investment without involving the state. The extent of NIOC's political independence is determined by its relationship with the stronger players in the Iranian security, clerical, and bazaar establishment.

### *NIOC in Iran's Foreign Relations*

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<sup>62</sup> Marcel, 135-6.

Iran has long used oil as a tool for state-craft. In the midst of the Iran-Iraq War, Iran cemented its strategic alliance with Syria by selling oil at reduced prices. Syria, in turn, agreed to cut-off Iraq's westward pipeline, provided Iran access to Soviet weaponry, and allowed Iranian military advisors to establish a foothold among the Shi'a militias in southern Lebanon.<sup>63</sup>

As for NIOC, while it has generally favored Iran's opening to other countries—particularly if this would bring in much needed foreign investment—by itself it has little leeway in the wider course of Iran's foreign relations, or in the domestic political contests which affect those relations. This is especially the case when it comes to the crucial question of oil sales. While such sales are inextricably linked to Iran's international conduct, NIOC has little choice but to accept the international projects deemed crucial to Iran's national security. Indeed, the more crucial the project is to Iran's larger foreign policy objectives, the less discretion NIOC maintains.

This point is amply demonstrated by NIOC's relations with OPEC. At the most mundane level, NIOC technical expertise naturally makes it Iran's chief representative at OPEC. Kazempour-Ardabeli has been Iran's OPEC governor since 1985 and served as an advisor in the foreign ministry and a deputy minister of oil. Since the late 1990s, Iran has consistently been one of OPEC's most hawkish members, advocating lower supply and higher prices. Given Iran's inability to meet its OPEC quota, it has no incentive to support higher global production. While NIOC provides most of the technical advice to Ministry and the President, as noted above, ultimately decisions about output are made in the executive branch.

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<sup>63</sup> Marvin Zonis and Daniel Brumberg, *Khomeini, the Islamic Republic of Iran, and the Arab World* (Cambridge: Harvard University Center for Middle Eastern Studies, 1987), 39.

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Beyond OPEC, Iran continues to see relations with both oil producing and oil consuming nations as connected to a larger foreign policy agenda—a perspective that NIOC has little choice to fully support. Both Rafsanjani and Khatami's sought to end Iran's international isolation by subverting the U.S.-backed sanctions regime and reaching out to states interested in commercial relations with Iran. In the 1990s, Iran cooperated with Russia, one of its traditional rivals, in the development of the Caspian energy fields. Suspicious of U.S. and Turkish designs on the region, the two worked to thwart the U.S.-backed Baku-Tbilisi-Ceyhan pipeline.<sup>64</sup> By coordinating with Gazprom, NIOC lowered the price of oil swaps with Turkmenistan, Kazakhstan, and Azerbaijan.

This undermined the need to build a pipeline for physical delivery. Alternatively, Iran sees itself as the logical transfer point for all Caspian Sea energy, a position fully supported by NIOC since it stood to benefit from any direct revenue generated by an Iranian pipeline.<sup>65</sup> Iran continues to demand an international condominium for the Caspian sea bed consistent with the previous Russian-Iranian and Soviet-Iranian agreements, which provided for an even split between the two parties. Following the break-up of the Soviet Union, Iran maintains that it should retain its share of the Caspian Sea, while all the successor states can divide the waters as they see fit. As an alternative, Iran offers to extend its exclusive territorial claims from 12-14 percent of the surface to 20 percent, taking some of the territory currently claimed by Azerbaijan. To back this claim, in 2001, the Iranian naval and air forces interdicted BP vessels conducting research in the Azerbaijan-designated Araz-Alog-Sharg field, demanding that until the

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<sup>64</sup> R. Hrair Dekmejian and Hovann H. Simonian, *Troubled Waters: The Geopolitics of the Caspian Region* (New York: I.B. Tauris, 2001), 78.

<sup>65</sup> Robert O. Freedman, "Russian Iranian Relations in the 1990s," *Middle East Review of International Affairs*, 4:2 (2000).

international dispute was resolved, no further exploration could be permitted. Iran left Russian oil companies unmolested.<sup>66</sup>

Tehran has also used oil to reach out to potential strategic partners in Asia. This is consistent also with a longer trend of Iranian identification with and affinity for Asia. As early as the first Constitutional Revolution, Iranians looked towards Japan as a model for successful development without European domination.<sup>67</sup> From 1990 to 1995, Kazempour Ardabili served simultaneously as Iran's OPEC governor and as its ambassador in Tokyo. As president, Khatami took a personal hand in bringing Japanese and Chinese investment into the Iranian oil sector. In 2000, Khatami invited Japan to begin developing the Azadegan oil field in southwestern Iran. MITI Minister Hiranuma Takeo and Oil Minister Zanganeh soon finalized an agreement to allow the Japanese National Oil Company to participate.<sup>68</sup> While some Iranian conservatives feared that any Japanese investment would be subject to U.S. sanctions, others took this as opportunity to try to pry Japan away from the U.S., insisting during the course of negotiations that Japan not support sanctions on Iran for its nuclear program.<sup>69</sup> In 2001, INPEX signed an initial agreement with NIOC (through the off-shore NICO) for exploration of the Azadegan field in Ahwaz, a field with an estimated 35 to 40 billion barrels. By 2004, INPEX extended its commitment with a \$2 billion buy-back contract for the field.<sup>70</sup>

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<sup>66</sup> Ariel Cohen, Iran's Claim Over Caspian Sea Resources Threaten Energy Security, Backgrounder #1582, Heritage Foundation, Washington DC, September 5, 2002; Bahman Aqiya, *The Law and Politics of the Caspian Sea in the Twentieth Century* (Bethesda, MD: Ibex Publishers, 2003).

<sup>67</sup> Charles Kurzman, "Weaving Iran into the Tree of Nations," *International Journal of Middle East Studies* 37:1 (2005); John Calabrese, China and Iran: Mismatched Partners, Jamestown Foundation Occasional Paper (August 2006), 3-4.

<sup>68</sup> Japan Focus, <http://japanfocus.org/products/details/1590> (accessed August 16, 2006).

<sup>69</sup> Guy Dinmore and Bayan Rahman, "Tehran Presses Tokyo on Oilfield Rights," *Financial Times*, December 8, 2003.

<sup>70</sup> Masao Yamaguchi, "Japan, Iran OK Azadegan Oil Project," *Daily Yomiuri*, July 10, 2001; Amir Paivar and Ikuko Kao, "Iran Signs Contentious Oil Deal with Japan," Reuters, February 19, 2004.

The Tehran-Beijing relationship has also burgeoned since the 1990s. In February 2006, Sinopec took a 51 percent interest in the Yadavaran project, with NIOC 20 percent, and the remained open to other firms.<sup>71</sup> Iran currently supplies 15 to 17 percent of China's oil.<sup>72</sup>

While such agreements have been widely reported in the West and have generated concern that Iran has successfully forged an Asian strategy that could be used to thwart preset or future sanctions pressures, it must be emphasized that many of the promises Iran held out to its Asian customer base have proven chimerical. NIOC officials have repeatedly referred to the so-called "Asian premium" paid for east-bound oil as the "Western discount" and implied that they would prefer to equalize this price disparity. This, however, is an issue in which NIOC cannot unilaterally effectuate much change, since reducing the Asian premium would require a reworking of standard industry contracts. In October 2006, after years of delay, Japan withdrew from nearly the entire Azadegan project. INPEX claimed that the drilling area had not been adequately cleared of mines laid during the Iran-Iraq War, but many in Iran and the international community speculated the Japan had buckled to U.S. pressure and the threat of international sanctions.<sup>73</sup>

Plans for an Iran-India pipeline, on the drawing board since 1989, are stalled as NIOC raise its price demands. As Indian prime minister Manmohan Singh acknowledge in a 2005 interview, "I am realistic enough to realize that there are many risks, because

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<sup>71</sup> Radio Free Europe/Radio Liberty News, February 21, 2006; Mehr News, June 6, 2006.

<sup>72</sup> Stephen Blank, "China's Emerging Energy Nexus with Central Asia," ChinaBrief, Jamestown Foundation, vol. VI, no. 15, July 19, 2006, 9.

<sup>73</sup> David Pilling and Gareth Smyth, "Inpex-Iran Oil Deal in Doubt as Deadline Expires," *Financial Times*, October 5, 2006; R. Shaoul, "An Evaluation of Japan's Current Energy Policy in the Context of the Azadegan Oil Field Agreement Signed in 2004," *Japanese Journal of Political Science*, 6:3 (2005).

considering all the uncertainties of the situation there in Iran. I don't know if any international consortium of bankers would probably underwrite this [pipeline].”<sup>74</sup> A gas pipeline stretching from Iran through central Asia to China similarly remains only hypothetical.<sup>75</sup>

Despite these set-backs, at least these Asian projects have offered a potential upside for NIOC. More explicitly political motivations are behind NIOC's activities in Venezuela. Ahmedinejad's stark anti-U.S. foreign policy has led Iran into a comfortable alliance with Hugo Chavez. This relationship is cemented by NIOC's participation in the consortium developing Venezuela's Orinoco Oil Belt, where PetroPars has been assigned the Ayacucho block in the Anzoategui.<sup>76</sup> The total value of this project is estimated at \$4 billion. In meetings during the summer of 2006, Vaziri-Hamaneh and the Venezuelan Minister of Oil and Energy discussed plans for a joint energy committee between the two countries, for Iran to take on the training of Venezuelans in the oil market, and for Iran to import refined gasoline from Venezuela.<sup>77</sup> Unlike NIOC previous overseas ventures under the Shah, the purpose appears less to improve NIOC's technical capabilities than to demonstrate them to a potential ally.

While this kind of diplomacy does represent a potential danger to Western interests, Iran's military and strategic leadership have also made far more direct warnings

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<sup>74</sup> Aresu Egbali, “Iran again presses India for higher price for LNG,” *Platts Oilgram News*, September 29, 2006; “On Natural Gas Pricing, Iran Keeps India Out,” *Indian Express*, September 22, 2006; *Washington Post*, July 20, 2005; Sanam Vakil, “Iran: Balancing East Against West,” *Washington Quarterly* (Autumn 2006): 60-1.

<sup>75</sup> See the presentation by Abbas Maleki at Harvard University, [http://bcsia.ksg.harvard.edu/publication.cfm?program=CORE&ctype=presentation&item\\_id=112](http://bcsia.ksg.harvard.edu/publication.cfm?program=CORE&ctype=presentation&item_id=112) (accessed August 5, 2006); Blank, op cit.

<sup>76</sup> PetroPars Plans to Develop in Iran, Press Release, February 27, 2006, <http://www.petropars.com/News/NewsArchive/IransPetroParsPlansToDevelopInVenezuela/tabid/210/Default.aspx> (accessed August 3, 2006).

<sup>77</sup> “Iran, Venezuela To Set Up Joint Energy Committee,” IRNA, July 30, 2006; Simon Romero, “Venezuela, Tired of U.S. Influence, Strengthens Its Relationship with the Middle East,” *New York Times*, August 21, 2006.

regarding the implications of an “oil weapon.” In fact, the threat to paralyze global oil markets is a core component of Iran’s concept of geo-strategic deterrence. During the Iran-Iraq War, Iran attacked merchant vessels in the Persian Gulf, restricting the flow of oil from the entire region. Prominent members of Iran’s security establishment have threatened that Iran could blockage the Strait of Hormouz again if Iran’s interests are endangered.<sup>78</sup> Just like Reza Shah’s threats to destroy the oil fields in the 1920s, the calculus is essentially zero-sum, positing that Iran would be willing to accept pain in order to inflict it.

Whatever the geo-strategic logic, however, such rhetoric is clearly deleterious to NIOC, which has struggled to establish Iran’s reputation as a reliable supplier of oil. In the midst of the ongoing dispute over Iran’s nuclear program, Vaziri Hamaneh assured the *Wall Street Journal* that while Iran had the capacity to disrupt oil markets, “we don’t want to cause hardship for any customers around the world. We have a commodity and we want to sell it, and we are doing our best and we have shown in the past we are a reliable source of supply and meeting the demand of the world.”<sup>79</sup> That said, when Supreme Leader Ayatollah Khamenei warned on June 4, 2006, that if they U.S. made a “wrong move regarding Iran, definitely the energy flow in this region will be seriously endangered,”<sup>80</sup> there was little NIOC could do but follow the leader’s line. Later that month the Oil Minister could only try to soften this stance, saying that in case of an attack on Iran, “we will use all our capabilities, and oil is one of them.”<sup>81</sup> The threat that the

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<sup>78</sup> For instance, see “Iran Military Hints at Straight of Hormouz blockade,” IranFocus, April 5, 2006, <http://www.iranfoc.us.com/modules/news/article.php?storyid=6606> (accessed September 5, 2006)

<sup>79</sup> Bhushan Bahree, Carla Anne Robbins and Chip Cummins, “Oil minister asserts Iran won’t cut exports,” *Wall Street Journal*, April 26, 2006.

<sup>80</sup> Richard Beeston, “Spiritual Leader Threatens to Cut West’s Oil Supplies,” *The Times* (London), June 5, 2006.

<sup>81</sup> “Iran Warns It Could Use Oil as Weapon If Interests Attacked,” *AFP*, June 25, 2006.

United Nations might impose sanctions on Iran also bodes ill for the reputation of NIOC, causing Vaziri Hamaneh to state that Iran would continue to supply oil even if sanctions were imposed.<sup>82</sup>

Inextricably linked and yet even more serious than the threat to Persian Gulf shipping is the question of Iran's nuclear program. The limits on NIOC's capacity to affect the course of Iranian foreign policy are also illustrated in regard to this issue. On one hand, NIOC has a clear institutional incentive to favor the development of Iran's nuclear program for domestic, civil purposes. In mid-1970s, the U.S. actually encouraged the Shah to develop a nuclear energy program, reasoning that substituting nuclear energy for domestic consumption would make available more Iranian petroleum for export. Since that time, Iran's population has doubled and energy consumption has skyrocketed.<sup>83</sup>

For NIOC, which is burdened by subsidizing domestic fuel consumption, the prospect of an alternative source of domestic energy is clearly a boon. As Vaziri Hamaneh said, "we are trying to build our nuclear plants to diversify our sources of energy and have access to cleaner energy as well. This is our real purpose."<sup>84</sup> On the other hand, NIOC also suffers because of the perception of increased political risk in Iran related to the nuclear standoff. In April 2006, the Fitch credit rating service downgraded NIOC to BB-, below investment grade, based on the risk of sanctions being imposed on Iran. Several IOCs scaled back their involvement in Iran. UBS and CSFB withdrew from financing projects in Iran and several lending agencies, like the Nippon Export and

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<sup>82</sup> "Iran Refuses to Stop Nuclear Work," *BBC News*, March 8, 2006.

<sup>83</sup> Muhammed Sahimi, "Iran's Nuclear Energy Program," *Harvard International Review*, 26:4 (2005).

<sup>84</sup> MEES, June 5, 2006.

Investment Insurance agency, also curtailed their support for Iranian projects.<sup>85</sup> Even the U.S. unilateral sanctions regime has driven off potential bidders on NIOC-issued contracts. One analyst relates that in the 1990s, Total was able to gain favorable terms from Iran because it was virtually the sole bidder for its contracts.<sup>86</sup> While defying international pressure on issues such as nuclear weapons may benefit Iran's geo-strategic position, this posture has the negative effect of drying up foreign investment for NIOC. Thus, while NIOC has been a reluctant player in Iran's geo-strategic maneuvering, it has been a pawn, nonetheless.

*NIOC and the Political Economy of Stunted Reform*

The Khomeini era imparted Iran a rigid structure of expectations and demands regarding the management of oil revenue. Article 44 of the Islamic Constitution mandated state-ownership of oil and its use to provide an elaborate social welfare net for the Iranian people. However, faced with the economic crisis of the 1980s and the task of rebuilding after eight years of war, many favored economic reforms. Creating a more attractive climate for private and international investment and reducing and rationalizing the scope of the government's redistribution system were particularly pertinent to NIOC. The firm felt hampered by the Majles' under-funding of projects for infrastructure upgrades and expansion and overburdened by the ever-increasing demand for domestic fuel subsidies. The investment short-fall has led to underfunding long-term infrastructure upgrades and maintenance. As recently as May 2005, for instance, the managing director of NIOC's National Iranian Drilling Company announced that Iran lacked sufficient

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<sup>85</sup> Ibid, May 1, 2006.

<sup>86</sup> Interview with H.E., August 15, 2006.

drilling platforms to meet production expansion plans.<sup>87</sup> Allowing foreign and other private investment into the oil sector could help make up for this short-fall.<sup>88</sup> Towards this end, NIOC has built alliances with reformists and traditional conservatives to further the cause of economic reform. This alliance has succeeded in loosening the state's grip on capital and introducing private investment into the oil sector.

These changes do not auger a general market opening, however. Rather, as typical of many Third World countries where the state determines the 'usage rights' of nominally private firms, these reforms have permitted the formation of a belt of semi-private firms that maintain close ties to the ruling elite.<sup>89</sup> This kind of stunted reform process and its place in the overall political economy of Iran bares further discussion and investigation.

During the early 1990s Rafsanjani first proposed legislation to loosen the interpretation of Article 44 and allow private investment in previously state-controlled sectors. The Islamic Republic could not simply return to the old joint-venture schemes used under the Shah, as this would violate one of the core principles—*independence*—upon which the regime based its legitimacy. The opening of Iran's oil sector began incrementally, with foreign investment first allowed into the less politically sensitive downstream markets of refining and petrochemicals, and only later into upstream markets.<sup>90</sup> A new type of transaction, called a 'buy-back' agreement, was developed to allow private investment in natural resources. In a buy-back agreement, the IOC agrees

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<sup>87</sup> MEES, May 2, 2005

<sup>88</sup> Neil Ford, "Iran: A Difficult Birth, the Liberalisation of the Iranian Economy," *The Middle East*, No. 329, December 2002; Marcel 134-5.

<sup>89</sup> Iliya Harik, "Privatization: The Issue, the Prospects and the Fears," In *Privatization and Liberalization in the Middle East*, edited by Denis Sullivan and Iliya Harik (Bloomington: Indiana University Press, 1992), 1-23.

<sup>90</sup> Interview with H.E., August 15, 2006.

to conduct the exploration and development of a field under a service contract, with NIOC re-paying capital expenditures and operating expenses. The contractor also receives remuneration, typically in the form of lifting rights to a set amount of the oil from the field. The agreement expires when the IOC is paid back in full.

Initially the terms of buy-back arrangement had serious drawbacks for the IOCs, reflecting Iran's wariness from its history. The agreement's duration was limited to five to seven years so as to mitigate any single firm from having too much power in Iran and fixed at a relatively low rate of return. Few IOCs were willing to enter into such contracts with little upside; NIOC itself was displeased with the lackluster and cautious response by international investors.<sup>91</sup> It was not until 1998 that France's Total and Malaysia's Petronas entered into the first major buy-back contract with NIOC, and many of these early deals were perceived as lopsided in favor of the IOCs.<sup>92</sup>

In place of international investors, NIOC turned to domestic firms as a source of investment capital. Yet this did not open up the benefits of oil privatization to a wide-swath of Iranian society. Instead, it reinforced the power of the small entrenched elite who had access to the oil economy and indirect government funding. Given the limited capacity and opacity in Iran's domestic banking industry and its distorted, multi-tier exchange rate system, only those with political connections could ever raise the necessary capital for investment in the oil sectors.<sup>93</sup> The first players capable of purchasing shares were banks, insurance companies, the two large pension funds of the state employees and

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<sup>91</sup> A. Brexendorff and C. Ule, "Changes Bring New Attention to Iranian Buyback Contracts," *Oil & Gas Journal*, November 1, 2004.

<sup>92</sup> U.S. Department of Energy, Energy Information Administration, <http://www.eia.doe.gov/emeu/cabs/Iran/Oil.html> (accessed August 17, 2006).

<sup>93</sup> *Iran Daily*, February 16, 2006; Maloney, 163, Massoud Karshenas and Hassan Hakimian, "Oil, Economic Diversification and the Democratic Process in Iran," *Iranian Studies*, 38:1 (2005); On foreign exchange rate distortions in the Iranian market, see Y.H. Farzin, "Foreign Exchange Reform in Iran: Badly Designed, Badly Managed," *World Development*, 23:6 (1995).

laborers, and the ubiquitous bonyads. While none of these were technically part of the government or subject to the direct control of a ministry, they were still tightly connected to the ruling elite.<sup>94</sup> Alongside these long-established para-statal entities, NIOC spun-off its own “semi-private” firms, often incorporated overseas, to gain access to the foreign capital. Among the best known of these are PetroPars and PetroIran Development Company (PedCo). PetroPars was founded in 1997 and registered in the British Virgin Islands. The firm was capitalized through NICO using the assets of NIOC and IDRO pension funds. A similar semi-private arrangement spawned PedCo. This meant that while these firms were connected to NIOC and to the Iranian state, their equity holders were restricted only to the personnel from the agencies. The growth of these spin-offs created domestic firms that compete against the IOCs in bidding for contracts. Additionally, NIOC was able to use the spin-offs to as conduits to reward political allies with lucrative contracts.

Iran’s development of the massive off-shore South Pars field is illustrative of the way these two motives of increasing competitive bidding and rewarding political allies overlap and compliment each other. By NIOC’s estimate, South Pars has a capacity of 13.14 trillion cubic meters of gas (nearly 38 percent of all of Iran’s natural gas) and 5 billion barrels of oil. South Pars is Iran’s most important new field.<sup>95</sup> As one analyst relates, when NIOC offered the tender for Phase 1 under a buy-back agreement, PetroPars undercut the next best bidder, Total, by over fifty percent. The threat of PetroPars made the IOC much more competitive in bidding on subsequent phases.<sup>96</sup>

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<sup>94</sup> Interview with M.S.

<sup>95</sup> National Iranian Oil Company, Pars Oil and Gas Company, [http://www.nioc.com/sub\\_Companies/7\\_pogc/index.html](http://www.nioc.com/sub_Companies/7_pogc/index.html) (accessed December 28, 2006)

<sup>96</sup> Interview with H.E.

Akbar Torkan, the president of PetroPars and former head of IDRO, stated directly that “PetroPars created a rivalry that eventually led to a price break. With PetroPars in the competition, prices fall and this is to the benefit of NIOC.”<sup>97</sup> Yet PetroPars was hardly the best suited to undertake this project. Due to its inexperience and management problems, phase 1 ran several years behind schedule before finally coming online in November 2004. Nevertheless, NIOC accepted PetroPars to work on latter phases alongside ENI, Statoil, and other foreign investors. According to a Western analyst, this has caused some international firms to reconsider their willing to continue to partner with Iranian firms. Statoil ultimately wrote-off its investment in South Pars as a loss.<sup>98</sup>

The retention of such sub-standard and inexperienced firms is more related to political than economic needs. PetroPars, after all, represented the interest of key political allies. Its chairman, Behzad Nabavi, was a close advisor to Khatami and a leading reformist Majles deputy, indicted on corruption charges and forced to resign in 2001. Nabavi claimed in an interview that the charges were “purely politically motivated” to target Khatami and his supporters in the reform movement.<sup>99</sup> In an unrelated case, Norwegian investigators found that Statoil had paid \$15 million to Mehdi Hashemi Rafsanjani, son of the former president and a senior executive involved in several NIOC subsidiaries, in order to gain preferential access to the South Pars fields.<sup>100</sup> Alongside these newly created firms, the bonyads have entered the oil sector, providing services in consulting, drilling, pipelines, and other downstream markets. The mere

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<sup>97</sup> “Interview: PetroPars,” *Payvand*, December 19, 2002, <http://www.netnative.com/news/02/dec/1100.html> (accessed December 29, 2006)

<sup>98</sup> Interview with A.T.

<sup>99</sup> “Iranian Parliament Member Views Campaign Against Reform Movement, Khatami’s Role,” London *Al-Sharq al-Awsat* in Arabic, June 9, 2002, FBIS-NES-2002-0109; Paul Sampson, “Iran: Who’s who in the oil sector,” *Energy Compass*, March 18, 2005.

<sup>100</sup> Nicholas George, “Statoil and Former Executive Fined Over Iran Affair,” *Financial Times*, June 30, 2004.

presence of bonyads in a sector is often enough to deter entry by other firms, as the bonyads' have historically used violence to intimidate non-favored firms.<sup>101</sup> Observers in the oil market see the bonyads as even less technically capable than PetroPars.<sup>102</sup> While NIOC probably would prefer to have a more transparent process for bidding that encourages more legitimate bids, allowing the bonyad and other politically prominent firms favored access to the oil market is the price NIOC must pay to achieve any changes toward privatization.

Khatami's opponents regularly accused his government of corruption and financial irregularities, particularly surrounding the oil sector. Many pointed to the opacity of the PetroPars-NIOC arrangement and NICO's anomalous position outside Iranian law as an indication of the dangers involved in allowing private investment in the oil sector. In 2001, a leading conservative ally of the Supreme Leader and former chairman of the Guardian Council, Ayatollah Ahmad Jannati, accused the oil ministry of diverting millions in state funds to foreign bank accounts. There were further accusations that NIOC officials had made fortunes by manipulating Iran's system of multiple exchange rates when converting foreign investment into rials and of illegally disposing of drilling acreage under the revised buy-back agreement. Besides the dismissed Nabavi, Oil Minister Zanganeh, one of Rafsanjani's strong supporters, was hounded by rumors of his coming indictment.<sup>103</sup> Ultimately, Zanganeh was able to defuse the PetroPars scandal only by having NICO, the wholly-owned overseas subsidiary, purchase the entirety of

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<sup>101</sup> For instance, see MJF's campaign to eliminate a rival in the soft-drink market, Maloney 164.

<sup>102</sup> Interview with A.T., September 8, 2006.

<sup>103</sup> "The Fight Over Letting Foreigners in Iran's Oilfield," *The Economist*, July 14, 2001; "Iran: The Buy-Back Debate," *The Economist*, September 20, 2001; "Mixing Oil and Politics," *The Economist*, February 21, 2002; Guy Dinmore, "Iran Plays Down Deals with Foreigners," *Financial Times*, September 2, 2001; Guy Dinmore, "Iran Oil Case Hits Foreign Contracts," *Financial Times*, April 11, 2002.

PetroPars shares, thereby making the transactions between PetroPars and NIOC an entirely within-government transfer. Similarly, PedCo was eventually brought entirely within NIOC's control and re-registered within Iran.

Despite this resistance to 'reform,' however, NIOC was able to obtain crucial changes to the rules of the game that furthered the very uneven process of economic liberalization. In 2004, the Expediency Council, headed by Rafsanjani, overruled the Guardian Council to allow changes in the buy-back agreement. Full privatization of the downstream oil market was mandated, and the durations of the upstream buy-back agreements were tripled to fifteen to twenty years, thus making them more enticing to private investors.<sup>104</sup>

*“Reform” Versus Populism Under Ahmedinejad*

All of the gains made under Khatami seemed imperiled by Ahmedinejad's victory over Rafsanjani in the 2005 presidential election. During his campaign, Ahmedinejad denounced a so-called “oil mafia” for its corrupting influence and called for expanded state social welfare.<sup>105</sup> As a columnist in *Keyhan*, a leading conservative newspaper, put it, the fight was between the “principle-ists” who think about “issues like justice, supporting the underprivileged layers, fighting against tyranny” and the “political oil club.” This club consists of “intertwined networks in the Ministry of Oil, Ministry of Foreign affairs, [and] banks.” They “care about profit without caring about ideological tendencies” and are therefore responsible for massive corruption in the oil industry through the use of middle men. Most insidiously, though, this group, it was claimed,

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<sup>104</sup> Amir Talebi, “High Economic Council: Article 44” *Iran Daily*, October 19, 2004, <http://www.irandaily.ir/1383/2117/html/focus/htm> (accessed August 3, 2006).

<sup>105</sup> Katherine Gannon, “New Iranian president must fulfill promises on improving economy without politicizing,” Associated Press, June 29, 2005.

seduces well-intentioned individuals into unwittingly collaborating with it by offering them seemingly legitimate licenses for foreign trade. This overall picture of the ‘oil mafia’ is one of a near-omnipotent cabal manipulating Iran’s domestic political economy.<sup>106</sup>

Sacking Zanganeh was one of the new president’s first acts to combat this cabal. In his place, Ahmedinejad nominated a close-friend and ally with no significant experience in the industry. Yet, Ahmedinejad’s style of closed-door appointments alienated even his supporters, to say nothing of opponents who doubted the ability of a neophyte to effectively oversee Iran’s most important industry. The Majles refused to approve this candidate. Ahmedinejad attributed their refusal to “certain gangs within the Ministry... [and] certain decision-makers within the Islamic establishment whose hearts and minds are set on countries far beyond our borders but pretend to support the Islamic Revolution and its late leader Imam Khomeini.”<sup>107</sup> A number of theologians in Qom, the center of the Iranian clerical establishment, wrote a letter to parliament members reminding them that

[m]ultinational companies proved in the course of history to be seeking domination over the vital major oil and gas reserves of other countries are now awaiting the appointment of Iran's new oil minister in order to continue signing oil agreements at multiple costs and inflict high damage to the country....[T]he officials in charge should be vigilant to avoid letting the oil ministry be subject to such experimentation.<sup>108</sup>

But other prominent clerics close to the Supreme Leader argued in favor of privatization.

The head of the judiciary, Hashemi-Shahrudi, stated that Ahmedinejad’s methods were

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<sup>106</sup> Mohammad Jafar Behdad, “Political Oil Club,” *Keyhan* (Internet Version--WWW), March 8, 2006, T22:44:02Z, FBIS NewsEdge Document Number: 200603081477.1\_3d7c00fbb1667396

<sup>107</sup> Iranian President Says 'Oil Mafia' Responsible For Rejection of Cabinet Nominee, *Iran Daily* (Internet Version-WWW), October 1, 2005 T08:51:46Z, FBIS NewsEdge Document Number: 200510011477.1\_101b004642f61f7b

<sup>108</sup> “Oil-Ministry-Minister,” *IRNA* (distributed by UPI), August 8, 2005.

over-zealous and misplaced. Hashemi-Shahrudi criticized the government's welfare scheme, stating that "they think that the wealth of the rich should be taken away from them and given to the poor. This is not social justice. It is not social justice to put everyone under the welfare scheme. In Islam social welfare has a lofty and valued place. Islam wants the kind of social justice whereby everyone has a dignified job—not for people to be dependent on government handouts." Most importantly, he attacked the government's efforts to implicate individual officials for embezzlement when this was only "mini-corruption... because at the end of the day some funds have been embezzled but they have not been taken out of the country. It is just that the ownership of those funds has changed. At the same time it does not have any damaging effects on the economy." A far "greater sin" is to threaten private enterprise with expropriation and drive investors to leave the country.<sup>109</sup>

This stand off between populist and pro-capitalist agendas which very much recalls a similar collision during the mid 1980s in Iran, was further illustrated by the fate of three subsequent nominees for the position of Oil Minister. The first two of these had close ties to the president but limited experience in the oil industry, and were also rejected by the Majles. Then Ahmedinejad named Kazem Vaziri Hamaneh, a 32-year industry veteran. Vaziri Hamaneh was widely considered free of corruption and seemed to be more religiously oriented. But he proved reluctant or unable to purge NIOC officials suspected of graft or other forms of corruption, a position that was largely interpreted as a rebuff to the populist agenda of the president and his allies. In an interview with a reformist newspaper, Vaziri Hamaneh denied any knowledge of an oil

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<sup>109</sup> *Aftab-e Yazd* website, Tehran, in Persian 16 Nov 2005, in BBC News Monitoring, November 17, 2005, ACC-NO: A2005111745-F20B-GNW.

mafia, and explained that due to the inherently compartmentalized nature of NIOC's business, it was easy to mistakenly assume the existence of "special relationships within the ministry of oil." While vowing to uproot corruption within the ministry, he expressed puzzlement over exactly where to find it. Most importantly, he disavowed any desire for "radical" moves in personnel or policy.<sup>110</sup> True to form, Vazeri Hameneh did not bring any outsiders into NIOC senior management, instead appointing Gholamhossein Nozari, head of the Central Iran Oil Company subsidiary, as the new managing director of NIOC and deputy Oil Minister.<sup>111</sup>

In the summer of 2006, leftist reformists repeatedly pointed out Ahmedinejad's failure to mount any significant cleaning of NIOC and Oil Ministry.<sup>112</sup> By the fall of 2006, Ahmedinejad tried to circumvent what he saw as uncooperative senior ministers by replacing their lower-level staff and deputies. The ministries of Oil, Economy, Commerce, the Managing and Planning Organization, and the central bank have all seen some changes among deputies and project directors. Ahmedinejad has also pressured several other ministers to resign and others have been subject to increased Majles review. While it is still unclear whether Ahmedinejad's aggressive tactics will succeed or will engender further conflict with other stake-holders in the Iranian system, his manacled efforts to purge NIOC not only illustrated the limits and domestic political dangers of his

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<sup>110</sup> Interview by Reza Zandi with Minister of Oil Kazem Vazirhamaneh on 26 December, location not given: "The Oil Mafia in an Interview With the Minister of Oil" *Sharq*, January 1, 2006 T00:58:57Z, NewsEdge Document Number: 200601011477.1\_4a0b0be716a8fec3

<sup>111</sup> "Iran Announces Oil Ministry Shake-Up," *Reuters*, January 3, 2006.

<sup>112</sup> Daily Views Government's Developments on Election Anniversary Editorial: "One Year On" Aftab-e Yazd (Internet Version-WWW), *Persian Press*, July 6, 2006 T10:13:08Z, FBIS NewsEdge Document Number: 200607061477.1\_5396009e30cdaed5.

populist agenda; they also foreshadowed the growing antagonism from both conservatives and reformists to his domestic and foreign policies (see below).<sup>113</sup>

On the issue of domestic subsidies, too, Ahmedinejad's agenda also faced significant resistance. Iran has some of the richest oil subsidies in the world, with the price of gasoline reduced to around US \$.10 per liter. Due to its artificially depressed price, Iran's domestic consumption of gasoline, diesel and kerosene is astronomical. Furthermore, this subsidized fuel pricing creates an incentive for arbitrage-based smuggling of Iranian gasoline to neighboring states. By some estimates, nearly 5 percent of subsidized gasoline is smuggled abroad.

NIOC administers this subsidy, allocating petroleum reserves for the domestic market. But, due to its limited refining capacity, NIOC has to sell hard currency in order to import refined gasoline back into the country. From NIOC perspective, a more efficient economic route would simply be to sell petroleum on the open market and avoid paying the margins for refining outside the country. As Iran's domestic consumption increases, NIOC economists also recognize that there will be less available for export.<sup>114</sup>

In 1998, during the Asian financial crisis and ensuing drop in oil prices, Iran may actually have spent more in fuel consumption than it earned in fuel export. At that time, officials at the Planning and Budget Organization and Zanganeh called for the introduction of fuel rationing, if not a total phase-out of subsidies.<sup>115</sup> In a record high oil market, the strain on NIOC comes from the other direction: even as Iran exports oil at a

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<sup>113</sup> Bill Samii, "Iran: Government Shakeup Hits Many Levels," Radio Free Europe/Radio Liberty, November 7, 2006, <http://www.rferl.org/featuresarticle/2006/11/7C253ED8-1A8C-47BB-8264-2E2EC1B92B5D.html> (accessed November 9, 2006).

<sup>114</sup> A.M. Samsam Bakhtiari and F. Shahbudaghlou, "Energy Consumption in the Islamic Republic of Iran," *OPEC Review*, 24:3 (2000).

<sup>115</sup> Michael Lelyved, "Oil-rich Iran Faces Gasoline Shortages," *Journal of Commerce*, December 7, 1998.

high price, it must still import gasoline at a premium. To maintain the 10 cent per liter price, Iran had to import \$2.5 billion per year of finished product. In 2004, a managing director of NIOC's subsidiary for distribution predicted that in five years, gasoline subsidies would account reach \$15 to \$20 billion annually. The solution, he said, was to "expedite the privatization of all economic affairs."<sup>116</sup> In 2005, NIOC and other officials in the oil industry repeatedly pushed for a reduction of the subsidy. Hossein Kazempour Ardabili, Iran's OPEC delegate, said in 2005 that the fuel subsidy was "ridiculous... destroying other aspects in the development of the economy."<sup>117</sup> Conservatives fired back by accusing NIOC of inflating the profit margin on imported gasoline, thereby needlessly expanding the short-fall.<sup>118</sup> By the summer of 2006, though, even Kamal Daneshyar, the head of the Majles energy committee, warned that only an additional allocation of \$5 billion (on top of the previously budgeted \$2.5 billion) could allow the continued subsidy on imported gasoline, which comprised nearly 40 percent of the gasoline consumed domestically.<sup>119</sup> This consensus has allowed the introduction of rationing in provincial cities as a prelude to bringing it to the capital.

In a country that considers itself oil-rich, however, many citizens consider the provision of cheap fuel a governmental obligation. Due to the low gasoline prices, many hundreds of residents in Iran's cities are able to supplement their incomes by driving private taxi services. Cutting into their livelihood would likely provoke enormous public protest by, in effect, punishing both the providers and consumers of this vital, middle

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<sup>116</sup> IRNA News Agency (Tehran) in BBC Monitoring International Reports, June 19, 2004, ACC No. A2004061913-86A9-GNW.

<sup>117</sup> "Low Fuel Prices Do Little to Oil Iran's Economy or Roads," *Financial Times*, April 7, 2005.

<sup>118</sup> See editorials by Mohammad Kazem Anbarlu'i in Resalat, March 11, 2006 in BBC Monitoring International Reports, ACC No. A2006031840-106DC-GNW and October 14, 2005 in BBC Monitoring International Reports, ACC No. A200510143-EC33-GNW.

<sup>119</sup> Gareth Smyth, "Iran 'Needs Dollars 5bn Subsidy' to Avoid Petrol Rationing," *Financial Times*, May 29, 2006.

class service. Here, again, some compromises arose between Ahmedinejad's populism and market liberalization. Plans to develop a rationing system, whereby a percentage of the gasoline sales would sold be at market (un-subsidized) rates, appears to be in development. This decreases NIOC's financial burden to maintain the subsidy, but retains the incentives for black-marketeering of ration cards and smuggling.<sup>120</sup>

After introducing his budget in January 2007, Ahmedinejad himself conceded that some reduction in the fuel subsidy cost needed to be found, but preferred developing alternative energy vehicles (NIOC itself has a division devoted to developing energy saving technologies like LNG cars) and expanding public transportation. Subsidies cannot immediately be eliminated because "all our economy is tied to this and it would create traumas in people's lives if we were to change our views, lift control over gasoline prices, allowing them to rise by up to 40-50 percent and then have to face all the consequences."<sup>121</sup> At the same time, though, NIOC has steadily increased its investment in new refineries in a failing effort to keep pace with growing demand.

Acceptance of fuel rationing is part of a more general shift away from Ahmedinejad's populist electoral platform. A critical moment in this shift came in April 2006, when the Supreme Leader formally announced his approval of a plan for implementation of the revisions to Article 44 requiring privatization of considerable state assets (although still ruling out privatization of NIOC). Yet even here, the interests of entrenched groups are subtly insinuated; the law requires that 50 percent of the privatized assets be reserved for poorer Iranians, but actually reserved for purchase by provincial

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<sup>120</sup> Nazila Fathi, "Iran, an Oil Giant, in Gasoline Squeeze," *New York Times*, July 16, 2006.

<sup>121</sup> Abbas William Samii, "Iran Considers Gasoline Rationing," *The Weekly Standard*, February 7, 2007.

development corporations, yet another form of para-statal organization.<sup>122</sup> Since that time, Ahmedinejad, Speaker of the Majles Gholamali Haddad-Adel, and Minister of Economics Davud Danesh-Ja'fari have all made statements agreeing with the Supreme Leader on the extent to which the government should strengthen the private sector and shrink back to become only a coordinator of the economic sphere.<sup>123</sup> Just as NIOC was forced to accede when Khamenei made definitive declarations, the populists too can only maneuver within the boundaries demarcated by the Supreme Leader.

As NIOC adjusts the terms of the buy-backs, it continues to ensure that domestic firms can participate, possibly even by requiring the formation of joint ventures between any foreign investor and a domestic partner.<sup>124</sup> This is in line with the tenor of Ahmedinejad's call for "the expansion of the domestic [oil and gas] industry... Definitely, in the oilfields, the priority will be with domestic constructors, specialists, investors, and workers."<sup>125</sup> In 2005, PedCo was awarded contracts for the Ahwaz-Bangestan and South Pars fields. Qeshm Oil and Energy, a public-private joint venture firm, was awarded the Rag-e Safid field after BP, ENI, and Shell withdrew from the bidding due to their dissatisfaction with the structure of the buy-back arrangement.<sup>126</sup> Phases 15 to 18 in the South Pars field are reserved for an Iranian firm.<sup>127</sup> NIOC also

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<sup>122</sup> IR Leader Approves President's Offer, Office of the Supreme Leader,

<http://www.leader.ir/langs/EN/index.php?p=news&id=3176> (accessed August 18, 2006).

<sup>123</sup> IRNA News Agency (Tehran) in BBC Monitoring International Reports, July 5, 2006, ACC No. A2006070522-11958-GNW; Iranian TV in BBC Monitoring International Reports, July 5, 2006, ACC No. 2006070536-1195E-GNW; Text of Farhang-e Ashti daily newspaper in BBC Monitoring International Reports, July 20, 2006, ACC No. A2006072018-11BEE-GNW.

<sup>124</sup> MEES, May 15, 2006.

<sup>125</sup> Ibid, July 4, 2006.

<sup>126</sup> Ibid, March 28, 2005.

<sup>127</sup> Ibid, February 20, 2006.

cancelled a contract with the German firm Linde, Iranian Sazeh and South Korean Hyundai for Olefin crackers in order to pursue the project domestically only.<sup>128</sup>

While privatization and liberalization proceed sporadically, economic nationalism remains a significant factor uniting many Iranians. The Iranian daily *Entekhab*, which tended to serve a bridge between Khatami and religious conservatives, credited his “economic achievement” in building companies like PetroPars. These companies raised “the presence of Iranians at the higher level affairs of oil and gas” rather than allowing American, British, or Italian companies to develop petroleum, thereby pushing Iranians to the “margins.”<sup>129</sup> Domestic firms with ties to the regime have taken an increasing role as ‘gatekeepers’ to the market. PetroPars now bills itself a “general contractor” for the South Pars project, “making maximum use of domestic sources and capabilities of local contractors and companies specifically in terms of local job creation and employment of local experts.”<sup>130</sup>

Initially, NIOC hoped that privatization would combine foreign investment with the firms own semi-private ventures, funneling the profits back to NIOC for re-investment. Once the door to private capital opened, however, para-statal groups have been able to enter as well. For over a decade, NIOC had refused to allow the bonyads to move into upstream industries. MJF, the largest bonyad, broke into the upstream market in partnership with the Russian TatNeft.<sup>131</sup> MJF is now also collaborating with the NIOC

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<sup>128</sup> Ibid, May 15, 2006.

<sup>129</sup> “Iranian Daily Says Khatami Government More Successful Than Not,” *Entekhab* (Tehran), November 23, 2004, FBIS-NES-2004-1123.

<sup>130</sup> PetroPars company webpage, “About PetroPars,” <http://www.petropars.com/OurCompany/tabid/53/Default.aspx> (accessed August 18, 2006).

<sup>131</sup> “MJF May Take Charge of Developing Ahvaz-Bangestan Oil Field,” PetroEnergy Information Network, August 27, 2006, <http://www.petroenergyinfo.net/NewsView.aspx?NewsId=29943&Type=1&Subject=8> (accessed September 3, 2006); Margaret McQuaile, “Iran’s Aghazadeh Appears Likely to Retain Oil Ministry,” *Platt’s Oilgram News*, August 5, 1993.

pension fund and the Kish Free Zone Organization in investing in a new oil exchange.<sup>132</sup>

As one of the key groups in the pro-privatization alliance, the bonyads have gravitated toward the oil sector, by far Iran's most lucrative industry.

The Pasdaran has also become assertive in the oil sector. The Pasdaran's members have some connections to Ahmedinejad (himself a Pasdaran veteran), but their major loyalty and direct overseer is the Supreme Leader. Given the group's charge to guard the revolution both at home and abroad, the Pasdaran has long maintained a hand in civilian affairs and function more as a praetorian guard than the Artesh, Iran's regular armed forces. According to Brigadier General Abdol-Reza Abed, head of the Khatam al-Anbiya base, a full 30 percent of the the Pasdaran construction corps' resources are devoted to civilian use. In July 2006, after the withdrawal of international investors from South Pars, the Pasdaran was the sole-bidder for development of Phase 15 and 16 and worked on a gas pipeline in Baluchistan. By some estimates, the Pasdaran conducted \$3 billion in business with the Oil Ministry. Often these projects use local and international sub-contractors. Despite denials from Pasdaran leadership, the Iranian press and opposition members in the Majles protested that the Pasdaran's political and military weight suffocated authentic private investment.<sup>133</sup> While this represents a way for the conservative faction to exert control over the oil sector, it erodes the bedrock of state ownership of natural resources, inviting private exploitation of the national patrimony. For NIOC, sharing the bounty of privatization from foreign investment with the bonyads

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<sup>132</sup> "Establishment of Iran's Oil Bourse in Final Stages," *Fars News Agency* (Internet Version—WWW), June 5, 2006, FBIS Document Number 2006060514777.1\_2cee00212205f928.

<sup>133</sup> Sharq (Tehran) in Persian, BBC Monitoring, July 16, 2006, ACC-NO: A200607161B45-GNW; Aftab-e Yazd (Tehran) in Persian, BBC Monitoring, July 6, 2006, ACC-NO: A200607063D-1198C-GNW; Farhang-e Ashti (Tehran) in Persian, BBC Monitoring, June 26, 2006, ACC-NO: A2006070617-11981-GNW; Sharq (Tehran) in Persian, BBC Monitoring, July 6, 2006, ACC-NO: A2006070631-1197C-GNW.

or Pasdaran ensures that the populists are held at bay and that economic liberalization continues. For the IOCs, finding the right Iranian partner assures that their investment is not threatened by expropriation or interference by a jealous domestic political elite.

## **CONCLUSION**

At the turn of the millennium, Iran has developed some of the key attributes of a captured state. NIOC's growing autonomy and its collusion with foreign and domestic firms allowed it to bypass the state, retain rents and re-distribute them to private hands. Through this collusion, NIOC was able to advance changes in the rules of the game, most importantly adjustments to Article 44, thereby allowing for furthering economic reform and rolling back of state domination of the oil sector. This advance did not come for free, however. NIOC's partners in economic liberalization have their own agendas, chiefly the retention and expansion of the semi-formal sector. Thus, while foreign investment was invited to Iran, NIOC also had to look after the interests of the bazaar conservatives and the reformists to some extent, reciprocating their political support with economic largesse. Rather than simply reducing fuel subsidies and eliminating the incentive for arbitrage smuggling, the ration card system reduced the burden on NIOC but retains the market distortion of price regulation. Similarly, rather than allow foreign firms to compete openly and directly for buy-back contracts, domestic firms were able to skim a margin from every foreign investor. The state monopoly in oil may be over, but its successor is a system of state-sponsored oligarchs. This form of 'tactical' or stunted liberalization allows all portions of Iran's political elite to share the wealth, but at the cost of an approach that follows the dictates of what some would deem to be economic

efficiency. In Iran, as in so much of the Arab world, politics dictates the boundaries of economics.

Just as the oil oligarchy has proven adept at manipulating domestic market distortions to its benefit, so too has it guided a steady stream of profits to reward key constituencies. The U.S.'s unilateral sanctions have raised the price of investing in Iran, but even American allies like Japan, Italy, and France have found the prospect of investing in Iran irresistible, to say nothing of Russia and China, who have built strategic alliances with Tehran. As NIOC diversifies Iran's energy customer base, the regime is able to drive a wedge between any potential international coalition that would act to impose further sanctions on Iran in response to its nuclear program. But as Ahmedinejad's defiant rhetoric on the nuclear issue continues and the threat of truly comprehensive sanctions grows, a coalition of the business leaders and the security establishment successfully appealed to the Supreme Leader to walk Iran back from the brink.<sup>134</sup> Like nearly all segments of the Iranian establishment, NIOC would welcome the acquisition of a nuclear program, but they hesitate to jeopardize the flow of foreign direct investment.

Like his aggressive international stance, Ahmedinejad's populist domestic agenda is similarly reminiscent of Khomeini. Like Venezuela's Hugo Chavez and Bolivia's Evo Morales, Ahmedinejad appeals for a return to a familiar model of rentier state-society interaction. The state should use its monopoly over oil wealth to allocate assets consistent with the principles of justice, insulating the population from the vagaries of the market and ensuring a strong social safety net. This system is premised on the *relative*

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<sup>134</sup> Nazila Fathi and Michael Slackman, "Rebuke in Iran to Its President on Nuclear Role," *New York Times*, January 19, 2007.

autonomy of the state compared to society in general as well as its ability to placate and prostrate society through a careful distribution of rents. It is relative because it frees the state from the taxation-representation nexus typical of Western democratic states, but at the same time constrains the state because its legitimacy with both the masses and the elite is ultimately based on the vulnerable condition of economic goods in return for the loyalty—or docility—of the population.

The double edged nature of rentierism is amply demonstrated by the ups, and most recently downs, of Iran's president. Since taking office, Ahmedinejad's revanche rentierism has foundered. A year after his defeat in presidential elections, Rafsanjani and his allies won resounding victories in municipal election and in the ballot for the Assembly of Experts, defeating the slate backed by Ayatollah Mohammed Taqi Mesbah Yazdi, Ahmedinejad's spiritual advisor.<sup>135</sup> In tandem with this development, Ahmedinejad partly conceded to the demands of the advocates of economic reform. He allowed the plans for fuel rationing to proceed and the formation of more capital markets in the Tehran Oil Exchange. His most visible concession was in the Oil Ministry, accepting a technocrat from within the Ministry who offered little hope of changed NIOC's business practices. At the same time, though, Ahmedinejad also made significant advances, forcing NIOC to accept his choice of middle management and to expand its domestic refining. Spending on social welfare remains at a high level. One of the most interesting developments is the newly found ability of socially conservative forces, both among the bonyad and the Pasdaran, to compete for private contracts,

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<sup>135</sup> Scott Peterson, "What Iran vote says about Ahmadinejad's support," *Christian Science Monitor*, December 18, 2006; Najmeh Bozorgmehr and Gareth Smyth, "Ahmadi-Nejad suffers setback in Iran elections," *Financial Times*, December 18, 2006.

entering through the door that NIOC opened to favor its own semi-private progeny. The seemingly inexorable collision between the oligarchs and populists has yet to materialize.

To some extent, the flood of oil rents into Iran has ameliorated this tension. As Karl observes, so long as coffers are full, all the stakeholders in the rentier state can afford to defer hard fiscal decision.<sup>136</sup> Both the Khatami and Ahmedinejad's governments have made frequent recourse to Iran's oil stabilization fund to pay for social programs.<sup>137</sup> The cost of this deferment continues to accrue for NIOC. Certainly, the higher the price of oil, the greater revenue NIOC enjoys, but NIOC must also import refined gasoline at these elevated prices and sell them on the domestic market at a mark-down. Where production growth has stagnated, consumption has risen precipitously every year.

Yet beyond the contingency of an oil spike, Iran's multiple overlapping institutions also function to defuse the conflict between NIOC, its allies in the bazaar class, and Ahmedinejad's populism. Unlike previous Iranian regimes, the Islamic Republic's institutional make-up knots together the quotidian politics of rent distribution with the charismatic politics of the sacred.<sup>138</sup> At a profane level, the conflict revolves around a choice between a set of economic policies in which there are clear winners and losers. In such a forum, Ahmedinejad was not lacking the coercive means by which to enforce his vision of populist government. The state could have confronted the 'oil mafia,' arrested its purported members, seized their assets, and ejected their foreign counterparts. This would have precipitated a crisis similar to what Iran saw in 1951 and

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<sup>136</sup> Terry Lynn Karl, *The Paradox of Plenty: Oil Booms and the Petro-State* (Berkeley: University of California Press, 1997).

<sup>137</sup> Jahangir Amuzegar, "Oil Stabilization Fund: A Misnomer," *MEES*, November 27, 2005.

<sup>138</sup> Daniel Brumberg, *Reinventing Khomeini: The Struggle for Reform in Iran* (Chicago: University of Chicago Press, 2001), 239-42.

1979, when the domestic conflicts over oil—as a symbol and a commodity—became entangled in the international competition for energy. But today, another institution is able to intervene—Supreme Leader Ayatollah Khamenei. Khamenei’s spiritual and political authority to oversee interpretations of Ayatollah Khomeini’s legacy has made him uniquely authoritative in debating the content of Iran’s state-society contract.

Without changing a word of the revolutionary constitution, Khamenei’s tacit and explicit approval for economic liberalization altered the basis of legitimacy upon which NIOC was premised, partially relieving NIOC of its statist responsibility, at least temporarily. NIOC’s autonomy is provisional upon Khamenei’s blessing. Khamenei enjoys access to two kinds of institutional power: at the formal, state level, through appointment of the Guardian Council, vetting power over the Majles and other governmental institutions, and command of the armed forces; at the informal level, through contacts and collaboration with the bonyad and other para-statal groups, which often compete with the states’ formal institutions. NIOC was once solidly in the formal apparatus of the state, dutifully forwarding oil profits directly to the national treasury. Now it functions more like a para-statal firm, using distributional networks to ensure that every part of Iran’s political base benefits.

The shift in the relationship between the government and the firm is indicative of a larger trend in the Islamic Republic’s consolidation through incorporation. Many saw Ahmedinejad’s election in 2005 as an orchestrated campaign by religious conservatives to purge backsliding reformists and corrupt oligarchs in the business community.<sup>139</sup> Such arguments about a conservative house-cleaning or consolidation seem premature today, as NIOC and its allies have weathered Ahmedinejad’s onslaught intact and have even

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<sup>139</sup> Hen-Tov, 166.

drawn closer to the Supreme Leader through informal and indirect business relationships. Retaining circumscribed pluralism is the key strategy for the Islamic Republic's success. On the mass level, the Republic relies on popular participation; maintaining the viability of multiple political factions is necessary to ensure that popular disaffection can be channeled within the system rather than being shunted into unapproved, and hence more dangerous and destabilizing, venues. Furthermore, the need to balance among elite factions with disparate interests keeps Iran from veering too far in any direction and preserves policy options available in case of crisis.

At the moment, two major crises loom on the horizon: first and most immediately, the risk of a military confrontation with the U.S. We have already discussed how NIOC and the business community has tried to warn-off the Supreme Leader from escalation, since the latter imperils the foreign investment necessary to keep Iran's oil economy afloat. A more distant, but more likely, problem is the eventual decline in global energy prices.<sup>140</sup> Here, the response by each faction is difficult to predict, since every segment of Iran's political and economic balance is tied to the price of oil. As noted above, Iran's earlier attempts to create a stabilization or "rainy-day" fund from excess oil profits have been feeble at best. However, NIOC's continual insistence (and Ahmedinejad's concession) to begin some form of austerity planning now, during a time of economic bounty, increases the possibility that Iran can improvise a solution when rents do decline significantly. In both scenarios, the key to NIOC's success is its ability to appeal to the pragmatic interests of the Supreme Leader in order to maintain a balance among the regime's heterogeneous social base, rather than maintaining a principled and consistent stand on socio-economic policy. Thus, the turn toward a para-statal relationship increases

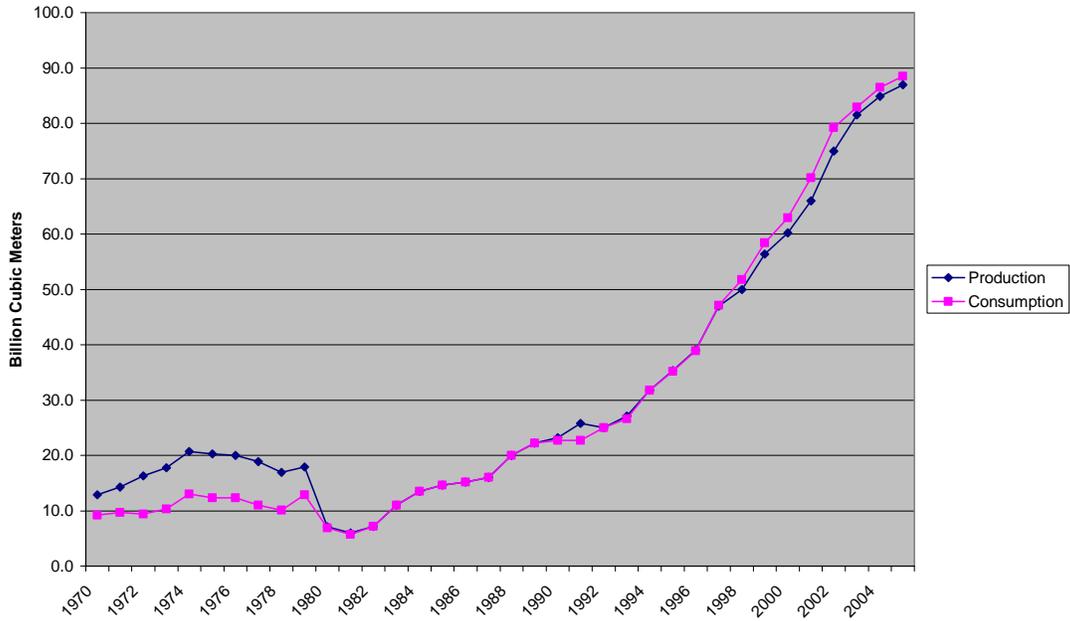
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<sup>140</sup> Stern, *op cit.*

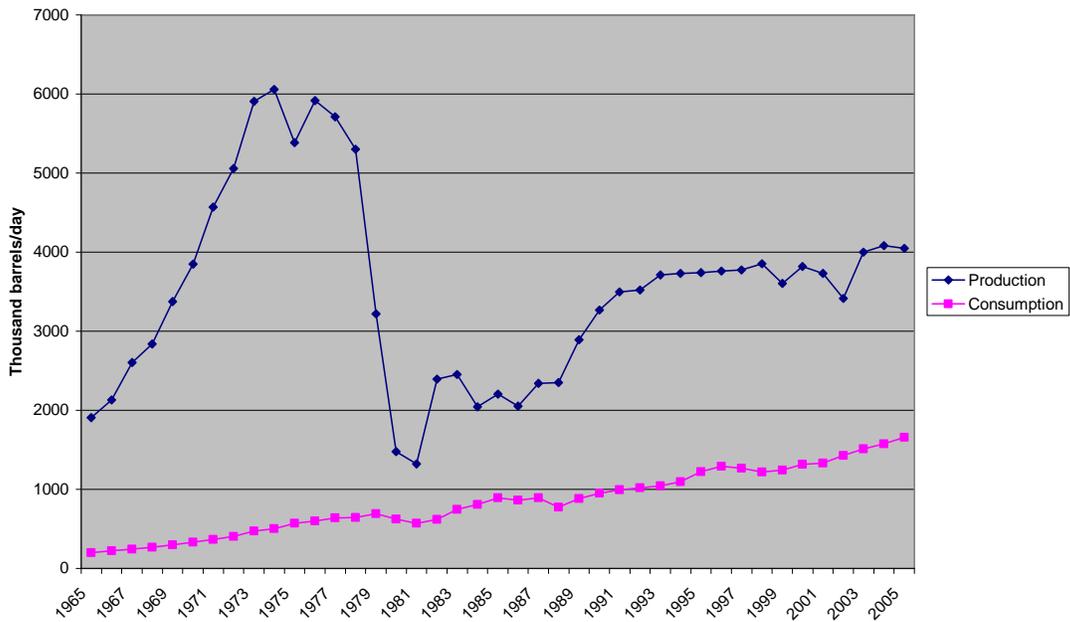
the flexibility of the regime and hence its durability without impairing its ideological unanimity.

# APPENDIX

Iran: Gas Production and Consumption, 1970-2005  
Source: BP Statistical Abstract, 2006

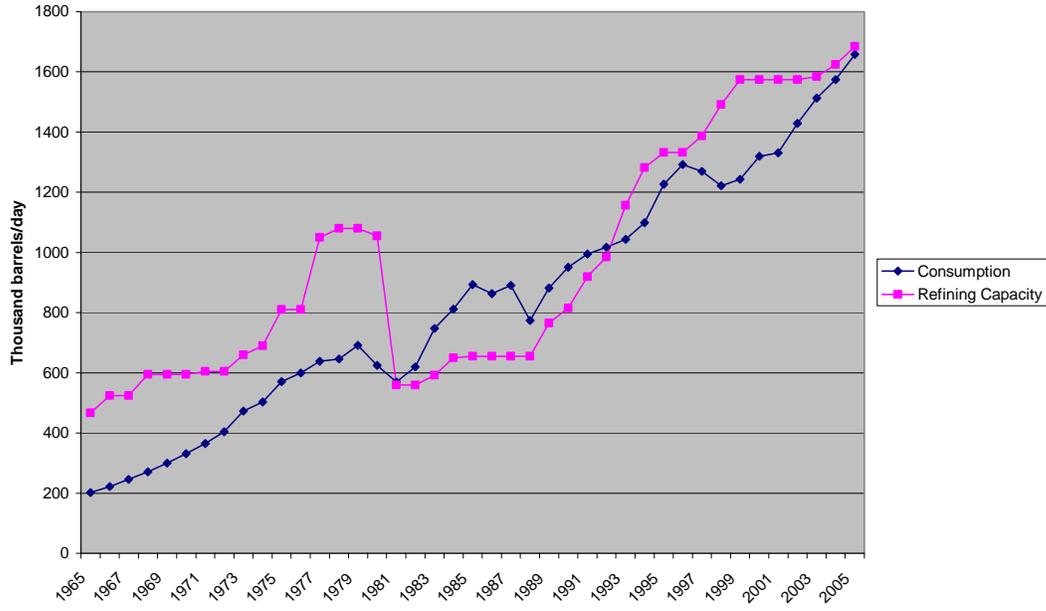


Iran: Oil Production and Consumption, 1965-2005  
Source: BP Statistical Abstract, 2006

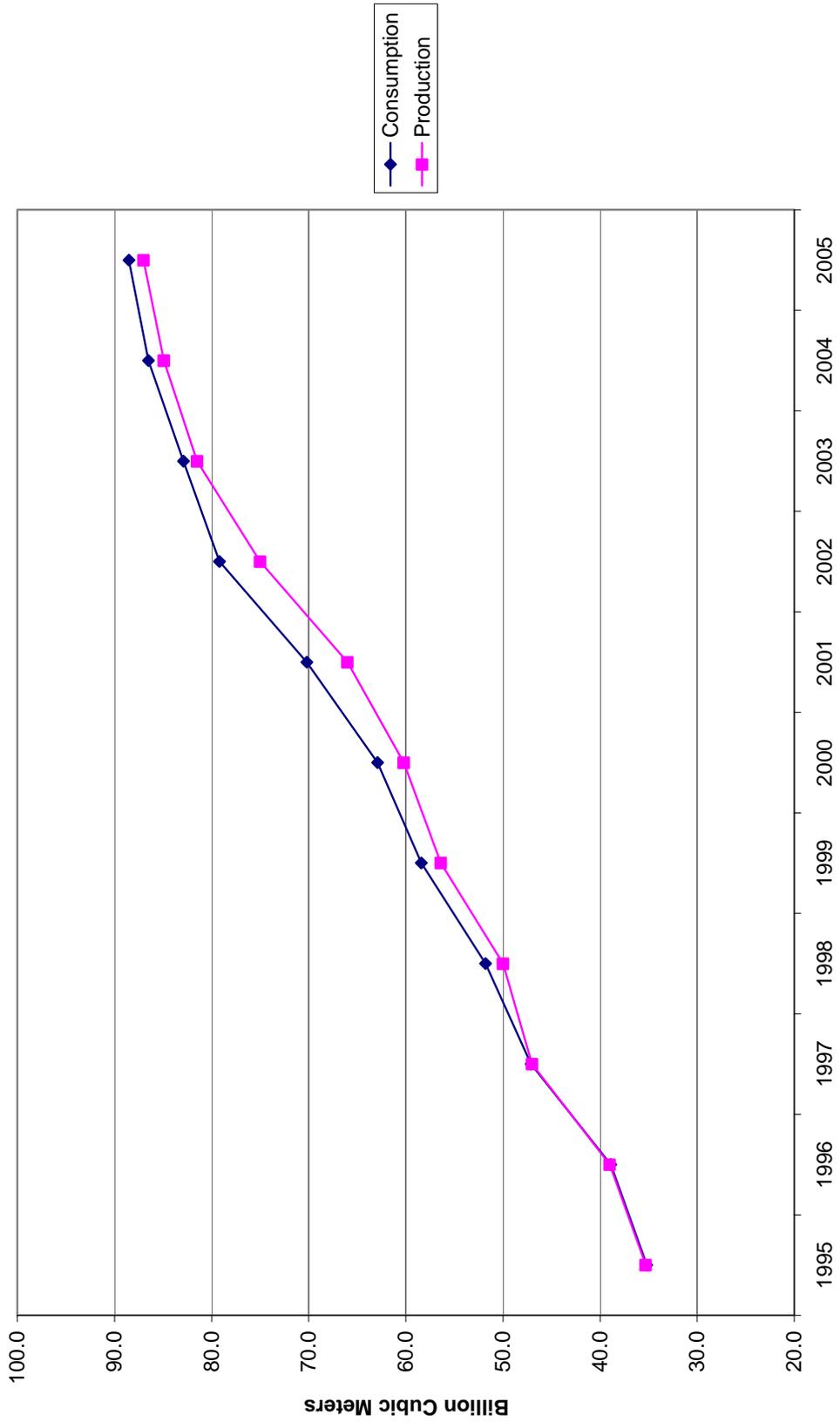


# National Iranian Oil Company

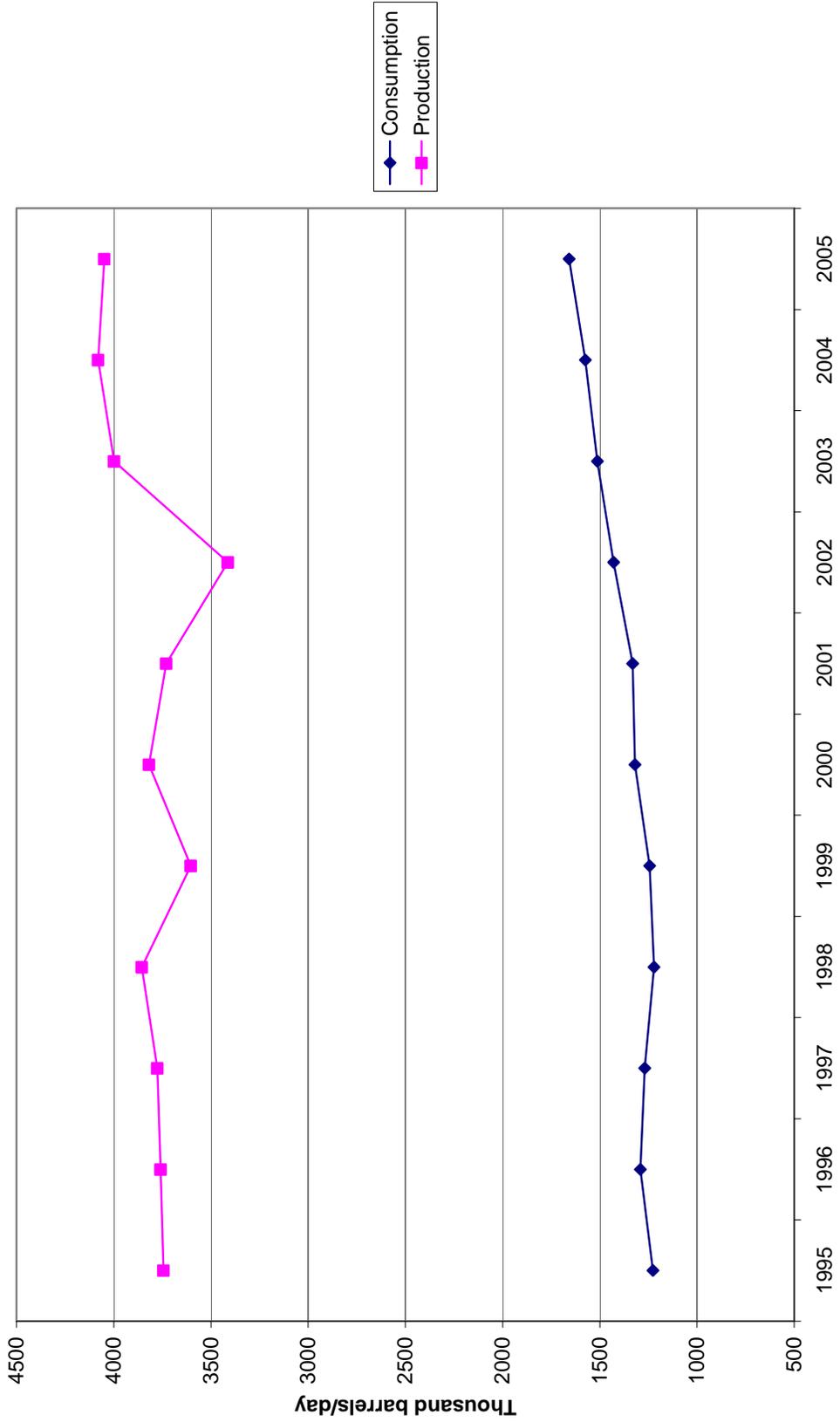
Iran: Oil Consumption and Refining Capacity, 1965-2005  
Source: BP Statistical Abstract, 2006



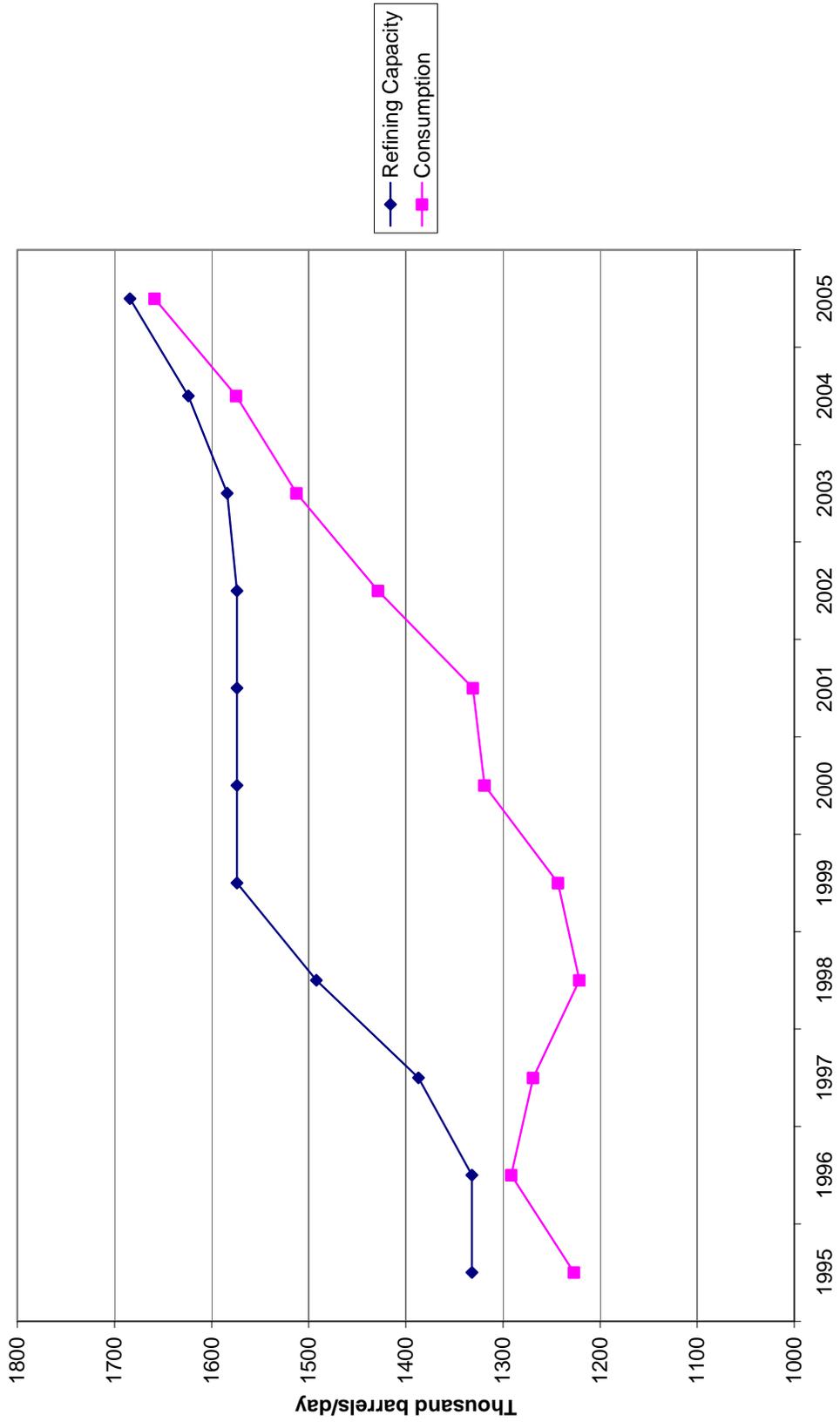
Iran: Gas Production and Consumption, 1995-2005  
Source: BP Statistical Abstract, 2006



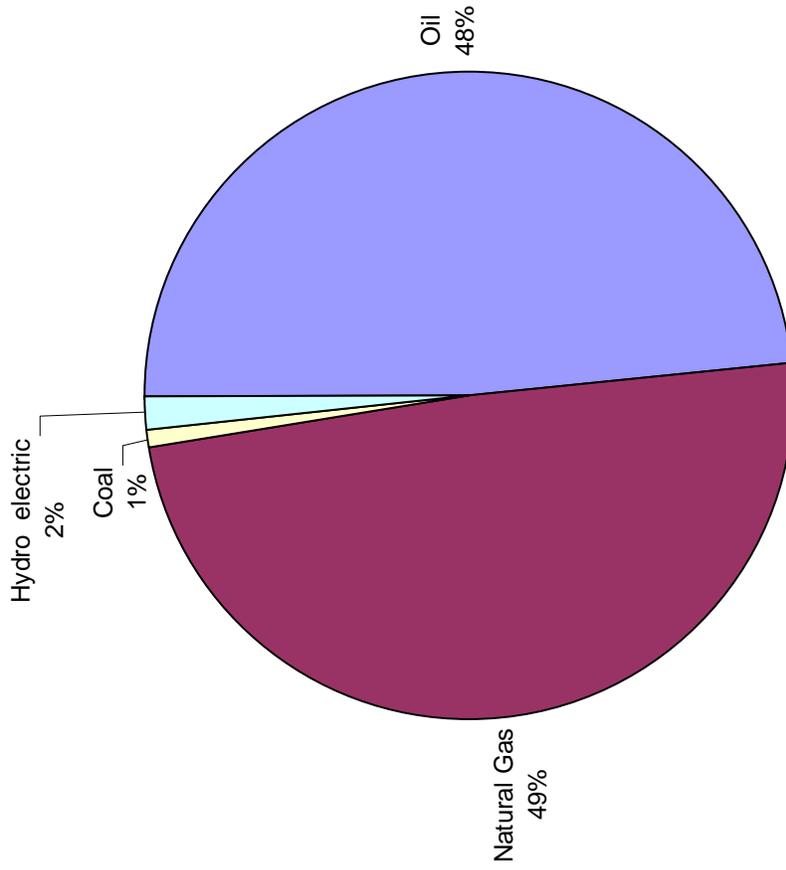
Iran: Oil Production and Consumption, 1995-2005  
Source: BP Statistical Abstract, 2006



Iran: Oil Consumption and Refining Capacity, 1995-2005  
Source: BP Statistical Abstract, 2005



Iran: Domestic Energy Usage  
Source: BP Statistical Abstract, 2006



## Major Iranian Oil Fields, with estimated production for early 2005

Source: U.S. Dept. of Energy

<b>Onshore</b>	<b>Offshore</b>
Agha Jari (200,000 bbl/d)	Abuzar (125,000 bbl/d)
Ahwaz-Asmari (700,000 bbl/d)	Dorood (130,000 bbl/d)
Bangestan (245,000-550,000 bbl/d)	Salman (130,000 bbl/d)
Bibi Hakimeh (130,000 bbl/d)	Sirri A & E (95,000 bbl/d)
Gachsaran (560,000 bbl/d)	Soroush/Nowruz (60,000 bbl/d)
Karanj-Parsi (200,000 bbl/d)	
Marun (520,000 bbl/d)	
Pazanan (70,000 bbl/d)	
Rag-e Safid (180,000 bbl/d)	

**Major Refineries and Capacity in Iran, 1992-2005 (thousand barrel/day)**

Source: Arab Oil &amp; Gas Directory, 2005

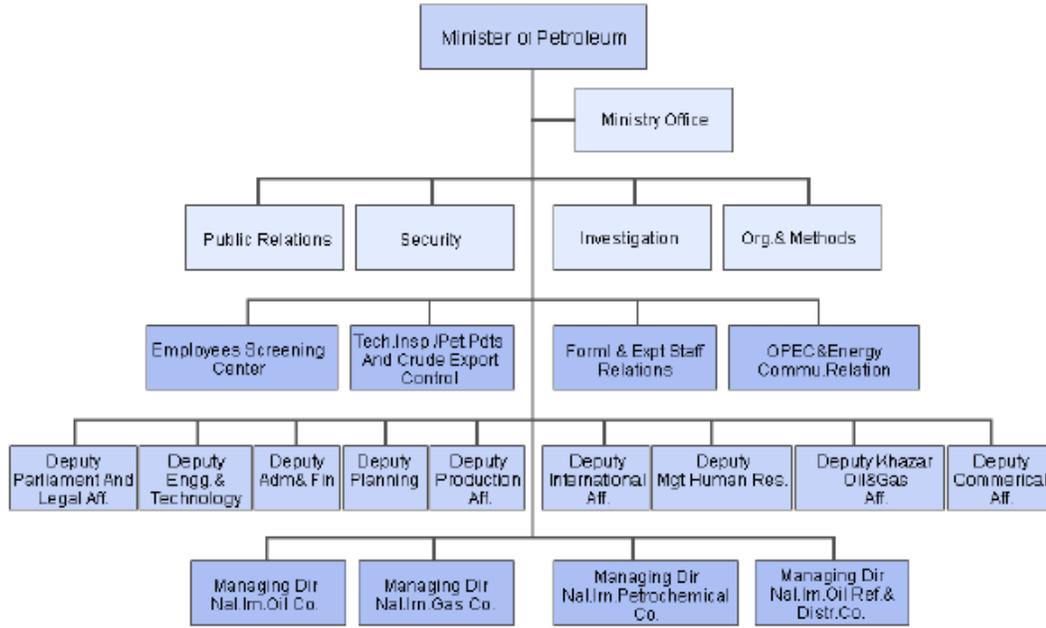
<i>Location</i>	<i>1992</i>	<i>1995</i>	<i>2005</i>
Abadan	250	297	450
Arak	--	135	165
Tehran	220	220	225
Isfahan	200	254	370
Tabriz	80	99	112
Shiraz	40	40	50
Kermanshah	20	27	30
Lavan	20	27	30
Bandar Abbas	--	--	232
<b>TOTAL</b>	<b>830</b>	<b>1,092</b>	<b>1.644</b>

## Gas Reserves by Field, Jan 1, 2004

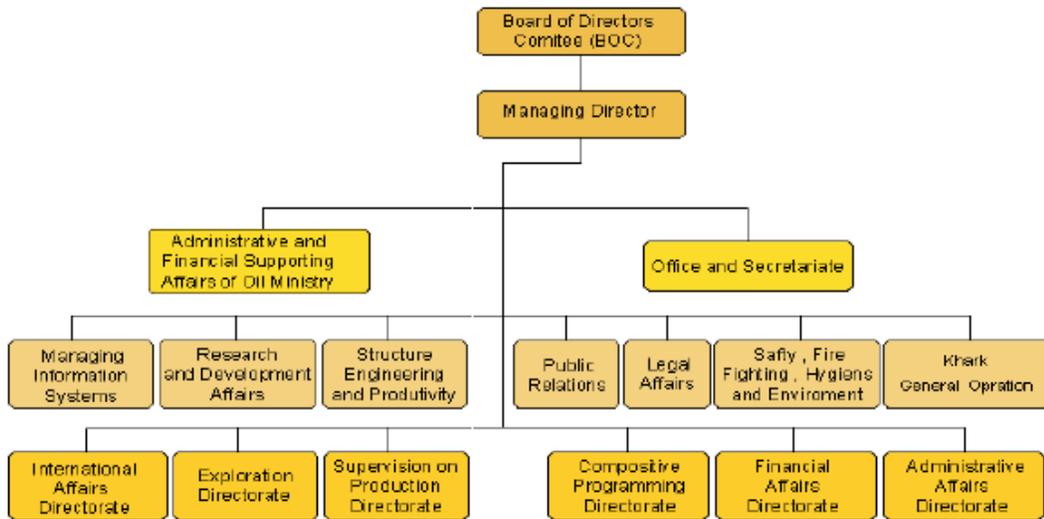
Source: Arab Oil & Gas Directory, 2005

<b>Field</b>	<b>Reserves (Billion cubic meters)</b>
South Pars	12,500
North Pars	1,416
Tobuak	850
Nar	364
Khangiran	322
Aghar	238
Asaluyeh	224
South Gashdo	208
Sarkhoun	179
Kabir Kouh	157
Hama	133
Dey	103
Bab Qir	90
Ghordin	59
Banbadli	45

# National Iranian Oil Company



**Organizational Chart, Ministry of Petroleum, 2006**  
(Source: NIOC)



**Organizational Chart, NIOC**  
Source: NIOC

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